

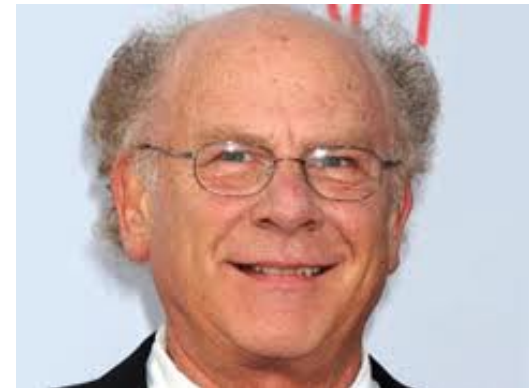


Bank Crises and Political Survival



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Question



- When do markets affect political outcomes?
 - Elections, government survival, political conflict
 - Domestic & international economic conditions; shocks (unexpected conditions)
- What explains the heterogeneity of the effect? Why do some get hit and not others?
 - Economic policies
 - Political institutions



Banking Crises



- Do bank crises have an effect on political survival?
 - Yes (Crespo-Toronio, Jensen, Rosas 2011)
- But, can we identify (a) the mechanism and (b) the role of international/external factors?
- Step 1: Document that banking crises->political survival
- Step 2: Identify foreign and domestic factors leading to a bank crisis

Data and Methods



- 165 Countries, 1975-2010
- Dependent Variable: Change in party of chief executive (DPI).
- Key Independent Variable: Bank failure (Laeven)
- Cox Survival Model w/ country specific frailties
 - All variables lagged one year
- Robustness: partisanship not significant; capital openness or trade * failure

Bank Crises → Political Survival

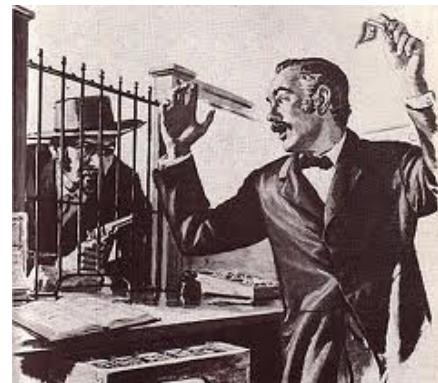
Bank Crisis	1.596**	(0.368)
Unified Government	1.000	(0.000176)
Years in Office	0.997**	(0.000511)
Number of Veto Points	1.187**	(0.0277)
Log(Real GDP/PC)	0.978	(0.0477)
Capital Market Openness	1.017	(0.0406)
GDP growth (annual %)	0.983**	(0.00824)

Observations	3997	
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Shared Frailty Model; Cox Regression.

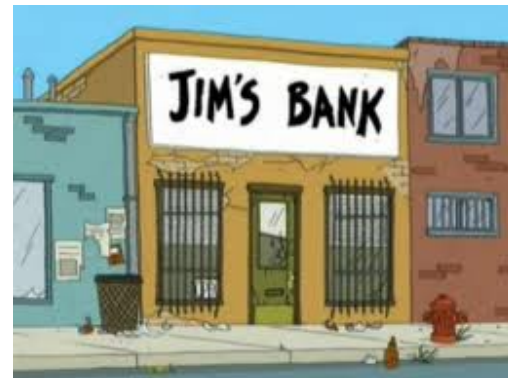
Exponentiated coefficients; Standard errors in parentheses

* $p < 0.10$, ** $p < 0.05$



Determinants of Bank Crises

- Existing literature
 - credit booms/busts; financial market structure, etc
- Cross-border transmission of shocks
 - Focus on bank's balance sheet: contraction in deposits can reduce lending activity. Contraction caused by domestic monetary policy
 - Cross-border banking allows for transmission of shocks across countries as liquidity shocks in A effect balance sheet of bank in B.



Sample, Data, and Method

- Dependent Variable: Banking Crisis
- Logit with splines
 - All variables lagged one year
- Independent variable: Change in intermediated bank lending from US banks to banks in country i at time t (BIS).



US Lending → Bank Crisis

Δ US Bank Lending %GDP	-6.136*	(3.199)
Δ Domestic Bank Lending %GDP	0.0320**	(0.00973)
Current account balance (% of GDP)	-0.00797	(0.0122)
Capital Market Openness	-0.103	(0.0806)
Polity2 Score	0.000885	(0.0180)
Trade %GDP	-0.00523*	(0.00278)
Inflation Rate	0.000398**	(0.000127)
GDP growth (annual %)	-0.0160	(0.0243)
Log(Real GDPPC)	0.270**	(0.114)
Constant	-5.437**	(0.974)
Observations	2568	

All RHS variables lagged by one year. Temporal splines included but not reported

Probit model; Robust standard errors in parentheses

* $p < 0.10$, ** $p < 0.05$

Linking the Models: Two-Stage Probit

	Leader Exit	Bank Crisis
Bank Crisis	4.777** (0.978)	
Unified Government	-0.000240* (0.000131)	-0.00000161 (0.0000106)
Years in Office	-0.00231* (0.00124)	0.0000101 (0.0000305)
Number of Veto Points	0.0406** (0.0174)	0.0000202** (0.0000101)
Log(Real GDPPC)	-0.0951** (0.0339)	0.00313 (0.00238)
Capital Market Openness	0.0103 (0.0183)	-0.00148 (0.00224)
GDP growth (annual %)	0.00642 (0.00762)	-0.00282** (0.000823)
Polity2 Score	0.0365** (0.0145)	0.000800 (0.000498)
Δ US Bank Lending %GDP		-0.0374** (0.0163)
Δ Domestic Bank Lending %GDP		0.000769** (0.000382)
Constant	-0.337 (0.272)	-0.0297 (0.0203)
Observations	2882	

Instrumental variables probit model;
Splines not reported
Robust standard errors in parentheses

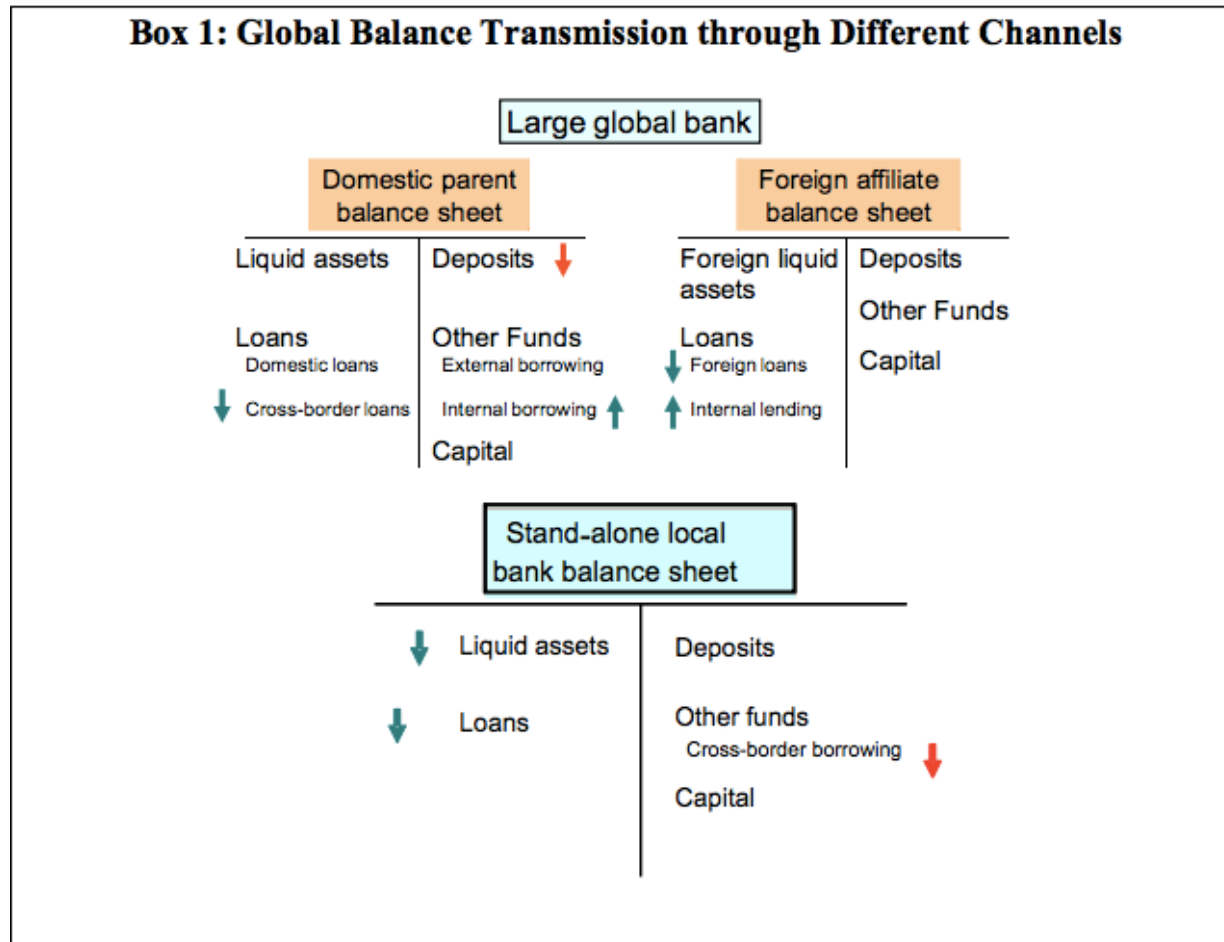
Does Bank Lending Spread Crises?

	(1)	
	Bank Crisis in Borrower	
Bank Crisis in Lender	6.517**	(0.374)
Log(Consolidated Lending from L to B)	0.0422**	(0.00292)
Log(Bilateral Distance)	0.0227**	(0.0110)
Shared Border	0.107	(0.0680)
Capital Account Openness, Borrower	-0.0151**	(0.00625)
Crisis in Lender * Bank Lending	0.0380**	(0.0102)
Crisis in Lender * Distance	-0.738**	(0.0448)
Crisis in Lender * Shared Border	-0.579**	(0.249)
Crisis in Lender * Capital Acct Open Borrower	0.112**	(0.0260)
Domestic Credit Growth, Borrower)	0.000379	(0.00128)
Common Language	-0.106**	(0.0242)
Log(Real GDP PC, Borrower)	-0.0469**	(0.00726)
Log(Real GDP PC, Lender)	-0.102**	(0.0151)
Exchange Rate Change	-0.000490	(0.000761)
Time Trend	-0.0171**	(0.00111)
Constant	33.31**	(2.206)
Observations	87837	

Robust Standard errors clustered by country pair in parentheses

* $p < 0.10$, ** $p < 0.05$

Transmission of Bank Crises



Our Work Thus Far

- Political expectations → economic volatility and crises (IO, Pricing Politics)
- Link markets to government popularity and survival (QJPS, PRQ)
 - Action in these models comes from international exposure through the exchange rate
- “Blame it on the Benjamin” finds Arab Spring “causes” by US interest rates:
 - US real int rate → Commodity Prices → Conflict

- So, lending can decrease $p[\text{bank crisis}]$ but a decrease in lending can increase $p[\text{bank crisis}]$.
- A one standard deviation in US lending (increase by 75 million dollars) decreases the $p[\text{bank crisis}]$ by 16%.
- And (next slide) there is pass through to decreasing the $p[\text{leader exit}]$ by 9%.

- But all bets are off if there is a crisis in the lending crisis as bank crises are contagious.