In this paper the authors attempt to compare and contrast the insolvency resolution procedures of non-financial enterprises of two countries namely, UK and Singapore alongside that of India. The objective is that this comparison will yield important lessons for India at a stage when it is poised for a significant reform of its corporate insolvency laws. India at present lacks a single, comprehensive law that addresses all aspects of insolvency of an enterprise. The current system does not address the interests of unsecured creditors, foreign creditors or institutions other than banks. The fragmentation of the legal framework and inordinate delays in enforcement, create incentives for rent seeking by various participants in the insolvency process. Such delays have twin effects - the cost of liquidation goes up and the realizable value of assets drops.

The choice of UK and Singapore for the cross country comparison is influenced by the common legal tradition, wherein UK is the country of origin for corporate insolvency law and both Singapore and India follow the common law tradition and their insolvency codes find their origins in the English system. However, each of these countries has experienced different outcomes with respect to corporate insolvency resolution, and they are also at a different stage in the process of reform of their corporate insolvency framework.

Both in Singapore and India, the respective Companies Act continue to be the primary laws for dealing with insolvency. The Indian Companies Act, 1956 deals mainly with liquidation and winding up of companies, with insolvency as one of the conditions for winding up. Reorganisation under the Act can only be through a Scheme of Arrangement, which is not a procedure specific to insolvency. The only formal provisions for reorganisation of insolvent companies are laid out in the Sick Industrial Companies Act (SICA), 1985. Companies that are not eligible under SICA have no formal reorganisation procedures available to them. Since a large number of micro and small enterprises do not register as companies, such firms have no access to any insolvency provisions. Further, in the UK, specific carve outs have been made in several laws for dealing with cases of insolvency. In India, in contrast, the subject of interaction between laws has been fraught with complexity and has been the cause of significant litigation contributing to delays in the resolution process.

The timeliness of insolvency proceedings depends on the capacity and capability of the court system. Both the UK and Singapore have a single adjudicating authority for dealing with insolvency related matters. In the UK, corporate insolvency matters are heard by the Chancery Division of the High Court. This court deals primarily with matters related to business and trade disputes, intellectual property and trusts and inheritance. In India, the fragmentation of the laws for liquidation and reorganisation is further complicated by the presence of separate adjudicating authorities under each.
The Board of Industrial and Financial Reconstruction (BIFR) and the Appellate Authority of Industrial and Financial Reconstruction (AAIFR) were set up, which are deemed to be civil courts, have jurisdiction over reorganisation cases under SICA. The presence of multiple laws and adjudication fora has created opportunities for the debtor firms to exploit the arbitrage between the two systems to frustrate the recovery efforts of creditors and to adversely impact the timeliness of the resolution process. SICA provides that the orders and proposals made under the Act cannot be appealed in any other civil court except the AAIFR. However the BIFR and the AAIFR are deemed quasi-judicial bodies and hence subordinate to the High Court. This means decisions taken by them can be appealed at the High Court. The High Court has the authority to hear cases, on which BIFR has given a ruling, afresh on merits.

In the UK, the ministerial responsibility for insolvency matters rests with the Ministry of Business, Innovation and Skills (BIS). The Insolvency Service, an executive body of the BIS is the regulator for this area and specifically for the insolvency practitioners (IPs). In Singapore, the Ministry of Law acting through the Insolvency and Public Trustees Office has jurisdiction over insolvency matters. In most cases the government Official Assignee or the Official Receiver is appointed to administer insolvency.

In India, the Ministry of Corporate Affairs (MCA) has jurisdiction over all Companies Act related matters. The provisions for appointment of an official liquidator (OL) are laid out in the Companies Act. OLs are appointed by the central government and typically, each High Court has one OL attached. Under SICA, an operating agency (OA) aids the eligible company in proposing a draft rehabilitation proposal. Under the Act, any public financial institution, scheduled bank, state level institution or person can be appointed by the BIFR as an OA.

A firm in distress can get reorganised and continue as a going concern or it can get liquidated. Reorganisation of a firm can be through an informal work-out, a voluntary reorganisation process under the law, and a formal process for assessing viability and deciding between reorganisation and liquidation, typically supervised by the court. Liquidation in turn can have two procedures, namely voluntary liquidation, where the firm itself proposes liquidation when it becomes insolvent; and compulsory liquidation, where the creditor/s apply to court for liquidating the firm.

The wide variety of procedures available reflects the complexity in dealing with a failing firm. Some countries follow the linear model, where a common linear process evaluates the viability of the firm before deciding on whether it should be reorganised or liquidated. However, given the complexity and subjectivity in assessment of value, most countries follow a non-linear model where both reorganisation and liquidation procedures are made available to parties and the choice of procedure is left to the party initiating the process. Each of these models has advantages and disadvantages. A linear model is well suited for countries that have constraints in capacity of the institutional infrastructure. However, they impose an additional cost of a common procedure on all parties. The non-linear model provides choice to the concerned parties but adds to complexity.

UK, Singapore and India each has a formal procedure to evaluate whether a firm should be reorganised or liquidated. In the UK, Administration is a collective remedy whose main
The objective is to hold the company together till a decision can be made regarding the resolution of its insolvency. In Singapore, Judicial Management (JM) is a court-supervised corporate rescue proceeding modeled on the Administration regime in the UK. In India, the Sick Industrial Companies Act, 1985 provides for rehabilitation of firms. However, its applicability is limited only to eligible firms i.e. industrial companies that have become sick.

The primary differences in the above procedures among the three countries are tabulated as follows:

<table>
<thead>
<tr>
<th>Sr. No</th>
<th>UK</th>
<th>Singapore</th>
<th>India</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>The procedure can be initiated by both debtors and creditors</td>
<td>The procedure can be initiated by both debtors and creditors</td>
<td>Procedure can be initiated by the Board of the sick company</td>
</tr>
<tr>
<td>2</td>
<td>Insolvency has to be established for procedure to commence, unless initiated by a creditor with qualified floating charge</td>
<td>Evidence of inability to pay debts needs to be established</td>
<td>Balance Sheet trigger is necessary for the procedure</td>
</tr>
<tr>
<td>3</td>
<td>Existing management and Board lose control</td>
<td>Existing management and Board lose control</td>
<td>Existing Board remains in control</td>
</tr>
<tr>
<td>4</td>
<td>Reorganisation plan is voted for approval by the creditors’ committee</td>
<td>Reorganisation plan is voted for approval by the creditors’ committee</td>
<td>BIFR adjudges and approves the plan</td>
</tr>
<tr>
<td>5</td>
<td>Interim financing is enabled on a priority basis</td>
<td>NA</td>
<td>SICA does not provide for it</td>
</tr>
<tr>
<td>6</td>
<td>Administrator is generally appointed by the Board of the company</td>
<td>Judicial Manager is appointed by the court.</td>
<td>The Operating Agency under SICA acts under the directions of the court</td>
</tr>
<tr>
<td>7</td>
<td>The Court primarily acts as a body for dispute resolution</td>
<td>The Court has a more active role, and has powers to adjourn meetings and allow amendments to the plan</td>
<td>BIFR plays the major role in rehabilitation plan</td>
</tr>
</tbody>
</table>

In addition to the formal procedure for evaluating reorganisation, each of these countries also has formal procedures that enable voluntary negotiations between the debtor and creditors. In the UK, there are two such procedures, the Company Voluntary Arrangement (CVA) and a Scheme of Arrangement, which is used for a wide range of purposes going beyond insolvency. In Singapore, voluntary reorganisation can only be through a Scheme of Arrangement under the Companies Act, even though Schemes are not insolvency specific procedures. In India, voluntary mechanism to enable restructuring of viable companies outside the legal framework for recovery and insolvency resolution. It is unique in that the RBI provides relief on prudential norms for loan accounts that have been restructured using the CDR mechanism. The CDR process is only available to CDR lenders and bondholders and foreign lenders are excluded from the process. In addition to CDR, in June 2015, RBI introduced a Strategic Debt Restructuring (SDR) mechanism to help banks recover their loans by taking control of the distressed listed companies.
Liquidation of a distressed or insolvent firm should occur only if it is not economically viable and there is no possibility of reorganising it. Preserving value in liquidation and ensuring that it is conducted in an orderly manner by creditors racing to collect their dues is an important function of the insolvency resolution process. In UK, Singapore and India, liquidation precedes a winding up of the company. In the UK, winding up is a remedy available under the Insolvency Act while in Singapore and India, it is available under their respective Companies Acts.

There are two modes of winding up in an insolvency situation. The first is a voluntary winding up by creditors. The second is a compulsory winding up by the court and is initiated by a creditor, through an application to court.

In Singapore and UK, creditors nominate the liquidator, and the court usually accedes to this nomination. In India, each bench of the High Court has an Official Liquidator (OL) attached to it. This OL is appointed by the court for liquidation proceedings. Once a liquidation proceeding is commenced, the company normally ceases business. The liquidator is empowered to manage the affairs of the company in liquidation. In both compulsory and voluntary winding up, there is no statutory time limit on liquidation proceedings.

Each of these countries also has an individual enforcement procedure available to certain categories of creditors. Administrative Receivership in the UK, Receivership in Singapore and SARFAESI (The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act) in India fall in this category. The powers available to eligible creditors under these procedures go beyond contract enforcement.

Prior to the enactment of the Enterprise Act in 2002, Administrative Receivership was a widely used procedure in the UK. The Administrative Receiver is appointed by the qualified floating charges (QFC) holder based on the terms agreed on in the debt/security contract and represents only the interests of that creditor. The Enterprise Act, 2002 largely abolished Administrative Receivership, though the procedure is still available to QFC, created before September, 2003.

In Singapore, Receivership is a common remedy used by secured creditors. It is an expedient and effective procedure for a debenture holder to realise his security and displace the management of the company in favour of an insolvency practitioner of his choice.

In India, the SARFAESI Act provides wide powers to secured creditors with regard to recovery of the loans made by them that have become non-performing. This Act also paved the way for setting up of Securitisation Companies/Asset Reconstruction Companies (SC/ARC), regulated by the RBI. Enforcement actions under this Act, if agreed on by 60% of the lenders in value, took precedence over BIFR proceedings for rehabilitation and winding up proceedings in the High Courts. Appeals against SARFAESI actions can only be made in the Debt Recovery Tribunals, but any appeal could only be made after depositing 60% of dues beforehand with the tribunal.

In India there are no specific provisions in the law that would encourage financing for debtors that have led for bankruptcy whereas in the UK debtors can obtain credit post commencement of insolvency proceedings. In the case of reorganization proceedings while in both UK and Singapore creditors have voting rights on the
proposed rescue plan, in India only BIFR has a say in this matter. This further adversely affects the creditors’ rights when it comes to insolvency resolution in India.

In conclusion, the authors state that if a robust market for credit is to develop in India, the corporate insolvency process must give clarity to all debtors as well as all classes of creditors about the procedures and rules to deal with in an event of insolvency. There is also an urgent need to consolidate the laws in India including the individual enforcement as well as informal procedures. The choice is either to opt for large scale, thorough judicial reforms to improve the efficiency of the court system, or to build an effective, well-functioning IP institution so as to support a relatively weaker judiciary.

A key element of an effective insolvency resolution framework is to create a strong and well defined liquidation law, which will create substantial incentive for the parties involved to push for reorganization. Additionally, there should be well written rules under the insolvency resolution laws so as to design a resolution framework that will minimize the probability of default and maximize the loss given default. Furthermore mechanisms need to be built at every stage of the law to create sufficient disincentives for strategic behaviour by the parties involved. Likewise the insolvency practitioners system must also be a strong one such that their objectives are aligned with those of the insolvency resolution system.

Finally, the authors sign off by underlining the fact that the success of the new law proposed by a committee in any country including India will depend critically on the extent to which existing institutions can also be reformed and made more effective, new enabling infrastructure can be set up and adequate State capacity can be created.

Source: www.igidr.ac.in
The fluctuating capital levels of banks over the last two decades have led researchers to explore the rationale behind the optimal capital decisions of banking firms. Three broad strands of thinking have come to dominate the literature. The first is commonly labeled as the regulatory view. According to this, although the proportion of debt and equity might differ between banks and non-financial firms, the regulatory capital requirements as stipulated in the Basel Accord and safety net in the form of deposit insurance are the two major elements that drive bank capital behavior. The second view as to why banks hold excess capital can be traced to the buffer or discretionary capital view. In this framework, it is posited that since issuing fresh equity at short notice is costly, banks hold excess capital to avoid the associated costs. A capital buffer protects the bank against costly and unexpected shocks, if the costs of financial distress stemming from holding low amounts of capital are substantial and the transactions costs of raising new capital quickly are overwhelming.

The third is the corporate finance view, which primarily builds on the characteristics of non-financial firms. Three main theories - trade-off theory, pecking order theory and agency theories - constitute the core of this view. The main contention of the trade-off theories is that the decision maker balances the various costs and benefits of leverage. The theory predicts that the optimal debt ratio is determined when marginal costs of debt equals its marginal benefit. The pecking order theory builds primarily on information asymmetries and argues that a firm follows a 'pecking order' in its choice of capital in the sense that it prefers internal to external and debt over equity, if external financing is employed. Unlike the trade-off theory, the pecking order theory does not indicate what the optimal capital structure might be but instead, puts forth a hierarchy of financing options. A third area, i.e., agency costs, explores the impact of conflicts between stakeholders of a firm on its capital structure. The three major forms of such costs include: asset substitution, debt overhang and the free cash flow theory. The asset substitution problem occurs when the equity holders insist that the company invests in assets that are much more risky than what the bondholders might want. The riskier investment increases the return for equity holders, but also increases the risk that bondholders are compelled to take, since equity holders get the upside and the downside is absorbed by bondholders, and thereby, raises overall bankruptcy risk.

The debt overhang or under investment refers to the situation where a company is highly levered and it cannot borrow more money easily to even finance a new investment with positive Net Present Value (NPV). Equity holders will be reluctant to undertake such projects, since most of the benefits will accrue to debt holders. The free cash-flow theory models the agency cost between managers and investors, where the former are assumed to have incentives to

In this paper, the authors analyse the determinants of capital structure for Indian banks covering the period 1992-2012 that encompasses the recent financial crisis, and also report results for non-financial firms with a comparable set of variables.
maximize own welfare at the expense of owners. Thus, increasing leverage increases the probability of financial distress, but it can also add value by imposing financial discipline on managers.

Several studies have examined which of the aforesaid theories are pertinent for banks. The evidence indicates that profitable banks with better growth opportunities face lower costs of issuing equity and therefore, are likely to be more levered. The effect of bank size on leverage is not evident, a priori. On the one hand, larger banks face lower informational and therefore, hold lower buffers. On the other hand, if the costs of financial distress are larger for big banks, then it is more likely that these banks will hold larger buffers. Riskier banks are likely to hold higher buffers in order to limit the probability of financial distress.

For the data required for the analysis, disaggregated data on bank balance sheet and profit and loss accounts for the period 1992-2012 are culled out from the various issues of Statistical Tables Relating to Banks in India; and the bank-wise prudential and financial ratios are culled out from the Report on Trend and Progress of Banking in India. Since the authors have restricted their analyses to publicly listed banks, closing NSE share price and outstanding number of shares for these banks are extracted from the Prowess database, including certain other relevant variables, such as the size of bank board in a given year, number of female members on the board and a measure of duality, which equals one when the CEO and the board chair are the same person.

The results of the estimation suggest that leverage is lower for profitable banks, and that banks with higher growth opportunities are less levered. It is also observed that state operated banks (SOBs) operate with higher leverage as compared to private banks, possibly because first, the majority ownership by the government limits their flexibility in raising capital from the market. Secondly, the 'safe heaven' perception of depositors in these banks coupled with state guarantees could mean that these banks operate with lower capital.

For non-financial firms, profitable firms are less levered as they rely on their retained earnings to build reserves and dividend paying firms with greater riskiness, exhibit lower leverage. In case of the former, dividend paying capacity indicates less financial constraints and lower requirements of borrowed funds. In case of the latter, costs of borrowing are much higher and the owners may have to bring in the required funds.

The results further suggest that the financial crisis exerted an uneven impact, and it was essentially the riskier banks that delevered during the crisis. In terms of market leverage, there is evidence of an increase in leverage by high market-to-book ratio (MTB) banks during the crisis. During tranquil times, banks with higher MTB reported lower market leverage as they benefitted from higher market price. However, as their stock prices fell quite sharply during the crisis, it was reflected in higher market leverage. The reverse was the case with dividend paying banks: in normal times, these banks were more levered as they probably enjoyed relative cost advantage in raising debt through deposits and/or borrowings. During the crisis period however, this advantage got nullified. There is no evidence of any perceptible impact on market leverage across bank ownership.

Moving on to decomposition of leverage, the authors posit that bigger and riskier banks as well as those with high growth opportunities have higher recourse to non-deposit liabilities. Similarly, private banks rely more on non-deposit liabilities. Interestingly, banks with higher tangible assets have higher share of deposit liabilities. Greater tangibility
is associated with lower informational asymmetries, so that greater transparency improves the deposit base of banks. Looking across ownership, the evidence suggests that both state-owned and new private banks increased reliance on deposits during the crisis, although given the greater dependence on non-deposit funding for the latter in the first place, the net effect still was a lower dependence on deposit funding. It is also borne out that profitable banks and dividend paying banks could garner more deposits during the crisis, implying that the health of the bank is an important consideration for depositors to repose their faith in them.

Next, the authors attempt to identify the effects of regulatory pressure (RP) on bank leverage. As observed, regulatory pressure was higher for domestic private banks during the early half of the sample. Especially during the crisis and after, the regulatory pressure for SOBs has significantly exceeded that of domestic private banks. Banks constrained by regulatory pressure would be inclined to raise capital in order to meet the stipulated capital levels. This needs to be weighted alongside the fact that, partly as a response to the crisis and the subsequent downturn, corporate balance sheets have been severely stretched, impacting their cash flows. This, in turn, has had its manifestation in weakening of banks' balance sheets as well. The authors' analysis further suggests that increases in regulatory pressure is initially associated with an increase in leverage as banks aggressively compete for market share, but once regulatory pressure exceeds a threshold, banks are compelled to increase equity to meet the regulatory standards. In contrast, there is no evidence of any perceptible impact of regulatory pressure on market leverage.

Additionally, the relationship between ownership and regulatory pressure suggests that private banks lower leverage in response to regulatory pressure. As compared to this, SOBs do not exhibit any perceptible response to regulatory pressure. Intuitively, PSBs are not unduly impacted by the constraint on their capital position, given the implicit government guarantee.

Exploring the interlinkages between capital structure and board structure, the authors find that in case of SOBs, more diversified boards entail lower book leverage, although the results are reverse for private banks. With greater flexibility in decision making, the risk-taking capacity of private banks tends to be attuned to market dynamics, so that irrespective of higher women representation, the net impact is manifest in higher book leverage. As compared to this, for SOBs, greater female representation is manifest in lower risk-taking. Second, larger board size leads to lower book leverage, especially for private banks.

Concluding, the authors point to several findings that stand out in their analysis. First, some of the variables identified as standard in the corporate finance literature also appear to hold empirical validity in case of banks. Second, the crisis appears to have exerted a perceptible impact on bank capital. The positive effects of capital support by national governments weighed against the sharp decline in banks market value of equity arising from the slump in their share prices. The net effect was higher market leverage than otherwise for banks with high MTB. The evidence also indicates that bigger banks with high growth opportunities have been lowering the role of deposits in their funding structure.

On balance, the authors state that their analysis does not provide unequivocal support to the regulatory view of bank capital structure. Instead, the results would indicate that banks capital decisions are influenced by several non-regulatory considerations as well, including government policies towards banks.

Source: www.rbi.org.in
The Political Economy of Government Debt

Investigating factor model of political economy, the paper reviewed the fiscal policy and its inter-linkages with government debt. The politics of fiscal policy cover a wide range of diverse issues like level of centralization versus decentralization, the structure of taxation, pension systems, and the design of insurance programs like health care and unemployment subsidies and others. Fundamentally fiscal policy is deeply intertwined with politics since it is mostly about redistribution across individuals, regions and generations. The distributive role of government is dynamic and depends of nature of social welfare programs during distressed periods (like Great Depression) and period of strong economic growth (booms). The provision of public goods has a redistributive component as they are used more or less intensively by individuals in different income brackets.

As debt is one of major source of fiscal financing, the paper analyzes the debt/GDP ratios as macroeconomic indicators and found large debt/GDP ratios across all economies during distressed period. In general, there is a tendency in democracies to pursue sub-optimal fiscal policies which lead to the accumulation of excessive debt. Another important concern is about the optimal level of public debt and substantial departure from optimality. But the central stage of political debate is how and at what speed to reduce the public debt, especially during booms period. The literature viewed fiscal rules are possible solution to limit the extent of the problem of excessive deficits and the best and most famous rule is balanced budget proposition. However, there is a trade-off between the rigidity of fiscal rules and their lack of flexibility. More flexible rules may be superior but harder to enforce, because they have too many escape clauses. The second major issue is related to implementation of these rules or how political distortion prevents the efficient way of implementation of the fiscal rules.

Focusing on economic side of fiscal policy, the paper analyses structure of taxation (progressive structure of the income tax brackets) along with other macro policy areas like monetary policy, financial regulation and inter-linkages between monetary and fiscal policy. Referring to Keynesian theories of taxation, the paper states that higher government spending or lower taxes during a recession may help economic recovery because higher government spending and lower tax rates may increase aggregate demand in environment of high unemployment and low capacity utilization. But Keynesian models prescribes that deficits should be countercyclical, but should not lead to a secular increase in debt over GDP and the increased government spending during the recession should be compensated by discretionary spending cuts during booms.

Generally optimal tax rates and government debt are not random walks. The optimal tax rates are closely tied to the government expenditure and hence taxes are not random walks. The paper argued that taxes should be smooth with a smaller variance than a balanced budget. Referring to Aiyagari et al. (2002) approach of the optimal taxation problem in an incomplete markets setting, the paper opined that with some restrictions on preferences and the qualities of risk-free claims, the government can issue and own risk-free government debt, and it is also possible to obtain the random walk characterization of optimal taxation. However, the very basic principles of optimal debt policies must be intact with constant
(on average) expected debt-income ratio - which generally rises in periods of abnormally high government spending or abnormally low aggregate income. That's why government debt goes up during wars and major recessions along with accumulation of asset under “war chest”. But at the same time, it is important to smooth tax structure or normalization of accumulation process - which must be consistent to address the problem of large accumulation of government debts as over-accumulation of large debt constraints further borrowing capacity of the government.

Another problem is related to internalization of secular downturn of the growth process during booms. The government continues higher growth of debt accumulation even during good periods to keep the size of government constant - which leads to further pressures on debt accumulation. This misperception may be an 'honest mistake', but is more due to political distortions. It is common for government to justify large spending programs with very optimistic growth forecasts. Studying intergenerational structure of accounting procedures of policy, the paper referred Auerbach, Gorkhale and Kotlikoff (1991) model that computes the net amount in present value that current and future generations to pay to the government now and in the future. Assuming inter-temporal budget constraint, the government requires the sum of generational accounts of all current and future generations plus existing government net wealth is sufficient to finance the present value of current and future government consumption. This concept is used to compute “lifetime net tax rate” - which measures the burden of taxes minus transfer payment on a generation over its lifetime and it remains same for current and future generations. If the net tax rate for future generations exceeds the net tax rate for newborns, then according to these criteria, the fiscal policy is not in generational balance.

Discussing 'fiscal illusion' of Buchanan and Wagner (1977), the paper observed that voters don't understand the notion of inter-temporal budget constraint for the government, therefore they reward the incumbent in case of pending hike or tax cuts near-and-during election period, but remain unaware about consequences of such policies on public debt and the future costs of taxation. This problem is further aggravated by the 'Keynesian' policy stand - in which politicians are eager to follow the Keynesian rule of increasing discretionary spending during recessions, but then they don't counterbalance it with cuts during booms. Thus the result of Keynesianism and fiscal illusion leads to persistent deficits and explosive debt levels. Although the fiscal illusion argument is overly simplistic, it does raise important warning bells on the conduct of fiscal policies in democracies.

Elaborating the political budget cycles on level of rationality and perfect information, the paper says more competent government tax less but provide better/higher combination of public goods by introducing less wastage in the fiscal process. However, the full combination of income taxes, spending, seigniorage and government wastage (negative competence) is learned with one period delay by the voters. A higher level of competence implies that the government provides public goods with lower taxes (or seigniorage). After the election a less competent government would have to increase seigniorage generating also an inflation cycle. The competent policymaker cut taxes before election to a level that cannot be matched by the less competent one. However, the unpleasant feature of these models is that the more competent policymakers engage in budget cycles by cutting taxes before elections to signal their competence
and distinguish themselves from the less competent ones who cannot afford such a large tax cut. In this scenario, the less competent government does more visible public goods (like fixing of holes in the street, streetlights) than less immediate visible public goods (like increasing the quality of the training of teachers). Thus near election-time, the politicians are more prone towards overspending in more visible public goods but not necessarily the most productive public goods. But rationally-based modern theories of political business cycles advocates rationality of voters output into limiting political seigniorage and incentive (rewards to policymakers) along with more freedom of press in established democracies.

Source: nber.org