

Topics in Banking and Political Economy

Module 0: Political Economy *in* Finance

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Course overview

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The course is very short, so it is crucial that we get up to speed as quickly as possible

Lecture format:

- Introduction to some topics in the political economy of finance literature
- In-depth discussion of selected articles denoted by (*) in the syllabus
- Overview of additional articles in the literature

Assignment and evaluation:

- Referee report of one recent working paper
- In-class presentation of the article

Goals

1. Gain a broad understanding of the **political-economy approach to finance** through banking-focused modules
2. Learn some of the questions in the literature (subjective)
3. Get familiar with some empirical methods, designs, and datasets
4. Learn about the research process (in general)

Modern Political Economy

Modern Political Economy studies the interaction of political systems with economic ones

It operates in areas that follow the footsteps of **Social Choice** (Ken Arrow, 1972 Nobel Laureate), **Public Choice** (James Buchanan, 1986 Nobel Laureate), the **Chicago School** (George Stigler, 1982 Nobel Laureate), while heavily borrowing from **Political Science**

It may not be yet a fully mainstream field in Economics (this is changing)

It can complement more established fields such as Finance, Public Economics, Trade, Development, Macro/Labor, IO, Behavioral (be mindful of this for the job market)

If you look around departments you will find people who are essentially full-time political economists slotted under artificial field boundaries

Module 0. Political economy *in* finance

Module 1. Political institutions and financial structure

Module 2. Politics and credit

Module 3. Political economy of financial crises

Module 4. Politics of central bank independence

Module 5. The (financial) origins of populism

The research process

What is the research question (**question**)?

Why is it interesting (**motivation**)?

- Gap in the literature (*bof*)
- Policy debate

How is it answered (**methodology**)?

- Do you trust the results?

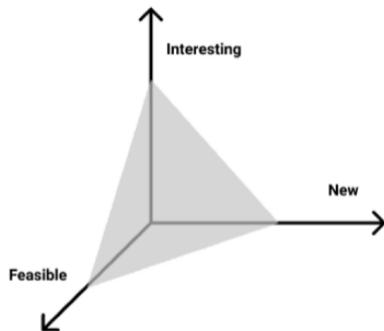
What do we learn (**contribution**)?

The intro should contain these 4 dimensions

- Advice: read [Cochrane \(2005 \[3\]\)](#) carefully!

A good project: the impossible triads

A project is *good* if it is (1) interesting, (2) new, and (3) feasible, as in the Figure below.



The problem, of course, is that most research ideas check at most two out three boxes. If an idea is interesting and new, then probably nobody wrote about it because it is unfeasible. If an idea is interesting and feasible, then probably somebody already took it. If an idea is new and feasible, then it probably is just not that interesting.

The political-economy approach to finance

Finance studies contracts on **income** and **control rights** of assets

Separating ownership and control over assets:

- enables specialization and diversification
- but also creates agency and governance problems

Need reliable investor protection (“contracting institutions”)

Ex ante and ex post inefficiencies motivate regulation and interventions

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} shaped by
political power

Finance also shapes the **distribution** of the economy's resources

Distribution of wealth and economic power:

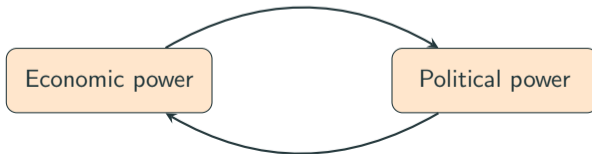
- affects incentives and preferences for reforms
- shapes ability to influence the political process

A Medici vicious circle

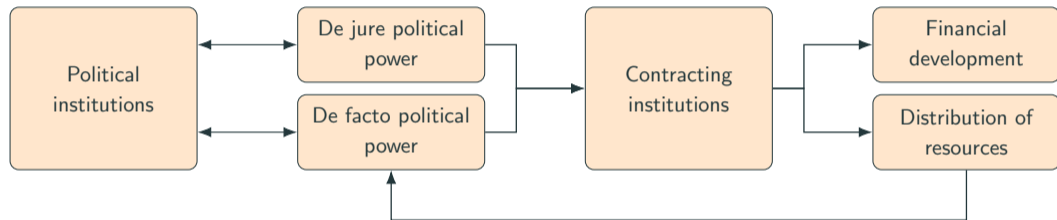
Economic power stems from market concentration (sources: network externalities, information-intensive goods, weaker antitrust enforcement)

Political power is shaped by conditions of the media market, campaign finance, judicial independence, and dominant ideology

Economic and political power reinforce each other, creating a **self-reinforcing cycle**, undermining in turn both competition and democracy → key remedy: **public awareness** (Zingales 2017 [8])



A conceptual framework



Source: Lambert and Volpin (2018 [4])

Financial development and the hierarchy of institutions

Financial development matters for economic growth via capital accumulation and technological innovation (Levine 1997 [5])

North and Thomas (1973 [7]): capital accumulation and innovation as endogenous mechanisms of growth, not fundamental causes

Institutions are thus seen as **fundamental drivers** of financial development because they shape incentives in society and persist over time

And, within a hierarchy of institutions, **political institutions** come first because they are more difficult to change than contracting institutions (among others)

Political institutions are **endogenous** as they are affected by the **distribution of resources**

Lambert and Volpin (2018 [4], p.477)

“[argues] that changes in political institutions have a fundamental influence on the historical evolution of financial systems across nations while they are at the same time affected by the distribution of [resources] associated with a specific financial system.”

State variables and political power

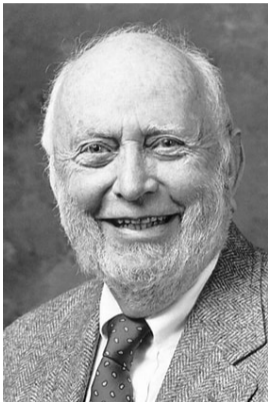
Political institutions and the distribution of resources are the **state variables** in this framework

The knowledge of both state variables at time t is sufficient to **determine all the other variables** in the framework

Two sources of **political power** affect the choice of contracting institutions and influence the future evolution of political institutions:

1. Political institutions determine the distribution of **de jure** political power
2. The distribution of resources influences the distribution of **de facto** political power

Endogenous political institutions: From Douglass C. North's influential work...



Douglass C. North

"Institutions are the rules of the game in a society [...]"

"[...] institutional change shapes the way societies evolve through time and hence is the key to understanding historical change." (p.3)



Political Economy
of Institutions and Decisions

North (1990 [6])

... to Daron Acemoglu, Simon Johnson, and James A. Robinson



From left to right: Simon Johnson, Daron Acemoglu, and James A. Robinson

2024 Nobel laureates: “for studies of how institutions are formed and affect prosperity”

Big-picture approach: history + economic theory + case studies + **causal identification**

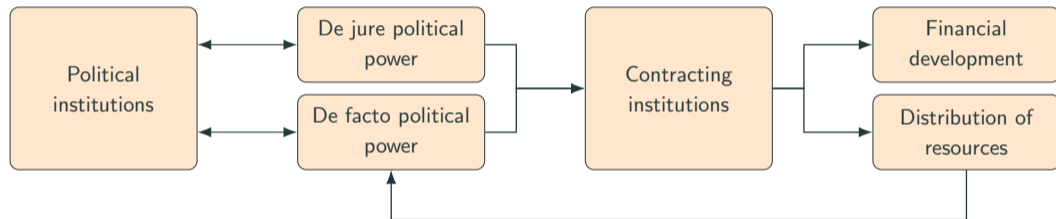
Large follow-up literature (including in **finance**): testing the impact and origins of institutions and historical development

Increasing relevance: **authoritarianism and institutional challenges** today

See e.g. [Acemoglu, Johnson and Robinson \(2005 \[1\]\)](#)

Course outline

Walking through the framework



Source: [Lambert and Volpin \(2018 \[4\]\)](#)

Key questions

- What fundamentally drives the evolution of countries' financial structure?
- Why does political power account for cross-country and intertemporal variation?
- What is the relative importance of contracting institutions versus political institutions, and how do they interact in shaping financial structure?
- Does democracy matter for financial development?

Key questions

- How do banks' political connections affect access to and the terms of credit?
- What are the benefits and (social) costs of political connections?
- How does partisan alignment influence bank behavior?

Key questions

- How can financial instability reflect a political equilibrium rather than unavoidable vulnerabilities or external shocks?
- How do constituent and special interests affect the prevention, management, resolution, and recovery of financial crises?
- What role does regulatory capture play in financial crises?
- How can distortions arising from regulatory capture be mitigated?

Key questions

- Why are some agencies independent?
- What political and institutional factors drive de jure central bank independence?
- How does de facto independence interact with de jure independence?
- What are the macroeconomic consequences of central bank independence (or the lack thereof)?
- Is a Carbon Central Bank desirable?

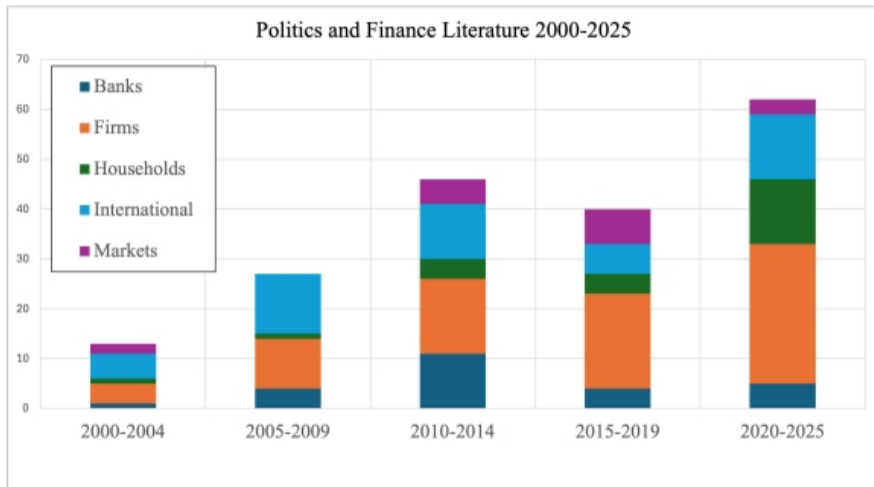
Module 5. The (financial) origins of populism

Key questions

- How do financial crises reshape politics?
- What is populism and what are its consequences?
- How do banking crises and creditor–debtor conflicts contribute to political radicalization and the rise of populism?
- To what extent have banks supported the advent of populist politicians into power, historically and contemporaneously?

Banks and beyond

Growth in political economy of finance literature



Source: Akey, Gupta and Lewellen (2026 [2])

It is still a niche field, but there is a lot of interest in the profession:

- Pol-Fin sessions at most major finance conferences
- Specialized small conferences (at least 3 annual series)

Check out our www.poleconfin.org initiative for a repository of recent working papers and an annual themed conference series (2026 conference theme is “**crony capitalism in 21st century America**”)

Inspiration:

- Research-based political economy / political science / sociology podcasts:
 - Capitalisn't
 - Not Another Politics Podcast
 - Thinking Allowed
- Law, sociology, political science papers

Some current important themes

Corporate
democracy

The green
transition and
politics

Mechanisms of
partisan alignment
in finance

Different forms of
corporate political
activities

De facto vs.
de jure
political power

Geopolitics
and finance

Tech sector and
authoritarianism

Culture,
institutions
and finance

Costs and
benefits of
political
connections

Populist
leaders
and firms

Aggregate
effects

Billionaires,
politicians,
and the media

Conclusion

Summary

The **political economy of finance** literature examines how political institutions and the distribution of political power shape the development and functioning of financial systems, and vice versa ([Lambert and Volpin 2018 \[4\]](#))

Early contributions in this literature find their roots in the literature linking the role of political and economic institutions and economic performance ([Acemoglu et al. 2005 \[1\]](#))




The literature expanded rapidly after the Global Financial Crisis to become “mainstream”

Recent research has advanced in many directions, of which this course highlights five: (i) **countries' financial structure**, (ii) **bank lending**, (iii) **financial crises**, (iv) **central bank independence**, and (v) **the rise of populism**

Thank You

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