

**Pay Now, Play Later:
Political Contributions and Underwriting Relationships in the Muni Market**

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Research Questions

How do political contributions affect the underwriting relationships in the municipal issuance market?

- Different contribution strategies under the regulation:
 - Rule G-37: A rule designed to curb the once rampant pay-to-play practice in the muni market;
 - Impact of different contribution strategies on underwriting market shares;
 - Factors affecting the choices of different contribution strategies by underwriters.

Why the muni bond market is a useful setting

- Political influence over negotiated bond deals
 - Elected officials decide who get their business
- It is big – \$1.83 trillion negotiated bond issues (1997-2015)
 - 77% bonds were placed through negotiated deals
 - \$8.51 billion underwriting fees
- Underwriters therefore have strong incentive to secure political connections with elected officials.
 - Contributions to campaign candidates and/or political parties
 - Rampant pay-to-play practice historically

Regulations: Rule G-37

- April 1994: The SEC approved the Municipal Securities Rule-making Board (MSRB) Rule G-37
 - Detailed disclosure on political contributions to the MSRB using Form G-37
- The *de minimis* limit \$250:
 - Two-year ban on underwriting business if contributing more than \$250 to officials that could influence the selection of underwriters
 - Coverage: contributions made by municipal finance professionals (MFPs), executive officers, and PACs of underwriting firms
- Exemptions:
 - Contributions less than \$250 by MFPs eligible to vote for the candidate;
 - Contributions of any amount to political parties.

Contribution Strategies under Rule G-37

- Large donations:
 - Contributions exceeding the de minimis limit of \$250 to a campaign candidate
 - This will trigger the two-year business restriction under Rule G-37.
- Multi-small donations:
 - Multiple contributions under the de minimis limit of \$250 to the same campaign candidate.
 - This will circumvent the restriction under Rule G-37.
- Small donations:
 - Contributions under the de minimis limit of \$250 (no duplication) to a campaign candidate.
- Party donations:
 - Contributions to political parties.
 - No restrictions under Rule G-37.

Example: Multi-small donations

FORM G-37/G-38

Name of dealer: Montgomery Legal FundReport period: January 1, 1998 - March 31, 1998

I. CONTRIBUTIONS made to issuer officials (list by state)

| STATE | Complete name, title (including city/county/state or other political subdivision) of issuer official | Contributions by each contributor category (i.e. dealer, dealer controlled PAC, municipal finance professional controlled PAC, municipal finance professionals and executive officers). For each contribution, list contribution amount and contributor category (For example, \$500 contribution by executive officer) |
|-------|--|---|
| AL | Don Siegleman, Lt Governor, State of Alabama (candidate for Governor) | \$250 contribution by Registered Rep |
| | Lucy Baxley, Treasurer, State of Alabama | \$250 contribution by Registered Rep |
| | DeWayne Freeman, candidate for Lt. Governor | \$250 contribution by Registered Rep |
| | Don Siegleman, Lt Governor, State of Alabama (candidate for Governor) | \$250 contribution by Registered Rep |
| | Lucy Baxley, Treasurer, State of Alabama | \$250 contribution by Registered Rep |
| | DeWayne Freeman, candidate for Lt. Governor | \$250 contribution by Registered Rep |
| | Mac McArthur, candidate for Attorney General | \$250 contribution by Registered Rep |
| | Don Siegleman, Lt Governor, State of Alabama (candidate for Governor) | \$250 contribution by Registered Rep |
| | Lucy Baxley, Treasurer, State of Alabama | \$250 contribution by Registered Rep |
| | DeWayne Freeman, candidate for Lt. Governor | \$250 contribution by Registered Rep |
| | Mac McArthur, candidate for Attorney General | \$250 contribution by Registered Rep |
| | Don Siegleman, Lt Governor, State of Alabama (candidate for Governor) | \$250 contribution by Registered Rep |
| | Lucy Baxley, Treasurer, State of Alabama | \$250 contribution by Registered Rep |
| | DeWayne Freeman, candidate for Lt. Governor | \$250 contribution by Registered Rep |
| | Mac McArthur, candidate for Attorney General | \$250 contribution by Registered Rep |
| | Don Siegleman, Lt Governor, State of Alabama (candidate for Governor) | \$250 contribution by Registered Rep |
| | Lucy Baxley, Treasurer, State of Alabama | \$250 contribution by Registered Rep |
| | Sharon Vaise, Court of Civil Appeals, Montgomery | \$200 contribution by Registered Rep |
| | DeWayne Freeman, candidate for Lt. Governor | \$250 contribution by Registered Rep |
| | Don Siegleman, Lt Governor, State of Alabama (candidate for Governor) | \$250 contribution by Registered Rep |
| | Lucy Baxley, Treasurer, State of Alabama | \$250 contribution by Registered Rep |
| | DeWayne Freeman, candidate for Lt. Governor | \$250 contribution by Registered Rep |
| | Don Siegleman, Lt Governor, State of Alabama (candidate for Governor) | \$250 contribution by Registered Rep |
| | Chris McNair, Jefferson County Commission | \$250 contribution by Registered Rep |
| FL | Sandra Morham for Secretary of State, Republican Primary | \$250 contribution by Registered Rep |

Contributions to the Literature

- Impact and choice of different contribution strategies:
 - Prior studies have treated political contributions as a single strategy and examined the collective effect of contributions.
- Motivations of political contributions:
 - Investment-driven hypothesis:
 - Stigler(1971), Shleifer and Vishny (1994), and Snyder (1992)
 - Corporations use political connections as a means of investment to gain access to government resources.
 - Consumption-driven hypothesis:
 - Ansolabehere et al. (2003) and Coate (2004)
 - Political contributions reflect a form of consumption, motivated by individual ideologies instead of business considerations.
 - We show that different contribution strategies are likely driven by different incentives.

Contributions to the Literature (cont.)

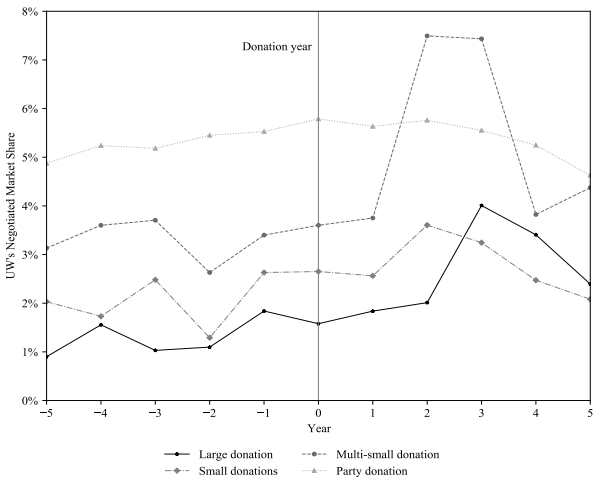
- Impact of political connections on firm values and the underlying channels:
 - Firm values: Fisman (2001); Faccio, Masulis and McConnell (2006); Goldman, Rocholl and So, (2009, 2013); Cooper, Gulen and Ovtchinnikov (2010).
 - Underlying channels: Claessens, Feijen, and Laeven (2008), Goldman, Rocholl, and So (2013), Brogaard, Denes, and Duchin (2015)
 - Connected firms have better access to finance or receive government contracts with favorable terms.
 - Our paper studies whether connections bring in more municipal bond underwriting business.

Contributions to the Literature (cont.)

- Pay-to-play practice in the municipal underwriting market during the post-G-37 era:
 - Butler, Fauver, and Mortal (2009): issuance costs
Underwriters charge higher fees before G-37: 11.8 ~13.8 bps
 - Brown (2017): underpricing
Contributing underwriters are associated with 20 bps more underpricing and 2.9% higher fees than non-contributing underwriters
- We focus on different contribution strategies during the post-G-37 era.
 - Effects of different contribution strategies on negotiated market share
 - Factors affecting the choice of different contribution strategies

Main results

- Larger political contributions are associated with significantly higher negotiated market share.
 - Multi-small donations: A one standard deviation increase leads to a 2.34% increase in negotiated market share in the next year.
 - Large donations: A one standard deviation increase leads to a 1.09% increase in negotiated market share, but with a two-year delay.
- The above results are driven by contributions made to candidates winning the elections.
- We find no significant relation between small and party donations and future underwriting market shares.

Figure 1: Donating underwriters' market share

Main results (cont.)

- Underwriters have adopted a mixture of donation strategies with different incentives.
 - Strong persistence except for large donations.
 - Large donations and multi-small donations appear to be substitute strategies.
 - National underwriters are more likely to make large donations in states with high growth rate in negotiated deals.
 - Regional underwriters favor multi-small donations.
 - Underwriters tend to make party donations in states where they already have strong business relations.

Data Sources

- Political contributions: 1997-2013 hand-collected from Form G-37 published through MSRB's website.
 - Large donations, multi-small donations, small donations, and party donations.
 - Over 99% of all candidate donations are made by municipal finance professionals and executive officers.
- Muni bond data: Mergent database
 - We use negotiated bonds issued by state authorities and agencies.
 - 94 underwriters account for 93% of the negotiated sales during 1997-2015.
- Economy and election data: Bureau of Labor Statistics, U.S. Census Bureau, and OurCampaigns.com

Variable Definitions

- Market Share:

$$\text{Market share}_{u,s,t} = \frac{\text{Negotiated amount by underwriter}_{u,s,t}}{\text{Total negotiated amount}_{s,t}} \times 100$$

- Donation Percent:

$$\text{Donation Percent}_{u,s,t} = \frac{\text{Donation amount by underwriter}_{u,s,t}}{\text{Total donation amount}_{s,t}} \times 100$$

- Office Percent:

$$\text{Office Percent}_{u,s,t} = \frac{\text{No. of offices supported by underwriter}_{u,s,t}}{\text{Total No. of offices in election}_{s,t}} \times 100$$

Identification strategies

- Matched non-contributing underwriters sample
 - Home state
 - Market share in the state during the past 5 years
 - Total market share in U.S. during the past 5 years
- Staggered effects due to G-37's two-year regulation period.
 - An event (diff-in-diff) study on the effect of large donations
- Election results
 - Results driven by unobserved non-political factors, instead of donations?
 - Elected (contributions to winning candidates) vs. Unelected (contributions to losing candidates)
- Placebo test
 - Results driven by unobserved competitive advantages of donating underwriters?
 - Effect of political contributions on underwriting market share in *competitive* deals

Table 2 Panel A: Summary statistics for different donations

| Type | Variables | N | Mean |
|----------------------|--------------------------------------|-----|------------|
| All donation | Total donation amount | 595 | 9,066.435 |
| | Donation percent in connected states | 595 | 55.630 |
| | Pre-donation market share | 595 | 4.094 |
| | Post-donation market share | 595 | 4.364 |
| Large donation | Total donation amount | 68 | 7,209.059 |
| | Donation percent in connected states | 68 | 56.866 |
| | Pre-donation market share | 68 | 1.148 |
| | Post-donation market share | 68 | 2.155 |
| Multi-small donation | Total donation amount | 43 | 1,262.470 |
| | Donation percent in connected states | 43 | 45.213 |
| | Pre-donation market share | 43 | 2.602 |
| | Post-donation market share | 43 | 4.758 |
| Small donation | Total donation amount | 190 | 412.721 |
| | Donation percent in connected states | 190 | 35.719 |
| | Pre-donation market share | 190 | 1.862 |
| | Post-donation market share | 190 | 2.652 |
| Party donation | Total donation amount | 400 | 11,929.024 |
| | Donation percent in connected states | 400 | 51.255 |
| | Pre-donation market share | 400 | 5.127 |
| | Post-donation market share | 400 | 5.109 |

- ▶ Market Shares increase following large and multi-small donations.
- ▶ Pre-donation market share is smallest (largest) for large (party) donations.

Table 4: Impact of donations on negotiated market share

| Variables | (1) | (2) | (3) | (4) |
|------------------------|---------------------|---------------------|---------------------|---------------------|
| | Donation Pct | Office Pct | Donation Pct | Office Pct |
| Candidate donation | 0.005 (0.008) | 0.005 (0.008) | | |
| Large donation | | | -0.007 (0.012) | -0.012 (0.013) |
| Multi-small donation | | | 0.066** (0.033) | 0.084** (0.040) |
| Small donation | | | 0.006 (0.008) | 0.002 (0.006) |
| Party donation | 0.009 (0.013) | 0.003 (0.017) | 0.011 (0.013) | 0.003 (0.017) |
| Past nego market share | 0.249*** (0.068) | 0.249*** (0.068) | 0.249*** (0.069) | 0.249*** (0.069) |
| Constant | -0.595 (1.644) | -0.647 (1.638) | -0.501 (1.659) | -0.456 (1.660) |
| Observations | 5,969 | 5,969 | 5,969 | 5,969 |
| Other controls | Yes | Yes | Yes | Yes |
| FE | UW-State Year | UW-State Year | UW-State Year | UW-State Year |
| SE Cluster | UW-State | UW-State | UW-State | UW-State |
| Adj. R | 0.489 | 0.489 | 0.490 | 0.490 |

- ▶ 1 stdev increase in multi-small donations \implies 2.34% in market share (relative to 2.60% average pre-donation share)

Table 5: Impact of large donations on market share

| Variables | (1) | (2) | (3) | (4) |
|------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | Donation Pct | Office Pct | Donation Pct | Office Pct |
| Large donation year ₀ | 0.004 (0.010) | 0.002 (0.010) | | |
| Large donation year ₁ | 0.002 (0.009) | 0.002 (0.008) | | |
| Large donation year ₂ | 0.005 (0.019) | 0.007 (0.019) | | |
| Large donation year ₃ | 0.028* (0.015) | 0.025* (0.015) | | |
| Large donation year ₄ | 0.027** (0.012) | 0.031** (0.012) | | |
| Large donation year ₀₋₂ | | | 0.004 (0.011) | 0.004 (0.011) |
| Large donation year ₃₋₄ | | | 0.028** (0.013) | 0.028** (0.013) |
| Large donation year ₋₆ | -0.002 (0.004) | -0.004 (0.005) | -0.002 (0.004) | -0.004 (0.005) |
| Large donation year ₅₊ | 0.011 (0.011) | 0.016 (0.013) | 0.011 (0.011) | 0.016 (0.013) |
| Past nego market share | 0.376*** (0.039) | 0.376*** (0.039) | 0.376*** (0.039) | 0.376*** (0.039) |
| Constant | 1.355* (0.800) | 1.358* (0.801) | 1.356* (0.801) | 1.359* (0.801) |
| Observations | 23,667 | 23,667 | 23,667 | 23,667 |
| Other controls | Yes | Yes | Yes | Yes |
| FE | UW-State Year | UW-State Year | UW-State Year | UW-State Year |
| SE Cluster | UW-State | UW-State | UW-State | UW-State |
| Adj. R | 0.386 | 0.386 | 0.386 | 0.386 |

- 1 stdev increase in large donations \implies 1.09% in market share in years 3-4 (relative to 1.15% average pre-donation share)

Table 6 Panel A: Election results and the effect of donations

| Variables | (1) | (2) | (3) | (4) |
|------------------------|---------------------|---------------------|--------------------|--------------------|
| | Elected | | Unelected | |
| | Donation Pct | Office Pct | Donation Pct | Office Pct |
| Large donation | 0.004 (0.014) | -0.003 (0.014) | -0.026 (0.026) | -0.076 (0.064) |
| Multi-small donation | 0.094** (0.009) | 0.115** (0.011) | 0.043 (0.019) | 0.053 (0.019) |
| Small donation | 0.004 (0.006) | -0.002 (0.006) | 0.014 (0.014) | 0.019 (0.018) |
| Party donation | 0.005 (0.013) | -0.009 (0.017) | 0.010 (0.022) | 0.011 (0.025) |
| Past nego market share | 0.236*** (0.067) | 0.235*** (0.066) | 0.290** (0.126) | 0.290** (0.126) |
| Constant | 0.590 (1.717) | 0.616 (1.715) | 0.168 (2.598) | 0.176 (2.603) |
| Observations | 5,355 | 5,355 | 2,329 | 2,329 |
| Other controls | Yes | Yes | Yes | Yes |
| FE | UW-State Year | UW-State Year | UW-State Year | UW-State Year |
| SE Cluster | UW-State | UW-State | UW-State | UW-State |
| Adj. R | 0.484 | 0.484 | 0.390 | 0.390 |

Table 6 Panel B: Election results and the effect of large donations

| Variables | (1) | (2) | (3) | (4) |
|------------------------------------|---------------------|---------------------|---------------------|---------------------|
| | Elected | | Unelected | |
| | Donation Pct | Office Pct | Donation Pct | Office Pct |
| Large donation year ₀₋₂ | 0.008 (0.014) | 0.006 (0.014) | -0.009 (0.018) | -0.005 (0.022) |
| Large donation year ₃₋₄ | 0.036** (0.018) | 0.032** (0.016) | 0.015 (0.011) | 0.024 (0.017) |
| Large donation year ₋₆ | -0.004 (0.006) | -0.005 (0.007) | 0.005 (0.004) | 0.008* (0.005) |
| Large donation year ₊₅ | 0.016 (0.016) | 0.021 (0.017) | 0.000 (0.010) | 0.006 (0.011) |
| Past nego market share | 0.350*** (0.044) | 0.350*** (0.044) | 0.409*** (0.063) | 0.409*** (0.063) |
| Constant | 2.086*** (0.805) | 2.074*** (0.803) | 0.467 (1.317) | 0.460 (1.316) |
| Observations | 19,391 | 19,391 | 9,268 | 9,268 |
| Other controls | Yes | Yes | Yes | Yes |
| FE | UW-State Year | UW-State Year | UW-State Year | UW-State Year |
| SE Cluster | UW-State | UW-State | UW-State | UW-State |
| Adj. R | 0.369 | 0.369 | 0.397 | 0.397 |

- ▶ Effects of political contributions driven by donations to candidates winning the elections.
- ▶ Coefficients larger for the "Elected" subsample

Table 7 Panel A: The impact of past donations on underwriter's competitive market share

| Variables | (1) | (2) | (3) | (4) | (5) | (6) |
|----------------------|-------------------|-------------------|-------------------|-------------------|-------------------|-------------------|
| | Full sample | | Elected | | Unelected | |
| | Donation Pct | Office Pct | Donation Pct | Office Pct | Donation Pct | Office Pct |
| Large donation | -0.001 (0.009) | -0.005 (0.010) | -0.003 (0.012) | -0.007 (0.012) | 0.003 (0.007) | 0.014 (0.022) |
| Multi-small donation | -0.015 (0.012) | -0.016 (0.011) | -0.021 (0.017) | -0.021 (0.015) | -0.013 (0.011) | -0.008 (0.012) |
| Small donation | -0.003 (0.005) | 0.000 (0.004) | 0.000 (0.003) | 0.003 (0.003) | -0.009 (0.011) | -0.012 (0.011) |
| Party donation | 0.001 (0.007) | -0.004 (0.010) | 0.009 (0.007) | 0.004 (0.010) | -0.018 (0.012) | -0.013 (0.014) |
| Constant | 0.968 (2.177) | 0.903 (2.171) | 2.398 (2.059) | 2.348 (2.056) | -2.186 (3.695) | -2.211 (3.687) |
| Observations | 5,474 | 5,474 | 4,908 | 4,908 | 2,095 | 2,095 |
| FE | UW-State Year | UW-State Year | UW-State Year | UW-State Year | UW-State Year | UW-State Year |
| SE Cluster | UW-State | UW-State | UW-State | UW-State | UW-State | UW-State |
| Adj. R | 0.262 | 0.262 | 0.262 | 0.262 | 0.287 | 0.287 |

- ▶ Placebo test: No significant relation between political contributions and underwriting market shares for *competitive* deals.

Table 7 Panel B: The impact of large donations on underwriter's competitive market share

| Variables | (1) | (2) | (3) | (4) | (5) | (6) |
|------------------------------------|---------------------|---------------------|---------------------|---------------------|-------------------|-------------------|
| | Full sample | | Elected | | Unelected | |
| Large donation year ₀₋₂ | -0.002 (0.006) | -0.000 (0.005) | 0.005 (0.005) | 0.005 (0.004) | -0.024 (0.023) | -0.024 (0.027) |
| Large donation year ₃₋₄ | -0.001 (0.012) | 0.003 (0.015) | -0.008 (0.009) | -0.008 (0.010) | 0.021 (0.045) | 0.044 (0.063) |
| Large donation year ₆ | 0.004 (0.007) | 0.004 (0.006) | 0.008 (0.007) | 0.007 (0.007) | -0.010 (0.017) | -0.009 (0.019) |
| Large donation year ₅₊ | 0.004 (0.012) | 0.010 (0.014) | 0.011 (0.016) | 0.016 (0.018) | -0.015 (0.019) | -0.014 (0.022) |
| Constant | 2.747*** (0.858) | 2.755*** (0.858) | 3.971*** (0.885) | 3.996*** (0.884) | -0.451 (1.818) | -0.466 (1.818) |
| Observations | 19,815 | 19,815 | 16,328 | 16,328 | 7,584 | 7,584 |
| FE | UW-State Year | UW-State Year | UW-State Year | UW-State Year | UW-State Year | UW-State Year |
| SE Cluster | UW-State | UW-State | UW-State | UW-State | UW-State | UW-State |
| Adj. R | 0.196 | 0.196 | 0.217 | 0.217 | 0.181 | 0.181 |

Table 8: Multinomial analysis for donation strategies

| Variables | (1) | (2) | (3) | (4) |
|---------------------------|-----------------------|-----------------------|----------------------|----------------------|
| | Large | Multi-small | Small | Party |
| Past large donation | 0.933 (0.790) | -15.674*** (1.313) | 0.280 (0.424) | 0.699* (0.412) |
| Past multi-small donation | -16.138*** (0.775) | 4.068*** (0.677) | 0.681 (0.430) | -0.106 (0.996) |
| Past small donation | 0.987 (0.761) | 2.086** (0.993) | 2.205*** (0.249) | 0.270 (0.396) |
| Past party donation | 0.578 (0.742) | -0.096 (1.078) | 0.694** (0.292) | 2.770*** (0.212) |
| Past nego market share | -0.076 (0.058) | 0.011 (0.030) | 0.023 (0.024) | 0.035*** (0.009) |
| Closeness (Ln) | 0.437*** (0.105) | 0.243** (0.109) | 0.244*** (0.058) | 0.304*** (0.059) |
| National | 1.656*** (0.433) | -14.548*** (1.566) | -2.052*** (0.527) | -0.089 (0.239) |
| UW's experience (Ln) | -0.164 (0.390) | -0.552 (0.429) | -0.470** (0.195) | -0.406*** (0.154) |
| Public company | -1.712*** (0.563) | 0.515 (0.682) | -0.064 (0.266) | -0.177 (0.198) |
| UW's total share growth | 0.114** (0.054) | 0.327 (0.391) | 0.067 (0.118) | 0.020 (0.059) |
| State's issue growth | 0.363** (0.162) | -0.187 (0.262) | -0.159* (0.088) | -0.097 (0.059) |
| Constant | -2.216* (1.344) | -6.882*** (2.136) | -2.999*** (1.106) | -1.547** (0.698) |
| Observations | 15,862 | 15,862 | 15,862 | 15,862 |
| Other controls | Yes | Yes | Yes | Yes |
| SE Cluster | UW-State | UW-State | UW-State | UW-State |
| Log-Likelihood | -1,961 | -1,961 | -1,961 | -1,961 |

Conclusions

- Political contributions play an influential role in lead underwriter selections:
 - Multi-small donations are associated with higher market share.
 - Large donations, subject to the two-year business ban, are associated with higher market share during the third and fourth years after large donations.
- Contribution incentives and strategies:
 - National underwriters are more likely to make large donations to states with high growth in negotiated deals (e.g., Stigler, 1971; Shleifer and Vishny, 1994).
 - Regional underwriters are more likely to choose multi-small donations.
 - Underwriters contribute to political parties in states where they already have strong business relations (Snyder, 1992).

We provide evidence that political connections still play an important role in the muni market even after the Rule G-37. Contributing underwriters have adopted different donation strategies to advance their underwriting relationships with bond issuer officials.

Thank You !