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**Original Sin, Good Works, and Property Rights in Russia:
Evidence From a Survey Experiment**

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Abstract

Are property rights obtained through legally dubious means forever tainted with original sin or can rightholders make their ill-gotten gains legitimate by doing good works?² This is a critical question for developing countries (and Russia in particular) where privatization is often opaque and businesspeople may receive property, but remain unwilling to use it productively due to concerns about the vulnerability of their rights to political challenge. Using a survey of 660 businesspeople conducted in Russia in February 2005, I find that the original sin of an illegal privatization is difficult to expunge. Businesspeople, however, can improve the perceived legitimacy of property rights by doing good works, such as investing in the firm and by providing public goods for the region. Finally, managers that provide public goods for their region are more likely to invest in their firms than those who did not. The finding that public goods providers invest at higher rates is at odds with standard economic logic, but fits well with the more political view of property rights developed here. These findings have implications for political economy and contemporary Russia.

Keywords: Property Rights, Transition, Rule of Law, Privatization

JEL Codes: K11, P14, P16, 017

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The task that I have set before the government is to make the reforms irreversible.

Boris Yeltsin, October 1991.

Russian President Vladimir Putin has told leading Russian businessmen he does not want a reversal of privatization.

BBC July 28, 2000

Putin against reversal of privatization.

Headline Interfax New Agency, September 26, 2003

I am a categorical opponent of a review of the results of privatization.

Vladimir Putin, Italian News Agency, November 5, 2003

Any allegations that Russia is preparing to revise the privatization results are groundless.

Vladimir Putin, RFE/RL, April 11, 2005.

Are property rights obtained through legally dubious means forever tainted with original sin or can rightholders make their ill-gotten gains legitimate by doing good works? Does compliance with privatization laws influence subsequent perceptions of the legitimacy of property rights? Or are people willing to let bygones be bygones a decade later?

Answers to these questions have ramifications well beyond academic debate. Over the last twenty years privatization has become a central component of economic transformation in developing and transition countries. Based on the expectation that, other things equal, private ownership generates stronger incentives to produce than does state ownership, policymakers and international financial institutions have advised governments from Asia to Africa to transfer their state-owned assets to private hands. However, the potential gains from privatization may not be realized if the property rights are viewed as insecure. To the extent that these privatization outcomes are seen as illegitimate by the broader community, rightholders may view their property rights as vulnerable to challenge by politicians seeking to mobilize popular support against the “plunder of our country’s natural wealth.” Such populist challenges to privatization are a staple of

politics in developing and transition countries as illustrated most starkly by the recent case of YUKOS in Russia. In general, where rightholders view their rights as vulnerable to political challenge, they are unlikely to use their assets productively, and privatization may produce few benefits for society and for the firm.

Using an experiment embedded in an original survey of 660 businesspeople in Russia conducted in February 2005, this essay develops three theories that explore the conditions under which property rights come to be seen as legitimate. It asks whether the severity of violations of the Law on Privatization shapes perceptions of the legitimacy of property rights. This “original sin” argument suggests that property rights transferred via significant violations of the law retain their illegitimacy well into the future.

It also asks whether recipients of privatized assets can increase the perceived legitimacy of their property rights by investing in their firm or by providing public goods for the community. This argument suggests that businesspeople can make their ill-gotten gains more legitimate by doing “good works.”

In addition, it explores the economic consequences of doing “good works.” It argues that rightholders may use the provision of public goods to make their rights less vulnerable to political attack, and therefore more secure. This logic predicts that firms that provide public goods for the region will invest at higher rates – a prediction at odds with conventional economic reasoning.

These analyses shift the study of property rights from institutional factors to the strategies of rightholders themselves. Most studies focus on the degree to which businesspeople expect their rights to be respected under different institutional arrangements. Scholars have developed an impressive body of literature that analyzes the impact of formal institutions (courts, police, and regime-type) and informal institutions (trust, social capital and networks) on property rights.³ These are important issues, but do not examine how rightholders themselves may take matters into their own hands to strengthen the legitimacy and, ultimately, the security of their property rights.

Similarly, much existing literature takes the initial distribution of property rights as given and does not explore how the origins of particular distributions of property rights may influence their future legitimacy. This is a critical question in developing and transition countries where privatization is rarely conducted with attention to legal niceties. Privatization is an inherently messy process that gives politicians considerable leeway to reward friends and punish enemies and

³ North (1990) and Eggertson (1990) provide good overviews of these large literatures.

therefore it is no surprise that the public typically views privatization with great skepticism. But having transferred state assets in a less than transparent fashion, what, if anything, can governments and individuals do to make these property rights more broadly accepted in the community? Research on the question is scant.

This study also provides new data on relations between business and the state in a transition economy. Our understanding of property rights in Russia is often unduly colored by high-profile conflicts over property which may blind us to the subtle and slow moving changes in property rights that occur largely outside of public view. This essay gathers the insights of a randomly selected group of businesspeople with the hope of gaining a more balanced picture of the current state of property rights in Russia. It also helps to place the ongoing debate over the reversal privatization in Russia in context.

Background

Property rights are the bundle of rights that include the power to use, transfer, and generate income from assets, including land, labor, and capital (Barzel 1989: 2). Much economic reasoning suggests that where rightholders assume the full cost and benefits of their actions, they use their assets most efficiently and generate greater welfare gains for all. Societies that use their property rights more efficiently enjoy higher rates of growth and greater prosperity (North and Thomas 1973). That private ownership generates stronger incentives to produce than does state ownership provides the economic justification for many types of privatization.⁴

Discussions of privatization often treat property rights as unproblematic. It is often implicitly assumed that having received legal title, rightholders will put those assets to their most productive use. However, the transfer of rights from state to private hands is only a first step in encouraging rightholders to use their assets productively. The state, through its monopoly on the use of coercion, retains its ability to redraw property rights in a variety of ways, from expropriation and renationalization to changes in regulation and tax policy. Having received their assets through privatization, rightholders who expect the state to alter their rights in the future have weak incentives to use their assets productively. As made clear in the quotes by President Putin that begin

⁴ Theoretical debates on incentives generated by private and state ownership have a long and storied history, but empirical evidence tends to favor private ownership. See Djankov and Murrell (2002) for a review of empirical studies from the postcommunist world.

this essay, the political threat that privatization may be reversed can loom large even years after assets have been transferred from state to private hands.

This threat is far from hypothetical. This year alone governments from Ukraine to Bolivia and Zimbabwe have changed or threatened to change the terms under which property rights were transferred to private rightholders.⁵ Most prominently, the YUKOS affair in which the Russian state ultimately seized assets privatized in 1996 from the largest private oil company in the country highlights the politically contingent nature of privatization.⁶ These ex post changes in the distribution of assets may redress past injustices where privatization was widely perceived to have been corrupt, but they also raise uncertainty about whether other transfers of property will suffer a similar fate. A primary concern inherent in reversing privatization is that the process will snowball and undermine property rights more generally (Sonin 2003).

The threat of reversing privatization may be heightened where existing definitions of property rights are perceived as illegitimate by the community. Where property rights are not broadly accepted, political entrepreneurs can bolster their standing by railing against the current distribution of property rights. In such situations, privatization is likely to produce few benefits as existing rightholders anticipate future limitations on their rights. In contrast, such appeals are likely to fall on deaf ears should the community view property rights as broadly acceptable and thereby allow rightholders to invest with confidence that their rights are less likely to be challenged. Thus, the extent to which property rights are broadly accepted by the community (e.g., legitimate), has a direct bearing on the security of property rights and, ultimately, on whether or not those assets are used productively.

Concerns about the legitimacy of industrial privatization have special importance in the postcommunist world where the scope and speed of de-etatization has been unprecedented. Having inherited massive state sectors and facing pressure from international financial institutions to privatize, incumbent politicians had vast opportunities to deliver assets to their political supporters in a less than transparent fashion. Perhaps no policy in the postcommunist world is the subject of more general opprobrium. Janusz Lewandowski, former Minister of Ownership in Transformation

⁵ The Ukrainian government is currently reviewing lists of several hundred enterprises thought to have been privatized under legally dubious circumstances. Recent conflicts over land seizures in Zimbabwe and demonstrations in support of renationalizing the largest gas company in Bolivia are only two prominent examples of the problem at hand.

⁶ More on this below.

in Poland, famously captured the inherently murky nature of privatization in the postcommunist world when he noted: “Privatization is when someone who does not know who the real owner is and does not know what it is really worth sells something to someone who does not have any money” (Verdery 1996: 210). Given the circumstances it is hardly surprising that state officials who missed out on the bounty of the initial round of privatization have tried to mobilize political support around perceived injustices committed by their predecessors. With a nod to Trotsky’s cry of “permanent revolution,” Hellman (2002) and Sonin (2003) refer to this process as “permanent redistribution.”

This more political treatment of property rights brings to the fore aspects of privatization that have received less attention in the literature. First, it suggests the importance of gauging the acceptance of existing definitions of property rights in the broader community as a determinant of property rights. Studies of property rights often focus on the perceptions of individual rightholders about their property. However, whether the state challenges existing property rights and whether those challenges are successful is likely to be influenced by how well those property rights are accepted in the community. Thus, it is useful to shift the analysis to perceptions about property rights more generally.

Second, rather than viewing property rights in a static fashion as protected by law, this interpretation suggests that property rights are continually redefined through political competition. Political challenges to existing property rights are likely to be more successful where the initial transfer of rights is seen as illegitimate. Moreover, as rightholders may anticipate that the rights they receive are politically vulnerable, they may be more likely to strip these assets than use them productively. Far from being fixed in law, property rights are highly dependent on the political climate.

Third, this conception of property rights leads to the counterintuitive proposition that firms that provide public goods for the region should invest at higher rates. A straightforward economic argument would suggest that a ruble spent on public goods is a ruble not available for investment. Thus, the provision of public goods should lead to lower levels of investment. In the view developed here, however, firms that provide public goods should feel more secure in their property and, therefore, be more likely to invest.

This work also differs from many empirical studies of property rights.⁷ There is a small, but growing literature using survey experiments that seeks to establish how different distributions of property rights influence behavior, but these studies rarely address privatization directly and have not been conducted in the postcommunist world (Duch and Palmer 2004). Surveys of businesspeople in the postcommunist and developing world have addressed similar themes and produced important insights (c.f., Frye and Shleifer 1996; Hendley, Murrell, and Ryterman, 1997; 1999; 2000; Shliefer and Vishny 1998; Johnson, McMillan and Woodruff, 1999, 2000; Hellman, Jones, and Kaufmann, 2000; Frye 2004). These works, however, focus on institutional, social, or political factors rather than how the process of transferring property or the actions of rightholders themselves influence perceptions of property rights. Scholars have produced a rich literature on the cross-national determinants of the security of property rights, but these works are less well suited for addressing the questions at hand as they focus neither on the perceptions of individuals or the effects of the origins of property rights (c.f., Knack and Keefer 1995; Kaufmann 1999; Acemoglu, Johnson, and Robinson 2003).

In sum, many works have explored the consequences of privatization, but few have examined how property rights come to be seen as legitimate by the community (c.f. North and Thomas 1973; Besley and Coates 1995; Djankov and Murrell 2002). In addition, existing literature rarely explores whether the legality of the privatization process itself influences subsequent perceptions of property rights or whether the actions of rightholders post-privatization can improve the legitimacy of property rights. These aspects of property rights have been understudied despite their importance for policy and social science.

Importance for the Russian Case

This salience of privatization as a political issue remains high in many parts of the world, but perhaps nowhere is this concern more timely than in Russia. In the Yeltsin years, big business and the state sought to balance the exchange of political support for economic benefits while avoiding a populist backlash that would threaten both.⁸ President Putin came to power with the backing of

⁷ Studies of the emergence of property rights tend to rely on simple settings, such as native American hunting communities, mining camps in the American West, or mountain farming communities (Demsetz, 1967; Ostrom 1990; Libecap 1992; but see Riker and Sened 1990).

⁸ See Shleifer and Treisman (2000) on the political economy of Russia's reforms.

some members of big business who saw him as willing to continue the policies of his predecessor, but Putin's unexpected rise in popularity allowed him to build a base of political support independent of big business. This popularity gave him leverage over his former backers, and shortly after coming to office, he began to chip away the power of individual big businessmen – many of whom had grown wealthy off privatization deals of dubious legality.⁹ With the transfer of power to President Putin, privatization deals conducted by previous administrations received renewed attention.

Most importantly, the arrest of YUKOS executives Platon Lebedev and Mikhail Khodorksky in 2003 on a variety of charges including violations of the Law on Privatization brought this issue sharply into focus. Among other charges, the two men were accused of underinvesting in the Apatit fertilizer plant whose privatization was conditional upon the owners meeting investment targets. Ironically, both men were eventually found guilty on charges related to this privatization, but the judge ruled that the statute of limitations had expired in this case. They were sentenced based on findings of guilt on numerous other charges. The economic and political fallout from this affair has been hotly debated.¹⁰

⁹ Of course, wealth redistribution continued after privatization as groups grown powerful from their control over former state assets were especially well-placed to shape public policy in their favor.

¹⁰ The issue has reinforced cleavages within the Russian political elite, but also generated an unusual and temporary alliance. Pro-government parties and their nationalist allies generally backed the move. The leader of the People's Party noted that his party "entirely supports the actions of law enforcers in the detention of the head of the oil company YUKOS, Mikhail Khodorkovsky. The Prosecutor General's Office has brought serious charges against the oligarch, including, tax evasion. We do not fear that an investigation into the affairs of one oligarch might cast doubt on the reforms of the 1990s. All civic-oriented political parties must come to the defense of the interests of the people, the state, and the president from the impertinent oligarchs" (quoted in Shishkunova 2003). Boris Nemtsov, a former leader of the liberal Union of Right Forces noted: "A re-examination [of privatization results] is the way toward confrontation, toward pumping money out of one business structure into the pocket of another. It means capital flight, the loss of millions of work places and plunging the country into poverty." (Interfax) In a rare show of unity (or at least the lack of open disagreement) with the liberals, the head of the Communist Party of the Russia Federation was also critical of the Putin Administration's handling of the affair. Gennady Zyuganov described actions undertaken against YUKOS, as "barbaric" and noted that prosecutors were "doing a great disservice to all Russian citizens". Of course, his views may

President Putin appears to recognize the explosiveness of the issue and has tried to walk a fine line that balances the political benefits of soaking the nouveaux-riches against the economic costs of capital flight, heightened uncertainty, and reduced investment. As noted in the quotes that begin this essay, President Putin has repeatedly stated his position that the effects of privatization should not be reviewed. That he has had to repeat this position for five years running indicates, however, that he has had little success in convincing the public of his sincerity.¹¹

Three Theories

This essay develops three arguments about the extent to which property rights obtained through privatization become accepted by the community.

Original Sin. The “original sin” argument suggests that the manner in which property is transferred from state to private hands influences perceptions of the legitimacy of property rights. Former state-owned assets obtained through serious illegality acquire a birth defect that is long-lasting and impervious to treatment. Property rights that are broadly seen as ill-gotten may provoke uncertainty among rightholders who fear future revisions of their rights due to changes in the political environment.

The “original sin” argument suggests that the designers of privatization policy should pay considerable attention to crafting means by which the outcome is seen as legitimate. Absent broad acceptance of the procedures by which assets are privatized, transferring property rights from state to private hands may produce few benefits.

have been colored by the sizable campaign funds that many believe the Communist Party received from Khodorkovsky and YUKOS.

¹¹ President Putin has further insisted that not all privatization deals violated existing law. In a December 2003 speech before the largest business lobby in Russia he noted: “We often hear that laws were complicated and impossible to comply with. These are the statements of those who did not observe them. This is rubbish. Those who wanted to observe the law did so.” More ominously, he added that “if five or seven people did not observe the law it does not mean that everybody did the same.” This quote sparked a widespread guessing game about which leading businessmen would be the next to suffer the fate of Khodorkovsky. These remarks reflect the tension that confronts President Putin. Criticizing the manner in which privatization was conducted is politically advantageous, but threatens the economy.

The case at hand provides a hard test for the “original sin” argument. Most privatizations in Russia took place a decade ago and memories of the gory details of the initial bargain may have dimmed. In addition, the role of the market as a means for allocating goods is better understood and more broadly accepted today than it was a decade ago. Moreover, many have noted that formal, written law in Russia is not held in wide respect.

Echoing Coase (1960), the counter argument suggests that the initial distribution of property rights is relatively unimportant provided that rightholders are not prevented from exchanging their rights in the marketplace. This view seems to have been closest to that held by the advocates of rapid privatization who oversaw the process in Russia. While not condoning illegality, these leaders were most concerned with transferring property rights as quickly as possible with the hope that rightholders would provide a base of political support and eventually assets would reach the most efficient users. One observer reported that the state official in charge of privatization in Russia, Anatolii Chubais, told him the following about managers in Russia: “They steal and steal and steal. They are stealing absolutely everything and it is impossible to stop them. But let them steal and take their property. They will then become owners and decent administrators of this property” (Freeland 2000: 70).

The “original sin” argument focuses primarily on the behavior of government, rather than the rightholders, as an influence on property rights. It also devotes attention to the initial transfer of property rights rather than the subsequent use of those rights as key determinants of the legitimacy of property rights. The next set of arguments puts greater attention on how rightholders themselves can take steps to increase the perceived legitimacy of property rights after the initial privatization by doing “good works.” The argument comes in two versions.

Good Works 1.0. The private goods view of the “good works” argument suggests that the perceived security of property rights depends on how the managers have used the resource granted to them by the state. If a manager has modernized and restructured the firm, then others may be willing to view the property rights as legitimate even if the assets were obtained by cutting legal corners. This argument is often made by Russian business elites who seek to justify their wealth by pointing to the success of their firms in creating jobs and promoting growth. The good use of the asset generates its own justification for initial privatization outcomes. This argument suggests that managers can use their own actions to legitimate their property. If this view is correct, then policy should be directed toward encouraging rightholders to modernize and restructure their companies

after privatization. Doing so could help others to view the distribution of property rights as more legitimate.

Good Works 2.0. The public goods version of the “good works” argument suggests that managers who provide many public goods for the region may generate greater respect for their property rights. As the Robber-Barons in the 19th century United States tried to legitimate their gains by spending portions of their wealth on public goods and charitable giving, one might expect a similar process to be underway in Russia. Indeed, in recent years, the oligarchs of Russia have mimicked this strategy to some degree by sponsoring opera performances, rock concerts, museum exhibitions, ballet companies, and a variety of religious and social organizations.¹² They have created think-tanks that analyze social and economic problems. In addition, they have contributed directly to a range of social projects from scholarship funds to summer camps and hospitals.¹³

The movement is in its early days, but goes beyond the oligarchs. The Putin government has made corporate social responsibility an important theme and encouraged firms across the country to find ways to help provide critical services to their local communities. In addition, the largest lobby for big business in Russia, the Russian Union of Industrialists and Entrepreneurs has adopted corporate social responsibility as a key slogan and developed a variety of plans to encourage businesses to provide social goods. Much of these efforts remain at the level of public relations, but there is little doubt that many Russian businesses are trying to use good works to polish their public images.

The notion that firms should support social services in their surrounding communities is hardly a new one in Russia. During the Soviet period, enterprises provided a wide range of social services for their workers and the local population. Given this history there is perhaps a greater expectation that firms should provide public goods in Russia than is the case in other settings. The public goods version of the good works argument suggests that rightholders can legitimate their property rights by using their assets to provide benefits for all.

The implications for policy in this instance are clear. To heighten the perceived legitimacy of their property rights, managers should provide more public goods for their communities. The costs

¹² For a description of good works done by the Russian holding company Interros headed by Vladimir Potanin see <http://www.interros.ru/eng/human/>. Interros is a prominent funder of the Hermitage Museum in St. Petersburg.

¹³ For information on charitable deeds of the large metals holding company, Evrasia-Holding, see, <http://www.evrazholding.ru/ru/ecology/charity>.

of providing these public goods may be seen as insurance against a populist backlash that would threaten property rights.

The Data

To begin to investigate these and other arguments, I commissioned a survey of 660 company managers in 11 of Russia's 89 regions, including at least one from each of Russia's recently created "super-regions." The survey was conducted in January and February 2005 by the Levada Center, a Moscow-based polling firm with more than 15 years of experience. Using data on the population of firms from the Russian State Statistical Agency and other sources, researchers stratified the sample by size and sector to mirror the population of firms in each region. Firms from 23 sectoral classifications were included in the survey, with industry, construction, transportation, communications, finance and trade all represented. Excluded from the sample were agricultural enterprises, communal services, health and social services. Researchers selected firms at random from within each stratum so that each firm within each stratum had an equal probability of being included in the sample. Only chief executive officers, chief financial officers, and chief legal officers were potential respondents and the selection rule followed the principle of "one interview, one firm." The distribution of firms in the sample roughly consistent with the national population.¹⁴

Most managers (79 percent) were male and the age of the average respondent was 47. The mean number of workers in a firm in the sample was 727, and ranged from a minimum of 4 to a maximum of 70,000. Half the firms in the sample had fewer than 125 workers and one quarter of the firms had less than 50 workers. Twelve percent of firms were majority state-owned and 59 percent had undergone some form of privatization. Ownership concentration was high. In 49 percent of the firms more than half of the shares were owned by a single stakeholder. Only five percent of firms had foreign ownership.

The interview subjects here are business elites and it would be inappropriate to generalize these views to the population at large. Nonetheless, understanding the perceptions of business managers on these issues is important. First, they likely have given these issues considerable thought and should have fairly reasoned views on the matters at hand. Second, they are opinion leaders who likely exercise some sway over how the public perceives these issues. Indeed, the silence and servility of other leaders of big business in the YUKOS case spoke volumes. Third, they are a

¹⁴ See Appendices for more details on the survey.

diverse group that includes managers across the country with vastly different experiences and their perceptions are valuable in their own right. When compared to the mass public, one might speculate that business elites would express less concern for abiding by the legal niceties of privatization and give themselves more credit for doing good works for the region. The responses from businesspeople reported here should establish a lower bound for the “original sin” theory and an upper bound for the “good works” theories.

To focus on the three theories highlighted above, the survey included a question with an experimental research design.¹⁵ This technique randomly assigns one of several different versions of a question to a respondent. Because the versions of the questions are distributed randomly, the responses should not be correlated with other factors that may be influencing the results, such as the type of firm or the personal characteristics of the respondent. The differences in responses should only be attributed to the variables manipulated in the hypothetical scenarios.¹⁶ Survey-based experiments that manipulate different versions of the question are a powerful method for analyzing survey responses at the aggregate level because they isolate the effects of the variables of interest – in this case the actions of rightholders and the perceived legitimacy of property rights.

Table 1 describes an experiment used to assess the determinants of the perceived legitimacy of property rights obtained via privatization.¹⁷ In line with the theories presented previously, the experiment manipulates the actions of rightholders by varying whether or not they have used their asset well and whether or not they provided public goods for their community. In addition, it asked respondents to evaluate the legitimacy of property rights when violations of the law were minor and major. The last question does not use an experimental research design and simply asks respondents two questions in succession.

¹⁵ See Green and Gerber (2002) for a primer on experiments.

¹⁶ This method has the added advantage of avoiding statistical analyses that may rely on implausible assumptions.

¹⁷ As managers are typically the largest shareholders in the firm, it is appropriate that they are responsible for the firm’s actions.

A Survey Experiment on Privatization

Let's say that an industrial firm was privatized in the mid-1990s. After privatization, the managers invested **[little/a great deal]** in the modernization and restructuring of their firm and they have also realized **[no/many]** social programs for the public in the region.

If it turned out that the firm was privatized with **minor** violations of the Law on Privatization, do you think that this matter should be turned over to the courts?

- 1) Yes 2) More or less Yes 3) More or Less No 4) No

If it turned out that the firm was privatized with **major** violations of the Law on Privatization, do you think that this matter should be turned over to the courts?

- 1) Yes 2) More or less Yes 3) More or Less No 4) No

TABLE 1: Minor Violations of the Law on Privatization

	Good Use of Asset	Bad Use of Asset
Public Goods		
Provided	22.8	33.5
N = 145, 158		
No Public Goods		
Provided	33.1	36.2
N = 148, 152		

Cells report percent “Yes” or “More or Less Yes” responses. Yes indicates that the state court should review the privatization. Higher scores mean less legitimacy.

N = number of responses for each version of the survey experiment.

ANOVA Test: $F(3, 592), = 7.63, p < .0001$

Table 1 presents the responses for scenarios in which violations of the Law on Privatization were only minor and varies the actions taken by the managers.¹⁸ The upper left quadrant represents a best-case scenario. Here the manager used the asset well and provided many public goods for the region and violations of the Law on Privatization were minor. In this instance only 22.8 percent of respondents agreed that the privatization should be reviewed by the state arbitration court.

Now consider the responses in the upper right corner. In this case, the respondent received a scenario in which managers provided public goods for the community, but did not use their asset well. Here 33.5 percent of managers said that the matter should be turned over to the arbitration courts. This indicates a decrease in legitimacy of the privatization of almost 11 percent. Thus, public goods provision can increase legitimacy.

Consider the response in the lower left corner which report results from a scenario in which manager used the asset well, but did not provide public goods for the region. In this case, 33.1 percent of the respondents agreed that the matter should be turned over to the arbitration court. Again, this is strong support that the good use of an asset can make it more legitimate.

Finally, consider the responses in the lower right corner. In this scenario, respondents received the version of the question in which the manager neither used the asset well nor provided public goods for the region and the violations of the Law on Privatization were minor. In this case, 36.2 percent of respondents believed that that the matter should be turned over to the arbitration courts.

Doing neither type of “good works” increases the percentage of respondents who said that the matter should be reviewed from 22.8 to 36.2. This marks a dramatic increase in the perceived legitimacy of property rights from previous scenarios. It also suggests that a combination of a relatively well administered privatization program and good works on behalf of the manager can make property rights fairly legitimate even in the difficult setting of post-communist Russia.

The next section provides a test of the “original sin” argument by comparing responses to questions on the severity of the violations of the Law on Privatization. Respondents were asked the same questions as in the preceding example, but were asked to consider that the violations of the

¹⁸ One way to improve the experiment would be to randomly assign whether violations were major or minor. Doing so would reduce the number of observations in each category and thereby make it more difficult to identify relationships with precision. Given the novelty of embedding experiments in a survey in Russia, I took a conservative approach by only varying the types of “good works” in the experiment.

Law on Privatization were major. The responses in Table 2 reveal a roughly similar pattern. Good works can improve the legitimacy of property rights and the effect is largest when good works are done in combination. First, consider the responses in the lower right corner. Here we see a worst-case scenario in which managers neither invested in the firm nor provided public goods for the region and privatization was conducted with major violations of the law. In this scenario, 71.8 percent of respondents agreed that the matter should be reviewed by the state arbitration court.

Moving to the response in the upper right corner in which the manager provided public goods for the region, but did not invest in the firm indicates that 61.5 percent of respondents agree that the matter should be turned over to the state arbitration courts. This is a significant reduction and suggests that even when privatization has been conducted with major illegalities, the provision of public goods can make property rights somewhat broadly accepted.

The lower left corner presents a scenario in which managers invested in the firm, but did not provide any public goods for the region. Here we see a marginal decline in the perceived legitimacy of property rights. In this case, 69 percent of managers said that the privatization should be reviewed by the state arbitration court.

Finally, the upper left quadrant presents results that offer strong support for the “good works” hypothesis, but again with an interesting twist. Here respondents received a version of the question in which managers invested in the firm and provided public goods for the region. Although the privatization was conducted with major violations of the law, only 48 percent of managers agreed that the state arbitration court should review the matter. As in Table 1, managers who both invested in their firms and provided public goods for the region dramatically increased the perceived legitimacy of their property rights.

TABLE 2: Major Violations of the Law on Privatization

	Good Use of Asset	Bad Use of Asset
Public Goods		
Provided	48.0	61.5
N = 150, 148		
No Public Goods		
Provided	69.0	71.8
N = 145, 149		

Cells report percent “Yes” or “More or Less Yes” responses. Yes responses indicate that the state courts should review the privatization. Higher scores mean less legitimacy.

N = number of responses for each version of the survey experiment.

ANOVA test: $f(3, 603) = 3.61, p < .01$.

The next section provides a test of the “original sin” argument by comparing responses to the scenarios when violations of the Law on Privatization were minor and major. Significant differences between these groups would indicate support for the “original sin” argument. Table 3 reports the sample means for the percent “yes” or “more less yes” responses for all scenarios when violations of the Law on Privatization were minor and when they were major. The results indicate stark differences in the perceived legitimacy of property rights. When violations of the Law on Privatization were minor, 31.5 percent of respondents in all four conditions responded that the privatization should be reviewed. The figure was almost twice as high (62.5 percent) when the violations of the Law on Privatization were major.

Thus, there is a dramatic increase across categories in support for the review of privatization when the violations of the Privatization Law were major. This indicates that the manner in which privatization is conducted has long-term effects on property rights. Privatizations that are conducted with serious violations of the law are tainted by an original sin that is difficult to expunge.

Table 3: Assessing the Original Sin Argument

Percent “Yes” or “More or Less Yes”

Minor Violations	
Of the Law on Privatization	31.5
N= 603	
Major Violations	
Of the Law on Privatization	62.5
N= 592	

Percent “Yes” or “more or less yes” responses. Yes response indicates that the courts should review the privatization. Higher scores mean less legitimacy.

N = number of responses.

A comparison of the responses in Tables 1 and 2 provides slightly more detail. Consider the worse case scenario reported in the lower right corner in Tables 1 and 2. In this instance, managers have neither used the asset well nor provided public goods for the region. Increasing the severity of the violations of the Law on Privatization from minor to major raises the percentage of respondents who said that privatization should be reviewed from 36.2 to 71.8 percent in this scenario. This increase of more than 35 percentage points marks a substantial decrease in the perceived legitimacy of property rights and is strong evidence in support of the original sin argument. Similar increases are reported in each of the other conditions as well.

Two main results emerge from these analyses. First, controlling for other factors the severity of the violations of the Law on Privatization had a strong impact on perceptions of the legitimacy of property rights. In three of the four scenarios, the number of respondents who thought that the state arbitration courts should review the privatization doubled when the violations of the Law on Privatization were major.

On the positive side, these results indicate that the formal law influences the perceptions of business managers in Russia. The prevailing wisdom is that businesspeople in Russia pay little attention to formal rules, but the findings here suggest that violations of the Law on Privatization undermined the perceived legitimacy of property rights. On the negative side, it suggests that privatizations that are perceived to be legally flawed bear a birth defect that endures.

These findings also suggest that rightholders are not powerless to change the security of their property rights. Good works matter as well. Managers who use an asset well or provide public goods can increase the perceived legitimacy of property rights.

In addition to the usual caveats about conducting survey research in a postcommunist setting, a number of potential limitations to these findings are in order. The survey experiment on privatization does not directly test whether the content of the law influences perceptions over the security of property rights. A legally scrupulous privatization that gave all the assets to a single individual may be in compliance with the law, but still be seen as grossly unfair. In reality, there is likely a fairly high correspondence between compliance with the privatization law and perceptions of the outcome of privatization, but this issue is not addressed directly here.

More importantly, the sample of respondents here are businesspeople rather than the population at large. Caution is appropriate in translating these findings to the larger population.¹⁹

¹⁹ I plan to repeat this survey experiment with the mass public in the fall of 2005.

However, one might expect to find even greater support for the original sin argument among the mass populace who benefited far less from privatization than the respondents, and perhaps, less support for the good works argument.

Public Goods and Property Rights

The next section examines a behavioral implication of the argument by asking whether the provision of public goods is associated with more secure property rights as proxied by investment. Conventional economic wisdom would suggest no. A ruble spent on an orphanage or public housing is a ruble not spent on investment in the firm. The view of property rights offered here makes the opposite prediction. The provision of public goods should be associated with higher levels of investment. By providing public goods for the region firms can make their property rights more broadly accepted by the public and therefore less vulnerable to political attack.²⁰ Here the provision of public goods may be a means to reduce political risk by perhaps appeasing the governor or the public, and thereby make property rights more secure.²¹ With less to fear from a political reversal of property rights, managers have heightened incentives to invest in their firm.

To assess this claim, I analyze three measures of investment that serve as indicators for the security of property rights. Respondents were asked whether managers made a significant new capital investment (such as a major renovation or construction project, purchase of new equipment, etc) in the last two years or intended to make a significant new capital investment in their firm in the coming year. In addition, interviewers asked whether firms had built a new building in the last two years. These are tangible, long-term investments that indicate considerable confidence in the security of property rights. Just over half of the respondents (55 percent) made a significant new capital investment in the last two years while almost forty percent of respondents were planning to do so in the coming year. Just over a quarter of respondents (26.4) had built a new building in the last two years.

²⁰ Ideally, one would like individual data that identified firms whose privatizations were done with minor and major violations of the Law on Privatization, but this is not possible.

²¹ Future research may seem to identify whether firms use public goods to buy the goodwill of the governor or the mass public.

Interviewers also asked respondents whether their firm provided a variety of public goods for the region, including support for educational and health institutions, aid to orphanages, pensioners and other forms of charity.²² Seventy-one percent of respondents said that their firm took part in at least one such program. Almost 40 percent of these respondents reported giving aid to health, education, cultural or sporting programs.

Table 4. Private Investment in the Firm and Public Goods

	Percent Yes
1. Made significant new capital investment in last 2 years	54.9
2. Plan significant new capital investment in coming year	39.7
3. Constructed new building in last 2 years	26.4
4. Provided public goods for region in last 2 years	71.3

In Row 2, the reported responses included “yes” or “more or less yes” responses. See Appendix II for question wording.

Using multivariate analysis, I explore whether firms that provided public goods for the region invested at lower rates as conventional economic wisdom suggests, or at higher rates, as the argument made here suggests. The dependent variable in Model 1 in Table 5 is the response to the question about whether firms had made a new investment in the last two years. I use a probit

²² See Appendix A5 for the question wording. The dummy variable treatment of public goods provision is crude, but asking for more precise information would likely have produced unreliable responses. These responses are self-reported and therefore are likely biased upward as managers may have wanted to paint themselves in a positive light.

estimation because the dependent variable takes one of two categories. In addition to a dummy variable for firms that provided public goods for the region, I introduce controls for factors specific to the manager (age and education, and the perceived quality of the court system; perceived levels of trust) and factors specific to the firm (property type, membership in a business organization, profitability, access to credit; extent of competition, and number of employees). I also include 9 dummy variables for economic sectors and 10 dummy variables for the region in which the firm was located.

Table 5. Public Goods and Property Rights

	New Equipment in the Last Two Years	New Building in last Two Years	Plan New Investment In Coming Year
	1	2	3
Public Goods	.47** (.15)	.31** (.14)	.43*** (.16)
Courts	-.07 (.08)	-.07 (.08)	-.06 (.08)
Trust	.02 (.10)	.10 (.10)	.16 (.10)
Corruption	-.07 (.05)	.09 (.06)	-.01 (.05)
Privatized	-.08 (.15)	-.05 (.16)	.09 (.15)
State-owned	-.61** (.26)	-.58** (.31)	-.20 (.28)

Business	.32**	.40**	.11
Organization	(.14)	(.14)	(.14)
Profitability	.37**	.18	.27
	(.10)	(.11)	(.10)
Constant	.56	.84	-1.21
	(.64)	(.70)	(.70)
Prob >chi ²	.0001	.0000	.0000
Pseudo R ²	.12	.18	.13
N	481	481	473

Variables for Age and Education of the Manager, Firm size, Sector, Region, Access to Credit, Competition, included, not reported. * = p<.10, ** = p<.05, *** = p<.01

Results from Model 1 indicate that managers who provided public goods for the region were significantly more likely to have made a new capital investment in the last two years.²³ Confidence in courts was unrelated to past investment, as was firms having undergone privatization. Firms that were members of business organizations and had many employees were more likely to be planning a new investment, while state-owned firms were less likely to invest.

²³ I also ran the analysis using a dummy variable for each of the various types of public goods provision in each model. The most common form of public goods provision – providing aid for education, health, culture or sports – was consistently and positively associated with investment. Other types of public goods provision provided inconsistent results.

Model 2, which examines whether managers had constructed a new building in the last two years, yields a similar result. The coefficient on *PublicGoods* is positive and significant indicating that public good providers were more likely to be planning to make a new capital investment in the coming year. Finally, model 3 indicates that firms that provided public goods for the region were also significantly more likely to be planning to make a new investment in the coming year. Simulating the results suggests that when dummy variables are set at their modal categories and continuous variables are set at their means, a food processing firm in Smolensk that did not provide public goods had about a .61 probability of having bought new equipment in the last two years, a .37 probability of having constructed a new building; and a .18 probability of planning a new investment in the coming year. The figures for an identical firm that provides public goods for the region are .71, .44, and .26 respectively. The results, which are reported in Table 6 below, are substantively as well as significantly important. These results hold controlling for a range of firm-specific and manager-specific factors commonly associated with investment. Moreover, they are consistent across three different measures of the security of property rights which gives greater confidence in the results. Most important, these findings are at odds with standard economic logic, but are consistent with the more political view of property rights offered above. Perhaps doing goods works are their own reward.

Table 6. Simulation of Results

	No Public Goods	Public Goods
Bought New Capital Equipment	.61	.71
Constructed New Building	.37	.44
Plan to Buy New Capital Equipment	.18	.26

This table reports the results of a simulation based on results from Table 5. The cells indicate the probability of buying new capital equipment, constructing a new building, and planning to buy new equipment when firms do and do not provide public goods, controlling for other factors.

Conclusion

Many studies examine the institutional, political, and social roots of property rights, but these works rarely examine how the manner in which property was obtained or the actions of rightholders influence the security of these rights. These are critical questions for developing and transition countries where privatization is rarely transparent. Using a survey of 660 businesspeople conducted in Russia in February 2005, this essay tests three theories of the perceived legitimacy of property rights. It finds that the original sin of a legally dubious privatization continues to undermine the legitimacy of property rights even a decade after the transfer of assets from state to private hands. This is problematic as rightholders may perceive their ill-gotten assets as vulnerable to political attack and be reluctant to use their assets productively. Most studies attribute the failure of private property to promote investment in developing and transition countries to weak formal or informal institutions (North 1990; Acemoglu, Johnson and Robinson 2001). This study suggests that the birth defect of a flawed privatization may have a similar effect.

In addition, it finds that rightholders can significantly increase the perceived legitimacy of property rights by doing good works. Rather than viewing rightholders as passively responding to institutional constraints, it suggests that they can shape the perceived legitimacy of their property rights. This result introduces agency into a literature in which it has been largely absent.

Moreover, behavioral evidence is consistent with the argument that firms use public goods provision as a form of political risk insurance to increase the security of their property rights. In contrast to standard economic logic, firms that provide public goods for the region invest at higher, not lower, rates. This provides additional evidence that the behavior of firms can shape the security of property rights.

These results suggest that policymakers should pay considerable attention to the design of privatization programs because a lack of compliance with the formal rules of privatization may undercut the legitimacy of the transfer of property. In addition, governments should encourage managers to do good works by investing in their firms and by providing public goods for their regions. In combination, these actions can help managers increase the perceived legitimacy of their property rights.

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APPENDIX: Survey Details

The overall response was rate 53 percent for firms contacted by the interviewer. As is not uncommon in business elite surveys conducted in Russia the city with the lowest response rate was Moscow (28 percent). Fully one-third of all refusals came from the capital city. Absent Moscow the response rate increases to 62 percent. The analyses are unchanged if responses from Moscow are dropped from the sample. Twenty percent of respondents were called back to ensure quality control. Respondents were asked a range of questions about the legal and business environment. Many questions have been used in previous surveys and all surveys were pre-tested in pilot surveys. For comparison's sake, response rates for the National Election Studies in the US in 2000 was 60 percent.

Cites in the Sample

Moscow
Nizhnii Nivgorod
Volgograd
Smolensk
Novgorod
Ekaterinburg
Voronezh
Rostov
Ufa
Khabarovsk
Tula
Omsk

Table A1. Businesses by Sector

Sector	Number of Businesses	Percentage of All Firms in Survey
Construction	120	18%
Machinery	120	18%
Retail	67	10%
Food Processing	64	9.6%
Transportation	47	7.1%
Light Industry	45	6.8%
Wholesale	33	5%
Communications	26	3.9%
Forestry	26	3.9%
Publishing	19	2.9%
Metallurgy	16	2.4%
Chemical	14	2.1%
Electric	15	2%
Bank	12	1.8%
Bldg. Materials	11	1.7%
Insurance	10	1.5%
Medical	6	.9%
Real Estate	5	.8%
Grain	3	.5%
Investment	2	.3%
Commercial firm	2	.3%
Fuel	2	.3%
Glass	1	.2%
Oil	0	0%
Total	666	100%

Table A2. Mean Employment by Sector

Sector	Full-time	Part-time
Electric N=15	6427	7205
Fuel N=2	4375	4550
Machinery N=120	708	731
Metallurgy N=16	954	1415
Chemical N=14	504	533
Forestry N=26	173	173
Bldg. Materials N=11	391	435
Glass N=1	270	270
Light Industry N=45	237	250
Medical N=6	596	584
Food Processing N=64	253	269
Grain N=3	74	90
Publishing N=19	217	188
Construction N=120	204	183
Transportation	3533	2159

N=47		
Communications	820	302
N=26		
Wholesale	114	98
N=33		
Retail	127	110
N=33		
Bank	207	159
N=12		
Insurance	87	51
N=10		
Investment	9	9
N=2		
Real Estate	55	51
N=5		
Commercial Firm	24	20
N=2		

Table A3. Legal Organization of the Firms

	Percent
	(raw numbers)
State Owned (gup)	11% (69)
Company (ooo)	33% (219)
Open Joint Stock (oao)	33% (223)
Closed Joint Stock (zao)	18% (122)

Municipal ownership	2% (16)
Private Company without (pbyul)	2% (16)
Other	1% (5)

Table A4. Descriptive Statistics of Firms in the Samples

Firm Characteristics	Responses
Average number of employees	727
Median number of employee	125
Industrial firms	58%
Retail and wholesale trading firms	15%
Construction/Transport/ Communications firms	29%
Members of business organization	37%
Average age of the manager (yrs)	47
College Degree	90%
Privatized firm	59%
State-owned firm	12%

<i>Denovo</i> private firm	29%
No competitors	7%
Competition from foreign firms	7%
Member of production association, trust, holding	24%
Profit in preceding year	69%

Table A5.

Public Goods Question

Did your firms provide any social programs designed to help promote the development of the region in the last two years? If so, what types of assistance was provided?

	Yes (%)
1. Did not take part in any programs to help develop the region	27
2. Aid for education, health, culture or sports	38
3. Temporary assistance for the unemployed	6
4. Aid for orphanages	11
5. Aid for pensioners or other socially vulnerable categories	3
6. Build public housing	4
7. Participate in ecological programs	2
8. Charity	9
9. Other	1

Table A6.

New Investment Question

Is your firm planning to make a significant new capital investment, (such as a major renovation or construction project, purchase of new equipment, etc) in your firm in the coming year?

	(%)
No	38.6
Most Likely No	21.7
Most likely Yes	17.7
Yes	22.0

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