Judicial Capacity Increases Firm Growth Through Credit Access: Evidence from Clogged Courts of India

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Abstract

In this paper, I examine the effects of trial court capacity on local firms’ production decisions by exploiting quasi-random variation in judge vacancies. Use trial records for a third of district courts in India to construct annual court-level performance measures and summarize types of firm-level litigants. Merge court records with district-level lending and by firms’ registered office location. Find reducing judge vacancy increases repayment of outstanding loans in local credit markets, bringing back millions of $ for credit recirculation. This increases local firms’ labor use, production, and profitability through improved access to bank credit. Fixing judge vacancy generates between 2.7-20 times benefit relative to the cost.

Motivation

- Timely enforcement of contracts and rights by courts:
  - Liquidity Effects: Free tied-up capital
  - Expectation Effects: Reduce transaction costs and uncertainty
- Gap in literature using microdata from the judiciary in developing countries to examine the role of courts in facilitating day-to-day economic activities:
  - Provides a well-identified estimate of this relationship
- Highlights the role of judge vacancy as a state capacity constraint
- Illustrates the role of liquidity effects in local financial markets as an important mechanism behind the effects on local firms

Sample

- Sample includes 195 industrial non-metropolitan court districts and all 6 million trial metadata from 2010-2018
- Credit market: RBI district-level credit summary data
- Firm-level: CMIE Prowess dataset on formal sector firms (annual balance sheet data)

Key Reduced Form Results

IV approach also presents qualitatively similar results as the above event-study results, and provides estimates of elasticities with respect to rate of trial resolution

Estimation Strategy

- Structural vacancies in Indian judiciary
- Short tenure of judges (1-2 years)
- Centralized judge rotation with no non-repeat constraint, no home-town, no past workplace as a legal professional
- IV using judge occupancy as an instrument for court-level rate of trial resolution

Robustness

- No correlation between district population and judge vacancy over time
- Different constructions of court performance measures and judge vacancy
- Alternate identification using standard event-dummy similar qualitative results
- Two-way fixed effects correction
- Clustering standard errors at different levels

Conclusions

- Day to day functioning of trial courts, irrespective of changes in laws, matter for the economy
- Banks are the biggest litigators in trial courts, engaged in debt recovery
- An additional judge resolves 200 registered cases (including dismissals before trial)
- Local manufacturing and formal sector firms increase repayment leading to credit recirculation
- Wage bill, sales, and profit increases on average
- Addressing judge vacancy generates large benefit-cost ratio

Selected References

- http://dakshindia.org/access
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