



Threats to security of property rights in a transition economy: An empirical perspective

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ABSTRACT

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Effective property rights protection plays a fundamental role in promoting economic performance. Yet measurement problems make the relationship between property rights and entrepreneurship an ambiguous issue. As an advancement on previous research in this paper we propose a new approach to the evaluation of the security of property rights based on direct measures that overcomes some limitations of previous studies. We apply this new metrics to a survey of manufacturing firms in Russia to identify the economic effects associated with the lack of property protection in a transition economy. Our analysis supports the view that there is a close relationship between institutions, property rights and economic growth. Our findings confirm that redistributive risks provide a depressing effect on investment and innovative activity of manufacturing enterprises and potentially result in a huge loss in efficiency and economic growth, which in other institutional settings could have been avoided. *Journal of Comparative Economics* 41 (1) (2013) 245–264. Institute of World Economy and International Relations and National Research University, “Higher School of Economics”, Moscow, Russia; Lancashire Business School, UCLAN, Preston PR1 2HE, UK; Institute of World Economy and International Relations, Moscow, Russia; Manchester Metropolitan University Business School, Manchester, M15 6BH, UK.

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1. Introduction

The insecurity of property rights is widely recognised as one of the most fundamental obstacles to successful economic development (Besley and Ghatak, 2009). Inadequate protection of property rights encourages firm owners to increase spending on sheltering “their” assets and the seizure of assets held by “others” as a form of rent seeking. As a result resources become diverted from productive to non-productive purposes with negative consequences for investments and economic growth.

In transition economies the status of property rights acquires particular poignancy because of what Frye (2006) calls “the original sin of privatisation”. It has been noted that even in countries with a long and uninterrupted tradition of democracy

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the privatization of once public assets creates unique legitimisation requirements because it is usually accompanied by the provision of some concessions and privileges to the new owners at a cost to the public that require justification (Moran, 2001). In transition economies on many occasions the leaders of privatization sacrificed the need to prepare a socially acceptable privatization to achieving the maximum speed and breadth of the destruction of state property (Kornai, 2000). This was done in anticipation that once control was in the hands of private owners, they will support political reforms, creating strong legal property rights (rule of law). In quite a few cases, however, reality proved to be rather different as corruption and ineffective formal institutions “made private ownership close to irrelevant” (Freeland, 2000, p. 344). According to EBRD/World Bank 1999 business environment and enterprise performance survey systematic insecurity of property rights was a feature in 22 transition economies, including Russia (BEEPS, 1999). In fact, Russia is a prime example of a country in which lack of experience of a market economy, a murky privatization, abundant natural resources and low quality of institutional environment resulted in poorly-defined and poorly-enforced property rights (Hoff and Stiglitz, 2002).

The rich literature on the security of property rights has one acknowledged weakness: there is no single universally accepted set of measurements that allow to establish the degree of protection (Frye, 2006). The measurement problem makes the relationship between property rights and entrepreneurship an ambiguous issue because researchers often operate with indicators that cannot be directly compared. It does not help that property rights scholars normally employ a variety of indirect indicators to measure the security of property rights.

In this paper we propose a new approach to measuring the security (strength) of property rights on a micro level and to identifying the effects associated with lack of their protection in a transition economy, using Russia as an example. The key conceptual advance is to focus on the threat of seizure of control of the firm by state or corporate agents rather than on “weaker” threats to property rights such as contract violations and regulatory predation. In our analysis we attempt to overcome some limitations of previous studies. First, in contrast to previous estimates commonly derived from such inferential characteristics of the institutional environment as the level of corruption or trust in courts, our estimates are constructed on the basis of direct data about potential redistributive threats as they are perceived by individual firms. Second, this study examines how the perception of different types of asset seizures influences the long-term choices of the firm. The paper is mainly an empirical one and provides some novel individual level data on an important topic.

The results that we obtain confirm that risks of asset seizure are a factor that may seriously undermine investment and innovative activity with negative implications for efficiency and economic growth, which could have been avoided if property rights had been better protected. This result suggests that an increase in the security of property rights remains an important resource that can substantially improve the perspectives of economic growth in countries in which property rights do not receive adequate support from the institutional setup. In the paper Russia serves as an example of a country in which this problem is explicit. However, the problem of security of property rights and its effect on firm’s behaviour is a general one, making the implications of this study relevant to other economies, transition and developing countries in particular.

The rest of the paper is organized as follows. Section 2 discusses a conceptual background to our analysis. Section 3 presents our data and provides their descriptive analysis. Sections 4 and 5 identify major determinants of the threats to ownership in Russian manufacturing and evaluate impact of these threats on firm performance, using various econometric techniques. Section 6 concludes.

2. Conceptual background and the design of empirical analysis

Redistribution of property rights is an important and valid process that is essential for achieving market efficiency through concentration of capital in the hands of the most effective users. However, such redistribution requires the support of legal and regulatory institutions that hinder arbitrary changes in ownership following individual private or public decisions thus maintaining a level of security of property rights (Olson, 1996). Institutional failures may debase property rights and create a situation in which firm owners are more likely to pursue policies that prioritise short-term benefits over long-term returns; incentives to invest and innovate become reduced (Mauro, 1995); the structure of investments is distorted (Clarke, 2001) and assets seek safe rather than efficient applications (Dincer, 2007).

These predictions have dramatically materialised in a Russia. The importance of investigation of property rights in the country has been emphasised by theoretical insights that draw a link between extreme inequality in the allocation of wealth, a feature of many transition economies, and the imposition of the rule of law (Shleifer, 1997). This has given an impetus for a number of theoretical studies that show how lack of secure property rights can “lock up” an economy in a “bad” equilibrium when a system with insecure property rights serves well the economic elite and remains deficient for the others (Leonid and Savvateev, 2004; Sonin, 2003). When the most powerful and influential owners have sufficient resources to successfully defend their assets without recourse to a public mechanism of property protection by establishing and using private mechanisms of enforcement, they have no interest in the transition to a “good” equilibrium based on effective public mechanisms. As a result, the formation of efficient institutions is blocked because they do not find sufficient demand. Worse, the economy trapped in a “bad” equilibrium with fuzzy property rights may fall into a vicious circle, going through repeated cycles of coercive asset redistribution with low growth, high inequality, and wide-spread rent-seeking.

Although protection of property rights has always been one of the main sore points of the Russian economy, empirical studies devoted to this issue are mostly limited either to a description of the various technologies of assets seizure (Radygin,

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