Politics, State Ownership and Corporate Investments Shashwat Alok and Meghana Ayyagiri

- The paper aims to “evaluate the role political influence on investment decisions of SOEs”.
- The authors claim that they find “compelling evidence of a political investment cycle in the corporate investment decisions of state owned firms.”
- The question that is left unanswered is: Why should elected representatives attempt to influence investment decisions by SOEs?
- An intuitive answer would be to maximize the probability of being re-elected.
- But such a proposition has yet to be formally derived.
- In fact it could be loosely argued that any kind of expenditure could be used for this purpose.

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- Rogoff (1990, pg. 21) “A political budget cycle arises here due to temporary information asymmetries about the incumbent leader’s “competence” in administering the public good production process. The incumbent leader has an incentive to bias preelection fiscal policy towards easily observed consumption expenditure and away from government investment.”
- Operations of Non Financial Public Enterprises (owned by central and state govts.) are incorporated in the analysis of fiscal policy (either in relation to the business cycle or elections) because these are likely to have substantial fiscal implications.

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- Looking at data on SOEs alone is likely to provide a rather incomplete view of the “signaling mechanism” which incumbent leaders could use to influence voters.
- In any case promises of better infrastructure or employment opportunities in the future are very unlikely to influence voters.
- Any expenditure that has a more immediate impact on voter well being would obviously be a better bet to influence voter behavior.
- It is highly unlikely that a mere announcement of a project could influence voter behavior unless one endows the voter with some kind of “irrationality” because inordinate project delays and projects not taking off at all are rather common phenomena in India.

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- The authors use the CAPEX data base.
- What is unclear is whether this data base includes projects implemented departmentally (typically by the Public Works Department at the State level and say by the railways at the central level).
- The authors provide no description at all about the nature of projects. This is a major lacuna that needs to be addressed.
- If the data base does not track such investments then its coverage is not good enough to be used in this kind of analysis.
- The panel data used covers 18981 projects announced (1995-2009) over 435 (594) national (state) electoral districts.

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- In 2001 India had 593 districts which rose to 640 in 2011.
- Clearly a large number of districts do not figure in this data base.
- Are these districts dropped because there were no “announcements” in these districts or because it was difficult to match electoral constituencies and districts?
- Out of a total of 24,000 announcements only 18981 are considered in the study.
- In any case the “unobserved” component is likely to be large and thus empirical results reported are likely to be unreliable.

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- In section 5.3 the authors undertake a sort of an event study with respect to project announcements.
- It is well known that test statistics used in such studies are quite sensitive to outliers given that the sample sizes are typically small.
- Some nonparametric test statistics (say the binomial z statistic which tests whether the proportion of positive to negative returns exceeds the number expected by the market model) should have been reported.
- Excess returns and abnormal returns on the day of project announcement have been used. This is an extremely small window.

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- It is well known that when there is a good chance of information leakage the event window should include some time prior to the announcement of the event so that abnormal returns associated with the leakage are captured.
- Clearly the kinds of projects being considered information leakage is almost a sure thing. The event window is clearly too small to arrive at meaningful results.
- Another standard procedure in such event studies is to ensure that there are no confounding effects from other events. As the event window is only one day this is unlikely to be a major problem but it still needs to be checked.

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- While reading the paper one gets a feeling that the authors believe that the “political investment cycle” empirically uncovered is a bad thing.
- Rogoff (1990 pg.22) “A central conclusion here is that they (political budget cycles) may be a socially efficient mechanism for diffusing up-to-date information about the incumbent’s administrative competence. Efforts to curtail the cycle can easily reduce welfare, either by impeding the transmission of information or by inducing politicians to select more socially costly ways of signaling.”