

# Political Power-Sharing, Firm Entry, and Economic Growth: Evidence from Multiple Elected Representatives\*

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## Abstract

We examine the effect of political power-sharing on local economic activity by exploiting quasi-random variation in the number of politicians governing adjacent regions. We utilize haphazard overlap of electoral and administrative boundaries in India. This allows us to exploit geographic discontinuity across boundaries separating single and multiple-politician-governed regions, and within-region variation in the number of politicians. We find increasing the number of politicians governing an area leads to new firm creation, lower unemployment, and greater real economic activity. The effect is driven by greater state efficiency, lower regulatory bottlenecks, and reduced cronyism following increased checks and balances among non-aligned politicians.

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# 1 Introduction

Should political institutions concentrate power in more hands or a single hand? Political theorists have long debated the fundamental trade-off between the concentration of power among politicians and the checks and balances imposed on them in understanding the optimal design of political institutions. This paper examines a particular feature of the political-institutional design –multiple elected representatives or multiple politicians – and tests if increasing the number of politicians governing an area adds value. Specifically, we investigate the effect of the multiple politicians on firm entry and subsequent economic growth. Studying this relationship is imperative in understanding the implications of political institutions that foster power-sharing among politicians. Multiple politicians are typical across decentralized governance systems; for example, in the US, two senators govern each state, and coalition governments are becoming increasingly common across the globe. Moreover, answering this question can inform the broader literature on multiple managers that arise in a variety of situations, such as a firm or startup being managed by multiple managers or co-founders, the same entity being regulated by multiple regulatory authorities, doctoral students being advised by multiple chairs, courses being co-taught by multiple instructors, among others.

This paper presents microeconomic evidence on the link between power-sharing among politicians and economic activity in a setting that allows us to examine the effect of the presence of multiple elected representatives. Specifically, we study the role of these representatives in shaping the environment that facilitates firm entry and consequently fosters economic growth. New firm entry is an important determinant of aggregate productivity growth and local employment. Since new firm creation is a function of local economic and political conditions, this setting provides a natural setup for evaluating the effect of multiple politicians on local governance. Additionally, the heterogeneity in the reliance of new firms on governance allows us to identify the underlying mechanism.

Theoretically, the relationship between multiple politicians and economic growth is ambiguous. On the one hand, multiple politicians can hurt local economic conditions due to the presence of multiple grabbing hands, increasing the holdup problem, and due to the lack of collective action, because of coordination failure or free-rider problem. On the other hand, multiple politicians can improve local economic conditions by reducing the concentration of power and imposing checks and balances on each other ([Bardhan \(2002\)](#)), bringing different skills to the table as well as division of labor ([Holmstrom \(1978\)](#), [Epstein and O'halloran \(1999\)](#)) or reducing corruption ([Rasmusen and Ramseyer \(1994\)](#), [Rose-Ackerman \(1994\)](#)). Despite the theoretical ambiguity, the empirical evidence is limited, primarily due to issues of endogeneity associated with the emergence of political institutions that foster power-sharing among politicians, as discussed in [Aghion, Alesina and Trebbi \(2004\)](#).

The quasi-random variation in the distribution of the number of politicians and granular geo-referenced novel micro-data on firm entry allows us to use a geographic regression discontinuity (RD) to identify the effect of multiple politicians. Specifically, we compare units located close to the boundary separating split blocks from unsplit blocks.<sup>1</sup> Comparing units, villages hereafter, on either side of the boundary separating split and unsplit blocks after 2008, we find the number of new firms is 3% higher in villages just inside a split block relative to villages in unsplit blocks just outside the boundary. Similarly, the villages just inside a split block are associated with 7% higher nightlight intensity than villages in unsplit blocks just outside the boundary. Additionally, villages just inside a split block are associated with 5% higher employment and reduced demand for unemployment benefits, which is reflected in the lower application rates of the national employment guarantee scheme (NREGA). Furthermore, we document that the treatment effect increases monotonically with the number of politicians governing the split blocks.

We explore several dimensions of cross-sectional heterogeneity in industry and firm characteristics to evaluate the pathways underlying the higher entry of firms in blocks with multiple politicians. Our results suggest multiple politicians increase firm entry by reducing regulatory bottlenecks – manifested through the higher entry of firms in regulated industries. Moreover, we provide direct evidence showing the projects announced in split blocks take less time to receive regulatory approvals. This finding is further reflected in the higher entry of small firms, because regulatory or procedural bottlenecks often act as barriers to the entry of small firms.

Finally, we investigate if potential checks and balances drive multiple politicians to provide a better economic environment that facilitates firm entry. Our premise of checks and balances between multiple politicians will be highest if collusion between multiple politicians is difficult. We use two measures that can potentially affect the benefits of collusion or deviation – non-alignment in political parties and non-alignment in caste. Exploiting the differences in political parties and the caste of politicians in split blocks, we find greater firm-entry in blocks split across multiple politicians who are non-aligned either in political party or caste lineage. The results indicate the primary channel through which multiple politicians positively affect firm entry is by imposing checks and balances on each other.

## 2 Empirical Strategy

The empirical strategy hinges on comparing two administrative regions that are similar in all attributes but differ in the number of politicians at the helm of their administrative affairs. To do so, we follow two identification strategies. First, we employ a cross-sectional geographic regression discontinuity design by examining the differences in the outcome variable on either side of the boundary separating a split block and an unsplit block. Second, we employ a differences-in-

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<sup>1</sup>The unit in our analysis refers to a village. We use the terms village and units interchangeably.

discontinuity design by exploiting the 2008 delimitation of electoral constituencies. The redrawing of electoral constituency boundaries resulted in converting some unsplit blocks into split blocks and vice versa. The natural experiment of delimitation allows us to examine changes in differences across the border between two blocks in cases where delimitation changes the number of politicians in a block while keeping them fixed in the contiguous block.

### 3 Results

**Spatial RDD** This section examines the effect of multiple politicians. Specifically, we compare the spatial difference in the propensity of firms to enter and the consequent impact on local economic activity measured through nightlight intensity in a split block compared with an unsplit block. We find that entry of new firms measured through the MCA data is 3% higher in villages just inside a split block than in villages in unsplit blocks just outside the boundary. Similarly, a split block experience 7% higher nightlight intensity than villages in unsplit blocks just outside the boundary. Next, we analyze the effect on employment. Using census data, we find 6% higher employment in villages just inside a split block than in villages in unsplit blocks just outside the boundary. Lastly, we document 5% lower applications for unemployment benefits filed under National Rural Employment Guarantee Scheme (NREGS), suggesting lower demand for unemployment benefits.

**Robustness** We conduct a battery of robustness tests to ensure our results are not driven by a particular econometric specification, specific sample or transformation of the dependent variable, differences across villages along the boundary and covariates, firm exit, spatial auto-correlation, and spurious correlation.

**Differences-in-Discontinuity Results** Next, we examine the effect of the exogenous change in the number of politicians governing a block, following the 2008 delimitation. We analyse the result in two ways: First, a block switching from being unsplit to split following the 2008 delimitation – the treatment group. The control group comprises of blocks that are always unsplit both before and after the delimitation and share a common boundary with the treatment group. The estimate indicates the transition of a block from being governed by a single politician to multiple politicians is associated with a 1.1% - 1.6% increase in the entry of new firms. Second, associated with a block switching from being split to unsplit following the 2008 delimitation – the treatment group. The control group comprises blocks that are always split among multiple politicians before and after the delimitation and share a common boundary with the treated group. The estimate of interest is negative and indicates a reduction in firm entry by 0.7% - 1.0% when a block switches from being governed by multiple politicians to a single politician.

## 4 Mechanism

Theoretically, multiple politicians can either reduce or increase economic growth. The results discussed provide robust evidence that multiple politicians increase firm entry and, consequently, economic growth. This section probes the underlying mechanism through which multiple politicians positively affect firm entry. We show the increase in the entry of firms is driven by reduction in regulatory impediments, reduction in cronyism, and overall improvement in the efficiency of the state in providing public good aiding the entry of new firms. We argue these improvements result from greater checks and balances imposed by the existence of multiple politicians.

**How Do Multiple Politicians Encourage Firm Entry?** We show multiple politicians, particularly from opposing political dispensation or from different castes, impose checks and balances on each other, manifesting as better conditions that foster firm entry. We investigate the mechanism of checks and balances by examining the private returns that the politicians make through the power of their public office. [Bhavnani \(2012\)](#) and [Fisman, Schulz and Vig \(2014\)](#) show a relatively high rate of growth in assets of the winning politician (winner's premium) reflects rent-seeking by the winner. Moreover, they argue the rent-seeking behavior of winners is likely to be greater when corruption is higher. [Shleifer and Vishny \(1993\)](#) show corruption can increase in the presence of multiple politicians if they act as independent monopolies. However, corruption can decrease when multiple politicians exert checks and balances on each other. Consequently, in the presence of multiple politicians, a politician's assets are less likely to grow higher than the runner-up when checks and balances are the dominant force.

## 5 Conclusion

Political institutions play a vital role in shaping the economy. Hence, understanding what type of political institutions are relatively better at fostering economic growth is of utmost importance. In this paper, we examine a particular feature of political-institutional design – multiple politicians governing an area. Our empirical investigation is motivated by the theoretical ambiguity surrounding the potential effect of multiple politicians. Multiple politicians can hurt the local economy due to issues of coordination, free-rider problem, common agency problems, and too many grabbing hands. Alternately, multiple politicians can improve the local economy by reducing the overall concentration of power, imposing checks and balances on each other, bringing different skills to the table, and the division of labor. We show that multiple politicians improve the local economy, evidenced by greater firm entry and economic growth. We find the results are driven by an increase in checks and balances in the presence of multiple politicians, as manifested by a higher impact when they belong to different political parties. The increased checks and balances among multiple politicians boost the local economy by improving state efficiency and reducing regulatory costs and

cronyism.

The results expand our understanding of a specific feature of the political-institutional design that is particularly relevant in understanding the effect of horizontal decentralization, common across several decentralized governance systems. Our results strengthen the faith in the conjecture that imposing checks and balances on agents with authority can result in better governance. Moreover, our results expand our understanding of the costs and benefits of multiple principals and a potential channel through which multiple principals can have a positive impact.

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