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## 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: Large donations

### FORM G-37



Name of dealer: [REDACTED]

Report Period: *Third Quarter of 2006*

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

State	Complete name, title (including any 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 non-MFP executive officers). For each contribution, list contribution amount and contributor category (For example, \$500 contribution by non-MFP executive officer)
DE	Jack Markel, State Treasurer of Delaware	\$1,200 contribution by Municipal finance professional
WI	Jim Doyle, Governor of Wisconsin	\$5,000 contribution by Municipal finance professional

#### II. PAYMENTS made to political parties of states or political subdivisions (list by state)

State	Complete name (including any city/county/state or other political subdivision) of political party	Payments by each contributor category (i.e., dealer, dealer controlled PAC, municipal finance professional controlled PAC, municipal finance professionals, and non-MFP executive officers). For each payment, list payment amount and contributor category (For example, \$500 payment by non-MFP executive officer)
IL	Illinois House Republican Organization	\$10,000 payment by Municipal finance professional

## Example: Multi-small donations

FORM G-37/G-38

MSRB

Name of dealer: Montgomery Republican Primary  
Report period: January 1, 1998 - March 31, 1998

## 1. 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). List the name of the contributor, amount and contributor category (For example, \$500 contribution by executive officer)
	Category	Amount	
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	
	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 C. 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 Mortham 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.)

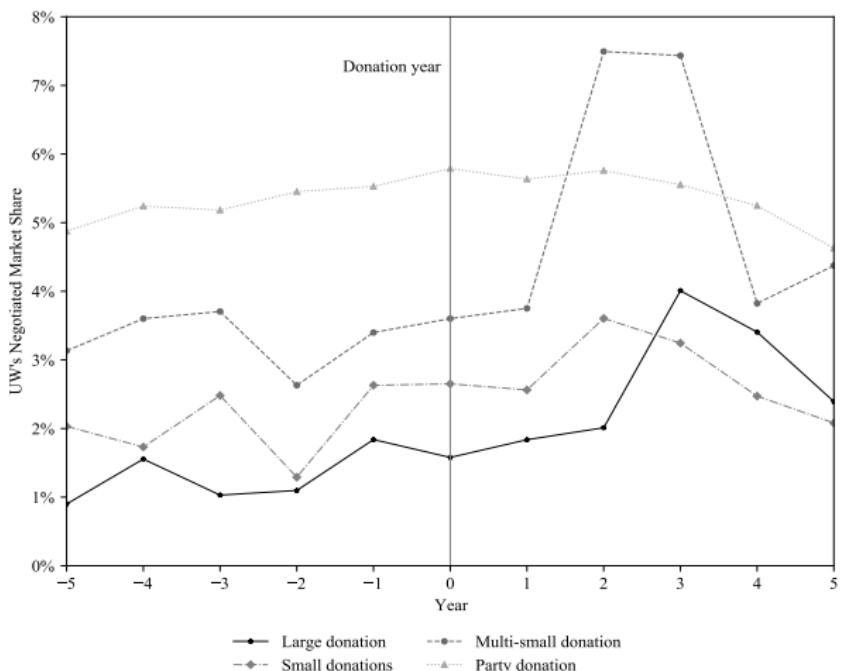
- Impact of political connections on firm values and the underlying channels:
  - Firm values: Fisman (2001); Faccio, Masulis and McConnell (2006); Goldman, Rocholl and So, (2009, 2013); Cooper, Gulen and Ovtchinnikov (2010).
  - Underlying channels: Claessens, Feijen, and Laeven (2008), Goldman, Rocholl, 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
SE Cluster	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 <sub>0</sub>	0.004 (0.010)	0.002 (0.010)		
Large donation year <sub>1</sub>	0.002 (0.009)	0.002 (0.008)		
Large donation year <sub>2</sub>	0.005 (0.019)	0.007 (0.019)		
Large donation year <sub>3</sub>	0.028* (0.015)	0.025* (0.015)		
Large donation year <sub>4</sub>	0.027** (0.012)	0.031** (0.012)		
Large donation year <sub>0-2</sub>			0.004 (0.011)	0.004 (0.011)
Large donation year <sub>3-4</sub>			0.028** (0.013)	0.028** (0.013)
Large donation year <sub>6</sub>	-0.002 (0.004)	-0.004 (0.005)	-0.002 (0.004)	-0.004 (0.005)
Large donation year <sub>5+</sub>	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
SE Cluster	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 <sub>-2</sub>	0.008 (0.014)	0.006 (0.014)	-0.009 (0.018)	-0.005 (0.022)				
Large donation year <sub>3-4</sub>	0.036** (0.018)	0.032** (0.016)	0.015 (0.011)	0.024 (0.017)				
Large donation year <sub>-6</sub>	-0.004 (0.006)	-0.005 (0.007)	0.005 (0.004)	0.008* (0.005)				
Large donation year <sub>+5</sub>	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 <sub>0,2</sub>	-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 <sub>3,4</sub>	-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 <sub>6</sub>	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 <sub>5+</sub>	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	UW-State	UW-State	UW-State	UW-State	UW-State
	Year	Year	Year	Year	Year	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) Large	(2) Multi-small	(3) Small	(4) 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.

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**Thank You !**