The role of politics in financial intermediation: evidence from Brazil

Paul Pelzl, NHH, Department of Business and Management Science

Abstract

Windfall gains from local natural resource booms in Brazil lead to an increase in local bank deposits and a rise in cross-border lending to districts without natural resources. We show that this rise in lending is significantly stronger if the mayor of the receiving district is from the same party as the governor of the province in which the district is located. This effect is driven by government-owned banks. These findings suggest that governors instrumentalize deposit inflows into government-owned banks to channel funds to politically aligned regions. Our rich branch-level data and within-country empirical design allow us to control for credit demand effects and to address the potential concern that political alignment is endogenous to district-level developments.