# The Political Economy of Anti-Bribery Enforcement

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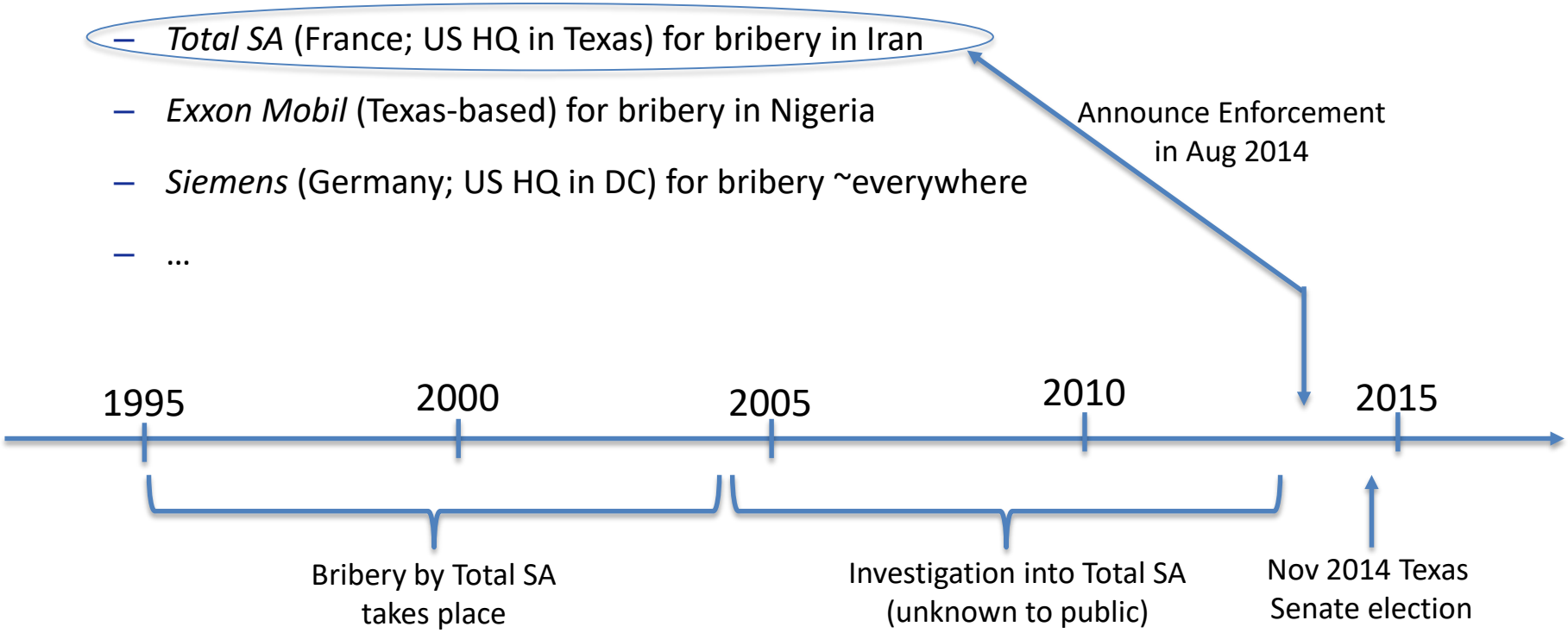
Discussed by Stefan Zeume
ABFER, June 2021

# This paper

- Authors study political influence on FCPA enforcement actions
  - => number of enforcement actions against foreign firms increases before senate elections

- *Illustration*: Suppose in June 2014 there are advanced SEC/DoJ investigations into…
  - *Total SA* (France; US HQ in Texas) for bribery in Iran
  - *Exxon Mobil* (Texas-based) for bribery in Nigeria
  - *Siemens* (Germany; US HQ in DC) for bribery ~everywhere
  - …



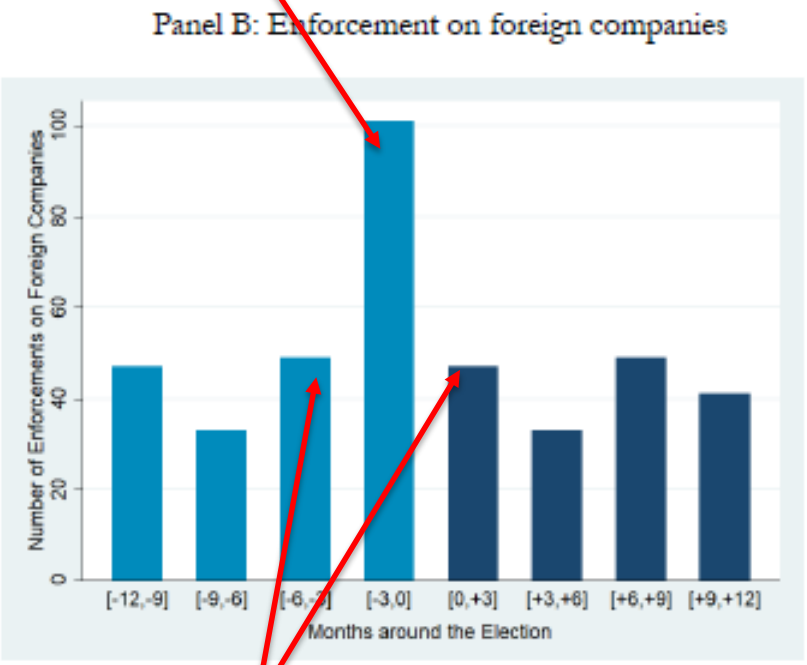
# Verdict

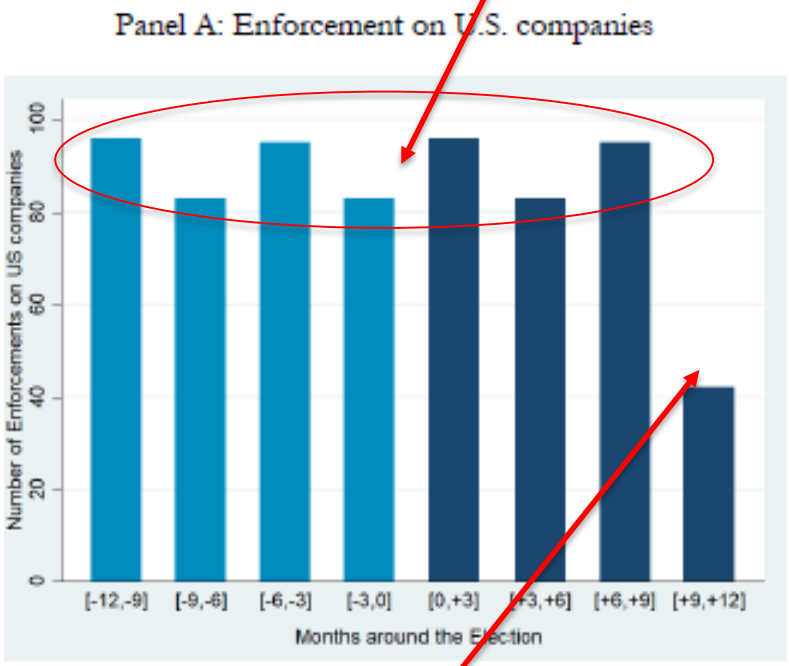
- Interesting, new, impactful.
  - You might (naïvely) think that regulatory enforcement is…
    - …based on unbiased detection of wrongdoing and…
    - …announced when appropriate, without agenda…
  - … **but this paper makes you think again!**
- Massive data collection: both SEC & DoJ cases, link to parent firms, case characteristics
- Neat setting:
  - 2/3 of U.S. states have a senate election every two years
  - timing of elections is predetermined ~ alleviates many concerns
  - states treated at different times, never all at once ~ allows for many controls
  - investigations into anti-bribery violations start much earlier ~ story is about selective enforcement
- I hope this paper succeeds—will try top challenge the authors a little.

# What do they find?

- **MAIN RESULT:** circa 60 (>100%) more enforcement actions against foreign firms in 3 months prior to senate elections

- no effect on enforcements against US firms around elections




- no visible 'missing mass' right before or right after 'treatment'(*)

- circa 50 fewer enforcement actions against U.S. firms mostly right in between elections ~ why?

# What's the main specification?

| | ALL | US | FOR |
|---|---|---|---|
| | (3) | (6) | (9) |
| Pre-election | 0.0007 | -0.0006 | 0.0014*** |
| | (0.0007) | (0.0005) | (0.0004) |
| Size | 0.0001 | 0.0012 | -0.0011 |
| | (0.0013) | (0.0008) | (0.0011) |
| Leverage | 0.0080 | 0.0089 | -0.0008 |
| | (0.0069) | (0.0061) | (0.0031) |
| Cash | 0.0149** | 0.0196*** | -0.0047 |
| | (0.0059) | (0.0047) | (0.0036) |
| ROA | -0.0005 | -0.0021 | 0.0016 |
| | (0.0058) | (0.0044) | (0.0039) |
| Sales Growth | -0.0004 | -0.0007 | 0.0003 |
| | (0.0011) | (0.0008) | (0.0009) |
| State Employment Rate | 0.3975** | 0.1415 | 0.2560* |
| | (0.1603) | (0.0921) | (0.1346) |
| State Population | 0.1576*** | 0.0633 | 0.0943** |
| | (0.0567) | (0.0419) | (0.0393) |
| State GDP | -0.0808* | -0.0087 | -0.0721** |
| | (0.0436) | (0.0259) | (0.0360) |
| Year FE | Yes | Yes | Yes |
| Country, state, industry FE | Subsumed | Subsumed | Subsumed |
| Firm FE | Yes | Yes | Yes |
| Observations | 137,840 | 137,840 | 137,840 |
| R-squared | 0.4682 | 0.4703 | 0.4276 |

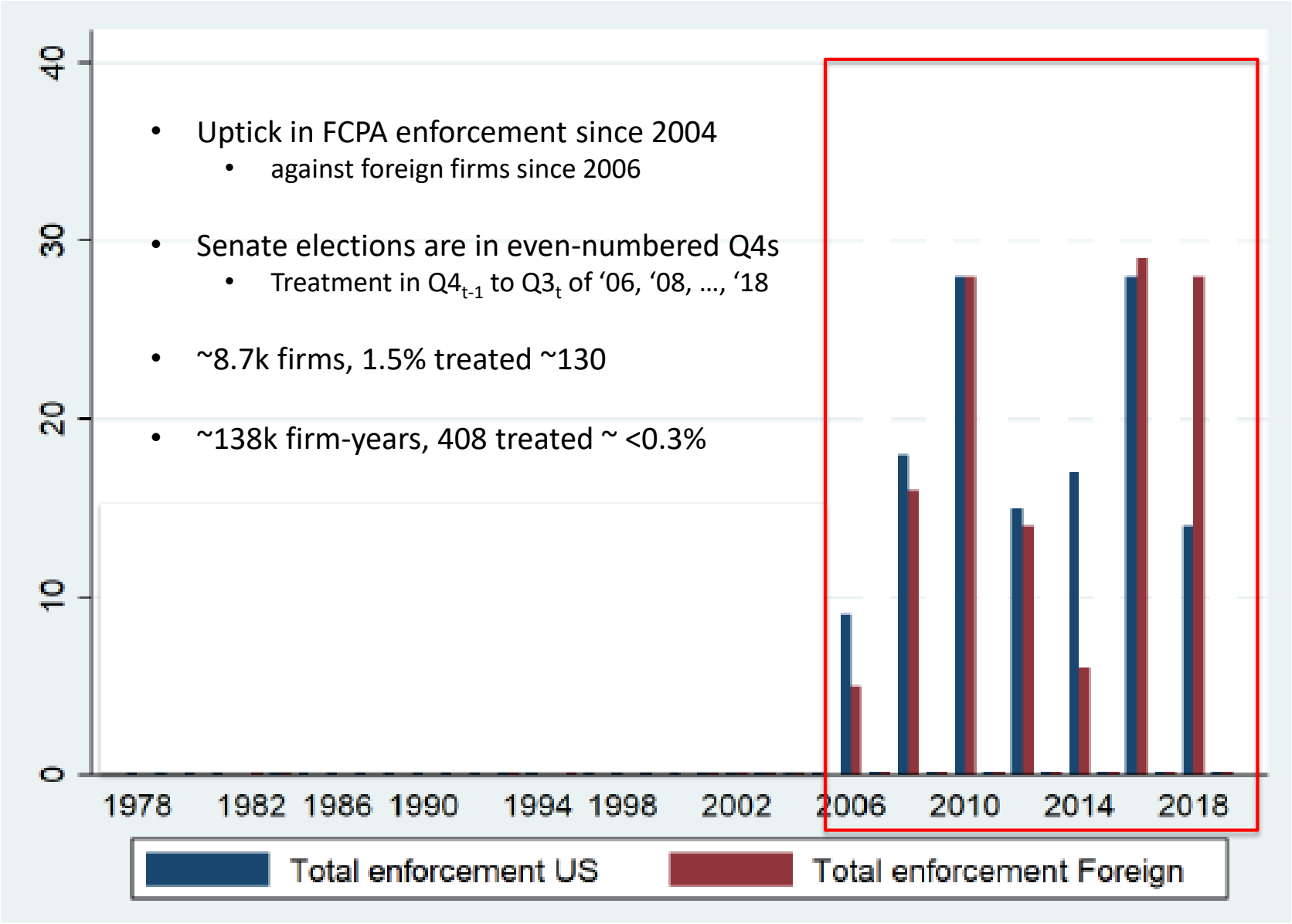
In year prior to state's senate election, foreign firms with main US operations in that state experience increased enforcement activity

Control for possibility that some state-/firm dynamics drive result

Control for possibility that

- #enforcements different in election years
- treated firms have higher prob(enforcement)

# Where is the action?



# Wishlist

- 1) Help the reader
- 2) Use case characteristics more
- 3) Consider implications of time trends
- 4) Other

# 1) Help the reader

- **First impression: Introduction** requires a lot from the reader

Not everyone agrees.

- **Starting point:** Foreign Corrupt Practices Act (**FCPA**) of '77 **leveled the playing field**
  - Theory: regulating n<N of participants in 1st pr auction w/side paymts hurts them (Beck & Maher '89)
  - Empiricists: FCPA reduced U.S. exports (Hines '95), M&A activity (Graham & Strout '06)
  - Some others: Corruption/bribes sometimes greases the wheels (Dutt & Traca 2010)
- **This paper: FCPA is used to *unlevel* the playing field**: ↑ enforcement against foreign firms
  - [Was it leveled before?]
  - Is enforcement against foreign firms effective in hurting foreign firms? ~ paper right now does not show this—could be shown but a lot of work, see Goldman & Zeume 2021 ssrn
- **Channel: Political influence**
  - Some may wonder HOW politicians can influence SEC, DoJ enforcement decisions.

Can level playing field for readers some more.

- *Thoughts:*
  - *'Leveling the playing field' argument may not be needed: it is still curious that enforcement actions against foreign firms spike in pre-senate election years.*
  - *May need more to prepare reader for political influence as main channel.*

# 1) Help the reader 1/2

**Could link role of political influence more to the literature:**

- **Antitrust enforcement**
  - in 1901 (Baker Frydman Hilt 2020)
  - more recently (Mehta Srinivasan Zhao 2020 JAR)
- **Corporate misconduct investigations**
  - fraud detection (Yu Yu 2011 JFQA)
  - prob of enforcement & penalties (Correia '14 JAE, Heitz Wang Wang '21, Mehta Zhao '20 JAE)
- **Deregulation**
  - Interstate bank branch deregulation (Kroszner Strahan (1999 QJE)
- **Regulatory implementation**
  - Fair lending regulations (Akey Heimer Lewellen 2021 JFE)

⇒ *Would provide background along these lines.*

⇒ *"Since enforcement affected by political interests elsewhere, why not also wrt FCPA?"*

⇒ *"Interesting finding is that foreign firms are hurt (rather than domestic firms helped)."*

# 1) Help the reader 2/2

**Could motivate from what should drive enforcement actions**

[though I don't think we know much about this]:

- Naïve view : Enforcements driven by…
  - detection of wrongdoing & supportive evidence that warrants enforcement
  - unbiased detection probability
- In practice, enforcers face challenges, e.g., limited budgets
  - Go for bang for the buck? ~ highest fine per $ spent on investigation, etc.
  - Take action with highest deterrence effect on other firms?
  - Go for the low-hanging fruit to pump up the case count?
- Then there are other considerations
  - Actions that help local firms
    - By helping local firms, or
    - **By punishing competitors of local firms**
    - [note where to help local firms? At home? Abroad?]

⇒ *Would discuss that U.S. regulators are probably neither unconstrained nor uninfluenced.*

# 2) Use case characteristics more

- Paper features detailed data on case characteristics… hidden in the appendix
- *Seems to me that some of this data can be used to help argument:*

| | U.S. companies | | | | | Foreign companies | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Election years | | Non-election years | | | Election years | | Non-election years | | |
| | Mean | SD | Mean | SD | Diff (t-stat) | Mean | SD | Mean | SD | Diff (t-stat) |
| Bribery Amount (millions) | 3.610 | 6.315 | 17.694 | 45.788 | -14.084* (0.069) | 41.675 | 89.034 | 39.492 | 73.753 | 2.183 ( 0.903) |
| Timing (investigations to enforcements | 4.403 | 3.768 | 3.573 | 2.237 | 0.832 (0.109) | 5.472 | 2.443 | 3.848 | 2.387 | 1.624*** (0.002) |
| Timing (bribery to enforcements) | 7.714 | 2.916 | 8.895 | 3.990 | -1.181* (0.084) | 10.171 | 5.039 | 10.597 | 3.967 | -0.426 (0.620) |
| Timing (bribery to investigations) | 4.676 | 2.539 | 6.625 | 5.571 | -1.949** (0.042) | 8.146 | 8.676 | 7.958 | 5.663 | 0.189 (0.889) |

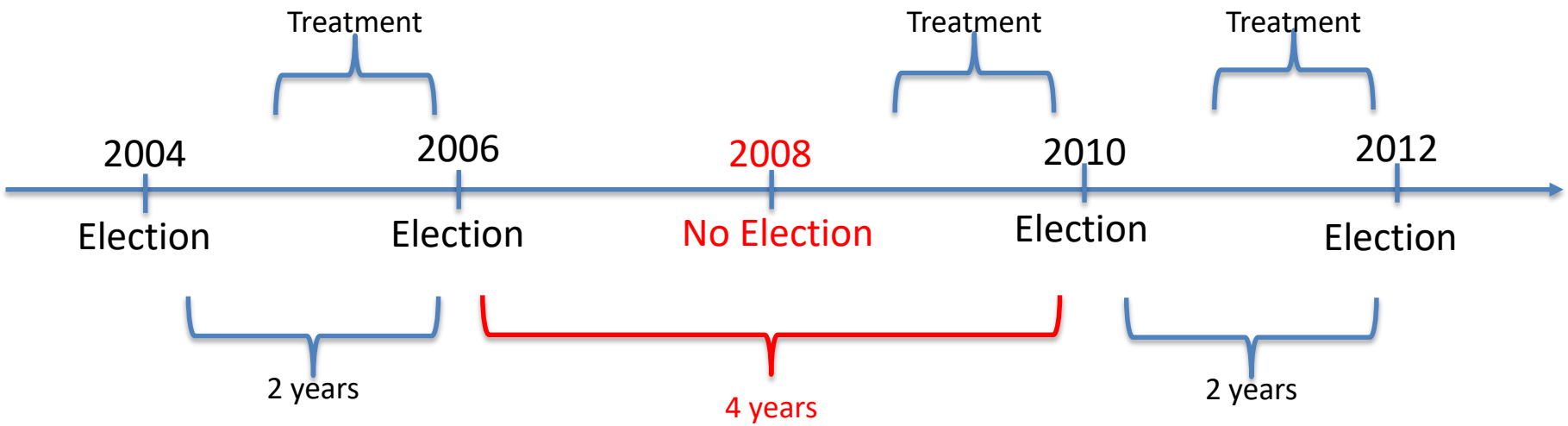
Pre-election cases against domestic firms are smaller. Strategic? [In line with literature.]

Longer investigation time among pre-election cases against foreign firms => strategic announcement delay?

# 2) Use case characteristics

- Can use case characteristics for further show that politics drives foreign firm enforcement
  - Example 1: Gaps between general elections vary between 2 years or 4 years

    -> 4-year wait gives more time to collect important impactful cases




- Compared to 2-year wait, are pre-election cases against foreign firms after 4-year wait…
  - …bigger cases ($$$bribe)?
  - …strategically delayed/'dustier' (longer time between investigation and enforcement)?
  - …

# 2) Use case characteristics

- Can use case characteristics for further show that politics drives foreign firm enforcement
  - Example 2: Different senate elections feature different incentives to 'unlevel' the playing field.
    - E.g., incentive to bring up important cases may be higher ahead of important elections.

- ***-> Overall, suggest making more use of case characteristics to support quantitative evidence from regressions.***
  - -> Note this part of the analysis might also help inform the question of whether politicians 'receive something in return' for their influence on enforcement against foreign firms.
    - Do bigger pre-election cases result in greater financial support (PACs)?, etc.

# 3) Trends

- General senate elections offer a neat setting in that their timing is predetermined: pre-defined sets of states are treated in pre-defined years
  - [high number of published papers that use this setting]

- In this paper, additional feature: predictions & tests on foreign firms vs. domestic firms

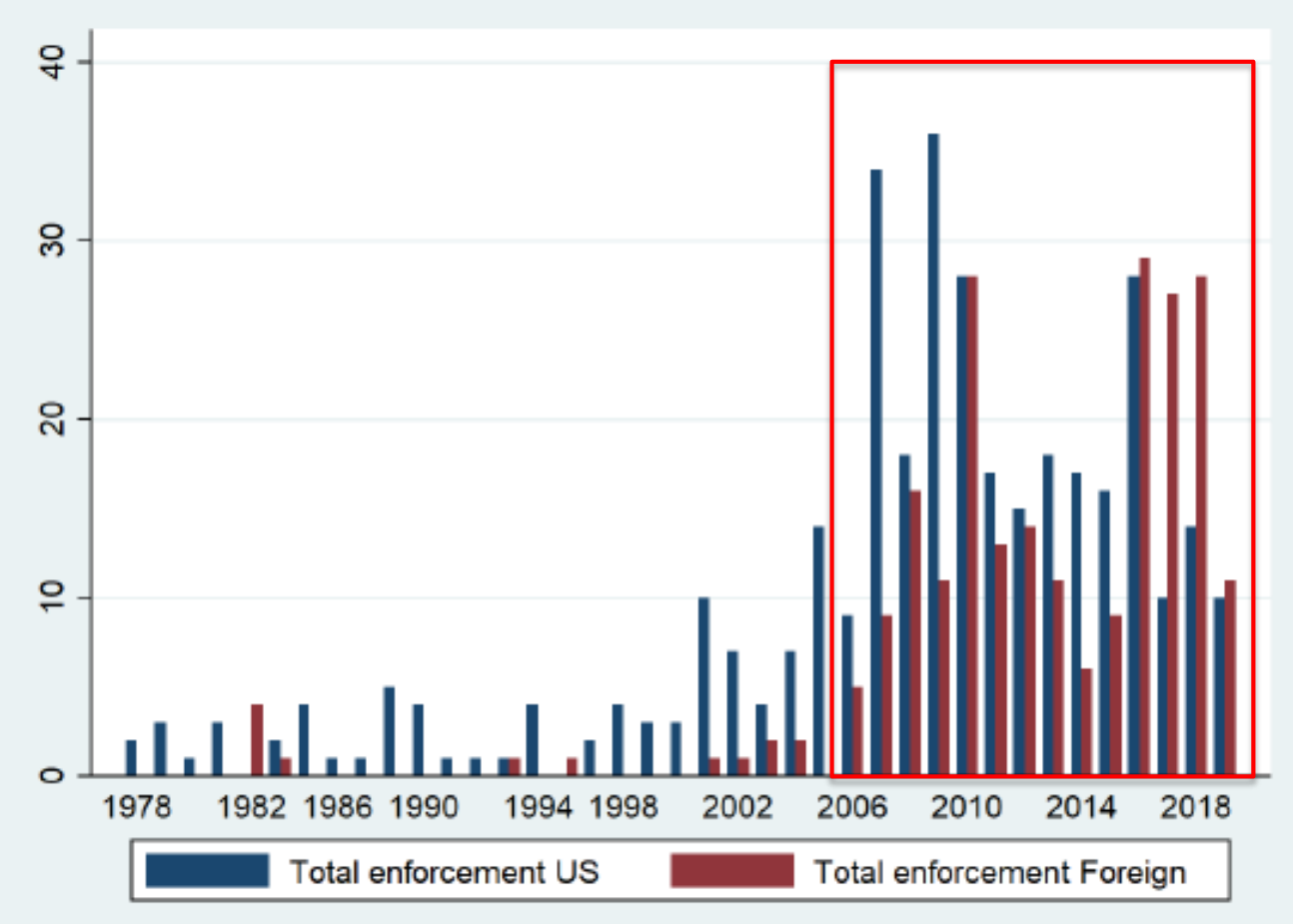
- Issues may arise where
  - (i) sets of states have different time trends in
    - (a) outcome variable or
    - (b) omitted variables that may drive the outcome, and*
  - (ii) different sets of treated states are treated different #times

- In the following, will
  - Argue that (i) and (ii) may(!!) be at work, could bias twds finding an effect on enforcement against foreign firms;
  - Suggest fixes; and
  - Use simulations to show that issues above may lead to underrejection of null ('no effect')

* I think 'or' is not enough.

# 3) Trends

- Spike in #FCPA actions over last 14 sample years: 2006-2019




- Will illustrate using these 14 years [will show in simulations that this is ok]

# 3) Trends

- Over the 14 year spike in enforcement actions, 2/3 of states had 5 treatments (=senate elections), other* states had 4

| State | #Treat | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| AK | 4 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| AL | 4 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| AR | 4 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| AZ | 5 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 |
| CA | 5 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 |
| CO | 4 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| CT | 5 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 |
| DE | 5 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
| FL | 5 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 |
| GA | 4 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| HI | 5 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 |
| IA | 4 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| ID | 4 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| ... | | | | | | | | | | | | | | | |
| ... | | | | | | | | | | | | | | | |
| ... | | | | | | | | | | | | | | | |
| PA | 5 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 |
| RI | 5 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
| SC | 4 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| SD | 4 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| TN | 5 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
| TX | 5 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
| UT | 5 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 |
| VA | 5 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
| VT | 5 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 |
| WA | 5 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 |
| WI | 5 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 |
| WV | 5 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |
| WY | 5 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 | 1 | 0 | 0 | 0 | 1 | 0 |

* IL had 3.

# 3) Trends

**Remark: Some obvious differences between 5- & 4-election states**

- Differences in number of firms, demographics, geography, politics, …
- Differences in enforcement intensity against foreign firms, e.g., because
    - … more foreign firms engage in FCPA violations, or
    - … foreign firms are less able to hide FCPA violations

**Data: 5-election state foreign firms are from more corrupt headquarter countries**

- Based on Historical Bvureau van Dijk/Orbis:

| Variable | 5 Elections | 4 Elections | Diff |
|---|---|---|---|
| Foreign Parents' HQ Corruption Index | 26.7 | 25.4 | 1.3* |
| %of Foreign Parents HQ in High-Corr Countries | 2.0% | 0.8% | 1.2%** |
| Foreign Parents' Avg Subs Corr Index | 29.7 | 29.0 | 0.7 |
| Foreign Parents' % of Subs in High-Corr Countries | 4.5% | 3.8% | 0.7% |

⇒ **Such static differences** are taken care off by **state (and later firm) fixed effects.**

⇒ **But what about time trends in these variables?**

# 3) Trends

**Concern: Different trends wrt enforcement against foreign firms**

- States with 5 elections may have different time trends than 4-election states
  - Cannot control for these since state x year fixed effects would subsume treatment
  - Different time trends also receive more weight in regressions: greater number of treatments

- E.g., greater increase in enforcement against foreign firms in 5-election states because
  - … foreign firms in these states increasingly commit FCPA violations, or
  - … detection of FCPA violations becomes increasingly easier for firms in these states

**Data: 5-election state foreign firms are**

- from increasingly more corrupt countries and
- increasingly more exposed to corruption through their subsidiaries

| Variable | 5 Elections | 4 Elections | Diff |
|---|---|---|---|
| ΔForeign Parents' HQ Corruption Index | 9.0 | 7.0 | 2** |
| Δ%of Foreign Parents HQ in High-Corr Countries | 0.5% | 0.9% | -0.5% |
| ΔForeign Parents' Avg Subs Corr Index | 5.1 | 4.1 | 1* |
| ΔForeign Parents' % of Subs in High-Corr Countries | 1.4% | 0.8% | 0.6%* |

  - **This concern is harder to take care off but let me try.**

# 3) Trends

- **Summary of the potential issue:**
  - (drivers of) enforcement against foreign firms might follow different trend in 5- vs 4-election states
  - 5-election states receive more weight in regressions: treated 5 vs. 4 times, twice as many such states

- **Possible solutions:**

  - **1) Account for foreign vs domestic differences in enforcement intensity <u>across</u> U.S.**
    - a) Interact treat & year FE with $I_{foreign}$ , b) analyze subsets of dom & for firms

    => but… does still not account for state-foreign-year level trends

  - 2) Add controls for **firm-year level characteristics that may predict enforcement**
    - e.g., subsidiary corruption exposure, foreign: parent HQ corruption

    => but… not all characteristics observable, need to measure at investigation start, …

  - 3) Repeat analysis only on subset of **5-election states or** for **2007-2019** (all states treated 4x)

  - [4) Use **special elections** though probably too few of those]

# 3) Trends

- Quick-and-Dirty(!) **Simulation**
  - 50 states, 1,000 domestic + 1,000 foreign firms per state, 35 years, 1000 reps, year & firm FE
  - **Dependent variable (binomial):**
    - p(enforcement$_{i,t}$)=0.3%(=408cases/138,000 firm year), centered around 2006-2019 (p=0.075%), 0.001% before 2006 *[motivated by data section]*
    - Foreign: Δp(enforcement$_{i,t}$) -0.1%pt for 1/3 of states ('4-election states') and +0.1%pt for 2/3 of states over 2006-2019 *[to reflect my trend argument]*
    - Domestic: Δp(enforcement$_{i,t}$) opposite of foreign
  - **Treatment** defined from congressional elections as in the data…
  - **=>Importantly, treatment effect not hard-wired: arises mechanically as described above.**

# 3) Trends

- Quick-and-Dirty(!) **Simulation**
  - **Results:** Overrejection of 0 (if 0 is 'no effect')

| | 1% | 5% | 10% |
|---|---|---|---|
| Full Sample (1985-2019) | 3% | 15% | 31% |
| Action (2005-2019) | 4% | 13% | 30% |

  - **A few other observations:**
    - Simulation used balanced data. Unbalanced data with low coverage early on seems to increase probability of overrejections.
    - Prob(enforcement) close to p=0% as in paper keeps challenge at bay ('little growth/few success obs to work with'). Move twds p=50%, overrejections become the norm.
    - [Probably some other comments about OLS with near-0 success rate in order.]
    - [Seems that trend arguments could be extended to cross-sectional results.]
  - **Cautious note:** My simulation exaggerated the trends, also I had no firm-year & state-year controls, just firm and year fixed effects.

# 4) Others

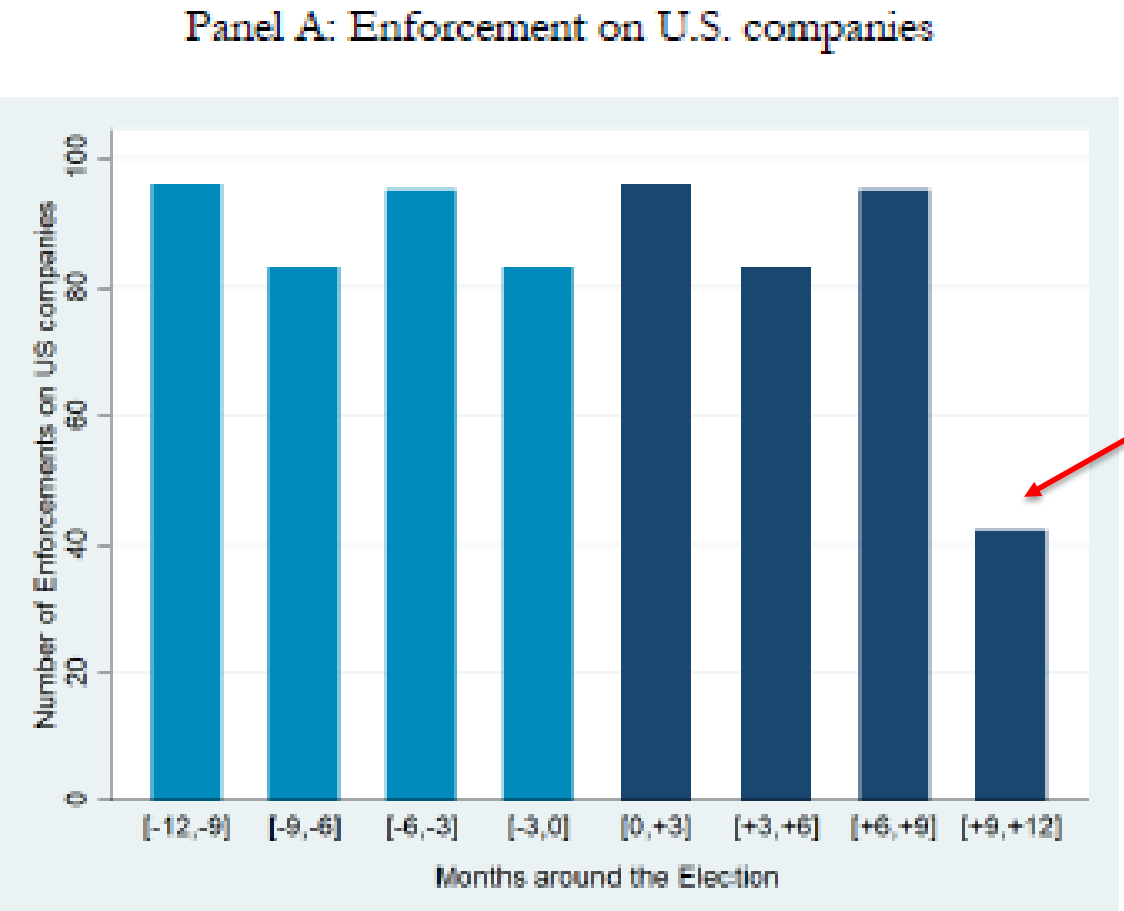
- Variables, sample
- Discuss results that seem at odds with literature
- What to make of Tables 9-11

# 4) Other stuff

- Would improve discussion of variable construction, sample selection
  - Right now, very hard to replicate the paper, even parts that don't rely on data on characteristics of DoJ&SEC actions
  - Would invest heavily into writing data section, defining variables, …
  - Would also discuss potential shortcomings of some of the data sources and whether & how this may affect analysis
    - e.g., Bureau van Dijk: historical data/discs (less survivorship bias) vs WRDS version (survivorship bias); coverage issues pre-2005, …
  - Lastly, took me a while to figure out that while 1.5% of firms are treated (Table 2->8,677*1.5%=130), there are very few treatment events in the data (408/137,844<0.3%). How does this affect use of OLS (or probit?) regressions?

# 4) Others

- Would discuss decline in #enforcements against US companies
  - Appears a year after election but often (2 in 3 times) that's also 3 quarters before the election




- Fits with Metha et al. who have documented that misconduct enforcement goes down right before election (or up right after), etc.

# 4) More discussion of how things are done

- What to make of Tables 9-11?
  - Last set of tables seek to establish how firms subject to FCPA enforcement action respond: They reduce their corruption exposure.
  - This is interesting but unrelated and the paper could do without it—unless you can show that firms that faced political enforcement actions as opposed to standard enforcement actions respond differently
  - If this part of the analysis is kept, need to invest more: year-by-year effect, trends, etc.

# Summary

- Like the paper, intriguing results
- Comments on helping the reader, using case characteristics more, discussing implications of time trends
- Good luck!