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Revealing Corruption: Firm and Worker Level Evidence from Brazil

Based on BFI Working Paper 2022-04, "Revealing Corruption: Firm and Worker Level Evidence from Brazil," by Emanuele Colonnelli, Chicago Booth; Spyridon Lagaras, University of Pittsburgh; Jacopo Ponticelli, Northwestern University; Mounu Prem, Universidad del Rosario; and Margarita Tsoutsoura, Cornell University

Firms exposed by anti-corruption programs grow larger after audits, despite experiencing a decrease in procurement contracts. Exposed firms adapt to the loss of government contracts by increasing capital investment and borrowing more to finance such investment.

In recent years, governments and international organizations around the world have started transparency initiatives to expose corrupt practices in the allocation of public procurement contracts. How do such initiatives impact business practices? How, if at all, is the performance of firms and employees affected by such actions?

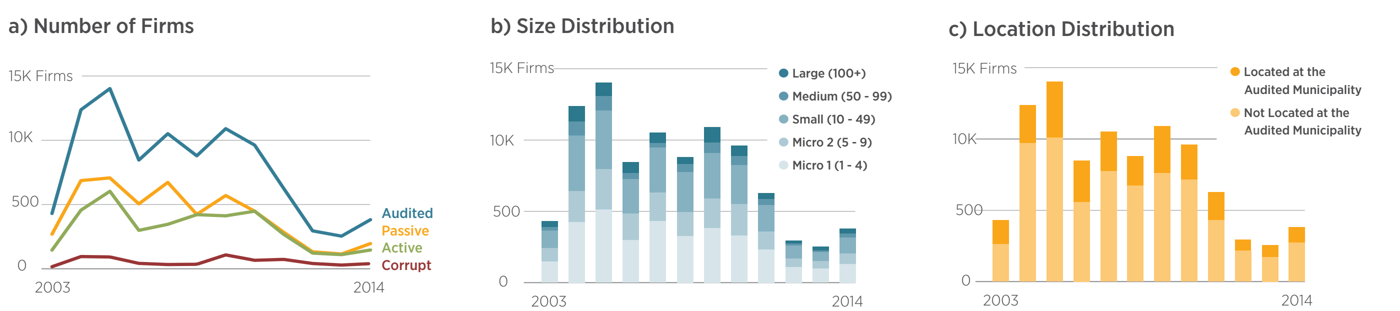
These questions and others motivate this new research, which uses micro-data from Brazil within a unique institutional setting to study the real effects of a large anti-corruption program on firms involved in illegal interactions with the government. The authors' empirical design relies on a government initiative that randomly audits municipal budgets with the aim of uncovering any misuse of federal funds.

While the program targets the budget of municipalities, the audits expose the identity of specific firms involved in irregular business with the government. Most such firms are located outside the boundaries of the audited municipalities. By focusing on those firms, the authors can better isolate the direct effect of exposure of corrupt practices from its overall impact on the local economy of the audited municipality. In addition, the random nature of the audits provides the authors with a unique setting in which the timing of firm-level exposure is plausibly exogenous.

The authors reveal two key, seemingly contradictory findings:

- Firms exposed by the anti-corruption program experience, on average, a 4.8 percent larger

Figure 1 • Audited Firms, Location, and Size Distribution



Notes: This figure presents the number of audited firms and their size and location distribution by year. Panel A presents the number of firms audited by year and type of exposure by the audit from 2003 to 2014. Panel B shows the distribution of firms based on size categories over time for all audited firms. Panel C shows the distribution over time of audited firms based on whether they are located inside or outside the audited municipality.

Becker Friedman Institute FOR ECONOMICS AT UCHICAGO increase in size (as measured by total employment in the firm) relative to the control group in the three-year period following exposure.

- Exposed firms experience a significant decrease in their access to procurement contracts over the same period. These effects indicate that while negative exposure generated by the anti-corruption campaign decreases a firm's ability to rely on government contracts, it also benefits firm performance in the medium run, suggesting that firms were on average hindered by the presence of corruption they were directly involved in.

How to explain these conflicting findings? The authors argue that, by cutting access to government contracts for exposed firms, anti-corruption campaigns might force such firms to adjust their investment and business practices to compete in the market for private demand. They find evidence consistent with this mechanism using detailed micro data on firms' investment and access to credit. On the other hand, the authors do not observe major changes in the internal organization of firms after exposure.

The authors chart out avenues for future research, including efforts to fully identify the links between corruption and firms' growth strategies, and efforts to understand the specific ways through which operating in a corrupt environment might affect firm behavior. This work speaks to the extent to which an anti-corruption program impacts some of these margins, thus leaving several open questions more directly linking corruption and firm decisions.

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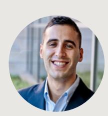

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