

## AN ANALYSIS OF THE FINANCIAL SERVICES BAILOUT VOTE

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Washington's remedy to the financial problems that began in 2008 was the Troubled Asset Relief Program (TARP)—the so-called bailout of the banking system. Whatever its merits, it was, for the most part, unpopular with the American public. Lawmakers, fearful that the economy might actually collapse without some action, were likewise fearful that action—in the form of a payout to the Wall Street financiers—would prove to be harmful to them at the polls. Thus, politicians sought to assure the public that their vote on the measure would reflect Main Street virtues, not Wall Street greed.

Members of Congress, addressing the public's misgivings about the bailout, asserted that they were wrestling with difficult issues such as fairness and equity, banking regulation, executive pay, job losses, moral hazard, 401(k) values, and the proper role of the state. Furthermore, they argued, these complex issues were difficult for the public to understand, and legislators, vigilant in carrying out their duty, were weighing the pros and the cons in order to cast a vote that was in the best interest of the nation.

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But it turns out that when one moves beyond the speeches, the underlying motivation behind most votes cast was hardly complex and actually quite simple. In this article, we construct a model to analyze the bailout vote of each legislator. A simple reelection model of legislator behavior explains a majority of the votes taken either for or against the measure from politician to politician.

## Wall Street vs. Main Street

Those with an appreciation of the merits of limited government enjoy reflecting on the past. They recall those halcyon days when a balanced budget amendment—a rather quaint notion by today's standards—failed by only a single vote in the Senate. How things have changed.

The economic zeitgeist is government takeovers, bailouts, and stimulus plans along with escalating debt and deficits. Indeed, commenting on the federal budget for FY 2009, Stanford University economist Michael Boskin (2009) put government borrowing in perspective: “The budget more than doubles the national debt held by the public, adding more to the debt than all previous presidents—from George Washington to George W. Bush—combined.” Indeed, the FY 2009 budget deficit was larger than the entire economy of India and almost as much as the Canadian economy. “Forecasts of more red ink mean the federal government is heading toward spending 15 percent of its money by 2019 just to pay interest on the debt, up from 5 percent this fiscal year” (Crutsinger 2009).

It could be argued, however, that the staggering explosion of federal debt under the Obama administration was precipitated by unprecedented spending during the Bush administration. The Emergency Economic Stabilization Act of 2008, otherwise known as TARP, whatever its merits in terms of rescuing the economy, represented a dramatic departure from normal government operations. As President Bush all but acknowledged in his November 12, 2009, address at Southern Methodist University, TARP opened the floodgates of government intrusion into the private sector:

I went against my free-market instincts and approved a temporary government intervention to unfreeze credit and prevent a global financial catastrophe. . . . As the world recovers, we will face a temptation to replace the risk-and-reward model of

the private sector with the blunt instruments of government spending and control. History shows that the greater threat to prosperity is not too little government involvement, but too much [Bush 2009].

The \$700 billion dollar stabilization package was designed to provide liquidity to the nation's banking and financial firms that faced, at best, uncertain futures. Assisting the financial industry through taxpayer loans and grants proved to be unpopular with the American public.

Jonathan Weisman, writing in the *Washington Post*, acknowledged the unusual nature of the vote: "Rarely has a congressional vote held such high drama and produced such immediate repercussions, directly from the House floor to the trading floor" (Weisman 2008).

Congress, fearful that the economy might actually collapse without the bailout but aware that rewarding Wall Street would agitate voters, did what they do best—they made speeches appealing to populism. Most castigated Wall Street greed, differentiating between Main Street virtue and Wall Street avarice. Others took aim at Treasury Secretary Henry Paulson. Representative Brad Sherman (D-CA) provides a useful example:

We live in an era of great concentration of power in the Executive Branch and great concentration of wealth on Wall Street. Today we are asked to approve the greatest power grab any executive has ever asked for and the greatest transfer of wealth Wall Street could imagine. . . . We can make a bill that reflects American values and not Wall Street values [Sherman 2008].

Senator Sherrod Brown (D-OH) acknowledged the public's displeasure with TARP: "I don't think a single call to my office on this proposal has been positive. I don't think I have gotten one yet of the literally thousands of emails and calls we're getting" (Brown 2008).

Representative Peter DeFazio (D-OR) criticized Wall Street but, in addition, attacked Secretary Paulson directly:

He wants to take care of Wall Street's illiquid assets, as what he nicely labels them. Nice charitable pundits have said Cash for Trash. Wall Street could then return to business as usual. That is Mr. Paulson's plan. He is of, by, for and about Wall

Street, former head of Goldman Sachs. We should not be rolled by a Wall Street exec who is masquerading as Secretary of the Treasury [DeFazio 2008].

Senator Chris Dodd (D-CT), chairman of the Senate Banking Committee, echoed the Wall Street versus Main Street theme and pointed out who was likely to benefit from the expenditures:

It would do nothing, in my view, to help a single family save a home, at least not upfront. It would do nothing to stop even a single CEO from dumping billions of dollars of toxic assets on the backs of American taxpayers, while at the same time do nothing to stop the very authors of this calamity to walk away with bonuses and golden parachutes worth millions of dollars [Dodd 2008].

Richard Shelby (R-AL) agreed with his Democratic colleagues, asserting:

The Treasury's plan has little for those outside of the financial industry. It is aimed at rescuing the same financial institutions that created this crisis, with the sloppy underwriting and reckless disregard for the risks they were creating, taking or passing on to others. Wall Street bet that the government would rescue them if they got into trouble. It appears that bet may be the one that pays off [Shelby 2008].

Lawmakers unequivocally pronounced that Wall Street elites would not win the day. It was made clear that Main Street had the ear of the Congress. Taxpayers would not bear the brunt of the miscalculations of the bankers, brokers, and financiers.

## Government Allocation of TARP Funds

A few politicians were uncomfortable with the expanded role that government was playing in the market. Representative William Thornberry (R-TX) made this observation and pointed out that he had wrestled with the issue:

Deciding how to vote on this issue has been among the most difficult votes I have cast in Congress. The economic condi-

tion and well-being of every American will be affected. I continue to be uncomfortable with the degree of government intrusion into our economy that this bill would authorize. I also continue to be concerned about the economic consequences to all Americans if some sort of action is not taken. It is balancing those two positions that make this vote extremely difficult [Thornberry 2008].

While we are admittedly getting a little ahead of ourselves, Representative Thornberry's fears proved to be valid. The bailout vote did indeed pass, but the funds were not directed in a manner consistent with an effort to increase liquidity—and thereby, hopefully, bring about recovery. Instead, funds were directed to financial institutions with political clout.

Healthy banks that could make loans and supply liquidity were supposed to receive TARP funds in order to head off financial calamity. OneUnited Bank certainly did not meet that requirement. The bank was in deep trouble. However, the bank was tied to two powerful legislators: Congressman Barney Frank (D-MA) and Congresswoman Maxine Waters (D-CA). Both Frank and Waters served on the House Financial Services Committee, with Frank serving as chairman and Waters as the third-highest Democrat in seniority. Until recently, Waters's husband, Sidney Williams, was a director of the bank. Representative Waters at one time had investments in the bank and her husband also owned stock in the firm. In addition, bank executives donated to Waters's political campaigns.

She acknowledged calling the Treasury Department on OneUnited's behalf. The bank eventually received \$12 million in TARP funds. The money made its way to the bank through a special provision written into the bailout legislation. *Wall Street Journal* reporter Susan Schmidt explained, "A provision designed to aid OneUnited was written into the federal bailout legislation by Mr. Frank, who is chairman of the financial services panel. Mr. Frank said he inserted the provision to help the only African-American owned bank in his home state" (Schmidt 2009).

Financial regulators were not impressed with many of the bank's practices and the bank was ordered to name a new independent board. In addition, "the bank was ordered to stop paying for a Porsche used by one of its executives and its chairman's \$6.4 million beachfront home in Pacific Palisades" (Schmidt 2009).

Empirical evidence also shows a systematic political component to the distribution of TARP funds. Duchin and Sosyura (2009) examined the Capital Purchase Program, the largest TARP initiative in terms of the amount of expended capital. They measured political influence by examining the number of seats held by bank executives on the board of directors at Federal Reserve banks or branches, whether the bank's headquarters was located in the district of a U.S. House member serving on a key congressional committee or subcommittee dealing with the financial service sector, the bank's lobbying expenditures, and the bank's campaign contributions to congressional candidates.

Controlling for nonpolitical bank characteristics thought to influence the distribution of TARP funds, Duchin and Sosyura found that employing a bank executive that also serves at a Federal Reserve bank was associated with a 31 percent increase in the likelihood of receiving TARP funds. Having the bank's headquarters located in the district of a U.S. Representative serving on a key financial service committee improved the chances of TARP funding by 26 percent. In addition, TARP funds flowed to those institutions that spent large sums of money lobbying and made significant contributions to politicians.

Duchin and Sosyurn also found that political influence was strongest for poorly performing banks. Thus, political ties shifted funds to weaker institutions, a result at odds with the original stated purpose of TARP. The public, like Representative Thornberry, should be uncomfortable with the expanded role of the state. Instead of allocating funds in an effort to bring about economic recovery, legislators distributed dollars to politically connected banks.

Our focus is on the original bailout vote of each legislator. We seek to determine to what extent political considerations drove the decision by legislators to support or reject TARP.

## Political Evidence

Lawmakers made it clear that they faced a complex bill that grappled with extremely difficult issues. They assured the public that much time and effort had gone into assessing the merits of the proposed legislation. Issues such as fairness and equity, banking regulation, executive pay, and job losses all entered into their calculation. In addition, moral hazard, 401(k) values, and the proper

role of the state made the vote difficult at best. But it turns out that when one moves beyond the speeches, the underlying motivation behind most votes cast was hardly complex and actually quite simple.

An examination of the bailout vote reveals that almost three-fourths of the variation in the vote from politician to politician is explained by only four variables in the House of Representatives and only five variables in the Senate. The model investigating the House vote included the following independent variables: party affiliation, tenure, membership on the Financial Services Committee, and recent contributions to each politician from the financial-services sector. In the Senate model the same variables were included with the exception that the House Committee is replaced with a Senate Committee—membership on the Banking and Urban Affairs Committee. Also, a new variable is added—the number of years until each senator faces the voters in the next election.

The dependent variable in the model is the vote—a yea or a nay—and thus, a Logit model is estimated. The first bill was defeated in the House with 228 members voting against the measure and 205 voting in favor.<sup>1</sup> Democrats offered the most support with 140 voting in favor and 95 voting against the legislation. Only 65 Republicans supported the bill while 133 opposed. In the Senate, the measure passed with 74 members favoring the bill and 25 against.

Campaign contributions to politicians from the financial service industry covering the years from 2003 through 2008 is used in the analysis. The industry includes security brokers and investment companies; commercial banks and bank holding companies; credit unions; finance, insurance, and real estate businesses; private equity and investment firms; banks and lending institutions; credit agencies and finance companies; stock exchanges; commodity brokers/dealers; venture capital funds; securities, commodities, and investment firms; and hedge funds. Both the vote and the amount of contributions to each member of Congress came from [opensecrets.org](http://opensecrets.org) and [maplight.org](http://maplight.org). Party affiliation (1=Democrat; 0 other-

<sup>1</sup>In the end, of course, the bill ultimately passed after it was altered (made better, according to lawmakers). Some of the alterations: NASCAR racetrack builders received over \$100 million, Movie and television producers that made films in America were to receive \$478 million over the next 10 years, a 39 cent excise tax on toy wooden arrows was repealed and rum producers in Puerto Rico and the Virgin Islands were to receive \$192 million (Kang 2008).

wise), tenure (number of years in Congress), membership on key financial committees (1=member; 0 otherwise), and the number of years until the next election in the Senate are from the Maplight.org website.

Tables 1 and 2 present the results for the House and Senate bailout vote analysis. Table 1 reveals that party affiliation, tenure, and contributions from the financial services sector are all significant at the 1 percent level. Specifically, the House model indicates that if members are Democrats, served for a longer period of time, or received contributions from the financial service sector, they were more likely to vote for the bill. Committee assignments are insignificant in the model.

An investigation of the Senate bailout vote analysis in Table 2 yields results that are similar to the House of Representatives but not identical. Again, we find that the committee assignments included in the model did not offer any explanatory power. Likewise, party affiliation and years until the next election are not significantly related to the vote. Senators with greater years of service were more likely to support the measure (at the 10 percent level of statistical significance). Contributions were associated with a vote in favor of the bailout package and this variable was significant at the 1 percent level.

TABLE 1  
HOUSE BAILOUT VOTE ANALYSIS

Variables	Estimate	Significance
Constant	-1.89	0.0001*
Party	1.36	0.0001*
Tenure	0.05	0.0002*
Committee	-0.43	0.204
Contributions	0.000005	0.0001*
Percent Concordant	72.2	

NOTES: \* indicates significance at the 1 percent level. Dependent Variable: 1 if vote in favor of bailout bill, 0 otherwise.



TABLE 2  
SENATE BAILOUT VOTE ANALYSIS

Variables	Estimate	Significance
Constant	-1.26	0.135
Party	0.62	0.265
Tenure	0.057	0.077**
Years until Election	0.154	0.373
Committee	-0.437	0.481
Contributions	0.000001	0.0174*
Percent Concordant	74.7	

NOTES: \* indicates significance at the 1 percent level; \*\* indicates significance at the 10 percent level. Dependent Variable: 1 if vote in favor of bailout bill; 0 otherwise.

## Conclusion

In the end, as the results make clear, the vote had very little to do with representing those on Main Street. Instead, politicians were guided by political considerations. In the House of Representatives, the longer politicians had served (safe seat), the more likely they were to vote in favor of the bill. Also, Democrats in the House were more likely to support the measure. In the Senate, party did not play a role but tenure was significantly and positively related to a yes vote.

The most interesting factor in the model is the level of campaign contributions from the financial service sector. With the public paying unprecedented attention to the decision, those politicians that had received greater contributions from the financial service industry were the same politicians more likely to vote for the wealth transfer. Wall Street, like other special interest groups in America, continues to exert an inordinate amount of influence on Congress—and Main Street, as usual, picks up the tab.

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