

Original Sin, Good Works, and Property Rights in Russia

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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? Answers to these questions have ramifications beyond academic debate. Based on the expectation that private ownership generates stronger incentives to produce, policymakers and international financial institutions have advised governments from Asia to Africa to transfer state-owned assets to private hands. However, the transfer of rights from state to private hands is only a first step in encouraging rightholders to use their assets well. 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. Owners who expect the state to alter their rights in the future have weak incentives to use their assets productively today. The threat that privatization may be reversed can loom large well into the future despite (or perhaps because of) repeated assurances to the contrary.

The specter of reversing privatization may be heightened where the community views existing definitions of property rights as illegitimate. This underlying illegitimacy may allow political entrepreneurs to bolster their public standing by railing against the current distribution of property rights. Under these circumstances, privatization is likely to produce few benefits as rightholders anticipate future limitations on their assets. This threat is far from hypothetical. Most prominently, the YUKOS affair in which the Russian state ultimately seized assets privatized in 1996 from Russia's largest private oil firm highlights the politically contingent nature of privatization. Despite its importance, surprisingly little empirical research has focused on the legitimacy of privatization.

This essay uses an original survey of 660 businesspeople in Russia conducted in

January and February 2005 to examine the conditions under which property rights come to be seen as legitimate. An experiment embedded in the survey 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 major violations of the law retain their illegitimacy. In contrast, an alternative view of privatization suggests that it matters little how property rights are initially distributed as long as owners can trade them after privatization. This view was held by privatizers in Russia including Anatolii Chubais. This essay also asks whether recipients of privatized assets can increase the 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.”

To focus on these three arguments, the survey included a question with an experimental design. This technique randomly assigns one of four different versions of a question to a respondent. Because the four versions of the questions are distributed randomly, the responses should not be correlated with other factors that may be influencing the responses, such as the type of firm or the personal characteristics of the respondent. The differences in responses should only be due to the small changes in the four slightly different versions of the question. The experiment aims to capture a familiar situation in Russia. Most firms were privatized in the early to mid-1990s in an environment of weak legal norms, and observers have spent much of the past decade discussing the legitimacy of these transfers of property. In line with the theories presented above, 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 region. In addition, all respondents were asked to evaluate the legitimacy of property rights when violations of the law were major and minor. The question and responses are reported below.

An 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 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

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

Table 1: Major Violations of the Law on Privatization

	Good Use of Asset (Restructuring)	Bad Use of Asset (No Restructuring)
Social Programs Provided (N= 150, 148)	48.0	61.5
No Social Programs Provided (N=145, 149)	69.0	71.8
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.		

Table 1 reports the responses when violations were depicted as major. In the lower right corner, we see a worst-case scenario. Here the respondent received a version of the question in which managers neither invested in the firm nor provided public goods for the region. In this scenario, 71.8 percent of respondents agreed that the courts should review the privatization. Moving to the upper right corner in which the respondent received a scenario in which the manager provided public goods, but did not invest in the firm, 61.5 percent agreed that the matter should be turned over to the courts. This increase of more than ten points indicates that the provision of public goods on its own can bolster the legitimacy of property rights.

The lower left quadrant presents a scenario in which managers invested in the firm, but did not provide any public goods for the region. Here 69 percent of managers said that court should review the privatization. This represents only a slight increase in legitimacy.

The results in the upper left corner are striking. When managers both used the asset well and provided public goods for the region, only 48 percent of respondents agreed that the courts should review the matter. Doing both forms of good works in combination increases the legitimacy of property rights by almost 24 percentage points.

Table 2 compares responses to the same scenarios, but here managers were asked to consider that violations of the Law on Privatization were minor. In the lower right corner in which the manager neither used the asset well nor provided public goods, 36.2 percent of respondents believed that that the matter should be turned over to the courts. Doing either form of good work on its own produced small and statistically insignificant increases in legitimacy as indicated by the responses in the upper right and lower left corners. In the upper left corner where managers used the asset and provided public goods for the region only 22.8 percent of respondents believed that the case should be reviewed. As in the preceding case, doing both forms of good works provided a dramatic increase in the legitimacy of property rights.

Table 2: Minor Violations of the Law on Privatization

	Good Use of Asset (Restructuring)	Bad Use of Asset (No Restructuring)
Public Goods Provided (N= 145, 148)	22.8	33.5
No Public Goods Provided (N=148, 152)	33.1	36.2
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.		

To test the “original sin” argument, Table 3 reports the means for the percent “yes” or “more or less yes” responses for the sample as a whole when violations of the Law on Privatization were major and minor. The results indicate stark differences in the two groups. When violations of the Law on Privatization were minor, 31.5 percent of respondents favored a review. The figure was almost twice as high (62.5 percent) when violations of the Law on Privatization were major. While more than one-third of respondents were willing to let stand a privatization with major violations of the law, the manner in which privatization was conducted had a strong impact on the legitimacy of property rights.

Table 3: Assessing the Original Sin Argument

	Percent “Yes” or “More or Less Yes”
Minor Violations of the Law on Privatization (N=603)	31.5
Major Violations of the Law on Privatization (N= 592)	62.5
Percent “Yes” or “more or less yes” responses. Yes responses indicate that the courts should review the privatization. Higher scores mean less legitimacy.	
N = number of responses.	

Two results emerge. First, rightholders have some agency to change the legitimacy of their rights. In particular, managers who provide public goods *and* use their asset

well can increase the legitimacy of their property rights. In addition, there is evidence from Table 1 that providing public goods on its own can significantly bolster legitimacy. Thus, even without a change in the formal legal status of their property, managers can make their holdings more legitimate. Second, the severity of the violations of the Law on Privatization had a strong impact on the legitimacy of property rights. This supports the “original sin” view of privatization.

On the positive side, these results indicate that the formal law matters. The prevailing wisdom is that businesspeople in Russia pay little attention to the formal law, but the findings suggest that violations of the law undermined the legitimacy of property rights. On the negative side, a privatization seen as legally flawed bears a birth defect that endures.

Conclusion

The results have two implications for policy. In contrast to the view of privatization that the initial distribution of property rights is relatively unimportant, a view favored by privatizers in Russia, the findings here suggest that the design and implementation of privatization programs are important determinants of the subsequent legitimacy of property rights. Privatizers should favor designs that are broadly acceptable to the community. This may involve greater transparency, simplicity, and public discussion of privatization policies than is often the case.

Second, the results suggest a possible, but long, path out of the current illegitimacy trap that bedevils private property in Russia. Governments may encourage the private provision of some public goods and the good use of assets, in part so rightholders can increase the legitimacy of their property rights. There are limits to this policy as the state is a more efficient provider of public goods than are private firms. But the private provision of public goods may be less socially costly than renationalization or reprivatization.

Appendix: Survey Details

The overall response rate was 53 percent for firms contacted by the interviewer. For comparison's sake, response rates for the National Election Studies in the US in 2000 was 60 percent. Twenty percent of respondents were called back to ensure quality control.

Cites in the Sample:

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

Table A1: 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
Managers with College Degree	90%
Privatized firm	59%
State-owned firm	12%
Denovo private firm	29%
No competitors	7%
Competition from foreign firms	7%
Member of production association, trust, holding	24%
Profit in preceding year	69%