Comments on Dao and Marisetty
EMF 2016

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December 17, 2016
Khwaja and Mian (2004) – Do Lenders Favour Politically Connected Firms

Findings
- Politically connected firms receive 45% larger loans and have 50% higher default rates
- Preferential treatment driven entirely by loans from government banks
- Incumbents receive greater access to credit, but those running from constituencies with higher voter turnout receive less

Interpretation
- Politically powerful firms obtain rents from government banks by exercising their political influence on bank employees (PCH)
- No evidence for “social lending” (SLH) – i.e. government banks lend to socially efficient but high risk projects and firms with politicians on their boards undertake such socially efficient projects
- In fact evidence against SLH – political preference results only appear with profit seeking banks and not those that have an explicit social objective
China and India.

Use only credit access to Public Private Partnerships (PPP) to provide a more direct test of SLH vs PCH.

Hypotheses:

- H1: Under SLH – “politically connected PPP firms should have higher access to credit compared to similar firms that do not engage in PPP projects”.
- H2: Under PCH – “bank loans should favour politically connected PPP firms that overinvest due to excessive lending to poor PPP projects”.
Unpacking SLH

- SLH – banks lend to socially efficient but high risk projects and firms with politicians on their boards undertake such socially efficient projects.
- In other words, while banks are willing to lend, there is no demand on the side of firms to engage in risky, socially efficient projects.
- But, when a politician enters the board, this changes the firm’s objective function.
SLH – banks lend to socially efficient but high risk projects and firms with politicians on their boards undertake such socially efficient projects

H1: Under SLH – “politically connected PPP firms should have higher access to credit compared to similar firms that do not engage in PPP projects”.

Not clear that H1 implies SLH

Do politically connected PPP firms undertake more socially important projects that non-politically connected PPP firms?

Evidence of H1 might just be because politicians find it easier to exert pressure on bank employees when there is a putative alignment of interests between the private firm and policy objectives

No proof that funds received are well utilised

PPP design not suited to test whether the presence of a politician changes a firm’s objective function
Matching on firm size and industry alone are not likely to give you a good match.

- Evident from t-tests. Tables I and II in the paper show very poor match balance.
- Especially for Indian firms.

<table>
<thead>
<tr>
<th>Variable</th>
<th>PPP (n=203)</th>
<th>Non-PPP (n=146)</th>
<th>Difference</th>
<th>t-test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bank loans/sales</td>
<td>2.208365</td>
<td>0.9165287</td>
<td>1.291836</td>
<td>1.97**</td>
</tr>
<tr>
<td>Interest coverage</td>
<td>4.490053</td>
<td>26.16461</td>
<td>-21.674557</td>
<td>-3.35***</td>
</tr>
<tr>
<td>Size</td>
<td>7.692521</td>
<td>7.545767</td>
<td>0.14654</td>
<td>1.99**</td>
</tr>
<tr>
<td>Age</td>
<td>7.917073</td>
<td>9.458904</td>
<td>-1.541831</td>
<td>-2.78***</td>
</tr>
<tr>
<td>Leverage</td>
<td>0.408932</td>
<td>0.311471</td>
<td>0.097461</td>
<td>5.05***</td>
</tr>
<tr>
<td>Tobin’s q</td>
<td>2.523122</td>
<td>2.086503</td>
<td>0.436619</td>
<td>0.84</td>
</tr>
<tr>
<td>Insider ownership</td>
<td>12.988430</td>
<td>7.067889</td>
<td>5.920541</td>
<td>3.19***</td>
</tr>
</tbody>
</table>
Consider:

\[ Y_i = X_i' \beta + \epsilon_i \]

- Assumed that \( E[\epsilon_i|X_i] = 0 \), i.e. \( X_i' \beta \) is the CEF
- With a random sample from the population, we could consistently estimate \( \beta \) by OLS
- But we do not have a random sample; rather we observe \( Y_i \) for a selected subgroup (e.g. only those that take loans)
- Heckit cures sample selection issues.
Heckit Example: Labour Supply

- We observe \( w_i \) for only those that work (i.e. \( D_i = 1 \)). Workers work if \( w \geq w^* \)

- Reservation wages described by:

\[
\begin{align*}
    w^*_i &= X_i' \theta + v_i \\
    w_i &= X_i' \beta + \epsilon_i \\
\end{align*}
\]

- Work iff

\[
X_i' \beta + \epsilon_i \geq X_i' \theta + v_i
\]
Therefore while

\[ E[\epsilon_i | X_i] = 0 \]

\[ E[\epsilon_i | X_i, D_i = 1] > 0 \]

In such a case, we can model the decision to work in a first stage, to purge our main specification of selection bias.

But your problem is not that only some firms take loans and others do not.
RD Example: Solis 2013

- I want to know the effect of credit access on college enrollment
- But banks do not randomly allocate loans to students. In fact, far from random.
- What to do?
College Enrollment of Chilean Students and PSU Test Scores

cutoff for loan
eligibility=475 pts
What You Need for an RD?

- Treatment – Loan
- Running Variable that determines Treatment – PSU Score
- Outcome – Enrollment Rate
- Assignment to the plus or minus side of treatment is as good as random
Your Case

- Treatment – UPA2 (i.e. PPP investment year $\geq$ 2009)
- Outcome – Bank Loans/Sales
- Running Variable – PPP investment year

But

- Lack of clarity on definition of PPP firm and political connection make it difficult to understand the design
- What is the treatment? No change of regime.
- Even if there were a change in regime, how does it affect a PPP firm’s ability to receive bank loans?
- Maybe what you want to do is an event study?
This is just your Heckit model, but now with a three way interaction between PPP, political connections, and high Tobin’s q

Suffers same problem as original Heckit

I am interested in $\beta_{11}$ from eq (4) in the paper

Even if true that High q firms receive loans in China and low q firms receive loans in India, this is neither proof of SLH or a refutation of PCH

Could be that there are no rents to be had in low q firms in China
My Version Of This Paper

- More descriptive statistics, graphs
- Fewer methods
- Focus first on replicating Mian and Khwaja in India and China
- Proving SLH is hard, but maybe there is an instrument?