Journal of International Money and Finance 32 (2013) 637–653

Contents lists available at SciVerse ScienceDirect

Journal of International Money and Finance

journal homepage: www.elsevier.com/locate/jimf

Government intervention and firm investment: Evidence from international micro-data

Chen Lin [a,*], Sonia Man-lai Wong [b]

[a] CUHK Business School, Chinese University of Hong Kong, Hong Kong
[b] Lingnan University, Hong Kong

JEL classification:
G31
G32
G38

Keywords:
Firm investment
Government intervention
International evidence

A B S T R A C T

Building on the important study by Beck et al. (2005), we examine how government intervention in firms' decision-making is related to their investment and sales growth. Using the unique World Bank dataset (WBES) covering 6500 firms in 70 countries, we find strong evidence that the extent of government intervention in firms' investment, employment, sales, pricing, dividend, and merger and acquisition decisions is negatively related to their investment and sales growth, with the effect being more profound in foreign owned firms and less significant in state-owned firms. The empirical results are robust to a series of robustness tests and instrumental variable regressions.

© 2012 Elsevier Ltd. All rights reserved.

1. Introduction

The roles of government in promoting economic growth and development have been a long-standing and unsettled debate (e.g. Rodan, 1943; Hayek, 1945; Morris and Adelman, 1988; Wade, 1990; Easterly and Levine, 1997). As firm investment is an important engine of economic growth (Levin and Renelt, 1992), the question of how governments can promote firm investment has received intensive attention from scholars and policy markers (e.g. Hall and Jorgenson, 1967; Barro, 1996; Kneller et al., 1999; Stevens, 2000; Knowles and Garces-Ozanne, 2003; Ndikumana, 2005; Javorcik and Wei, 2009). Previous studies on the role of government in influencing firm investments have focused on the effects of monetary policies via changes in interest rates and money supply (e.g. Kormendi and Meguire, 1985; Gavin, 1992; Goh and Oliver, 2004). Nevertheless, the effectiveness of monetary policies

* Corresponding author.
E-mail addresses: chenlin@cuhk.edu.hk (C. Lin), soniawong@ln.edu.hk (S. Man-lai Wong).

0261-5606/$ – see front matter © 2012 Elsevier Ltd. All rights reserved.
http://dx.doi.org/10.1016/j.jimonfin.2012.06.002

has been seriously constrained in many countries due to their prevailing low interest rates. A growing literature in finance has started to investigate how government can play an important role in promoting firm investment and growth through other government-firm nexuses. In particular, some studies show that sound legal systems and efficient financial infrastructure can facilitate firms' access to finance and thus their ability to fund investment projects (La Porta et al., 1997; Demirguc-Kunt and Maksimovic, 1998; Beck et al., 2006a), Beck et al. (2005) provide direct evidence on the beneficial effects of institutions on firms' investment and growth. Building on the earlier studies demonstrating the beneficial effects of governments at institutional level through the provision of appropriate institutions, this study employ international micro-data to examine how government intervention at firm level via involvement in firms' decision-making is related to firms' investment and growth.

The theoretical importance of appropriate institutions in fostering firm investment and growth has been well-accepted, although systematic evidence is available only recently. However, the effects of government interventions in firms' decision-making have been intensively debated. Proponents of free market systems and private entrepreneurship argued that government intervention in economic activities is very likely to result in economic inefficiency and low investment growth because of government's multiplicity of objectives and information problems (Hayek, 1945; Buchanan et al., 1980; Shleifer and Vishny, 1994). According to this perspective, government can promote firm investment and growth only by creating and maintaining basic institutional infrastructure while allowing entrepreneurs to make their own economic decisions.

Although agreeing on the positive role of government in providing basic market institutions, the interventionist view argued that government intervention of firm decisions could help to correct market failures (such as externalities and asymmetrical information) that firms cannot properly deal with on their own initiative (Vickers and Yarrow, 1989; Sacristan, 1980; Millward, 1976; Hart et al., 1997). Furthermore, in a state-regulated economy, government involvement in firm's decision-making could facilitate access to finance and other valuable business opportunities (Sapienza, 2004). As a result, government intervention in firms' decision making may help to realize more investment opportunities and promote firm growth.

Despite intense theoretical debate, direct evidence on how government intervention in firm's decision-making affects firm investment and growth are scarce. To the best of our knowledge, there are only a handful of studies on this issue – all focused on transitional economies. Based on a sample of 300 manufacturing firms in five Eastern European countries, Johnson et al. (2002) find that entrepreneurs in firms with less secure property rights reinvest less of their retained earnings. Cull and Xu (2005) find that Chinese firms exposed to a greater risk of expropriation by government have a lower reinvestment rate. Although these studies document a negative effect of government intervention on firm investment, the generalizability of their results is limited by the use of samples exclusively from transitional economies where government-firm relations tend to be unique due to the legacy of the central planning system. Furthermore, these two studies use indirect proxies of government intervention as reflected by private property right protection, but not direct measures of government involvement in firm's decision-making.

This study adds to the literature by using firm-level data from 65 developing countries to investigate how government intervention in firms' decision-making affects their investment and sales growth. We obtain valuable data on the extent of government intervention in various types of firm decisions (including investment, employment, sales, pricing, dividend, and merger and acquisition decisions) from a worldwide survey conducted by the World Bank in 2000. Our results show that the extent of government intervention in corporate decision making is negatively related to investment and sales growth. The results are robust to treatments for endogeneity issues and the inclusion of various aggregate variables to capture the quality of the institutional environment in the different countries. We also show that the negative effect of government intervention is more profound in foreign firms but less significant in state-owned firms. In addition, our study also offers evidence that the quality of the institutional environment is positively related to investment and sales growth.

We follow Beck et al. (2005) to study the roles of government in affecting firm investment and sales growth. While Beck et al. (2005) focus on the role of government in creating external institutions and offer evidence on a positive effect of government involvement, we analyze the effects of government involvement in firms' decision-making and find a negative effect. These two studies together suggest

Download English Version:

https://daneshyari.com/en/article/7366334

Download Persian Version:

https://daneshyari.com/article/7366334

Daneshyari.com