ARTICLE IN PRESS
JID: YJCEC [m3Gsc;October 23, 2015;20:4]

Journal of Comparative Economics 000 (2015) 1–16

Contents lists available at ScienceDirect

Journal of Comparative Economics

journal homepage: www.elsevier.com/locate/jce

The Great Recession and social preferences: Evidence from Ukraine[☆]

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ARTICLE INFO

Article history:
Available online xxx

JEL classfication:
F36
F61
P2
P34
P52

Keywords:
Ukraine
Social preferences
Great recession
Life in Transition Survey

ABSTRACT

De Haas, Ralph, Djourelova, Milena, and Nikolova, Elena—The Great Recession and social preferences: Evidence from Ukraine

We use detailed survey data to document stark differences between West and East Ukraine when it comes to household attitudes toward market-based economies and democratic institutions. Along both of these dimensions, Eastern Ukrainians are decidedly less supportive of liberal systems. We also find that economic attitudes changed in response to the global financial crisis. West Ukrainian households who were affected more extensively by the crisis were more disappointed with the market and private ownership, while in Eastern Ukraine economic attitudes became less pro-market across the board. Our evidence suggests that attitudes and values are determined by both deep-rooted factors and more transient macroeconomic shocks. *Journal of Comparative Economics* **000** () (2015) 1–16. EBRD, United Kingdom and Tilburg University, the Netherlands;Universitat Pompeu Fabra, Spain;EBRD, United Kingdom.

1. Introduction

Under what circumstances do individual preferences persist, and when are they malleable? Are personal beliefs influenced by deep-rooted historical factors or rather by more transient macroeconomic shocks? The Great Recession, which brought unemployment and economic fragility throughout the world, has turned the spotlight on these questions. This debate has been especially important for the transition countries in emerging Europe. This is the case not only because this region was much more affected by the financial crisis than Western Europe, but also because political, social and cultural cleavages are particularly salient within as well as across transition countries.

In this paper, we contribute to this discussion by exploring the drivers of social preferences in Ukraine. We exploit disaggregated data from the second round of the EBRD-World Bank Life in Transition Survey (LiTS II), a nationally representative household-level survey administered in fall 2010. In addition to household and demographic information, the survey includes questions on a wide range of attitudes and values. Importantly, it also collects detailed information about households' exposure to the global financial crisis.

☆ We would like to thank Sergei Guriev for many helpful discussions and advice, Yuriy Gorodnichenko and participants at the JCE Symposium on Ukraine for useful comments, and Hayk Gyuzalyan for assistance with data on Ukrainian media. The views expressed in this paper are those of the authors and not necessarily of the EBRD.

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http://dx.doi.org/10.1016/j.jce.2015.10.007
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Our analysis, which focuses on attitudes towards market economy and democracy, documents stark differences between West and East Ukraine. On average, those living in the Eastern part of the country are more than 35% less likely to be in favor of a market-based economic system and 42% less likely to support democratic institutions. As we argue below, this evidence provides partial support for theories focusing on persistent cultural differences as a driver of attitudes. However, we also find that economic attitudes were affected greatly by the crisis, and that this effect differed markedly between West and East Ukraine. Households who were hit hardest by the Great Recession were most disappointed with the market economy and this was particularly so in the West. In contrast, in Eastern Ukraine the declining support for market economy was unrelated to crisis exposure. The disillusionment with markets among Western Ukrainians was stronger for households who, as a result of the financial crisis, had to cut down on food consumption, education or had to delay payments on utilities and loans. While we find that crisis-affected Western Ukrainians were also less likely to approve of democracy, this effect is less robust.

Although we lack a longitudinal data set, the richness of the survey which we use allows us to look into the role of some suggestive mechanisms. Since our data are from 2010, one possibility could be that the East–West cultural divide which we uncover is in fact a consequence of different early transition paths. Accounting for sub-national indices capturing the severity of the early transition shock (using data on night-time light intensity as a proxy for local economic activity) suggests that respondents in regions which experienced a greater initial income loss were also more affected by the recent crisis. Even so, our earlier results remain broadly similar. A second question is whether our specifications are simply capturing differences between Russian and non-Russian speakers (and their potentially different cultural mindsets). The latter may dominate in the West and the former in the East. Our findings speak to the contrary, since additional controls for linguistic, cultural and historical ties with Russia are insignificant.

Our empirical setup raises two potential identification concerns. First, since the analysis is based on cross-sectional data, unobserved individual heterogeneity could be a problem, particularly since the sample of respondents living in East and West is not random. Second, the extent to which each household was affected by the Great Recession is unlikely to be exogenous. We adopt several approaches to address these issues. First, we control for a wide range of observable characteristics that are likely to be correlated with crisis exposure, place of residence and preferences. These include household income, employment status and education, as well as Primary Sampling Unit (PSU) characteristics such as urbanity, latitude and longitude. Second, to rule out geographic sorting of respondents, in all specifications we control for whether the respondent has ever moved. We show that all our results are robust to accounting for out-migration from Ukrainian regions.

Third, we instrument household crisis exposure with the pre-crisis composition of bank branches in a respondent's primary sampling unit using detailed data from the second Banking Environment and Performance Survey (BEPS II, administered by the EBRD). Previous work has shown that the crisis was an exogenous shock which was transmitted to emerging Europe mainly through the branch networks of foreign-owned banks (Popov and Udell, 2012). We therefore exploit local variation in the balance-sheet strength of foreign banks in each PSU to create a branch-weighted proxy for the intensity with which the global financial crisis transmitted to specific geographical localities within Ukraine. We show that households in PSUs dominated by branches of foreign parent banks which were heavily dependent on (unstable) wholesale funding were most affected by the crisis.

Our work relates to several strands of the literature. First, we contribute to a large scholarship which has shown that cultural differences can affect a variety of economic and political outcomes (see, for instance, Algan and Cahuc, 2010; Gorodnichenko and Roland, 2011; Guiso et al., 2006; Tabellini, 2010). In addition, we complement an important literature on the origin of preferences. On the one hand, scholars have argued that culture is stable, as it may be transmitted vertically (Bisin and Verdier, 2001) or influenced by long-run historical events (Alesina et al., 2013; Becker et al., 2015; Grosfeld et al., 2013; Nunn and Wantchekon, 2011). On the other hand, there is evidence that norms can change relatively rapidly. Beliefs can be affected significantly by macroeconomic and wealth shocks (Ananyev and Guriev, 2013; Di Tella et al., 2007; Fisman et al., 2013; Giuliano and Spilimbergo, 2014; Grosjean et al., 2013), access to information (Kuziemko et al., 2013) and political experiences (Alesina and Fuchs-Schündeln, 2007). We review these contributions in more detail, particularly as they relate to the Ukrainian context, in the next section of the paper.

This paper enriches the literature in four important ways. Our results suggest that deep-rooted factors and more short-lived macroeconomic shocks may interact to determine preferences for the market and democracy. This implies that claims emphasizing the importance of either mechanism may be only partially correct. Unlike much of the previous literature, we do not find that the East–West divide or the crisis explain trust, preferences for redistribution and risk, views about state paternalism, civic activity and social capital, and beliefs about the importance of effort versus luck for advancing in life. From an econometric point of view, focusing on a single large country helps to avoid identification biases present in cross-country regressions, on which much of the existing literature is based. Our contribution also stems from the fact that we are able to use disaggregated data from Ukraine prior to the Russia–Ukraine conflict which have not been explored before.

This paper is organized as follows. The next four sections present our conceptual framework, data, empirical approach and results, respectively. The final section concludes.

2. Macroeconomic shocks and the persistence of preferences

Social scientists studying the origins of preferences and beliefs face an important challenge: pinpointing the circumstances under which preferences persist and when they change. On the one hand, several influential studies argue that cultural values are determined by long-run historical events. For instance, Putnam et al. (1994) attributes the lack of civic competence in Southern