Tax Evasion of Politically Connected Firms: Labor Mobility Channel

Ruben Enikolopov[1,2,3] and Sergey Mityakov,[4]

New Economic School
ICREA-Universitat Pompeu Fabra
Barcelona IPEG
Florida State University

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Research Question

- What is the value of political connections created by hiring a government offical or his/her relative?

    - Look at the effect of establishing connection, not losing it

    - Look at the role of the bureaucrats rather than elected officials

- Identify direct channels in which companies may benefit from having political connections

    - Tax evasion

    - Funds received from government

Existing Literature

- Large body of work documenting value of political connections
- Identification usually comes from deaths...
    - e.g. Fisman, 2001; Faccio and Parsley, 2009; Cheng 2018
- ...or narrow election wins
    - e.g. Goldman et al, 2013, Do et al 2016, Lehne et al 2016
- Channels through which companies may benefit from having political connections
    - Preferential access to financing
        - e.g. Khwaja and Mian 2005; Claessens,et al 2008;
    - Increased likelihood of a bail out
        - e.g Faccio, et al 2006; Cingano and Pinotti 2013
    - More government contracts
        - e.g. Goldman et al, 2013; Baltrunaite 2016; Schoenherr 2016
    - Lax enforcement of regulation
        - Fisman and Wang 2015

Background Information

- We look at the effect of political connections with Moscow government in 1999-2003
- Headed by Mayor Yuri Luzhkov from 1992-2010
    - highly influencial politician and presidential contender at that time
    - often accused of corruption and embezzlement of funds
    - Incidentally, husband of the wealthiest woman in Russia at the time, Elena Baturina
- Several levels of city government
    - Main mayor office
        - The central governing body of the executive branch
    - Departments of the mayor office
        - Departments of finance, budget planning, public construction, etc.
    - 9 prefectures
    - 140+ upravas

Data

- The main source of data is Braguinsky, Mityakov, and Liskovitch (2014) and Braguinsky and Mityakov (2015)

- Covers all the residents of Moscow for the period 1999-2003
  - Employee-employer matched datasets
  - Reported wages
  - Value of cars owned by individuals
  - Measure of tax avoidance based on the mismatch between the two
  - Name and legal address of residency

- Banking transactions among all legal entities in Russia for 1999-2004
  - Previosly used in Mironov(2013), Mironov and Zhuravskaya(2014)

Using these data we construct the following variables:

- Dummy for the presence in a firm of at least one employee, who previously worked for one of the four groups of government offices
- Same but consider only top government officials
  - Defined as being in top 10 percent in the wage distribution of the respective government agency
- Same but for the household membes of (top) government officials
  - Household members defined as those with same last name residing at the same legal address

Specification

In the baseline regressions we estimate the following regression

$$Outcome_{i,t} = \beta\, Connected_{j,t} + \lambda \mathbf{X_{i,t}} + \delta S_{j,t} + f_j + \phi_i + \varepsilon_{i,t}$$

- where
    - $Outcome_{i,t}$ is the outcome of interest for individual i at time t
    - $Connected_{j,t}$ is the dummy variable that indicates whether firm j has a (top) ex-government official among employees
    - $\mathbf{X_{i,t}}$ is the vector of individual time-varying controls (age, position in the company proxied by percentile in reported earnings distribution)
    - $S_{j,t}$ is the number of employees in the company.
- Sample is restricted to employees who themselves were not ex-government officials
- Standard errors clustered at the firm level

Effect on Tax Evasion. OLS

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
		Transparency			*Log reported income*			*Log car value*	
Ex-government official dummy	0.054		0.209*	0.024		0.157	-0.009		-0.016**
	(0.100)		(0.117)	(0.088)		(0.103)	(0.007)		(0.007)
Top Ex-government official dummy		-1.885**	-1.932**		-1.632**	-1.667**		0.084***	0.088***
		(0.796)	(0.791)		(0.698)	(0.697)		(0.031)	(0.030)
Observations	747,438	747,438	747,438	747,438	747,438	747,438	754,048	754,048	754,048
R-squared	0.391	0.395	0.395	0.552	0.559	0.560	0.291	0.291	0.291
Employer FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Log # employees	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Age, Agesq, gender	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Effect on Tax Evasion by Government Office Type. OLS

	(1)	(2)	(3)	(4)	(5)	(6)
	Transparency	*Log income*	*Log car*	*Transparency*	*Log income*	*Log car*
	Panel A: Movers from Mayor office			*Panel B: Movers from subsidiaries of Moscow mayor office*		
Ex-government official dummy	0.114	0.096	-0.005	0.090	0.010	-0.027***
	(0.173)	(0.161)	(0.012)	(0.090)	(0.080)	(0.008)
Top Ex-government official dummy	-3.515***	-3.068***	0.144***	-2.953***	-2.586***	0.119***
	(0.472)	(0.409)	(0.024)	(0.695)	(0.602)	(0.028)
Observations	747,438	747,438	754,048	747,438	747,438	754,048
R-squared	0.398	0.564	0.291	0.397	0.562	0.291
	Panel C: Movers from Moscow prefectures			*Panel D: Movers from Moscow upravas*		
Ex-government official dummy	-0.318*	-0.344**	-0.010	0.256	0.211	-0.013
	(0.177)	(0.158)	(0.012)	(0.160)	(0.144)	(0.010)
Top Ex-government official dummy	-2.869***	-2.424***	0.147***	-2.255***	-1.952***	0.101***
	(0.611)	(0.539)	(0.025)	(0.831)	(0.732)	(0.031)
Observations	747,438	747,438	754,048	747,438	747,438	754,048
R-squared	0.397	0.564	0.291	0.396	0.561	0.291
Employer FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Log # employees	Yes	Yes	Yes	Yes	Yes	Yes
Age, Age^2, Gender	Yes	Yes	Yes	Yes	Yes	Yes

Source of Variation

- Baseline regressions do not establish causal relationship
  - Firms planning to be involved in tax evasion have more incentives to establish political connections
- Use variation in supply of former government officials
- Look at turnover of government employees in the neighborhood of the firm
  - Higher turnout is likely to increase the number of former government employees looking for a job
  - Effects are localized as long as people have constant geographical prepherance regarding job location
- Instrument: turnover of government employees below 90th percentile in the same zip code as the firm, excluding those moving into the firm itself
  - LATE is likelty to be lower than ATT, since marginal firms affected by the instrument are likely to have lower propensity to be engaged in tax avoidance

	(1)	(2)	(3)	(4)	(5)	(6)
	Transparency	Log income	Log cars	Transparency	Log income	Log cars
Top Ex-government official dummy	-4.516***	-3.690***	0.285***	-4.631***	-4.208***	0.136***
	(0.454)	(0.438)	(0.018)	(0.365)	(0.356)	(0.019)
Observations	492,625	492,625	497,632	460,201	460,201	465,186
Underidentification LM statistic	3.318	3.318	3.293	2.164	2.164	2.188
P-value	0.0685	0.0685	0.0696	0.141	0.141	0.139
Weak identification stat	178.1	178.1	175.5	32.74	32.74	37.53
Firm FE	No	No	No	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Log # firm employees	Yes	Yes	Yes	Yes	Yes	Yes
Individual-level controls: Age, Age², Gender	Yes	Yes	Yes	Yes	Yes	Yes

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Transparency	*Log income*	*Log car*	*Transparency*	*Log income*	*Log car*	*Transparency*	*Log income*	*Log car*
	Panel A: Movers any Moscow gov-t office			*Panel B: Movers from Main Mayor office*			*Panel C: Movers from subsidiaries of Mayor office*		
Top Ex-government official dummy	-1.038**	-0.922**	0.036**	-3.347***	-2.917***	0.139***	-1.323	-1.237	0.028
	(0.496)	(0.458)	(0.018)	(0.429)	(0.369)	(0.020)	(0.983)	(0.896)	(0.032)
Ex-government official own tax evasion score	-2.390*	-2.002	0.134***	-0.219***	-0.216***	0.001	-3.291*	-2.741	0.177***
	(1.446)	(1.315)	(0.050)	(0.064)	(0.062)	(0.006)	(1.903)	(1.733)	(0.057)
Observations	747,438	747,438	754,048	747,438	747,438	754,048	747,438	747,438	754,048
R-squared	0.396	0.561	0.291	0.398	0.564	0.291	0.397	0.564	0.291
	Panel D: Movers from Moscow prefectures			*Panel E: Movers from Moscow local/district office (uprava)*					
Top Ex-government official dummy	-3.543***	-3.085***	0.147***	-1.366*	-1.207*	0.053**			
	(0.534)	(0.480)	(0.018)	(0.703)	(0.637)	(0.025)			
Ex-government official own tax evasion score	2.678***	2.445***	-0.056	-2.117	-1.775	0.113***			
	(1.036)	(0.865)	(0.068)	(1.444)	(1.344)	(0.036)			
Observations	747,438	747,438	754,048	747,438	747,438	754,048			
R-squared	0.398	0.564	0.291	0.396	0.561	0.291			
Employer FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Log # employees	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Age, Age², Gender	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Effect on Transfers from Government. OLS

	(1) All sources	(2) Mayor office	(3) Departments	(4) Prefecture	(5) Uprava
			Panel A: no firm FE		
Top Ex-government official dummy	1.190*** (0.414)	0.248 (0.706)	1.389*** (0.458)	2.043*** (0.528)	0.613 (0.513)
Observations	18,691	1,900	15,919	1,643	2,968
R-squared	0.066	0.024	0.063	0.058	0.051
Firm FE	No	No	No	No	No
Year FE	Yes	Yes	Yes	Yes	Yes
log # firm employees	Yes	Yes	Yes	Yes	Yes
			Panel B: firm FE included		
Top Ex-government official dummy	-0.020 (0.564)	0.356 (0.657)	0.108 (0.566)	1.412 (1.103)	-0.105 (0.901)
Observations	18,691	1,900	15,919	1,643	2,968
R-squared	0.855	0.901	0.870	0.903	0.848
Firm FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
log # firm employees	Yes	Yes	Yes	Yes	Yes
			Panel C: Probit		
Top Ex-government official dummy	0.039** (0.018)	0.005 (0.003)	0.021 (0.014)	0.007* (0.004)	0.011* (0.006)
Observations	220,060	220,060	220,060	220,060	220,060
Firm FE	No	No	No	No	No
Year FE	Yes	Yes	Yes	Yes	Yes
log # firm employees	Yes	Yes	Yes	Yes	Yes

	(1) All sources	(2) Mayor office	(3) Departments	(4) Prefecture	(5) Uprava
	Panel A: IV no firm FE				
Top Ex-government official	7.856***	5.418**	7.111**	5.240***	7.058**
dummy	(3.000)	(2.429)	(2.966)	(1.901)	(2.939)
Observations	11,583	1,241	9,925	1,053	1,850
Underidentification LM stat	6.572	2.384	6.380	1.938	2.874
P-value	0.0104	0.123	0.0115	0.164	0.0900
Weak identification stat	15.15	9.982	14.89	9.070	16.76
Firm FE	No	No	No	No	No
Year FE	Yes	Yes	Yes	Yes	Yes
log # firm employees	Yes	Yes	Yes	Yes	Yes
	Panel B: IV firm FE included				
Top Ex-government official	-0.610	1.174	-1.298	4.226*	0.488
dummy	(1.711)	(1.484)	(1.597)	(2.315)	(0.938)
Observations	5,914	614	4,839	423	673
Underidentification LM stat	5.486	2.306	5.263	1.545	2.279
P-value	0.0192	0.129	0.0218	0.214	0.131
Weak identification stat	13.27	17.28	14.60	4.708	15.82
Firm FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
log # firm employees	Yes	Yes	Yes	Yes	Yes

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	All		No ex-government official (t-1)		No tax debt (t-1)		No ex-government official (t-1), no tax debt (t-1)	
Sample of companies								
	Tax overdue *2nd stage*	Gov-t dummy *1st stage*	Tax overdue *2nd stage*	Gov-t dummy *1st stage*	Tax overdue *2nd stage*	Gov-t dummy *1st stage*	Tax overdue *2nd stage*	Gov-t dummy *1st stage*
Top ex-government official dummy	1.028**		1.590***		1.157**		1.287**	
	(0.425)		(0.498)		(0.510)		(0.599)	
Log # same zip lower level		0.035**		0.030*		0.031*		0.022
government employees' turnover		(0.016)		(0.017)		(0.018)		(0.019)
Log # firm employees	0.011***	0.328***	-0.005	0.297***	0.010**	0.319***	-0.007	0.300***
	(0.004)	(0.024)	(0.006)	(0.024)	(0.005)	(0.026)	(0.006)	(0.026)
ATE	0.151**		0.239***		0.147**		0.170**	
	(0.062)		(0.075)		(0.065)		(0.079)	
Observations	97,031	97,031	41,520	41,520	62,075	62,075	37,862	37,862
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Conclusion

- We find that esteblishing new connections by hiring top ex-official from Moscow government increases tax evasion
  - income tax obligations of employees go down
  - actual compensation goes up
- There is evidence that this effect is causal
- The effect is higher if the top official was more corrupt while working in the government
- Hiring top official also increases amount of money the firm receives from the Moscow governmentt
- The effects are also observed after hiring a relative of a top government official
  - but the effect is smaller in magnitude
- There is evidence that more lax tax enforcement is a mechanism behind this effect

	(1)	(2)	(3)	(4)	(5)	(6)
	Transparency	Mover	Log income	Mover	Log car value	Mover
Top Ex-government official dummy	-3.971***		-2.896***		0.314***	
	(0.285)		(0.279)		(0.047)	
Log # same zip government employees		0.077*		0.078*		0.083*
(below 90th pct)		(0.042)		(0.043)		(0.043)
Observations	492,625	492,625	492,625	492,625	497,632	497,632
Log # firm employees	Yes	Yes	Yes	Yes	Yes	Yes
Year Fe	Yes	Yes	Yes	Yes	Yes	Yes
Individual level controls: Age, Age^2, Gender	Yes	Yes	Yes	Yes	Yes	Yes

	(1)	(2)	(3)	(4)	(5)	(6)
	Transparency	Log income	Log cars	Transparency	Log income	Log cars
Top Ex-government official dummy	-0.713	0.779	0.531***	-5.276**	-4.557**	0.259
	(1.515)	(1.710)	(0.154)	(2.061)	(1.786)	(0.170)
Observations	492,625	492,625	497,632	460,201	460,201	465,186
Underidentfication LM statistic	5.133	5.133	5.129	1.680	1.680	1.711
P-value	0.0235	0.0235	0.0235	0.195	0.195	0.191
Weak identification stat	5.605	5.605	5.608	1.733	1.733	1.768
Firm FE	No	No	No	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Log # firm employees	Yes	Yes	Yes	Yes	Yes	Yes
Individual-level controls: Age, Age^2, Gender	Yes	Yes	Yes	Yes	Yes	Yes