Journal of Financial Economics 117 (2015) 139–164

Contents lists available at ScienceDirect

Journal of Financial Economics

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

Foreign corporations and the culture of transparency: Evidence from Russian administrative data ☆

Serguey Braguinsky [a], Sergey Mityakov [b,*]

[a] Department of Social and Decision Sciences, Carnegie Mellon University, USA
[b] John E. Walker Department of Economics, Clemson University, USA

ARTICLE INFO

Article history:
Received 2 March 2012
Received in revised form
20 September 2012
Accepted 22 October 2012
Available online 7 March 2013

JEL classification:
K42
P37

Keywords:
Culture
Transparency
Foreign corporations
Diffusion
Foreign direct investment

ABSTRACT

Firms from developed countries carry a culture of transparency in business transactions that is opposite to the culture of hiding and insider dealing in developing and transition economies. We employ Russian administrative data on reported earnings and market values of cars to measure wage misreporting for individual employees of domestic firms in Moscow. We show that closer ties to multinationals lead to improved transparency of wage reporting in private Russian companies. Employees located closest to movers from multinationals in the job quality space experience the largest gains in transparency. We find a robust correlation between wage misreporting and accounting fraud.

1. Introduction

The role of foreign capital in promoting economic transformation in developing countries and countries in transition has received a great deal of attention in the literature. So far this attention has been limited almost entirely to its role in the diffusion of knowledge and/or the transfer of more efficient managerial practices.[1] In this paper we investigate another and potentially very important role of foreign capital in improving the environment for and diffusing the culture of transparency in economic transactions.

Proliferation of hiding in economic transactions in some countries suggests that it is likely to be privately profitable given the institutional environment. However, even though private benefits could outweigh private costs, hiding entails large efficiency costs for the market overall, such as market segmentation, high transaction costs outside a narrow range of trusted partners, and limited opportunities for outside investment.[2] Hence, if the

☆ We thank Andrey Liscovich for outstanding research assistance. We are also grateful to two anonymous referees as well as to Rajshree Agarwal, Nicholas Bloom, Howard Bodenhorn, William Dougan, Ray Fisman, Francisco Perez Gonzales, Luigi Guiso, Sergei Guriev, Steven Klepper, Maxim Mironov, Tom Mroz, Anna Paulson, Andrei Shleifer, Kevin Tsui, Luigi Zingales and the participants of NBER conference on "Causes and Consequences of Corporate Culture" for valuable comments and suggestions. All the remaining errors are our own.
* Corresponding author.
E-mail addresses: sbrag@andrew.cmu.edu (S. Braguinsky), smityak@clemson.edu (S. Mityakov).

[1] See, e.g., Branstetter (2006), Keller and Yeaple (2009), Bloom, Mahajan, McKenzie and Roberts (2010), Bloom, Eifert, Mahajan, McKenzie, and Roberts (2012), Görg and Strobl (2005), and Sabirianova-Peter, Svejnar, and Terrell (2005).

[2] See, e.g., Shleifer and Vishny (1997), Braguinsky (1999), and Braguinsky and Myerson (2007).

0304-405X/$ - see front matter
http://dx.doi.org/10.1016/j.jfineco.2013.02.016

activity of multinational corporations can nudge the local corporate culture towards greater transparency, this alone would imply a major role for foreign capital in fostering economic efficiency in developing and transition countries.

In this paper we first develop a novel way of measuring transparency of earnings based on unique data available for Moscow, Russia‘s political and economic center. These data contain information about officially reported earnings of Moscow residents together with the vehicle registration records that can be matched to earnings data for the same individuals over the period 1999–2003. Reported earnings can be falsified, but it is virtually impossible to drive an unregistered car in Moscow. This difference is the key for defining our transparency measure, which is computed on the basis of discrepancy between observed car values for a given individual and his or her reported earnings.

Using our transparency measure, we find that the employees‘ earnings reported by foreign-owned firms are, on average, four times higher than in domestic firms for the same car values, controlling for various firm characteristics, such as size and sector of economic activity, as well as individual characteristics and time effects. The finding that foreign-owned firms are more transparent in labor contracts than domestic companies has important implications in its own right. In particular, it suggests that conventional measures of the labor productivity gap between multinationals and local companies [which inevitably rely on reported output per worker or reported wages; see, e.g., Brown, Earle, and Telegdy (2006), Brown, Earle, and Gehlbach (2012)] should be taken with a grain of salt. Our results imply that a lion‘s share of actual employee compensation in domestic firms is paid outside of the formal reporting system. While the immediate role of multinationals in increasing labor productivity may thus be less than implied by conventional methodology, multinationals can nevertheless play an important role in improving the overall efficiency of the economy if they can spread the culture of transparency to domestic firms.

We then use our data to examine whether tighter links to multinationals have an effect on transparency of domestic companies. We identify in the data private Russian companies with a nonzero fraction of workers with experience in multinationals (hereafter, "foreign-related firms," FRF). Our estimates, controlling for employer × individual fixed effects,[3] indicate that an increase in the fraction of workers hired from multinationals by one standard deviation is associated with a 20% increase in transparency among workers who stayed employed in private domestic companies.

We further investigate possible mechanisms that could make domestic companies more transparent when they increase hiring from multinationals. One possible such mechanism is "vertical spillovers," when business practices of companies change with changes in top managerial personnel (e.g., Bertrand and Schoar, 2003). This conjecture led us to look for changes in transparency that might be driven by hiring high-ranking employees and managers from foreign-owned firms, but we do not find much empirical support for this hypothesis. Instead, we find empirical patterns that indicate the "horizontal" nature of transparency spillovers, that is, increased transparency among employees who are closer to newly hired workers from multinationals in the job quality space. We argue that this might reflect peer effects. It is also possible that, to prevent disruption in the workplace, domestic firms are forced to engage in "benchmarking" behavior, that is, bringing the officially reported earnings of incumbent employees closer to the earnings they have to officially pay to workers recruited from multinationals.

Finally, we investigate the relation between transparency of reported earnings and financial transactions. In particular, we utilize the measure of tunneling in Russian companies constructed in a recently published paper by Mironov (in press), which is based on firm-level data on banking transfers from legitimate firms to shell companies created specifically for tunneling purposes.[4] We show that firms that report earnings of their employees more transparently in our data, also tunnel a smaller fraction of their total payments through shell companies.

Our paper is related to several strands in the literature. A large body of literature investigates the impact of foreign direct investment on economic performance of companies in recipient countries. Existing attempts to assess this impact generated mixed results: Aitken and Harrison (1999) and Smarzynska-Javorcik (2004) present evidence of positive spillovers from foreign firms‘ presence in the industry, while Aitken, Harrison, and Lipsey (1996) find no or even negative effects. In a careful study of privatization in four countries of Eastern Europe, Brown, Earle, and Telegdy (2006) find that transition to foreign ownership had a large positive effect on multifactor productivity of privatized manufacturing enterprises, even though they do not find similar effects of privatization to domestic owners in Russia (see also Brown, Earle, and Gehlbach, 2012). More recently, availability of employee–employer matched studies allows for more detailed analysis through the channel of labor mobility; see, e.g., Görg and Strobl (2005) and Balsvik (2011).

Our paper follows this empirical approach. However, the conceptual focus is complementary to existing literature. Rather than trying to estimate actual productivity gains from the presence of multinationals in the industry, we focus on the latter‘s role in spreading the culture of transparency and thus affecting the hidden component of earnings. We argue that, without distinguishing between reported and true earnings, comparing wages in domestic and foreign firms is likely to be misleading.

Our paper also contributes to the growing literature on shadow or hidden economies [see Schneider and Enste (2000) for a survey]. Most of the existing studies in this field rely on indirect aggregate indicators, like electricity consumption (Alexeev and Pyle, 2003) and share of cash in transactions (Tanzi, 1983), or on survey data with self-reported consumption and incomes (Pissarides and

[3] Controlling for fixed effects is essential since it allows us to capture individual as well as firm level unobservables, which remain constant over time, including initial values of fractions of workers with prior work experience in foreign companies.

[4] We are grateful to Maxim Mironov for generously sharing his data that made these comparisons possible.