

Revealing Corruption: Firm and Worker Level Evidence from Brazil

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Abstract

We study how the disclosure of corrupt practices affects firms. We construct novel firm-level measures of involvement in corrupt practices using randomized audits of public procurement in Brazil. On average, firms exposed by the anti-corruption program grow larger after the audits, despite experiencing a decrease in procurement contracts. Using investment-, loan-, and worker- level data, we show that exposed firms adapt to the loss of government contracts by changing their investment strategy. They increase capital investment and borrow more to finance such investment, while we see no change in their internal organization. We provide qualitative support to our results by conducting new face-to-face surveys with business owners of government-dependent firms.

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I INTRODUCTION

Corrupt practices in the assignment of government contracts are largely diffused across countries. These practices are particularly widespread in emerging markets where they are considered a barrier to growth due to the extra costs of doing business that they impose on firms and the distortions in the allocation of resources across and inside firms they may generate (Svensson, 2005; Olken and Pande, 2012). In recent years, governments and international organizations around the world have attempted to fight corruption mainly through transparency initiatives aimed at exposing and sanctioning corrupt practices in the allocation of public procurement contracts (Hanna et al., 2011). Such efforts are attracting more and more attention from policy makers and the media, yet there is scarce direct empirical evidence on how they impact the business practices and performance of exposed firms and their employees.

In this paper, we rely on micro-data from Brazil and on a unique institutional setting to study the real effects of anti-corruption campaigns on exposed firms. Our empirical design relies on a government program which randomly audits municipal budgets with the aim of uncovering any misuse of federal funds. Previous literature has documented how this program affected a large set of municipality-level outcomes, including the probability of reelection of local politicians (Ferraz and Finan, 2008) and the performance of the local economy (Colonnelli and Prem, 2021). We exploit a key feature of the program that allows us to study its real effects on exposed firms. While the program targets the budget of municipalities, the audits expose the identity of specific firms involved in irregular business with the government. The vast majority of such firms are located outside the boundaries of the audited municipalities. Thus, by focusing on these firms, we are able to isolate the direct effect of exposure of corrupt practices on firms from its overall impact on the local economy of the audited municipality.¹ In addition, the random nature of the audits provides us with a unique setting in which the timing of firm-level exposure is

¹Most anti-corruption initiatives target entire industries, countries, or localities, which makes it complicated to isolate their effects on specific firms from other aggregate effects of the program. Recent examples include Zeume (2017), which studies the impact of the 2010 Bribery Act on U.K. firms' cost of doing business, and Rauter (2019), which studies mandatory extraction payment disclosures and their impact on multinational firms in foreign host countries.

plausibly exogenous.

A primary contribution of our paper is the construction of a novel dataset on corruption and firms. We build a dataset covering all firms that are exposed by the random auditing program of the CGU, the federal agency in charge of fighting corrupt practices in Brazil. Our main data source are the audit reports produced by the federal auditors that review municipal budgets. The reports, which are published online and made available to the public and the popular press, disclose the names of the companies involved in any misuse of federal funds. From the 1,881 audit reports produced by the CGU between 2003 and 2014, we manually collect information on all the irregularities reported including the tax identifier of the firms involved, the nature of the irregularity, the type of involvement of the firm, and the value of the contracts. We match the firm-level dataset with social security data from the Ministry of Labor (RAIS) containing detailed information on all formal workers employed in Brazil, as well as with data on firms' access to public procurement contracts, on firms' investment, and on firms' access to credit lines from the Brazilian Development Bank (BNDES).

The empirical strategy relies on the random timing of the audits, which are determined by a national televised lottery, thus guaranteeing exogenous variation in the timing of exposure. Yet, firms that do business with local governments might be selected on multiple dimensions. Hence, we combine a dynamic difference-in-difference design with a matching strategy that aims at identifying a plausible control for each exposed firm. Both treated and control firms do business with the government and are selected to be located outside of the audited municipalities, so that we can isolate the firm-level effects from any aggregate impact of the audits.

We start by documenting two key, seemingly contradictory findings. First, firms exposed by the anti-corruption program experience, on average, a 4.8 percent larger *increase* in size (as measured by total employment in the firm) relative to the control group in the three-year period following exposure. Second, exposed firms experience a significant *decrease* in their access to procurement contracts over the same period. These effects indicate that while negative exposure generated by the anti-corruption campaign decreases

a firm’s ability to rely on government contracts –consistent with large anecdotal evidence indicating that local governments steer away from firms somehow linked to corruption cases– it also benefits firm performance in the medium run, suggesting that firms were on average hindered by the presence of corruption they were directly involved in. At first glance, these findings appear somewhat in contrast with a large body of work on political connections and corporate misconduct showing that firms suffer after they lose their connections or after they are caught engaging in illicit activities.

In the second part of the paper, we investigate potential mechanisms behind the real effects of exposure. One potential explanation is that the increase in labor by exposed firms reflects their low productivity. That is, it is possible that these firms are inefficient firms that were able to generate a certain amount of profits with few employees because of their connections and ability to bribe officials to obtain government contracts. After the anti-corruption program, firms cannot obtain such contracts via favoritism, and need to hire more labor to generate similar profits. In this case, the growth we document would not be indicative of better performance by exposed firms.

To study this mechanism, we rely on the richness of our data on audit reports and manually classify exposed firms based on their degree of involvement in corruption practices. Auditors are required to report all firms involved in the corruption together with a description of the nature of the involvement. We uncover a large heterogeneity in the type of involvement by exposed firms. First, we label as *passively involved* those firms seemingly put at a disadvantage by a rigged bidding process which, while exposed by the program, can rather be considered victims of the corrupt system in place. Second, there are firms that are *actively involved* in an irregularity, but for which there is little evidence of inefficiency.² Third, there are firms that were clearly benefiting from the corruption scheme, such as those that received payments but did not deliver the goods and services required by the procurement contract (or did so unsatisfactorily). We define these firms as *corrupt*. We use this classification to study whether firms that were benefiting more from the corruption schemes before the audit are also the ones that grew more in the

²One common example are cases of over-invoicing for a specific good or service which is otherwise efficiently delivered to the municipality.

post-exposure period. If that were the case, then our baseline findings on employment would not be indicative of firms actually doing better after the audit. Our results are inconsistent with this mechanism: we find that firms more likely to have benefited from corrupt practices before the audit – the *corrupt* category – actually experience a *decline* in size relative to the control group.³

A leading alternative mechanism is one that links doing business with the government in the presence of corruption with firm-level distortions. Specifically, we argue that the revelation of corruption, by restricting a firm’s access to government contracts, forces exposed firms to change their investment and business practices to be able to compete for private demand. While this is a mechanism previous literature has hinted at (Shleifer and Vishny, 1993; Fisman and Svensson, 2007; Cole and Tran, 2011), data limitations make it difficult to tease it out. For this purpose, we obtain restricted access to confidential data on firms’ investment and access to credit. In particular, we use information on firm investment from a comprehensive survey of Brazilian manufacturing firms (PIA), and loan-level data from the development bank BNDES, which is a key provider of corporate loans for capital investment in Brazil (Torres and Zeidan, 2016). We find that exposed firms experience a larger increase in capital investment in the post-exposure period, as well as higher borrowing to finance such investments. Our findings are consistent with evidence presented in Cohen and Malloy (2016), who show that firms that rely more on government contracts tend to grow slower and invest less in tangible and intangible capital. In our setting, exposed firms might adapt to a negative shock to their access to government contracts by changing their growth strategy, from one in which they focus on securing government contracts in the pre-audit period, to one in which they invest to compete in the market for private demand after the revelation of corruption.

In a context like ours, which is representative of many contexts where private firms

³We corroborate this finding –that inefficient corrupt firms suffer after an anti-corruption program limits their ability to obtain government contracts– using data from a different but related transparency initiative named CEIS. Starting in 2008, the federal government started to ban highly corrupt firms found guilty in court from participating in public procurement. In line with our main results on *corrupt* firms in the auditing program, we find that CEIS firms experience a large and statistically significant decline in size once they lose access to government contracts (see also Szerman (2020) for a broader discussion of CEIS).

interact with local government officials, conclusively testing for such a mechanism whereby firms change strategy when moving away from doing business with the government would require granular data on firm activity and bribery that are typically unavailable. We do, however, attempt to provide further, largely qualitative support for this channel by means of an original face-to-face survey we conducted with the owners of 115 firms in Brazil representative of the ones in our main analysis sample.⁴ In our survey, we ask a series of questions about how operating in the presence of corruption affects firm strategy. The qualitative evidence from our surveys points to corruption introducing several distortions in firm investment and other strategic decisions, thus corroborating our earlier findings that firms change investment strategy following a crackdown on corruption.

In the final part of the paper, we analyze the potential spillover effects of exposure on a primary, yet largely understudied group of a firm’s stakeholders, namely its employees. We use worker-level data to explore the impact of the audits on incumbent workers’ employment status and labor income. We find that workers that were employed by firms exposed by the random auditing program experience no significant changes in their probability of being employed, nor on their annual labor income. This evidence is informative for two reasons. On the one hand, to the extent that corruption exposure is valued negatively on the labor market, the audits may independently influence individual outcomes in addition to the direct consequences on firms (Karpoff et al., 2008, 2014a). We do not find evidence that employees suffer, further emphasizing some of the surprisingly positive effects of the audits on the average exposed firm. On the other hand, the limited impact of audits on the workers of exposed firms helps rule out a further alternative explanation for our firm-level findings, in which audits lead firms to fire corrupt managers or other employees that were engaging in corruption for personal gain, leading to a change in its internal organization.

Overall, our analysis uncovers new micro-level findings on the real effects of anti-corruption transparency initiatives, which are often masked in aggregate estimates. Highly

⁴While descriptive, in-depth surveys are typically used as a way to corroborate difficult-to-test mechanisms and to collect commonly unavailable data, such as in the context of investors’ (Gompers et al., 2016, 2020) and CFOs’ (Graham and Harvey, 2001) decision making, with face-to-face surveys considered to be the ideal format when feasible (Bloom and Van Reenen, 2007, 2010).

corrupt firms experience a major decline in size when their corruption is exposed, seemingly driven by their inability to shift their customer base away from the government. However, the vast majority of firms mentioned in the audit reports subsequently grow after the anti-corruption crackdown. Our evidence points to an explanation according to which efficient firms are often stuck in a business relationship with the government, in which corruption and other frictions hinder their growth through operational distortions (Fisman and Svensson, 2007; Olken and Pande, 2012).

Related Literature

We primarily relate to three strands of literature. First, the paper contributes to the existing literature on corporate corruption and specifically to the set of papers examining the link between corruption and firm-level growth (see Bardhan, 1997, Svensson, 2005, and Olken and Pande, 2012 for comprehensive reviews of the literature). Interest in this link comes from the importance of a broad set of influential studies arguing that corruption affects aggregate economic growth and has implications for welfare (e.g., Shleifer and Vishny, 1993; Mauro, 1995; Clague et al., 1996; Hall and Jones, 1999; La Porta et al., 1999; Glaeser and Saks, 2006). Yet, the nexus between corruption and firm-level growth remains largely unexplored due to the lack of settings where causality can be established. Most insights therefore come from studies that place a strong emphasis on new data obtained through innovative methods, and which point to the importance of understanding heterogeneity across firms.⁵ We make three contributions to this body of work. First, we contribute from a methodological perspective by manually collecting new data on exposed firms using government audit reports. Second, our empirical design allows us to overcome some of the endogeneity issues related to the link between corruption and firms. Third, we bring in a large set of administrative data sources that allow us to investigate various ways through which corruption affects firms, their operations, and their employees. Indeed, an important contribution is that we shed light on various within-firm distortions

⁵Svensson (2003) use survey data from 250 firms in Uganda discussing when and how much they pay in bribes, and Fisman and Svensson (2007) use the same data to study the relationship between bribes, taxes and firm growth. Sequeira and Djankov (2014) collect data from 120 South African firms and their bribe payments at ports to argue that firms change production decisions due to bribe demands. Similarly innovative data is collected by Cole and Tran (2011) in an Asian country. Finally, Decarolis et al. (2019) use data from the Italian FBI to study criminal firms in public procurement.

associated with corruption, which we know little about in the academic literature (Dal Bó and Rossi, 2007, Smith, 2016). Our findings emphasize the importance of corruption for various strategic choices by the firm, such as those related to funding sources and market access.

Second, by looking at firms potentially receiving preferential treatment from local politicians, we broadly relate to studies that assess the importance of political connections to firms. A number of studies have explored various ways through which politically connected firms might receive unfair advantages (Fisman, 2001). For instance, Khwaja and Mian (2005) show that politically connected firms obtain preferential access to finance, while Faccio (2006) studies political connections across countries.⁶ Our study adds nuance to this literature by highlighting that even firms that are directly involved in the corruption with local politicians might benefit from an anti-corruption campaign, because the benefits from reduced corruption, such as lower operating frictions, seemingly outweigh those obtained through favoritism in the allocation of procurement contracts.

Finally, a growing literature provides evidence on the effectiveness of anti-corruption initiatives (e.g., Smith et al., 1984; Karpoff et al., 2014b; Griffin et al., 2016; Zeume, 2017; Giannetti et al., 2017; Chen and Kung, 2019; Christensen et al., 2020; Goldman and Zeume, 2020) and more specifically government audits in reducing corruption (e.g., Olken, 2007; Bobonis et al., 2016). In particular, following the seminal work of Ferraz and Finan (2008, 2011), several papers have investigated the effects of the Brazilian random audit program (e.g., Bologna and Ross, 2015, Zamboni and Litschig, 2018, Avis et al., 2018). Our paper is also related to Colonnelli and Prem (2021), who analyze the impact of the anti-corruption program on the local economy of audited municipalities, finding that economic activity increases mainly through the growth of government-dependent and procurement-intensive sectors. Importantly, while previous studies focus on the consequences of the audits on aggregate outcomes of the targeted municipalities, our empirical analysis focuses on the direct effect of disclosure on firms that are located *outside*

⁶Other examples include Faccio et al. (2006), Claessens et al. (2008), Goldman et al. (2009), Cooper et al. (2010), Cohen et al. (2011), Duchin and Sosyura (2012), Goldman et al. (2013), Cingano and Pinotti (2013), Akey (2015), Fisman and Wang (2015), Akey and Lewellen (2017), Schoenherr (2019), Brogaard et al. (2019), Colonnelli et al. (2020), González and Prem (2020), and Bertrand et al. (2020).

of targeted municipalities, thus removing any aggregate impact of the audits from our estimates. In addition, we are the first to assemble information on the specific firms that were directly associated with an irregularity, which allows us to explore the direct link between corrupt practices and firm-level outcomes.

The paper is organized as follows. Section II describes the institutional setting and provides a detailed description of the anti-corruption initiatives we study. Section III presents the new firm-level dataset on corrupt practices revealed by the random auditing program that we construct from the text of the audit reports. Section IV presents our identification strategy and describes all the main empirical results of the paper. Section V concludes.

II INSTITUTIONAL BACKGROUND: ANTI-CORRUPTION IN BRAZIL

Brazil has constantly battled with corruption. The primary institution involved in monitoring corruption practices in Brazil is the Office of the Comptroller General (Controladoria Geral da União - henceforth CGU), which was established in 2003 as the first federal executive body specializing in anti-corruption policies and internal control. The scope of CGU is to promote transparency and identify and prevent corruption in the federal administration and the management of public resources, by working directly with several other national enforcement agencies. In particular, the Federal Court of Accounts (TCU) is responsible for monitoring the budgetary performance of government bodies and applying administrative penalties related to the misuse of public resources, while the Federal Public Prosecutor's Office (MPF) is in charge of bringing the cases to the Federal Justice (JF) for initiating criminal and civil prosecution.

The major anti-corruption initiative carried out by the CGU consists of randomized municipal audits. This flagship program started in May 2003 with the purpose of identifying and preventing corruption in the use of federal resources by local governments. The municipal audits focus on the allocation and use of federal funds that have been transferred to the municipality, covering all procurement contracts between the local government and firms that span the two years prior to the audit. The program began by

selecting 26 municipalities per lottery (one from each state in Brazil), and later expanded to 60 municipalities per lottery. The program consisted of 39 lottery rounds of randomized audits, with replacement, over the 2003-2014 period. For transparency purposes, the lottery draw event invites the press, political parties, and the civil society to join and spectate. Only municipalities below a certain population threshold are eligible to enter the lottery, and state capitals are excluded. The population threshold was originally 100,000, but it was successively increased to 300,000 soon after the launch, and then rose to 500,000 for the remaining years of the program. As of 2014, more than 99% of Brazil's 5,570 municipalities were eligible, and 1,881 had been selected at least once.

The audit is performed by CGU auditors who travel to the municipality, manually review the municipality expenditures' documents and, in most cases, physically inspect the execution of federally-funded programs. To limit corruption in the audit process, the auditors are hired through a public examination and earn competitively high salaries. The audit starts immediately after the lottery draw and lasts about ten days. Following the fieldwork, the auditors write a detailed audit report that can span up to 300 pages. The report documents any irregularity associated with the use of federal resources, together with any justification presented by local government officials for these irregularities and the auditors' judgement on these justifications.

The reports are forwarded to the relevant administrative and judicial government agencies so they can proceed with the prosecution of any cases of corruption and pursue any administrative or legal fines and sanctions. In addition to the Federal Court of Accounts (TCU), the Federal Public Prosecutor's Office (MPF), the Federal Police (PF), and the municipal legislative branch, the results of the audits are released on the internet and to the media. As discussed in [Ferraz and Finan \(2008\)](#), the news of revealed corruption easily reaches the public through the local radio networks and is heavily used in political campaigns. From the mayors' side, corruption commonly takes the form of frauds, usage of phantom firms, over-invoicing, and diversion of public resources. The firms involved in the irregularities are identified publicly along with the local government officials in the audit reports, as long as they are linked in any way to the irregular contract.

There are several potential consequences for firms that are exposed by the auditing program. In particular, if later found guilty, firms can be barred from participating in future tendering processes for federal and local contracts. For example, Planam, an ambulance company with mafia connections, was found to charge the local government for services not provided, and as a result was subsequently declared illicit by the courts and barred from future public proposals. Furthermore, exposed firms might have to pay penalties or return misused funds. In certain instances, firm owners might face judicial action.⁷ Even when not directly prosecuted, several anecdotes indicate that local governments steer away from doing business with firms involved in exposed irregularities, due to reputational and political considerations.⁸ Many argue these are some of the undesirable consequences of transparency initiatives that might damage both culpable as well as innocent firms (Liu et al., 2021).

III DATA

In this section, we discuss the main data sources we use in the paper as well as the sample selection procedure to arrive at the final estimation sample. The main dataset used in the analysis combines information from the new measures we create from the CGU anti-corruption reports and administrative matched employer-employee data on the Brazilian formal sector. We also rely the data on public procurement contracts, on confidential loan-level data on government funding to firms, and on data on investment and sales for a sample of manufacturing firms.

III.A MAIN DATA SOURCES

III.A.1 A New Dataset on Firm-level Corruption from Audit Reports

We construct novel measures of corruption starting from the CGU audit reports with the goal of understanding the link between corruption in local public spending and firms.

⁷According to the audit reports: “Irregular practices are forwarded to the Public Ministry and the TCU for penal action, the CGU for civil action of returning misused funds, and to Congress.”

⁸See, for example, <https://valor.globo.com/politica/noticia/2019/12/16/a-lava-jato-destruiu-empresas-diz-toffoli-a-jornal.ghml> and <https://www.corecon-rj.org.br/anexos/C1D017FCEE732F4E1B9B4E13C46AD36E.pdf>.

We cover all 39 audit rounds and the 1,881 different municipalities randomly selected to be audited in the period 2003-2014.

We read and code each irregularity manually, collecting information on each case and constructing a final dataset at the irregularity-firm level. We focus exclusively on irregularities where the tax identifier or the company name of a private-sector firm appears in the auditors’ description of the case. This approach represents an important contribution relative to the previous literature using these data. Indeed, while [Ferraz and Finan \(2008\)](#), [Brollo et al. \(2013\)](#), and [Zamboni and Litschig \(2018\)](#) have used CGU audit reports to measure corruption, they only focus on aggregate municipal measures without identifying specific firms involved in the irregularities. Throughout the paper, we refer interchangeably to firms that are identified as being linked to an irregularity as “audited” or “exposed.”

For each irregularity we record, among other details, the tax identifiers and names of the firms involved (e.g., both winners and losers of public procurement bids), the amount of the contract, the date a contract was awarded and completed, and the extent of a firm’s involvement with the aim of understanding whether it is the firm or the public official that is responsible for the irregularity. Given our focus on firms, we capture irregularities mostly in public procurement. Audited contracts that show no irregularity are not reported by the auditors, and hence are not observed. Similarly, we do not capture cases of politicians’ embezzlement, such as the personal appropriation of funds that were supposed to be allocated to low-income families as part of federal cash transfer programs. We discuss more details of the data construction process in section [IV.C.1](#) and in Appendix [A.1](#).

III.A.2 Matched Employer-Employee Data

The firm and worker level information we use as outcomes in the analysis comes mainly from the RAIS (Relação Anual de Informações Sociais) database, managed by the Brazilian Ministry of Labor. The RAIS has been used in a growing recent number of studies, and it is widely considered an extremely reliable census of formal sector activity in

Brazil ([Dix-Carneiro, 2014](#)). Except for the informal sector and a subset of self-employed businesses, its coverage is almost universal.

RAIS is a matched employer-employee dataset, which allows us to track individual employment careers over time across both firms and business establishments. Individuals are tracked using a unique administrative worker tax identifier, similar to the social security number in the US. In the data, we also observe the tax identifiers of both the firm and the establishment of the worker, as well as the five-digit industry they operate in and the municipality they are located in. Similarly to other employer-employee matched data, such as the US Longitudinal Employer-Household Dynamics (LEHD) database, we have key information on the individual payroll and hiring and firing dates.⁹ Each job in a given year is assigned an occupational category, which allows us to characterize the managers of each firm, as well as lower level occupational layers such as blue-collar and white-collar workers.

III.A.3 Public Procurement Contracts

We use three different sources of data on public procurement. Data on federal public procurement come from the Ministry of Planning, Budget, and Management (Ministério do Planejamento, Orçamento e Gestão - MP), covering the universe of contracts awarded by federal agencies of the government over the 2000-2014 period. We refer to [Ferraz et al. \(2015\)](#) for a detailed explanation of the data.

The second dataset comes from the Court of Auditors of the State of Sao Paulo (Tribunal de Contas do Estado de São Paulo - TCE-SP), and includes information on public procurement contracts awarded by the 645 municipalities in the state of Sao Paulo over the 2008-2017 period. This dataset represents the most comprehensive municipality-level dataset on public procurement, since most other municipalities only started to report such information on specific transparency websites starting in 2016. We rely on this dataset to match audited firms to control firms in the analysis.

⁹Additionally, RAIS contains individual specific data on gender, nationality, age and education, as well as data on hours worked, reason of hiring and firing, and various contract details (such as temporary, short term, and apprenticeship contracts).

A third dataset allows us to identify suspensions of firms that are due to prosecuted irregularities in public procurement. The data come from the National Registry of Ineligible and Suspended Companies (Cadastro Nacional de Empresas Inidôneas e Suspensas - CEIS), also referred to as the “public procurement blacklist.” These data cover the period 2007-2017. CEIS provides information on the identities of firms and individuals that have been sanctioned and suspended from participating in public procurement tenders or entering into a contract with public agencies at any government level.

III.A.4 Access to Finance, Sales, and Investment

We obtain loan-level data from the Brazilian Development Bank (Banco Nacional do Desenvolvimento - BNDES), the only source of government loans in Brazil. The BNDES is the second largest development bank in the world (after the Chinese Development Bank), and the major lender to Brazilian companies. BNDES provides more than 70 percent of long-term bank lending in Brazil, and it is the largest source of investment in industry and infrastructure (Colby, 2012). For each loan, we have information on the tax identifier of the firm receiving the loan and the date the loan was received.

A shortcoming of the RAIS dataset is that it lacks balance sheet information, an issue that is common to matched employer-employee datasets on the universe of private sector firms. We alleviate this issue by accessing a unique administrative dataset collected by the Brazilian Institute of Statistics (IBGE), the primary data collection government agency in Brazil. The dataset is called the Annual Industrial Survey (Pesquisa Industrial Anual - PIA), and it is the equivalent of the US Census Annual Survey of Manufacturers. The sample is constructed using two strata: the first stratum (estrato amostrado) includes a nationally representative sample of single-establishment firms with less than 30 employees; the second stratum (estrato certo) consists of all larger firms, which are sampled with probability one. As it is standard in the literature, we use only information from the estrato certo (Ponticelli and Alencar, 2016). Even if for just a small share of our sample, PIA allows us to observe investment and total sales at the firm level.

III.B ESTIMATION SAMPLE AND DESCRIPTIVE STATISTICS

We collect 14,316 tax identifiers of firms that appear in all available audit reports. Figure I shows the number of audited firms over time. We find that the program was particularly intense in its first few years, with close to 1,500 firms being involved in irregularities at its peak in 2005. Approximately 1,000 firms appear in our dataset during the central phase of the program from 2006 to 2010, while the number drops significantly after that, in line with the reduced intensity of the CGU program.

To construct our analysis sample, we start by matching audited firms to the RAIS administrative database using the tax identifier. We match 9,454 of firms to RAIS, but the number drops to 4,085 when we restrict the focus on the years in which the local procurement data is available (i.e., post 2008), which we require for the matching.¹⁰ We then focus only on firms that have at least one employee in each of the three years leading up to the audit, and the year of audit: this reduces the sample to 2,910 firms. We then drop 1,604 firms that do not have a matched control firm, as discussed in section IV.A. As a result, our most restrictive analysis sample includes a total of 1,306 audited firms.¹¹

In Table I, we report summary statistics on the final sample of audited firms using data for the three-year period before the audit. The table highlights that while audited firms are typically small and medium-sized firms, they are relatively larger and more likely to receive a federal procurement contract and a government-subsidized loan compared to the population of firms in Brazil. Specifically, audited firms have a mean of 47 and a median of 12 employees, both larger than the population averages of 16 and 3 employees.¹² A non-trivial share of firms receive government-subsidized loans from BNDES (17%) and federal procurement contracts (5%). On average an audited firm has a total amount of federal procurement contracts of USD 1,297,000, with a median of USD 70,000.

¹⁰The reasons for the imperfect matching can mainly be linked to two issues: (i) there are formal firms that are not included in RAIS, such as firms without employees (e.g., sole proprietorship) or self-employed individuals (typical for example of consultancy services hired by the government); (ii) there are mistakes in the tax identifier in the audit reports, due for example to misspellings of the auditors.

¹¹The drop in sample size is typical of studies using dynamic difference-in-differences strategies combined to an exact matching approach like the one we discussed in section IV.A. See Jäger (2019) for a discussion of the trade-offs regarding this approach.

¹²The population averages are computed using the 2008 firm-level RAIS database.

Digging deeper into the firm size distribution, Panel A of Table II classifies firms into bins depending on size and shows that the distribution of audited firms is skewed to the right relative to the population of firms. Large and medium-sized firms are more prevalent among the audited firms, while small and micro firms are underrepresented. In particular, around 44% of audited firms have at least 10 employees versus only 21% in the population of firms. The difference is particularly striking in the number of medium-sized firms that have 10 to 49 employees. This finding is consistent with the fact that larger firms are more likely to bid and receive local procurement contracts. Panel B of Figure I plots the evolution of the size distribution of firms involved in irregularities with the local governments in our data and illustrates that the distribution has been relatively stable over time.

Panel A of Table II also reports the distribution of audited firms across sectors, compared to the national distribution in Brazil. 59% and 19% of firms are in the retail and construction sectors (column 1), respectively, compared to 40% and 7% in the economy (column 3). On the other hand, services are under-represented. This distribution reflects the higher prevalence of these sectors in public procurement more generally and highlights the importance of accounting for sectoral heterogeneity when estimating the effects of anti-corruption policies.

Finally, Panel C of Figure I demonstrates that the vast majority of audited firms are located *outside* of the audited municipality.¹³ Indeed, we find that 74% of firms are registered outside the audited municipality, consistent with the fact that several participants in the public procurement process are larger multi-region firms. This is a key feature motivating our research design, as it allows us to study growth patterns at the firm-level while abstracting away from any municipality-level outcome of the audits.

¹³The location is the physical location of the establishment for single-plant firms. For multi-plant firms, we define it to be the headquarter of the firm.

IV THE IMPACT OF ANTI-CORRUPTION AUDITS ON FIRMS

In this section, we start by describing our identification strategy based on a dynamic difference-in-differences with exact matching (section IV.A). We then provide direct empirical evidence on the impact of the random auditing program on two main firm-level outcomes: size and access to procurement contracts (section IV.B). Next, in section IV.C, we discuss and test potential mechanisms that can rationalize our findings using a new classification of firms based on their degree of involvement in corruption practices, firm-level data on investment and access to finance, and a new survey we administered to a sample of government-dependent firms. Finally, in section IV.D, we present evidence on the effects of exposure on worker-level outcomes.

IV.A IDENTIFICATION STRATEGY

The setting we study has several attractive features from an identification perspective. In particular, the timing of firm exposure is plausibly exogenous due to the random nature of the audits, which contrasts several other enforcement actions against firms that are typically triggered by endogenous events linked to the exposure of firms to corruption cases. Nevertheless, firms that do business with local governments might be selected on multiple dimensions. The main challenge we face is thus to identify a plausible control group for the exposed firms, capturing how those firms would have performed in the absence of the CGU anti-corruption program.

To make progress on this front, we complement a dynamic difference-in-difference specification with a matching strategy based on detailed data on firm characteristics, as it is standard in the literature when the time-series variation is exogenous but the cross-sectional variation is not (Jaravel et al., 2018). A key aspect of our strategy is that we are able to match each exposed firm with a non-exposed firm that is also involved in public procurement with local governments. To identify such firms, we rely on contract-level data covering all public procurement contracts with the municipalities of the State of Sao Paulo. These data allow us to select counterfactual firms that –similarly to the exposed

ones— provided goods and services to local governments and had a procurement contract awarded and completed in the year of the audit. The existing literature has documented that firms that receive a procurement contract tend to experience a temporary increase in size after the contract is completed (Ferraz et al., 2015; Carrillo et al., 2018). Thus, matching on existing access to local procurement alleviates the concern that our estimated effects are driven by the dynamics of firm growth when obtaining procurement contracts rather than by the effect of the anti-corruption program itself.

In addition to matching on access to local procurement contracts, we rely on detailed firm-level data sourced from RAIS to match on a set of observable characteristics. More specifically, we implement a Coarsened Exact Matching (CEM) procedure (Iacus et al., 2012), which consists of two rounds of sequentially less restrictive matching requirements based on a firm’s sector of operation, size, and characteristics of its location. In the first round, we match exposed firms with potential controls that: (i) operate in the same *five*-digit sector according to the CNAE classification, (ii) are in the same ventile of employment and payroll for the three years before the audit, (iii) are in the same quartile of the distribution of the following municipality characteristics: total number of plants, total employment, and total payroll. For both exposed firms and potential control firms, we restrict our sample to firms located in municipalities that were never audited by the CGU during the period under study. This last restriction is crucial to avoid any potential confounding effects derived from the impact of the auditing program on the local economy and political context, as documented by previous work (Ferraz and Finan, 2008; Colonnelli and Prem, 2021). In the second round, we relax the sector requirement to firms operating in the same *two*-digit sector, and we match on deciles, rather than ventiles, of the empirical distribution of firm characteristics.

When multiple potential control firms are found for a given exposed firm, we select the counterfactual firm as the one with the closest propensity score. The propensity score is computed based on a linear probability model that includes lagged employment levels. As mentioned in section III.B, at the end of the full matching procedure we were able to match 1,306 firms exposed by the CGU audit program.

IV.B MAIN EFFECTS ON FIRM GROWTH AND ACCESS TO PROCUREMENT CONTRACTS

We start by documenting the effect of exposure on firm size, which is the main firm-level measure we can observe from the RAIS dataset and that captures firm growth. In particular, we estimate the following specification for a time-window of 7 years around the audit:

$$\log(1 + L)_{it} = \alpha_i + \alpha_t + \beta_1 Post_{it} + \beta_2(Post_{it} \times 1(Exposed)_i) + \varepsilon_{it}. \quad (1)$$

Firm size is defined as the natural logarithm of one plus the number of employees of firm i at the end of each calendar year t . The dummy $Post_{it}$ captures the years after the audit for the exposed firm and their control, while $1(Exposed)_i$ is an indicator function equal to one for exposed firms and zero for the matched control firms as described in section IV.A. α_i and α_t are firm and year fixed effects that aim at capturing any observed and unobserved firm characteristic that is fixed over time, and aggregate level shocks at the year level that affect all firms similarly. ε_{it} is an error term that we cluster at the firm level. Our parameter of interest is β_2 , which captures the change after the audit in the outcome variable of exposed firms relative to the matched controls, taking into account any fixed characteristics at the firm-level as well as year-level shocks.

Table III reports the results. As shown in column (1), we find that firms exposed by the random auditing program experience an increase in employment after their exposure. In particular, the magnitude of the estimated coefficient β_2 indicates that exposed firms experience, on average, a 4.8 percent larger increase in size in the three years after being exposed by the audit relative to the control group.

Next, in column (2), we study the impact of exposure on the probability of firm exit. One potential explanation of our result on employment is that worse-performing exposed firms are more likely to exit after exposure, leaving in our sample only those exposed firms that grew after exposure. To analyze the impact of composition we estimate equation (1) using as outcome a dummy equal to 1 for firm exit. We find that the random

auditing program had a small and statistically insignificant impact on the exit probability of exposed firms relative to the control group, which indicates that our effects on firm size are not simply driven by compositional changes.

Finally, we study the impact of exposure by the random audit program on firms' ability to obtain procurement contracts. Access to government contracts is a key outcome in our analysis, given the nature of the program we study, which targets firms involved in corruption cases with government officials. To this end, we rely on data on procurement contracts from the federal government, which we can access for all firms in our sample.

The results are reported in columns (3) and (4) of Table III. In column (3), we estimate equation (1) where the outcome is an indicator variable capturing whether the firm obtained *any* procurement contract in a given year. We find that firms exposed by the random audit program are on average 2 percentage points –in any given year– less likely to receive federal procurement contracts after exposure, which represents a considerable decrease of around 40% with respect to the sample mean.

Next, in column (4), we study the impact of exposure on the value of the procurement contracts obtained by the firm. The outcome variable is the log of the total value of all federal procurement contracts obtained by a given firm. The estimated coefficient indicates a relative decline in the value of procurement contracts of about 21% in the three years after exposure.

To assess the validity of our identifying assumptions and explore the timing of the effects on firm size, exit, and access to procurement contracts, we further estimate the following dynamic specification:

$$y_{it} = \alpha_i + \alpha_t + \sum_{k=-3}^{k=+3} \alpha_k 1(t = k) + \sum_{k=-3}^{k=+3} \beta_k (1(t = k) \times 1(Exposed)_i) + \varepsilon_{it}. \quad (2)$$

In Figure II, we report the estimated coefficients β_k for each of the main outcomes. As shown in Panel (a), we find no differential trends in firm size between audited firms and their controls in the period before exposure. The effect of the anti-corruption program on firm size starts materializing in the same year in which the firm is exposed to it (year 0), intensifies in the year following exposure (year +1), and then stabilizes in terms of

magnitude in the two following years. Consistent with the results reported in Table III, we find no significant effect on exit for exposed firms in the post-exposure period, while the estimated difference between the two groups is zero by construction in the years before exposure.¹⁴ Finally, Panels C and D show the dynamic effect on access to and value of federal procurement contracts, again showing no major differences in the pre-period and a stark (negative) effect in the post-period.

The combination of the findings presented in Table III and Figure II are somewhat surprising. In particular, we show that, while exposure from the anti-corruption campaign decreases the firms' ability to rely on government contracts, it also benefits firm performance. In the next section, we explore potential mechanisms that can drive this seemingly counter-intuitive empirical finding.

IV.C MECHANISMS

One potential explanation that can rationalize our findings on firm growth and public procurement is that the employment increase by exposed firms reflects their low productivity. That is, to maintain the same level of sales or profits, firms that benefited the most from preferential access to government contracts via corrupt practices might need relatively more workers after exposure than those that can still rely on such government contracts. In particular, a typical explanation for such a story is one where –in the pre-audit period– corrupt but inefficient firms are able to compete by bribing public officials, rather than by out-competing other firms on efficiency grounds.

To investigate this mechanism, we use the richness of the data we collect from the audit reports to propose a classification of firms based on their degree of involvement in corruption. Our results are strongly inconsistent with such an alternative explanation: we find that firms more likely to have benefited from the presence of corruption tend to experience a decrease in size relative to the control group, as reported in section IV.C.1.

Subsequently, we investigate a different economic explanation. Existing literature has shown that firms that rely more on government contracts tend to grow slower and in-

¹⁴We condition on firms being in operation in the three years before exposure for both treatment and control group.

vest less in tangible and intangible capital (Cohen and Malloy, 2016). Building on this literature, we study whether the revelation of corruption, by cutting access to government contracts, forces firms to change their investment and business practices in order to compete for private sector’s demand. In particular, we hypothesize that exposed firms might change their internal growth strategy, from one in which they focus on securing government contracts in the pre-audit period, to one in which they invest to compete in the market for private demand after the revelation of corruption. We present two types of evidence for this mechanism. First, we obtain access to confidential data on firms’ investment and access to credit, which allows us to analyze whether the loss of procurement contracts corresponds to a change in investment at the firm level. We present these results in section IV.C.2. Second, we develop and administer original surveys of owners of small and medium government-dependent firms, which we use to provide suggestive evidence on how the presence of corruption might affect firm strategy and that we discuss in section IV.C.3.

IV.C.1 *Heterogeneous Effects by Degree of Involvement in Corruption Cases*

To shed light on the mechanisms, we start by analyzing whether the impact of exposure varies by the degree of a firm’s involvement in corrupt practices. Indeed, auditors are required to report all possible firms involved in the corruption together with a description of the nature of the involvement, thereby leading to a large degree of heterogeneity in the type of exposed firms. We manually classify firms whose names appear in the audit reports in three categories depending on their degree of involvement in the exposed corruption: passively involved, actively involved, and corrupt.¹⁵

First, we consider as *passively involved* those firms who are mentioned in the audit report as being linked to an irregularity, but they seem to be the victim of it. In this case, the most common example is the one of losing bidders of an irregular public procurement process. They are exposed by the program, because auditors are instructed to do so,

¹⁵To do so, we hired a large team of Brazilian research assistants, who were provided clear instructions for classifications. Trained supervisors were responsible for quality checks of all data entered. Appendix A.1 describes the data collection process in detail.

but there is no direct evidence that they are inefficient corrupt firms benefiting from preferential treatment.

Second, we consider firms who are *actively involved* in an irregularity, but where we cannot conclusively argue they are the perpetrators of a crime. The most common case is one of over-invoicing for a specific good or product. Over-invoicing is a typical scheme where a firm is invoiced for an amount larger than the actual good or product sold to the government, so that rents can be extracted from public funds from either the politician, the firm, or both. The majority of such cases involve a firm that wins a public procurement contract where auditors uncover that funds were mismanaged by the public official, for example because funds aimed at a specific government program were used to purchase goods from a firm in a completely different sector. Importantly, we do not directly observe any inefficiency related to these firms, as the evidence shows the quality of goods or services is satisfactory, unlike the subsequent case of corrupt firms.

We label as *corrupt* all cases where a firm is actively involved in the corruption and there is clear evidence it illegally benefited from it. A typical case is one where firms paid a bribe or did not provide the goods or services described in the procurement contract (or did so in an unsatisfactory manner). These clear-cut cases of corruption represent a minority –approximately 7%– of all irregularities we observe. All corrupt firms seem to be *inefficient* firms who benefit from the corruption, as evidenced by the lack of or the low quality of their output.

Panel A of Figure I plots the number of audited firms over time based on the degree of a firm’s involvement in corrupt practices. We do not observe significant differences in the extent of involvement of firms over time, with a large and mostly equal share of *passively* and *actively involved* firms, and a small share of *corrupt* ones across the entire sample period. Table A3 provides summary statistics on audited firms depending on the degree of involvement. *Actively involved* firms appear to be the smallest, employing on average 37 employees, whereas *passively involved* and *corrupt* firms have a mean of 54 and 58 employees, respectively. *Corrupt* firms have on average a lower number of federal procurement contracts and a higher access to government-subsidized lending compared to

passively and *actively involved* firms. However, we do not observe large differences in terms of firm characteristics for the median firm across different types of exposure to corrupt practices. Finally, Figure A1 plots the evolution of the size and spatial distribution of audited firms depending on the degree of involvement.

To study how the effect of the random audit program on firm size differs by type of exposure, we start by estimating equation (1) separately for each group of firms depending on their degree of involvement. The results are reported in columns (1) to (3) of Table IV. The magnitude of the point estimate in column (1) indicates that *passively involved* firms experience a larger increase in size than the average firm exposed by the anti-corruption program. In particular, *passively involved* firms experienced a 7.2% larger increase in size with respect to the control group after exposure, against the 4.8% average effect documented in column (1) of Table III. These results are consistent with the fact that *passively involved* firms that appear in the audit reports are often firms that were victims of the corruption scheme, who are unfortunate to end up being exposed in the audit reports due to the requirements for the auditors to list all possible firms related to the specific government contract under examination.

Interestingly, in column (2) of Table IV, we find that firms reported as *actively involved* in the corruption scheme experience a smaller but still positive and significant increase in size, which is similar in magnitude to the effect on the average firm in our sample. This finding indicates that our effects are not just driven by the unique feature of the CGU anti-corruption audits that expose non-guilty firms, because also firms directly involved in the corruption perform better after the audits. On the other hand, *corrupt* firms experience a strong and significant decline in employment of about 20% after their exposure in the audit reports, as shown in column (3).

To study whether differences in the effect of exposure across firms with different degrees

of involvement are statistically significant, we also estimate the following specification:

$$\begin{aligned}
\log(1 + L)_{it} = & \alpha_i + \alpha_t + \beta_1 Post_{it} + \beta_2 (Post_{it} \times 1(Exposed)_i) \\
& + \beta_3 (Post_{it} \times 1(Exposed)_i \times 1(Active)_i) \\
& + \beta_4 (Post_{it} \times 1(Exposed)_i \times 1(Corrupt)_i) \\
& + \beta_5 (Post_{it} \times 1(Active)_i) \\
& + \beta_6 (Post_{it} \times 1(Corrupt)_i) + \varepsilon_{it}.
\end{aligned} \tag{3}$$

The results are reported in column (4) of the same table. The coefficient on the main interaction with the exposure dummy β_2 captures the effect of the anti-corruption program on the *passively involved* firms, which represent the excluded category. Consistently, the magnitude of the point estimate on the excluded category is similar to the one reported in column (1). Firms reported as *actively involved* in the corruption scheme experience a smaller but not significantly different increase in size. On the other hand, the effect on *corrupt firms* is significantly different than the one on *passively involved* firms. The sum of the estimated coefficients β_2 and β_4 indicates that the 20% relative decline in size for corrupt firms is statistically significant.

To sum up, the results reported in Table IV, columns (1)-(4), show that the effect of the random audit program on firm size is heterogeneous across firms with different degrees of involvement. In particular, they show that firms that benefited more from the corruption schemes in the pre-exposure period are not the ones that hired more workers in the post-exposure period. This result is crucial for our analysis as it indicates that the finding of firms growing, despite suffering a loss in government access following the audits, is not mechanically driven by the need to hire more workers to maintain the same level of sales for firms that cannot rely on favoritism in public procurement anymore.¹⁶

One important concern with our measures of exposure to corruption is that they are

¹⁶Notice that firms with different involvement are similarly affected in terms of access to federal contracts, as we show in columns (1) and (2) of Appendix Table A2. This suggests that the federal government decided to reduce its business with firms whose names were disclosed in the audit reports, independently of the specific context in which they are mentioned. This finding is consistent with ample anecdotal evidence on the reputational consequences of being included in a publicly disclosed report on corruption.

somewhat arbitrary. In fact, it is inherently difficult to attribute guilt in corruption cases, where it is often challenging even for prosecutors to charge specific parties. Hence, we might be worried about mis-classification, and that all or most exposed firms might instead be inefficient politically connected firms that continue obtaining government favors even after the audit. While this story seems in direct contradiction with the negative effects on access to procurement contracts for exposed firms, we provide further contextual evidence and make our measures more transparent by reporting a random sample of detailed examples of irregularities in [Appendix A.2](#).

In addition, we provide corroborating evidence that corrupt and plausibly inefficient firms shrink in size after they lose preferential access to government contracts, by studying the impact of the CEIS program on firm size. Briefly introduced in [section III.A.3](#), CEIS is a different but related transparency initiative started by the federal government in 2008, whereby highly corrupt firms found guilty in court of wrongdoing in dealings with the government are formally banned from participating in public procurement. While the CEIS program does not offer the random-by-design variation in the timing of exposure, it helps maximize external validity. Indeed, firms included in the CEIS registry can be considered as “highly corrupt” firms, where the misconduct has not simply been exposed (as in the case of the audits), but also certified by the courts and punished through a suspension from getting government contracts. To estimate these effects, we use a similar matching strategy and estimate the same specification described in [equation \(1\)](#), where the indicator function for exposure is equal to one if a firm was reported in the CEIS dataset of corrupt firms, and zero otherwise. The time-series variation is given by the year of suspension from accessing public procurement contracts. As we report in [Table IV](#), [column \(5\)](#), we find a large and negative effect of this anti-corruption program on firm size, with employment in exposed firms declining by a staggering 90% more than in the control firms in the post-exposure period. This large and negative impact on suspended firms is consistent with our results on corrupt firms exposed by the random audit program, thus providing some validation for our categorization of firms across the

corruption involvement spectrum.¹⁷

Finally, we conclude by exploring the heterogeneous effects by type of exposure in a dynamic specification. The results are reported in Figure III. As shown in the figure, the positive effects on *passively involved* firms materialize already in the year of exposure. The effect on *actively involved* firms is also positive but milder when compared to the passively involved firms. The large and negative effect on the *corrupt* firms materializes with a slight lag from the time of exposure, while the effect for suspended firms materializes in the year of suspension. Reassuringly for our identification strategy, we find a widespread lack of differential pre-existing trends.

IV.C.2 Investment, Sales, and External Finance

Next, we test a key leading alternative explanation, namely whether the revelation of corruption, by restricting access to government contracts, forces firms to change their investment and business practices in order to compete in the private sector.¹⁸ We do so by testing the impact of exposure on investment using data from a comprehensive survey of Brazilian manufacturing firms (PIA), akin to the US Annual Census of Manufacturers. We also explore whether firms borrow more to change their investment strategy using loan-level data from the development bank (BNDES), the primary lender for small- and medium-size manufacturing firms in Brazil which specializes in corporate loans financing fixed capital investment.

The results are reported in Table V, where the smaller sample size for the PIA analysis reflects the fact that manufacturing firms with at least 30 employees are only a subset of the firms in our sample. We start in column (1) by studying the effect of firm exposure to the random audit program on capital investment. The outcome variable is constructed as the monetary value of capital investment as a share of sales. We find that exposed

¹⁷We also show in Tables A1 (column (2)) and A2 (columns 3 and 4), respectively, that firms black-listed as part of the CEIS program experience a higher likelihood of exits and a complete loss of public procurement access.

¹⁸A rather similar alternative interpretation is one where exposed firms decide not to do business with the government anymore after the audits. Given the nuanced difference and the fact that empirical predictions for our main outcome variables are the same, we abstract away from this slight variation in interpretation in the paper.

firms experience a larger increase in capital investment in the post-exposure period. The magnitude of the coefficient indicates that exposed firms increase investment by 2 percentage points more than the control group as a share of their sales, which represents a 50% increase with respect to the average of the dependent variable. In column (2), we also document that exposed firms experience a relative increase in sales of 13%. This is important, as it indicates that the result on investment is not driven by a negative effect of exposure on sales, and is consistent with a change in growth strategy that improved firm performance. Moreover, the increase in sales after exposure further corroborate our main employment-based results that exposed firms grow after the anti-corruption audits.

Finally, in column (3), we study the impact of exposure on firm borrowing. We match loan-level data with our firm-level dataset using the unique tax identifiers. We find that exposed firms experience a significant increase in the number of loans obtained from BNDES. The magnitude of the coefficient indicates that exposed firms have about 0.24 more loans from BNDES in any given year in the post-exposure period relative to the control group, which represents an increase of 59% with respect to the mean of the dependent variable. This positive effect is consistent with an increase in credit demand to finance long-term investments.¹⁹

Overall, while the sample size is too limited to distinguish across different firms based on their involvement in the corruption, this evidence helps rationalize our findings on the positive effects of exposure on the majority of audited firms. In particular, it is consistent with such effects being at least in part driven by a shift of exposed firms' growth strategy away from a reliance on government contracts.

IV.C.3 A New Survey of Corruption and Firm Strategy

The evidence so far relies on rich administrative data at the firm level. However, administrative data on firms are typically limited in several dimensions, such as the ability to observe changes in management and operational practices. These issues are even more

¹⁹We note that, of course, we cannot conclusively assert that this is all driven by additional demand, as we are not able to observe data on loan applications. Similarly, it is plausible that the effect on overall access to finance differs slightly, as BNDES is not the only lender of Brazilian firms.

severe when the focus is on small and medium private firms, and where a key mechanism of interest is a shift away from corrupt practices in government interactions to competing for private demand.

We therefore provide richer, largely descriptive evidence to complement our analysis using original surveys of owners of small and medium government-dependent firms representative of our context. Through these surveys, we aim to unpack even more the link between corruption and firm strategy, which we argue is a central driver of our empirical findings. In-depth surveys are typically used as either stand-alone or corroborating evidence in contexts where administrative data alone are not sufficient to identify all economic channels at play, such as in the context of investors' (Gompers et al., 2016, 2020) and CFOs' (Graham and Harvey, 2001) decision-making, with face-to-face surveys considered to be the ideal format when feasible (Bloom and Van Reenen, 2007).

We administered the surveys face-to-face, focusing on owners and top managers of small and medium government-dependent firms. We restricted our attention to municipalities around the city of Nova Lima, in the Brazil's southeastern state of Minas Gerais, meeting the CGU eligibility criteria for the anti-corruption audits, and to firms with up to 30 employees that had sold goods or services to local governments in the previous year.²⁰ We obtain this information from the list of government providers recently made available through the "transparency portals" of the selected municipalities. After applying these restrictions, we randomly sampled 175 firms, and were able to survey 115 of them, for a response rate of approximately 66%, which is extremely high for firm-level studies (Bloom and Van Reenen, 2010). The surveys were conducted by a local research manager, who disclosed the purely academic non-partisan goal of the research was to understand the role of corruption in public procurement and other government-firm relationships. Participation was voluntary and no incentives were provided. We summarize the main findings from these surveys in Figure IV and Table VI, and, for brevity, we only discuss some of the most interesting findings in the paper.

First and foremost, firms consider corruption to be a major cost of doing business,

²⁰For budget constraints and due to the size of Brazil, we chose to focus on a specific geographical area that is representative of our study sample.

ranking behind only “taxes and regulations” as the primary barrier to both entry in a new market as well as firm growth and expansion (Figure IV, Panels A and B). Looking at Panel A of Table VI, of the 115 firms, 112 state that corruption affects business operations, and two-thirds of them believe their growth rate would increase dramatically (by more than 10%) in a world without corruption. Digging deeper into the specific ways through which corruption impacts firm activity, we find that corruption seems to be a friction to investment and innovation (82%), to decisions regarding cash holdings and the allocation of financial resources within the firm (79%), to choices to expand to new markets and products (77%), and to bid for public procurement contracts (68%). These findings are consistent with our results on investment and access to finance, and more broadly with the presence of various distortions highlighted by the academic literature when thinking of corruption as a tax (Fisman and Svensson, 2007). We find some weaker evidence about corruption as a friction to the internal organization of firms, with 50% of respondents saying that corruption affects hiring and firing activity and employee selection, and only 29% saying it affects organizational structure, delegation of power, and allocation of jobs and tasks. About half (54%) of the companies interviewed report monitoring corruption within the firm, even though only 24% of them have a structured system in place to do so.

Second, the uncertainty around corruption plays a rather important role, which is reflected in the reluctance or inability of more than half of the firms to respond to questions about corruption’s prevalence and about the size of “unofficial payments” (i.e., bribes). Only 21% of firms say they know ex-ante how much they must pay in bribes to public officials, with the typical bribe being around 6% of the transaction value (even though only 15 firms decided to answer this latter question). Corruption is perceived as pervasive, with firms suspecting it affects approximately half of government contracts and half the firms in their sector. These statistics are reported at the top of Table VI, Panel B. These findings complement our evidence on increased investment rates after the audits: as suggested by the seminal work by Shleifer and Vishny (1993), the presence of corruption might hinder investment due to the uncertainty it entails for firm operations.

A third finding is that firms report corruption to mostly involve politicians and other public officials, rather than other firms, and that public procurement is the primary area where corruption happens, although firms also highlight its pervasiveness throughout several other encounters with public officials, such as for procedures to obtain licenses, permits, and authorizations, and for tax administration purposes (Figure IV, Panels C and D).²¹ Despite these issues, doing business with the government is still considered a rather competitive market, with firm efficiency –rather than political connections and collusion– seen as the main determinant to obtain a government contract (Figure IV, Panel E). Relatedly, as shown in Table VI, Panel B, 75% of firms report this market to be competitive, and a staggering 55% deem unofficial payments to public officials a necessary cost to compete. Such statistics are consistent with a world in which firms doing business with the government are not necessarily all inefficient politically connected firms, even when considering that several of them pay bribes, perhaps because that is the way “business is done” in this context. The firm-level data we collect from the audit reports, which highlight how most of the corruption cases involve wrongdoing initiated by the politicians and public officials, rather than the firm itself, seem consistent with these findings.

A related question we ask, central to our study, is: “In the hypothetical scenario in which you lose access to public procurement contracts, would you be able to maintain the same level of sales with only private sector contracts?” We find that 83% of firms indicate they would, which is both consistent with our empirical results, but that is also puzzling to the extent that a question remains for future work about why firms enter in possibly damaging business relationships with the government in the first place.

Finally, we see in Table VI that almost all firms consider initiatives to punish corrupt officials necessary to improve the business environment, even though they believe the government has mostly been unsuccessful in this endeavor and lament difficulties in reporting corruption to higher levels of government when local officials commit irregularities.

²¹We can interpret these findings as suggestive that the sizeable firm growth we observe following the audits might be driven by a more general reduction in interactions with the government, not just a move away from public procurement specifically.

IV.D WORKER-LEVEL EVIDENCE: EMPLOYMENT STATUS AND WAGES

In the final set of analyses, we use the granular worker-level data available through the RAIS dataset to study the impact of the CGU anti-corruption program on the employees of exposed firms. The employee-level analysis has two objectives. First, to the extent that corruption exposure is valued negatively on the labor market, the audits may independently influence individual outcomes in addition to the direct consequences on firms. Such analysis is highly important in light of the scarce but growing body of empirical evidence in the literature.²² Second, understanding how audits affect the employees of exposed firms helps further refine our analysis of economic channels. Specifically, it is possible that audits lead firms to fire corrupt managers or other employees that were engaging in corruption for personal gain. While not inconsistent with the main mechanisms we discussed in section IV.C, such a story would add a different dimension to why firms grow after the anti-corruption crackdown.

To investigate how employees are impacted by the anti-corruption program we rely on the detailed worker-level data that allows us to track employees both over time and across firms. We focus on incumbent workers that were employed at the time of exposure and estimate a worker-level version of equation (1) with three main outcomes related to employment and earnings. The first outcome is an indicator variable capturing the employment status of each worker in each year. This indicator is equal to one if an individual is employed at the end of the year and zero otherwise. Second, we look at the average monthly wage of each worker, independently of whether the individual is

²²The idea of labor market punishing misconduct through a “reputation” channel goes back at least to Fama (1980) and Fama and Jensen (1983). Consistent with such an argument, prior literature has shown that the market for directors disciplines those who are involved in mismanagement or misconduct (Srinivasan, 2005; Fich and Shivdasani, 2007; Fos and Tsoutsoura, 2014). Karpoff et al. (2008) and Karpoff et al. (2014a) study the career consequences for CEOs and culpable executives when involved in financial misrepresentation or for “cooking the books.” In a context related to ours in Brazil, Szerman (2020) finds that employees of disbarred firms experience a significant loss in both earnings and their probability of employment. There is also evidence of tolerance for misconduct in the labor market. For example, in the setting of financial advisors, while Egan et al. (2019) find increased turnover rates for advisors who previously engaged in misconduct, they also find that 44% of advisors who lost their jobs after misconduct find employment in the industry within a year. Similarly, Helland (2006) provides evidence of a premium placed on employees and managers with experience navigating these challenging situations.

employed or not after the year of exposure, and imputing zeros for the unemployed.²³ Our third dependent variable is the average monthly wage of each individual, conditional on the individual being employed at the end of the year.

The results are reported in Table VII. We start by presenting results for all workers in Panel A. Next, in Panel B and C, we split workers between those employed in managerial and non-managerial positions, respectively, given the large differences among the two groups that the previous literature has strongly emphasized. Indeed, within the small and medium firms in our sample, contracts with the government are typically handled by managers and employees at the top of the organizational layers.²⁴

By and large, we find that workers that were employed by firms exposed by the CGU random auditing program experience no significant changes in their probability of being employed, nor in their average pay (either conditioning or not conditioning on being employed). These results indicate that exposure by the random audit program did not significantly affect the employability or the compensation of managers and other workers employed by exposed firms, and therefore that the audits did not have a meaningful impact on the internal organization of these firms. This is consistent with the survey evidence discussed previously, where we see that while firms report corruption affecting several of their operational practices, they do not report corruption to have a strong impact on their internal organization choices.

V CONCLUDING REMARKS

Corruption practices in the assignment of procurement contracts have been documented in many countries, and especially in developing economies. The existence of such practices can have important implications for firms, as it can distort the allocation of production factors or shape their investment policies. Understanding how corruption af-

²³That is, this outcome variable is constructed as the natural logarithm of one plus the average monthly wage of the individual.

²⁴Moreover, in our context, managers of exposed firms might suffer a higher reputational cost of being associated with corrupt practices because they are often considered to have more influence on company decisions. On the other hand, managers' experience in dealing with the government might be considered a valuable asset in the labor market, providing them with good outside options after the revelation of misconduct.

fects firms is therefore key for our understanding of the drivers of firm growth in emerging markets.

In this paper, we use micro-data from Brazil to trace the impact of exposing corrupt practices on the exposed firms and their employees. We isolate variation in firm-level exposure to corrupt practices using randomized anti-corruption audits. We document that firms exposed by the audits lose access to procurement contracts but also grow faster in the years after exposure. We argue that, by cutting access to government contracts for exposed firms, anti-corruption campaigns might force such firms to adjust their investment and business practices in order to compete in the market for private demand. We find evidence consistent with this mechanism using detailed micro data on firms' investment and access to credit. We complement the quantitative evidence with a new survey of business owners, which provides qualitative support to our findings that anti-corruption programs affects firm growth as well as firm strategy.

We see several avenues of future research. First and foremost, more work is needed to fully identify the links between corruption and firms' growth strategies, and to understand the specific ways through which operating in a corrupt environment might affect firm behavior. Additional surveys and experimental designs might help further unpack these and other mechanisms, due to the difficulties to test them using administrative data only. We also think it is of crucial importance to understand why firms decide to do business with the government in the first place, even in contexts where engaging in public procurement might entail high costs. A large literature on management practices shows that firms might not adopt efficiency-enhancing changes to their operations simply because they lack information or because they have not been exposed to alternative scenarios (Bloom et al., 2013; Cai and Szeidl, 2018). We believe such a path linking firm-government interactions to information frictions to be particularly promising.

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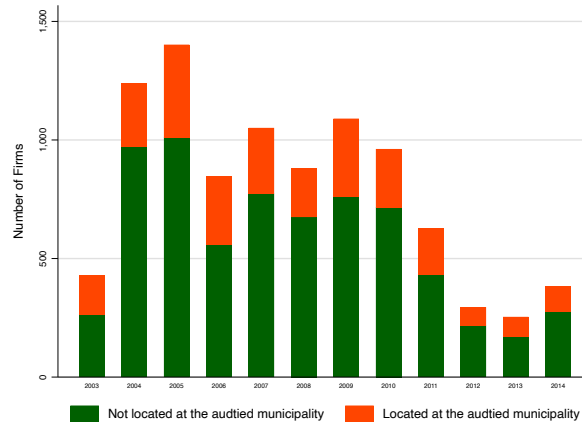
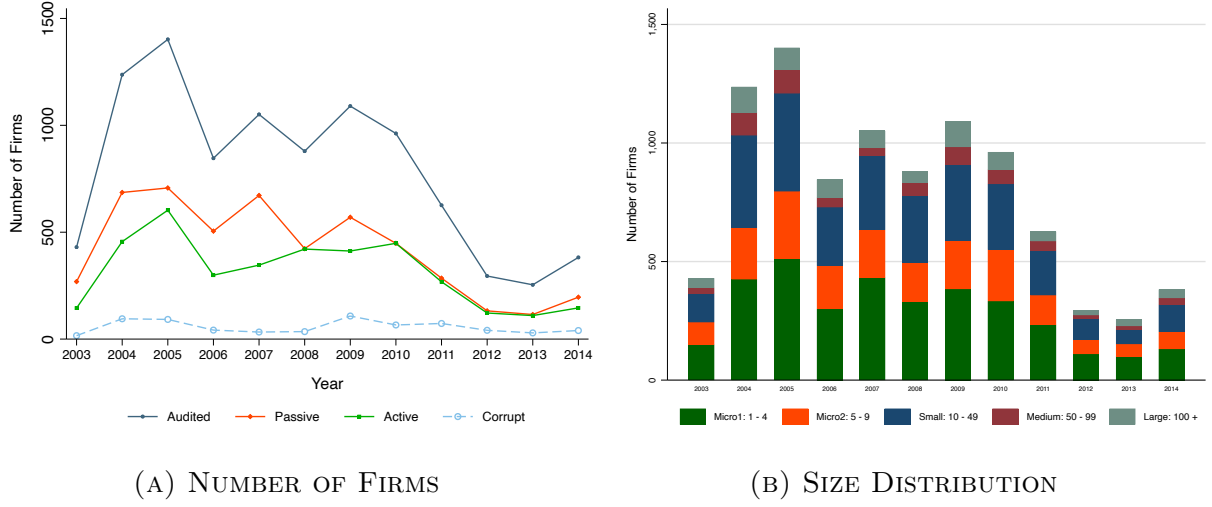
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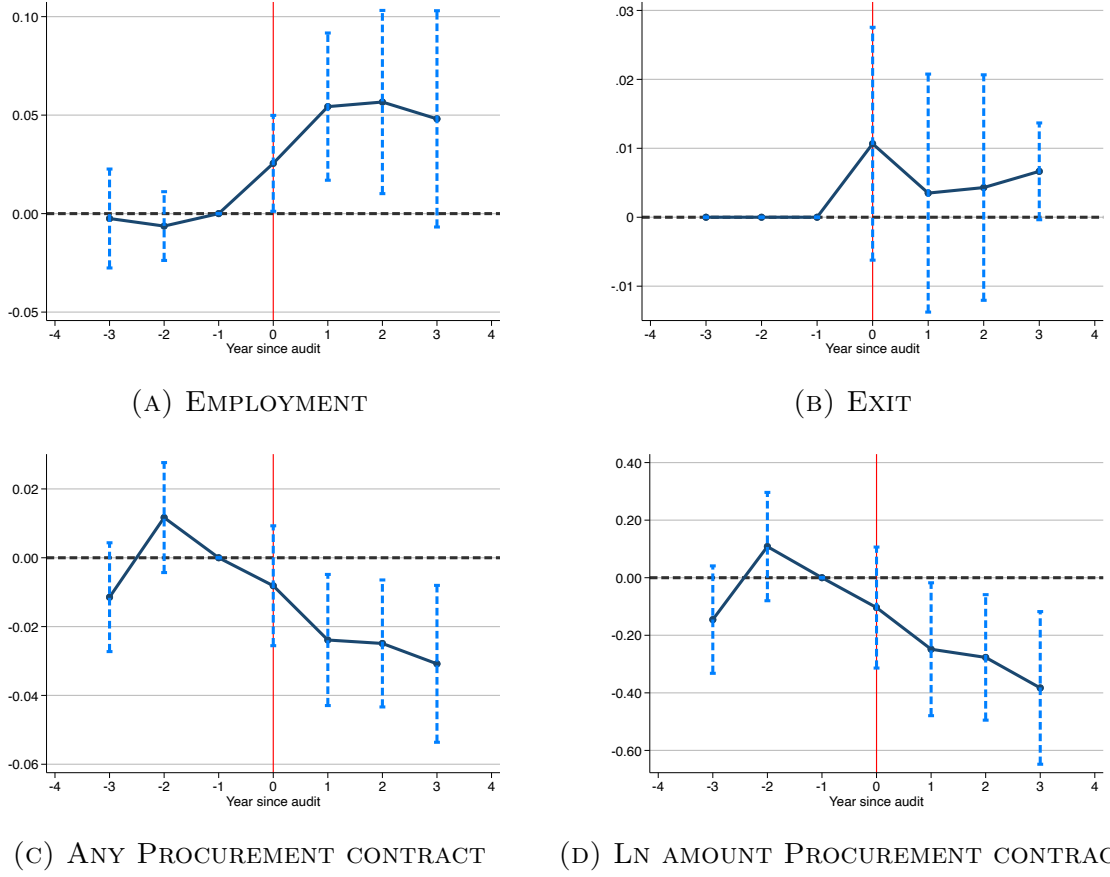
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FIGURE I: AUDITED FIRMS, LOCATION, AND SIZE DISTRIBUTION



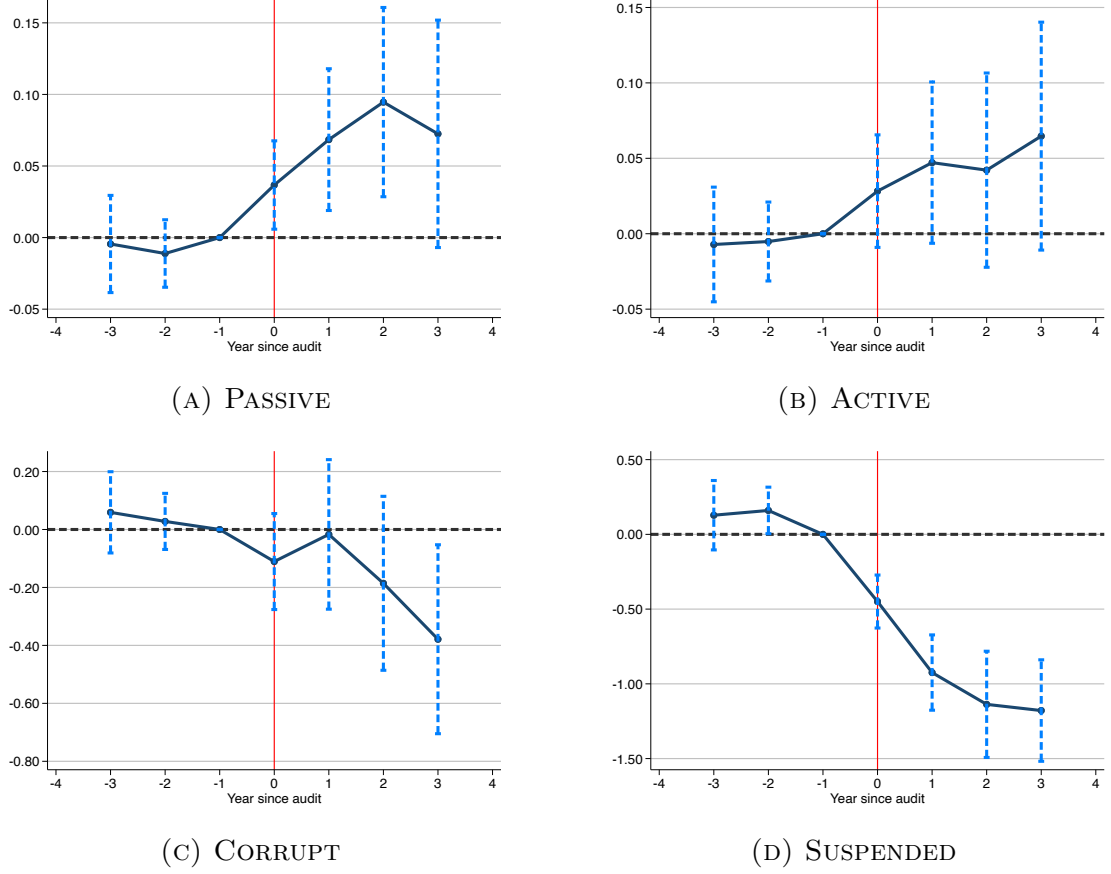
Notes: This figure presents the number of audited plants and their size and location distribution by year. Panel A presents the number of plants audited by year and type of exposure by the audit from 2003 to 2014. Panel B shows the distribution of plants based on size categories over time for all audited plants. Panel C shows the distribution over time of audited plants based on whether they are located inside or outside the audited municipality.

FIGURE II: AUDITS, FIRM GROWTH, AND ACCESS TO PROCUREMENT CONTRACTS



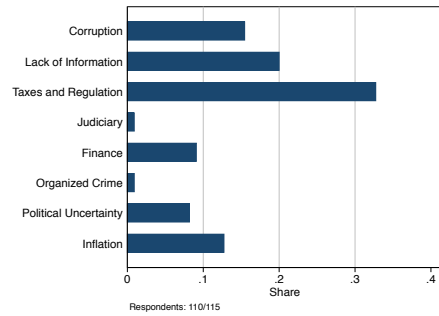
Notes: This figure presents the estimation from the following specification: $\text{Log}(1 + \text{Emp}_{fpt}) = \alpha_f + \alpha_t + \sum_{k=-3, \dots, 3}^{k \neq -1} \alpha_k * I\{t = k\} + \sum_{k=-3, \dots, 3}^{k \neq -1} \beta_k * I\{t = k\} * \text{Exposed} + \epsilon$, where it controls for firm fixed effect and year fixed effect. The dependent variables are the logarithm of one plus employment (Panel A), a dummy for exiting (Panel B), a dummy for having any federal procurement contract (Panel C), and the logarithm of the total amount contracted in federal procurement plus one (Panel D). The firms in the regression sample are audited firms and their matched control. Section IV.A details the matching method.

FIGURE III: TYPE OF CORRUPTION EXPOSURE AND EMPLOYMENT GROWTH

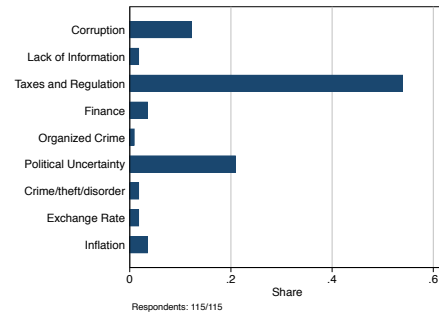


Notes: This figure presents the estimation from the following specification: $\text{Log}(1 + \text{Emp}_{fpt}) = \alpha_f + \alpha_t + \sum_{k=-3, \dots, 3}^{k \neq -1} \alpha_k * I\{t = k\} + \sum_{k=-3, \dots, 3}^{k \neq -1} \beta_k * I\{t = k\} * \text{Exposed} + \epsilon$, where it controls for firm fixed effect and year fixed effect. The dependent variable is the logarithm of one plus employment. In Panels A to C, we present the effects of the audits by type of exposure, while Panel D shows the effect of suspension. The firms in the audit regression sample (Panels A to C) are audited firms and their matched control. The firms in the suspension regression sample (Panel D) are suspended firms and their matched control. Section IV.A details the matching method.

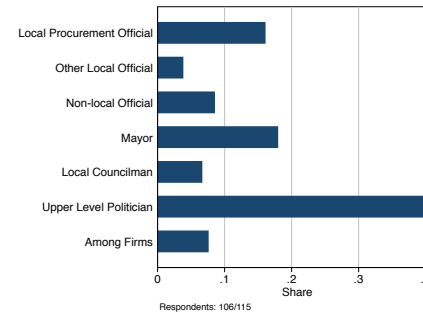
FIGURE IV: FIRM-LEVEL SURVEY RESPONSES



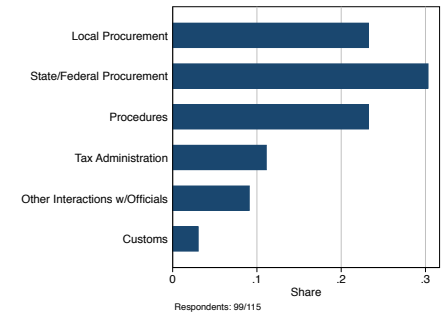
(A) MAIN BARRIER TO ENTRY



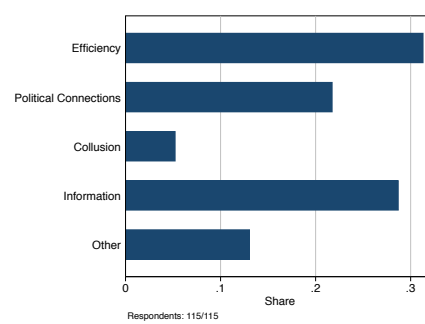
(B) MAIN BARRIER TO GROWTH



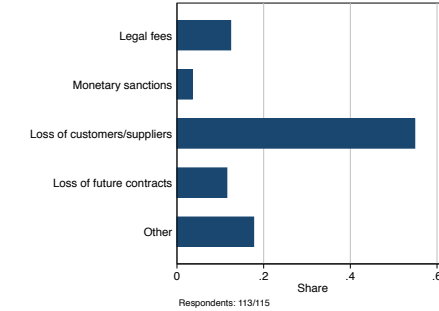
(C) CORRUPTION INTERACTIONS



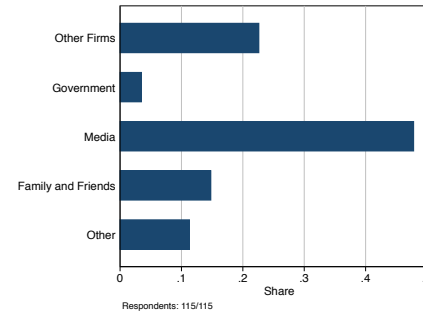
(D) CORRUPTION SITUATIONS



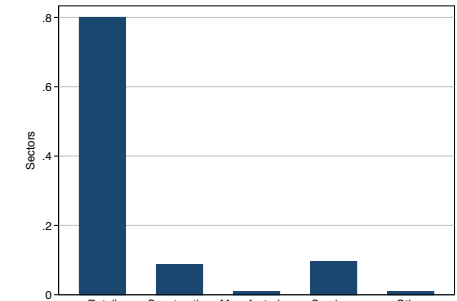
(E) WINNING FACTORS



(F) PERCEIVED CORRUPTION RISKS



(G) MARKET INFORMATION



(H) SECTOR OF RESPONDENTS

Notes This figure reports the shares of responses from our face-to-face firm-level survey. 115 firms from Brazil's southeastern state of Minas Gerais are sampled among the pool of those doing business with 15 municipalities that were eligible for the randomized anti-corruption program. Panel A asks: "What is the main barrier to entry in a market?." Panel B asks: "What is the main barrier to firm growth and expansion?." Panel C asks: "At what level does corruption most commonly take place in your sector?." Panel D asks: "In what situation does corruption most commonly take place in your sector?." Panel E asks: "In your view, what are the most important factors to win a government contract?." Panel F asks: "What type of costs would you be afraid of incurring, in the hypothetical case your firm were involved in a corruption irregularity?." Panel G asks: "What information do you rely on to find out the main issues related to accessing a new market?." Panel H reports the sector of the firms. All respondents are provided with a list of options to choose from.

TABLE I: SUMMARY STATISTICS

	(1)	(2)	(3)	(4)	(5)	(6)
	Full RAIS			Audited		
	Mean	Median	Standard deviation	Mean	Median	Standard deviation
Employees	15.66	3	351.15	46.52	12	112.62
Managers	0.71	0	20.04	2.47	0	6.67
Non-Manager	14.33	3	308.60	43.27	11	103.47
Wage	486.17	381	2569.26	524.97	438	310.39
Manager's wage	1150.38	752	4279.22	1282.43	907	1159.86
Non-Manager's wage	460.84	373	2415.63	496.80	425	260.80
Any federal contracts	0.00	0	0.05	0.05	0	0.21
Number of federal contracts	2.30	1	4.59	3.33	2	4.55
Amount of federal procurement	317.38	17	3677.10	1296.98	70	9639.44
Any public loan	0.03	0	0.16	0.17	0	0.37
Number of public loans	3.41	2	8.29	4.07	2	6.76

Notes: This table presents the summary statistics of firms in the Brazilian economy (Full RAIS) and in our audit regression sample. The firms in the audit regression sample are audited firms and their matched control. The amount of federal procurement is in thousand USD. Section IV.A details the matching method.

TABLE II: SECTOR AND SIZE DISTRIBUTION

	(1) Full RAIS	(2) Audited	(3) Audited
	Percentage	Number	Percentage
Panel A: Total Sample			
<i>Sector Distribution:</i>			
Retail	40.40	5,563	58.84
Services	29.58	1,034	10.94
Construction	7.10	1,773	18.75
Other	22.92	1,084	11.47
<i>Size Distribution:</i>			
Micro1	59.98	3,442	36.41
Micro2	18.45	1,881	19.90
Small	17.62	2,816	29.79
Medium	2.02	576	6.09
Large	1.93	739	7.82
Panel B: Matched Sample			
<i>Sector Distribution:</i>			
Retail		1,033	79.10
Services		75	5.74
Construction		91	6.97
Other		107	8.19
<i>Size Distribution:</i>			
Micro1		379	29.02
Micro2		213	16.31
Small		441	33.77
Medium		121	9.26
Large		152	11.64

Notes: This table presents the distribution of plants in the Brazilian economy (Full RAIS) and audited plants, by sector and size categories. Panel A presents the distribution for all plants, while Panel B presents the distribution for the matched sample. *Other* sectors include manufacturing, agriculture, mining, and utilities. The size categories are *Micro1*: 1-4 employees; *Micro2*: 5-9 employees; *Small*: 10-49 employees; *Medium*: 50-99 employees; *Large*: more than 100 employees.

TABLE III: THE IMPACT OF AUDITS ON FIRMS

	(1)	(2)	(3)	(4)
			Federal Procurement	
	Employment	Exit	Any Contract	Ln Amount
Post \times 1(Exposed)	0.048*** (0.017)	-0.002 (0.005)	-0.020*** (0.006)	-0.214*** (0.074)
Post	-0.023* (0.012)	0.044*** (0.005)	0.015*** (0.005)	0.153** (0.066)
Observations	16,986	16,986	15,284	15,284
R^2	0.952	0.189	0.612	0.642
Mean Dep. Variable	2.61	0.00	0.05	0.64
Plant Fixed Effects	YES	YES	YES	YES
Year Fixed Effects	YES	YES	YES	YES

Notes: This table presents the effects of the audit on firms. Column (1) presents the effect on the logarithm plus one for total employment, column (2) on a dummy that takes the value one if the firm exits the market that year, column (3) on a dummy that takes the value one if the firm had at least one federal procurement contract, and column (4) the logarithm of the total amount contracted with federal procurement plus one. The sample consists of audited firms and their matched controls. Section IV.A details the matching method. Standard errors clustered at firm level reported in brackets. Significance level: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

TABLE IV: TYPE OF CORRUPTION EXPOSURE AND EMPLOYMENT GROWTH

	(1)	(2)	(3)	(4)	(5)
	Audited				Suspended
	Passive	Active	Corrupt	All	
Post \times 1(Exposed)	0.072*** (0.024)	0.048** (0.025)	-0.188* (0.110)	0.071*** (0.024)	-0.897*** (0.107)
Post \times 1(Exposed) \times Active				-0.022 (0.034)	
Post \times 1(Exposed) \times Corrupt				-0.269** (0.112)	
Post \times Active				0.015 (0.022)	
Post \times Corrupt				0.054 (0.066)	
Post	-0.024 (0.079)	-0.022 (0.018)	-0.032 (0.016)	-0.032** (0.016)	0.383*** (0.083)
Observations	8,274	7,882	830	16,986	1,694
R^2	0.959	0.948	0.925	0.952	0.855
Mean Dep. Variable	2.68	2.51	2.98	2.61	3.27
Plant Fixed Effects	YES	YES	YES	YES	YES
Year Fixed Effects	YES	YES	YES	YES	YES

Notes: This table presents the estimation of the audit and suspension on the logarithm plus one for total employment. In columns (1) to (4), we present results for the audited sample which consists of audited firms and their matched controls. In column (5), we present results for the suspended sample which consists of suspended firms and their matched control. Section IV.A details the matching method. Standard errors clustered at firm level reported in brackets. Significance level: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

TABLE V: INVESTMENT, SALES, AND GOVERNMENT LOANS

	(1) Investment	(2) Ln(Sales)	(3) # of Loans
Post \times 1(Exposed)	0.020** (0.010)	0.130* (0.070)	0.237** (0.100)
Post	-0.017* (0.010)	-0.047 (0.055)	-0.186** (0.083)
Observations	1,520	1,520	16,510
R^2	0.014	0.120	0.451
Mean Dep. Variable	0.041	15.48	0.401
Plant Fixed Effects	YES	YES	YES
Year Fixed Effects	YES	YES	YES

Notes: This table presents the estimation of the effect of the audit on investment, sales, and access to government funding. The sample consists of audited firms and their matched controls. Section IV.A details the matching method. The outcomes are the capital expenditure over sales (column 1), the logarithm of sales (column 2), and the number of outstanding loans (column 3). The first two outcomes come from the Brazilian manufacturing census (PIA). Standard errors clustered at firm level reported in brackets. Significance level: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

TABLE VI: FIRM-LEVEL SURVEY RESPONSES

Question	Share	Responses	Don't Know
Panel A: Corruption and Firm Strategy			
Does the presence of corruption affect your business operations or those of firms in your sector?	0.97	115	0
Does the presence of corruption affect investment and innovation?	0.82	115	0
Does the presence of corruption affect cash holdings and allocation of financial resources within the firm?	0.79	115	0
Does the presence of corruption affect decisions to expand to new markets and products?	0.77	115	0
Does the presence of corruption affect bidding strategy for public procurement contracts?	0.68	115	0
Does the presence of corruption affect contracts with private sector firms?	0.53	115	0
Does the presence of corruption affect hiring and firing activity and employee selection?	0.50	115	0
Does the presence of corruption affect organizational structure, delegation of power, and allocation of jobs and tasks?	0.29	115	0
In the absence of corruption, do you think your firm would be able to grow more than 10%?	0.65	112	3
Do you monitor corruption among your workers and within your business establishments?	0.54	115	0
Is there a structured system in place to monitor corruption?	0.24	115	0
Panel B: Corruption and Public Procurement			
Do firms in your industry know in advance the precise amount necessary for extra unofficial payments to public officials?	0.21	115	0
When firms in your industry do business with the government, what percent of the contract value would typically need to be paid in additional or unofficial payments/gifts, in order to secure the contract?	5.78	14	101
What do you think is the percentage of firms doing public procurement in your sector who directly witnessed or were affected by a case of corruption?	53.27	47	68
What do you think is the percentage of local public procurement contracts affected by corruption?	47.35	57	58
Would you be able to compete for public procurement contracts without making unofficial payments to public officials?	0.55	115	0
Is the market for public procurement contracts in your industry competitive?	0.75	115	0
In the hypothetical scenario in which you lose access to public procurement contracts, would you be able to maintain the same level of sales with only private sector contracts?	0.83	115	0
Do you consider anti-corruption initiatives aimed at punishing corrupt politicians and public officials to be important to improve the business environment?	0.96	115	0
Do you think the current anti-corruption initiatives by the Brazil's government are successful?	0.24	114	1
If a public official acts in an irregular manner (e.g. asking for a bribe), can firms in your industry successfully contact a superior official or office to receive a fair treatment (i.e. no bribe/unofficial payment)?	0.50	115	0

Notes: This table reports the shares of responses from our face-to-face firm-level survey. 115 firms from Brazil's southeastern state of Minas Gerais are sampled among the pool of those doing business with 15 municipalities that were eligible for the randomized anti-corruption program. When not otherwise specified, the column "Share" indicates the share of "Yes" to each question. The column "Responses" indicates the number of responses, while "Don't Know" represent the remaining number of firms who opt not to respond to that specific question.

TABLE VII: THE IMPACT OF AUDITS ON WORKERS

	(1) Working	(2) Pay Unconditional	(3) Pay Conditional
Panel A: All Workers			
Post \times 1(Exposed)	0.003 (0.008)	0.029 (0.050)	0.010 (0.012)
Post	0.008 (0.008)	0.114** (0.048)	0.0692*** (0.018)
Observations	879,565	879,565	780,049
R^2	0.173	0.270	0.629
Mean Dep. Variable	0.89	5.85	6.56
Panel B: Managers			
Post \times 1(Exposed)	-0.007 (0.011)	-0.019 (0.085)	0.014 (0.021)
Post	0.035*** (0.0078)	0.272*** (0.068)	0.006 (0.025)
Observations	52,479	52,479	48,091
R^2	0.218	0.316	0.717
Mean Dep. Variable	0.95	7.09	7.45
Panel C: Non-Managers			
Post \times 1(Exposed)	0.004 (0.008)	0.031 (0.051)	0.008 (0.0103)
Post	0.0068 (0.008)	0.121*** (0.039)	0.0818*** (0.028)
Observations	820,843	820,843	725,834
R^2	0.177	0.271	0.652
Mean Dep. Variable	0.89	5.77	6.49
Plant Fixed Effects	YES	YES	YES
Year Fixed Effects	YES	YES	YES

Notes: This table presents the estimation of the effect of audits on the worker-level outcomes. The sample consists of workers from audited firms and their matched controls that were in the firm at the time of the audit. Section IV.A details the matching method. Working is a dummy that takes the value if the individual is working in that year. Pay unconditional is the logarithm of one plus the wage, while pay conditional is the logarithm of the wage. Standard errors clustered at firm level reported in brackets. Significance level: *** p<0.01, ** p<0.05, * p<0.1.

ONLINE APPENDIX

A.1 CODING OF CGU AUDIT REPORTS

A.1 DIGITIZATION PROCESS

We extract information from the audit reports thanks to the support of a team of research assistants. The coding of the information is performed starting with the download and careful analysis of a random sample of 100 audit reports by the team of coauthors. Based on this extensive reading, we develop a detailed instruction manual, highlighting the specific pieces of information we want to extract.

Four research assistant and a research supervisor are each assigned a set of audit reports to analyze. All researchers are native speakers, have at least a university degree, they are paid a competitive hourly wage, and they obtain a performance-based bonus based on speed and quality. The job is tracked online on a leading freelancing platform. Each team member is also assigned 30 audit reports that are also assigned to other team members. This provides a double check of 150 audit reports. Incompatible entries are checked and corrected by the research supervisor.

The researchers first code the data for the given audit report, namely round, municipality, state, date the audit took place, and date the audit was publicly disclosed. Then, the process consists of first looking for the word “cnpj” in the pdf file. The CNPJ is the tax identifier of firms in Brazil. For each occurrence, the researcher investigates the full evidence and discussion of the given irregularity, and extract the following information:

- Tax identifier and firm name
- Amount associated to the irregularity (i.e. value of public procurement contract)
- Description of irregularity, including excerpts from the text
- Involvement of the firm, i.e. cases of active or passive involvement, and uncertain cases, as illustrated in [A.2](#)
- The date the contract awarding and completion, when available (these are often months or years earlier than the date the audit takes place)
- Open-ended comments about additional information and issues

The same process is then repeated for the cases of firms who appear by name only and not by CNPJ. These are potentially informal firms. The only difference with this process is that the researchers originally look for one of the following keywords (and small spelling variations of them): empresa, companhia, firma, negocio, corporacao, entidade, estabelecimento, sociedade, parceria, empregador. Cases that already appeared in the previous CNPJ search are discarded from this round. The data extraction then remains the same. For all these “informal” firms, we then try to obtain the CNPJ from publicly available sources online. Data on firms with no CNPJ is not used in this paper, as we rely on the matching of the audits data with the RAIS database on formal firms.

On average, the coding of one report takes between 60 and 90 minutes. During the above process, we would conduct regular random checks of the data collected, and one-on-one weekly individual discussions with the team members.

At the end of the process, we conduct a thorough cross-validation of the information collected. This phase is carried out by the research supervisor and two new research assistants who are asked to go over a large random sample of the data.

A.2 EXAMPLES OF IRREGULARITIES IN CGU AUDIT REPORTS

We report here a list of 40 representative irregularity cases extracted from the audit reports. We split the types of cases so as to be representative of the distribution in the full sample. We omit tax identifiers and edit the precise extracts from the audit reports to improve readability.

A.3 CORRUPT

1. In the municipality of Alto Alegre do Pindare, auditors uncovered the misappropriation of public funds related to a tender for the purchase of food products needed to prepare school meals. The winning company, which was paid for this contract, presented fake “fiscal good standing” certificates, in order to access the bidding. In addition, the auditors found out that the products purchased from the company were never delivered to the schools, and that the invoices issued by the company were invalid, due to the lack of printed authorization from the Treasury Authority.

2. The company Construtora Mavil Ltda was hired by the municipality of Quixaba to provide drilling services and to install 11 deep tubular wells with pipeline and storage systems, for an amount of R\$ 203,245.13. The auditors found that two years and four months after the beginning, the work was far from being concluded, and the company had abandoned the project without providing explanations or contacting the municipality.

3. The municipality of Japoata awarded a construction procurement to a company for an amount of R\$ 415,248.44. The company was supposed to provide two water supply systems. The physical inspection by the auditors uncovered that the work had stopped and and the two water supply systems were never activated.

4. The municipality of Maribondo opened a tender to provide school transportation services. The tender was awarded to Ideal - Locacoes e Servicos Ltda. Upon inspection, it was discovered that the vehicles used to transport the students did not match the models specified in the contract (type and vintage). The vehicles were visibly old and lacked safety measures, and the drivers were not qualified to drive the vehicles. In addition, the company fully subcontracted the services to a third party company which was never mentioned in the original bidding documents.

A.4 ACTIVELY INVOLVED

1. Against provision 8,666/93, the municipality of Sao Desiderio did not hold an open bidding tender for the purchase of food products. Instead, the municipality hired directly the company Distribuidora Lord Ltda and other two suppliers to provide the products.

2. The company Mary e Nidia Comercio Ltda. provided food products to the Municipality of Saloá, but the municipality did not conduct a price survey that would guarantee the acquisition of materials at prices advantageous to the local government. The company's fiscal situation was also not in full compliance, which should have prevented its participation in public procurement.
3. Upon audit, it was found that three bidders may have colluded during the bidding process of a tender pertaining the provision of medicines. G. Odisio Com. Rep. Ltda was the winning company, while the other two bidders presented bids with prices that were only 1% and 1,5% lower.
4. The auditors uncovered several irregularities for a tender held by the municipality of Pequi, where multiple companies did not submit the required documents to participate in the tender. Three of the participating companies also had shared family ties. Additionally, the municipality did not publish the results of the tender.
5. The company Ometac Dental won a contract requiring to provide medicines and other medical items to the municipality of Amarante do Piauí. Ometac Dental however produced additional invoices, as part of the same contract, which included items that were not originally part of the tender.
6. The Municipality of Angical do Piauí published a tender for the purchase of schools' material. Although the winning company was Dinamica Comerical Distribuidora, G. DE S. Coelho - MEE the municipality paid the company Babylandia Variedades, Neida Marques Fernandes for the provision of such material. The latter company did not participate in the original auction.
7. A firm won a competitive auction for the provision of building material to the municipality of Placido de Castro. The audit uncovered company invoices that were larger than the value established in the contract documents.
8. The company provided several equipment pieces needed to set up a chicken production unit the municipality of Graccho Cardoso. While the company's original bid was for one total large amount, the municipality asked for four invoices, each smaller than R\$8,000, so as to bypass specific public procurement requirements.
9. The auditors uncovered over-invoicing irregularities in the municipality of Ronda Alta, in relation to a contract for the repair and modernization of infrastructure for recreational and leisure uses, provided by a specific company. Contracted prices were higher than those foreseen in the National System of Prices and Indices for Civil Construction (SINAPI). The SINAPI system must be observed in the execution of tenders contracted by means of federal transfer to the municipalities, as stated in the art. 115 of Law 11.439 / 2006, Budgetary Guidelines Law.
10. The company Jose Ozana Goncalves, which won the bidding for a specific procurement contract regarding the purchase of educational material, presented expired "fiscal good standing" certificates. Moreover, the auditors found that the company contravened

to art. 43, item IV of Law No. 8.666 / 93, as it did not cross-validate its prices to external price surveys.

11. The municipality of Urussanga opened a tender to rent tents, stages, power generators, and other large infrastructure to host a high-profile artistic show. Three companies presented their bids. After the bids were submitted, the municipality canceled the original tender, and hired a company through direct procurement for the same exact contract, through legal exemptions that the auditors found suspicious. Other small irregularities were uncovered during the audit of that tender.

12. The municipal government of Bagre opened a tender with the purpose of purchasing medicines and hospital materials. The company Medcfarma Ltda - ME won the procurement and provided the goods as per contract. However, the auditors uncovered overpricing, by comparing the price the municipality paid with the average prices recorded in the Ministry of Health's Price Bank.

13. The municipality of Jundia diverted funds coming from the FUNDEB, through various invoices paid to the company Auto Posto Novo Lino Ltda. The invoices did not specify product characteristics that would allow to validate their relevance for the FUNDEB federal transfer program.

14. The auditors discovered that a tender in the municipality of Alianca, with the purpose of hiring specialized companies to provide school transport services, lease of vehicles, machinery and other equipment, presented signs of lack of competition. The municipality added specific requirements to the tender, so that the only company who could fit the criteria was Personalite Locacoes Ltda. Other four bidding companies were excluded from consideration because they could not respect the restrictive requirements imposed by the municipality.

15. In a tender for the renovation of a school in the municipality of Laranjeiras do Sul, there was significant evidence of both over-invoicing and manipulation of the bidding documents to force a specific winning company.

16. A case of over-invoicing was uncovered in the municipality of Altos, which hired the company Construtora Ribeiro Veloso to provide renovation-related services of 21 public schools. While the company was paid R\$ 327,344.48, the value of renovations provided amounted to a total value of just R\$ 83,081.79.

17. The municipality of Salitre did not monitor the construction of a sports' court, which was a contract awarded to the company Construtora Astron Ltda. After auditing the relevant documentation it was discovered that the lack of monitoring led to the acceptance of services which presented some defects and inaccuracies.

18. An audit found that invoices related to a specific federal transfer were not marked with reference to the specific title and number of the Funds Transfer Instrument, therefore disregarding the legal requirement. Several companies have issued suspicious invoices pertaining to that transfer.

A.5 PASSIVELY INVOLVED

1. In the municipality of Itabaianinha, the invoices presented as proof of the expenses for the Educational Program PDDE did not match the name of the program paying for the expenses. N.P.R. Papelaria Moveis p/ Escritorio e Assistencia Tecnica Ltda was the company which provided the material and issued the invoices.
2. The company Comercial Marinho supposedly participated and won a bidding invitation for a value of R\$ 22,000.00 to provide schoolbags to students in the municipality of Alto Alegre do Pindar. The audit contacted the company owner, who denied participation in the procurement, and who did not receive any payments. The receipts presented by the municipality were false, according to the company representative.
3. The municipality of Carinhanha used two false invoices of the company Imunosystems Comercial Ltda to prove the acquisition of medicine for the Health Unit Centers. To counter the municipality's allegation, the company owner declared to the CGU that its company had never done business with the municipality, and presented all invoices ever issued by the company as proof.
4. The auditor verified that invoices in the total amount of R\$ 20.599,50 regarding the acquisition of medicine from the company in question were false. The company owner declared to the auditors that his company has never provided medicine to the municipality.
5. The bidding process for various repair services in the "Altino Arantes" park exhibition took place through an open invitation promoted by the municipality of Igarapava. Proposals were submitted by three companies: Construtora Batista e Martins Ltda., Construtora Souto Andrade Ltda. and Laterza Construtora Ltda. The first one was declared winner of the event, with a proposal of R\$ 150,000.00, but the auditors found the owner to be the same as the second company. The third company, Laterza Construtor, which we label Passively Involved, did not win the contract.
6. In the municipality of Catolandia, the auditors verified that in a tender regarding the acquisition of fuel, the companies Posto Dourado and Centro Automotivo Pneus Dourado appeared to participate in the tender, but the evidence showed this never happened. Instead, there seems to be evidence that the municipality faked the information to simulate the existence of the tender for the use of public funds.
7. The municipality of Jatoba held a procurement for the repair of five public schools. The audit uncovered the simulation of a tender which in practice did not take place. The company Construtora Esmeralda Ltda was listed as a participant to the auction, but information about the company (e.g., address) were fake.
8. The company DIVEPEL â Distribuidora de Veiculos e Pecas Ltda participated in the tender held by the municipality of Jatoba for the acquisition of vehicles. The auditors did not find the documentation provided by the company to be in full compliance with what was required in the public announcement of the tender. The company nonetheless did not win the procurement contract.

9. The municipality of Coroata had supposedly hired the cleaning service company P. S. Sousa e Cia Ltda. The auditors found all documentation of the contract in place, but some of the invoices attached in the documentation as proof of expenses were seemingly issued by another company, namely Remax Distribuidora Ltda. When contacted by CGU, the owners of Remax Distribuidora Ltda claimed that to have never issued invoices, and to have never taken part of any procurement with the municipality. The amount supposedly paid to the company was R\$ 626,199.40.

10. Instead of following the prescribed procedure, which requires the municipality to pay contractors using company-specific bank accounts, the municipality of Teotônio Vilela paid several different companies using personal checks. The procedure adopted is not adequate, as federal funds should be kept in separate accounts (one for each federal program), and specific payment methods are required for traceability.²⁵

11. The company NEL Projetos Ltda., which we label as Passively Involved, participated in a bidding invitation held by the municipality of Campos Belos, for a contract to build a public market space, but it did not win the contract. The contract was won by the company VM Vieira e Mendonça Construções e Serviços Ltda, which delayed the execution of the works without justification. The municipality had not taken any action to address this issue.

12. The company Siqueira Comércio e Serviços de Encadernação Ltda was legally hired to provide market price survey services for a bidding invitation regarding the acquisition of goods by the municipality of Acopiara. The auditors found out that the latter procurement (in which different companies were involved) was tainted by irregularities, namely the lack of documentation authenticated by appropriate notarial registries.

13. In lack of compliance of Interministerial Ordinance MF / MPAS 5.402 / 1999, the municipality of Pitimbu did not retain 11% of the total value of a payment made to the company JI Construções Cíveis Ltda, which was due to social security for tax purposes.

14. The municipality of Itatira misappropriated the resources coming from the Ministry of Education's Fund for Maintenance and Development of Basic Education (Fundeb), aimed at financing basic public education. The local government used the funds to pay for expenses not included in the program: the financial resources were used to pay for expenditure of vehicles for the transport of teachers. These services were provided by the company A&M Construções e Serv. Ltda.

15. Contravening to art. 22, paragraph 6, of Law no. 8,666 / 2003, the municipality of Passagem repeatedly invited the same set of companies to bid in two tenders involving the purchase of medicines. The law requires that, in these cases, the municipality should invite at least one new company. The company Farmácia Frei Damiano - Ana Maria Torres Leite ME participated as a bidder in both tenders, and did not win any contract.

²⁵The companies paid through these methods were classified as passively involved.

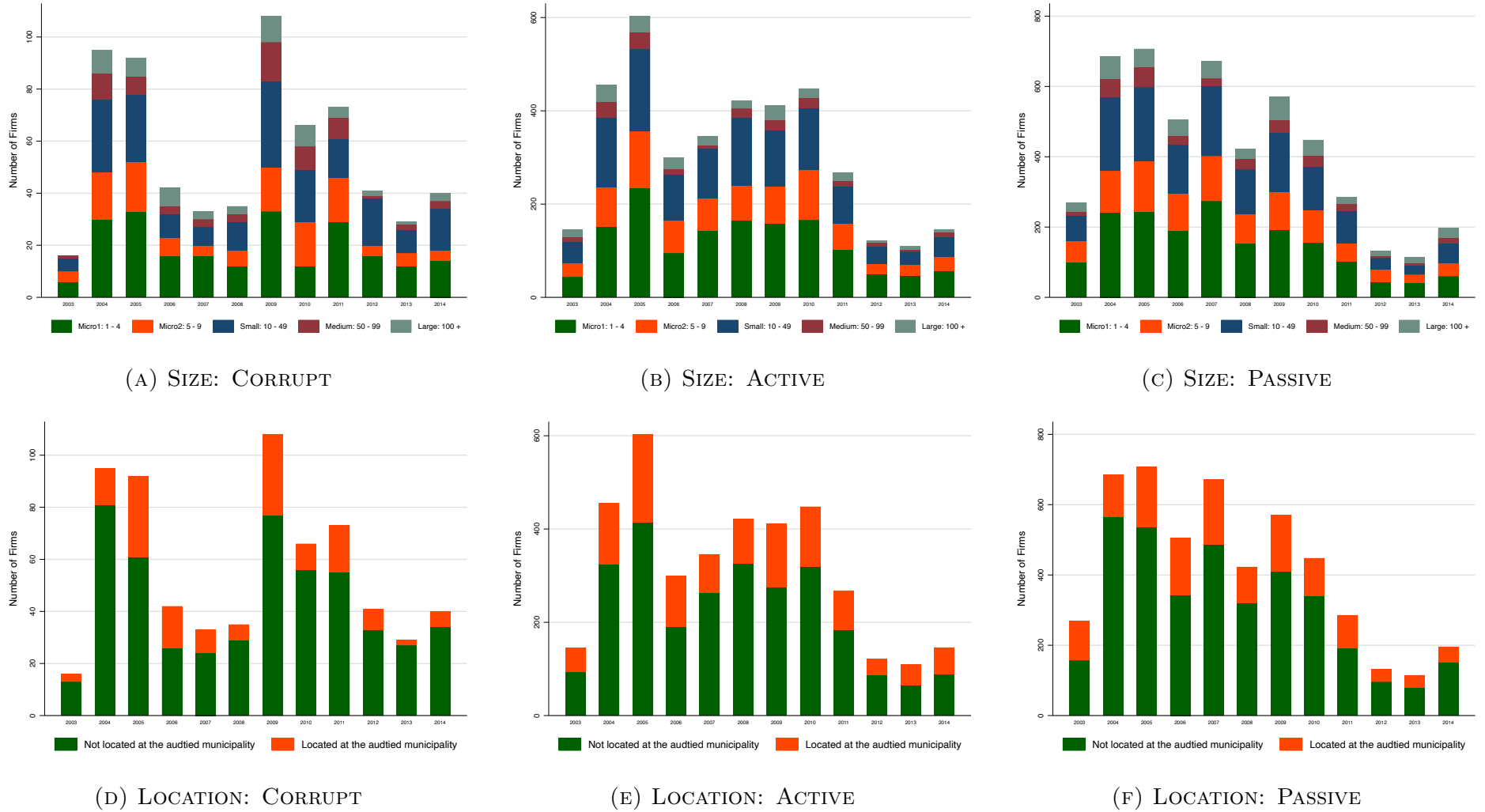
16. In the municipality of Sao Gabriel, the auditors uncovered multiple irregularities related to the use of federal funds. There was evidence of multiple cases in which signatures, invoices, and documents of real companies were falsified to simulate real contracts and use of funds. For example, the company Magazine Aquarela supposedly presented a bid to provide school furniture. However, the company owner informed the auditors that the company had never done any business with the municipality, and that his signatures were forged by local public officials.

17. The municipality of Luziani diverted resources belonging to the Ministry of Health's Basic Attention in Health Program away from its original purpose. The local government paid the company Sport Car Pecas e Servicos Ltda for several contracts regarding vehicle repairs, which were not the intended use by the Ministry of Health.

18. Upon inspection of invoices provided by the company Mercearia J.L., the auditors reported the lack of documentation regarding an itemized list of the specific products provided, which the municipality should have kept according to the provisions of art. 18 of Resolution CD / FNDE No. 6.

A.2 ADDITIONAL FIGURES AND TABLES

FIGURE A1: SIZE AND LOCATION DISTRIBUTION BY TYPE OF EXPOSURE



Notes: This figure presents the size and location distribution by type of exposure. Panels A to C show the distribution of audited plants based on size categories over time by the type of exposure they had. Panels D to F show the distribution over time of audited plants based on whether they are located inside or outside the audited municipality by the type of exposure they had.

TABLE A1: TYPE OF EXPOSURE, SUSPENSIONS, AND EXIT

	(1) Audited	(2) Suspended
Post \times 1(Exposed)	-0.003 (0.008)	0.108*** (0.017)
Post \times 1(Exposed) \times Active	0.009 (0.011)	
Post \times 1(Exposed) \times Corrupt	0.023 (0.028)	
Post \times Active	-0.005 (0.007)	
Post \times Corrupt	0.001 (0.018)	
Post	0.046*** (0.007)	0.104*** (0.020)
Observations	16986	2090
R^2	0.245	0.230
Plant Fixed Effects	YES	YES
Year Fixed Effects	YES	YES

Notes: This table presents the estimation of the heterogeneous effect of audit and suspension on a dummy for exiting. In column (1), we present results for the audited sample which consists of audited firms and their matched control. In column (2), we present results for the suspended sample which consists of suspended firms and their matched controls. Section IV.A details the matching method. Standard errors clustered at firm level reported in brackets. Significance level: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

TABLE A2: TYPE OF EXPOSURE, SUSPENSIONS, AND PUBLIC PROCUREMENT

	(1)	(2)	(3)	(4)
	Audited		Suspended	
	Any contract	Ln Amount	Any contract	Ln Amount
Post \times 1(Exposed)	-0.036** (0.015)	-2.607*** (0.188)	-0.447*** (0.052)	-5.148*** (0.606)
Post \times 1(Exposed) \times Active	-0.021 (0.023)	-0.482* (0.254)		
Post \times 1(Exposed) \times Corrupt	-0.031 (0.055)	-0.734 (0.706)		
Post \times Active	0.011 (0.019)	-0.035 (0.554)		
Post \times Corrupt	-0.001 (0.044)	0.064 (0.180)		
Post	0.138*** (0.014)	2.008*** (0.143)	0.406*** (0.047)	4.650*** (0.571)
Observations	13552	13552	1326	1326
R^2	0.785	0.750	0.569	0.598
Mean dep variable	0.49	3.18	0.37	4.46
Plant Fixed Effects	YES	YES	YES	YES
Year Fixed Effects	YES	YES	YES	YES

Notes: This table presents the estimation of the heterogeneous effects on public procurement contracts for the audited and suspended sample. The sample consists of audited firms and their matched control firms (columns 1 and 2) and suspended firms and their controls (columns 3 and 4). Section IV.A details the matching method. In columns (1) and (3), the dependent variable is a dummy for at least one contract from federal procurement, while in columns (2) and (4) is the logarithm of total federal procurement amount plus one. Standard errors clustered at firm level reported in brackets. Significance level: *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$.

TABLE A3: SUMMARY STATISTICS BY TYPE OF EXPOSURE

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	Audited: Passive			Audited: Active			Audited: Corrupt			Suspended		
	Mean	Median	Standard deviation	Mean	Median	Standard deviation	Mean	Median	Standard deviation	Mean	Median	Standard deviation
Employees	54.43	12	129.24	37.00	11	93.32	58.03	15	93.60	128.23	13	363.83
Managers	2.97	0	7.78	1.91	0	5.35	2.85	1	5.31	3.07	1	7.02
Non-Manager	50.34	11	117.78	34.61	10	86.82	55.00	14	88.95	124.96	12	359.58
Wage	551.85	449	343.17	497.34	426	277.51	519.38	452	228.16	534.03	454	294.68
Manager's wage	1393.69	971	1273.58	1180.27	849	1053.80	1084.11	873	699.85	1012.12	762	685.80
Non-Manager's wage	518.26	435	285.04	474.22	416	236.51	497.25	437	203.54	502.05	440	250.84
Any federal contracts	0.06	0	0.23	0.04	0	0.20	0.04	0	0.20	0.33	0	0.47
Number of federal contracts	3.61	2	4.54	3.14	1	4.74	1.54	1	1.36	2.87	2	3.65
Amount of federal procurement	1664.38	76	12585.80	870.18	56	3381.14	503.06	178	740.21	1001.45	75	5174.20
Any public loan	0.16	0	0.36	0.17	0	0.38	0.22	0	0.42	0.16	0	0.37
Number of public loans	4.40	2	7.85	3.75	2	5.59	4.18	2	6.26	4.81	2	7.61

Notes: This table presents the summary statistics of firms in our audit regression sample by type of exposure and in the suspended sample. The amount of federal procurement is in thousand USD. The firms in the audit regression sample are audited firms and their matched control, while the ones in the suspended sample are the suspended firms and their controls. Section IV.A details the matching method.