Comments on Dao and Marisetty

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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

This Paper

- 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

H1

- 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 politicans 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

- 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.

Panel A: All sample (n=349)	PPP (n=203)	Non-PPP (n=146)	Difference	t-test
Bank loans/sales	2.208365	0.9165287	1.291836	1.97*
Interest coverage	4.490053	26.16461	-21.674557	-3.35***
Size	7.692321	7.545767	0.146554	1.99**
Age	7.917073	9.458904	-1.541831	-2.78***
Leverage	0.408932	0.311471	0.097461	5.05***
Tobin's q	2.523122	2.086503	0.436619	0.84
Insider ownership	12.988430	7.067889	5.920541	3.19***

When to Use a Heckit?

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 β by OLS
- But we do not have a random sample; rather we observe Y_i for a selected subgroup (eg. 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:

$$w_i^* = X_i'\theta + v_i$$

- Offered wages described by:

$$w_i = X_i'\beta + \epsilon_i$$

- Work iff

$$X_i'\beta + \epsilon_i \geq X_i'\theta + v_i$$

Heckit Example: Labour Supply

- Therefore while

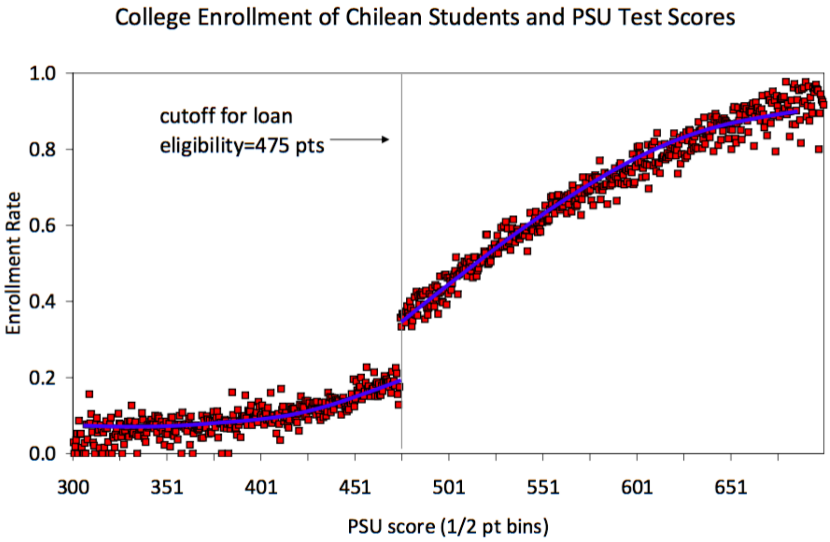
$$E[\epsilon_i|X_i] = 0$$

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

- 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
Enrollment Rate
1.0
0.8
0.6
0.4
0.2
0.0
300
351
401
451
501
551
601
651
PSU score (1/2 pt bins)

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?

Slope Differences

- 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 β_{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?