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Comment Juan Pantano

Summary

In this original and captivating piece, Pshisva and Suarez identify the causal impact of regional kidnapping rates on corporate investment. They find that a one standard deviation decrease in the rate of management-targeted kidnapping within a Colombian department is, on average, associated with an increase of 1.7 percentage points in department-level corporate investment rates. However, the investigation of potential causal mechanisms

responsible for this effect turns out to be somewhat inconclusive, with non-significant findings across a range of hypotheses. The study pursues a disaggregated analysis by exploiting firm-level data, a noble endeavor I sympathize with. On one hand, as the authors emphasize, this strategy provides a tighter perspective, relative to what can be learned from cross-country analyses. On the other hand, the results may be idiosyncratic to the Colombian case, and this may cast doubts about what we can learn, in general, about the relationship between kidnapping and investment. In this brief comment, I will first describe the strengths and then highlight some concerns about the study. I will then conclude by sharing some thoughts that this innovative study stimulates.

Strengths

Rather than exploiting a clear source of exogenous variation in the kidnapping rates, the authors come up with an empirical strategy that leverages the rich firm-level microdata to test the causality of the measured association between kidnapping and investment. In particular, the tradability of the firm's product becomes a key ingredient of a clever test, which attempts to rule out the "omitted demand conditions" threat to identification. The authors find that the effect of kidnapping on investment is not smaller for firms who sell abroad, as it should, if poor unobserved local demand conditions were spuriously generating their findings. Importantly, they also show that results are not mechanically driven by the firms whose management fell victim of a kidnapping. Rather, the results hold, more generally, across firms not directly affected by kidnappings but headquartered in the same region.¹

Concerns

The basic identification strategy is somewhat risky. Indeed, a case can be made that omitted demand conditions could, perhaps, have differential effects across the different types of crime. Moreover, not all types of crime are included in the model to begin with. For example, the property crime rate can affect investment and it is likely to be correlated with kidnappings as well as other crimes. Are kidnappings picking up the effect of other types of crime on investment? Presumably the data from DNP should provide information on property crimes as well as data on guerrilla attacks and homicides. If the data is available, it should be used to test whether it is really kidnappings that drives investment down.

1. Given the small number of observations in table 2.6, panel A, it would be interesting to see the results in a specification that pools the data in panels A and B but includes an indicator for whether the firm's management has been kidnapped and an interaction of this indicator with the kidnapping rate at the department level.

In addition to the potential selection problem induced by firms' entry and exit, which the authors acknowledge, there might be another problem if results are being generated by firms' location decisions regarding their investment plans. In such a case the real cost of kidnapping is not the decline in investment (which may not occur at all), but rather the efficiency loss introduced by distorting the optimal geographic allocation across departments of investments that happen anyway.

The test that exploits tradability is without doubt very clever, but results should be interpreted with caution if firms that do not export abroad can nevertheless sell their excess supply in other Colombian regions when facing declines in local demand.

Kidnappings are substantially underreported everywhere. The magnitude of the problem, then, is substantially larger than official figures indicate. The hope is, of course, that the level of underreporting does not vary systematically across regions over time.

What We Want to Know

The reading of Pshisva and Suarez's chapter answers some very important questions and stimulates many others. To mention just a few:

Are firms paying ransom for their kidnapped employees? This seems key to understanding the relationship between management kidnapping and corporate investment. As the authors recognize, however, the available data does not allow them to address this issue.

Are cash abundant firms (who are more likely to invest), still abundant in cash after costly investments are undertaken? Do firms or individuals undertake costly, irreversible investments to make their liquid assets more illiquid, thus becoming less attractive targets to kidnappers? This type of strategic avoidance behavior thus generates a countervailing effect in which the kidnapping rate actually increases investment.

Pshisva and Suarez point out that more than half of the kidnappings in the sample were perpetrated by guerrillas. A natural question is, then, whether corporate investment responds more to kidnappings by guerrillas than it does to those by ordinary criminals? In other words, what is the impact of the guerrilla-perpetrated management-targeted kidnapping rate? Suppose that the overall kidnapping rate is driven by the guerrilla kidnapping rate and that because kidnappings are complex operations, the guerrilla kidnapping rate is a measure of the influence or "ability to operate" that guerrilla groups have in the region. Is it possible that this influence of guerrilla groups, whose political goal is not compatible with private property rights, is the fundamental driver of corporate investment declines? In other words, kidnappings may just proxy for the level of influence that anti-capitalist sentiment has in a given region. It should come as no surprise that investment and, more generally, capital accumulation declines when the regional power of groups that stand against private property increases.

Does personal investment follow the same pattern as corporate investment?

What Can We Learn?

Extrapolation to Other Contexts

While kidnapping rates are up worldwide, Colombia's kidnapping rate has gone down substantially since 2002, some suggest, as a result of Uribe's "Política de Seguridad Democrática." Fortunately, given this substantial decline, perhaps the results are of no direct relevance for Colombia today. However, we sure can still learn from the Colombia's study. Studies replicating Pshisva and Suarez's strategy should be conducted in other countries facing increasing kidnapping rates. However, it should be kept in mind that the identification of an average impact at the subnational level does not directly translate into an impact at the national level. Among other things, geographic reallocation within departments across Colombia is likely governed by different incentives and mechanisms than those governing reallocation of investment (if any) into countries outside Colombia.

Policy Issues

The lack of causal mechanisms explaining the findings and other data limitations provide no firm ground for strong policy recommendations. There are, however, several questions within the kidnapping policy domain that still require answers. To mention just a few: (a) criminalization of ransom payment; (b) subsidization of unobservable security measures that help track the victim (for example, the possibilities of replicating in the kidnapping context the successful experience of Lo Jack in deterring car theft should be explored carefully); (c) should corporations design their security budgets to prevent the kidnapping of their management, insure against it, or both? (d) What should be the appropriate legal status of kidnapping insurance? Hopefully, future studies will build upon the lead of Pshisva and Suarez and help to shed more light on some of these important questions.