Firms and Social Policy in the Post-Communist Bloc: Evidence from Russia [*]

Israel Marques[†]

Draft version: March 29, 2015

Abstract

When does business support the expansion of social policy in the developing world? Existing work on managers preferences has tended to concentrate on the developed world, where governments can credibly commit to policy, tax evasion is constrained, and mechanisms exist to hold the bureaucracy accountable for policy implementation. In this paper, I relax these assumptions, arguing that weak institutions create opportunities for some firms to shift costs onto others: making social policy more attractive. I argue that firms with political connections are uniquely positioned to benefit from subsidies and property rights protection, which decreases the cost of social policy, while firms with low visibility can evade taxes and free-ride off universalistic social policy. I test this argument using a survey of 666 firms in 10 Russian regions.

Key words: Labor markets, Firm preferences, Tax evasion, Politically connected firms, Welfare state

JEL codes: L21, L33, O15, 017, H53

1 Introduction

When does business support the expansion of social policy in the developing world? Much of the literature on the development and evolution of the welfare state has pointed to the central role of business in shaping and enacting the social policies that underpin the welfare state (Estevez-Abe, Iversen, and Soskice, 2001,

[†]Research fellow at ICSID and doctoral candidate at Columbia University. *im2219@columbia.edu*

Manow, 2001, Mares , 2001, Rhodes, 2001, Swensen, 1997). Recent work in this area has focused on unpacking the preferences of firms for (or against) specific types of social policy as part of a broader labor market strategy designed to attract skilled workers and quite labor unrest (Kuo, 2010, Martin, 2005, Yang, 2013).[1] As with much of the work on the evolution of the welfare state, however, existing work on firms' preferences has tended to concentrate on the developed world, where governments can credibly commit to policy and mechanisms exist to hold the bureaucracy accountable for implementation. As a consequence, we know relatively little about how (and even whether) institutional quality shapes preferences for social policy (Mares and Carnes , 2009).[2]

The failure to consider the effect of institutional quality, and its mechanisms, is surprising. Conceptualizing institutions as humanely devised constraints on human interaction (North, 1981), work on the political economy of institutions and investment highlights how a lack of constraints creates credible commitment problems between the state and investors. Where institutions are poor, state officials can take advantage by engaging in weak or opportunistic policy enforcement and outright rent-seeking, which increases investor risk and transaction costs (North, 1990, North, Wallis, and Weingast, 2009, North and Weingast, 1989). Knowing this, rational firms invest at lower levels, since these additional costs weaken returns. A rapidly growing literature shows that not everyone loses. Those able to protect themselves from the state, whether by leveraging political connections or simply evading notice, can find themselves at a competitive advantage due to their ability to shift or mitigate the costs of poor institutions (emphc.f. Boix and Svolik (2013), Gehlbach and Keefer (2011), Haber, Maurer, and Razo (2003)). Some can even profit from the unique opportunities afforded by unconstrained state representatives willing to privilege their friends (Faccio, 2006, Faccio, Masulis, and McConnell, 2006, Gehlbach, 2008).

In this paper, I argue that these insights can be extended to inform our understanding of businesses' preferences for social policy. As with standard investments, individuals and firms pay into the welfare state today expecting benefits, when eligible, tomorrow. As with all investment, however, social policy contributions are vulnerable to opportunism and rent-seeking. Consequently, contributions may never be paid out in full or as legally stipulated, making poor institutions like dead-weight costs. Extending existing individual level models of preferences for social policy would suggest that the increased dead-weight costs of poor institutions dim enthusiasm for social policy (Becker, 1985, Mares, 2005, Meltzer and Richards,

---

[1]Although some accounts challenge the assertion that labor market strategy was the key consideration at all points (Hacker and Pierson, 2002, Paster, 2013).

[2]An important exception is Mares (2005), who explicitly considers how state capacity in the form of preventing tax evasion conditions individual worker preferences for social policy. Marques (2012) also explores how institutional quality shapes the preferences of workers and small-scale entrepreneurs at the micro-level.

2

1981).

Using this work as a point of departure, I argue that not everyone loses (or at least not to the same extent) from poor institutions. In particular, I identify two groups who can mitigate the costs of social policy and whose ability to do so are enhanced in poor institutional settings. On the one hand, those who have strong political connections may receive privileged access to social policy funds for their employees and protections against rent-seeking and opportunism for their contributions. On the other hand, some firms may be able to take advantage of weak institutions, and the shirking they encourage, to hide some or all of their wage bill, allowing them to sidestep social policy contributions (Mares, 2005, Schneider, 2005). Free-riding is possible, because even where the welfare state is a leaky bucket unable to collect enough tax revenue to fully sustain its expenditures, many still receive social policy benefits (Kaufman and Kaliberda , 1996).[3]

Because cross-national surveys of firms are rare, I test these two hypotheses directly using a unique survey of 666 Russian firms carried out in 11 Russian regions. A single country survey, especially one with relatively centralized tax and social policy structures like Russia, precludes problems with differences in welfare state design and financing (Kenworthy and McCall , 2008). It also mitigates concerns about other important unobservable (or poorly observable) variables such as those related to culture or the historical legacies of intitutions. Due to the small number of regions in my sample, it is difficult to test whether the preferences of well-connected firms and those who can hide differ across settings with varying institutional quality. Instead, I focus on a narrower element of the argument: do well-connected firms and those who can hide support social policy as my framework predicts? I assume that while substantial variation exists in the quality of Russia's regional institutions, even the "best" regions still have poor institutions by global standards. Russia is an ideal subject for such a study, as it was struggles with basic institutional constraints. The World Bank's Governance Indicators, for example, place Russia in the bottom 23% of countries with respect to its ability to control bureaucrat corruption, while Russia's Rule of Law ranking (a measure of contract enforcement and the quality of police and courts) put it in the bottom 20% of countries (Kaufman et al. , 2006).[4] As such, Russia provides a good test of how firms behave in institutionally poor settings.

This paper makes two contributions to the literature on social policy preferences. First, as noted above, it extends our understanding of firm preferences to settings not considered in the existing literature. Poor

---

[3]This is not to say that such groups may not benefit disproportionately from the welfare state in good institutional settings. Tax evaders, in particular, can free-ride anywhere. I do, however, argue that settings with poor institutional quality both make it easier for the well-connected to take advantage of social policy and increase the number of firms able to free-ride. I discuss this in more depth below.

[4]I discuss cross regional variation in institutional quality in more depth in section **??**.

institutions are endemic in the developing world, making an understanding of whether (and how) they shape

firm preferences critical to making predictions about the rise and evolution of the welfare state. Knowing

who supports the welfare state in poor institutional settings can also help to resolve the long-standing puzzle

of welfare state origins and development in authoritarian and poorly institutionalized settings (Mares and

Carnes , 2009). Second, this paper contributes to the welfare state literature methodologically through the

use of micro-level, firm surveys. The most prominent work on firm preferences has used archival materials

from businesses and business associations to expand our understanding of firm preferences and lobbying (*c.f.*

Kuo (2010), Mares (2005), Mares (2003a, 2001), Swensen (2002, 1991), Thelen (2004). This paper seeks

to complement these studies with new data and methodology, bringing with it the traditional advantages of

large-N survey work.

In the next section, I present a framework that identifies groups who benefit from poor-institutional

settings in ways that enhance support for social policy. Section 3 briefly discusses the political and social

policy contexts in Russia in the mid-2000's, the period of interest of this study. Section 4 introduces the

survey instrument and discusses the empirical strategy. Section 5 presents the results of the main analysis,

robustness checks, and a validation exercise of the conceptual validity of the measures. Section 6 concludes.

2   Firm Level Preferences for Social Policy

While there are potentially many different dimensions to welfare state policy – degree of redistribution,

social justice, risk pooling, financing, etc. – for simplicity here I focus primarily on two: generosity and

control.[5] Along the generosity dimension, existing work has largely characterized firms' preferences as a

function of firms' overall production strategy. Firms support generous welfare states where the anticipated

effect of social policy on the overall make-up of the labor market and labor costs complement the firm's

labor market strategy. As a tool for shaping the labor market, social policy decreases costs by helping em-

ployers and employees to overcome credible commitment problems and encourages co-investment in skills

(Estevez-Abe, Iversen, and Soskice, 2001, Mares , 2001, Thelen, 2004). Social insurance backstops em-

ployee investment in human capital by mitigating risk (Iversen and Soskice, 2001, Moene and Wallerstein,

2001, Rehm, 2009), while allowing employers to take advantage of economies of scale to offer larger com-

pensation packages (Mares , 2003a,b, Swensen, 2002). This increases the overall supply of skill and makes

---

[5]Existing work has yet to agree on which dimensions are actually most important and typologies vary widely based on author. For examples of different approaches, *c.f.* Hausermann (2010), Kato (2003), Myles and Pierson (2001), van Oorschot and Meuleman (2012), Pierson (2001), Sabbagh (2006).

it easier for firms to acquire skilled employees, benefiting those who utilize highly skilled workers.

As a tool for shaping labor costs, social policy can decrease the cost of skilled labor by placing effective floors on wages. This disrupts the ability of firms to compete by deskilling and engaging in "ruinous product market competition" premised on a race to the bottom in wages (Swensen (1997) :74). It also helps firms to compensate employees for the risks and uncertainty of the business cycle, particularly for exposed sectors or during economic downturns.[6] By improving the supply of skilled workers in the labor market and lowering the costs of acquiring such highly skilled workers, social policy produces benefits for high-skill firms that surpass the costs. Consequently, the more firms depend on skill, the more generous a welfare state they will support.

Firms also care about who controls social policy. In her seminal work, Mares (2003a) argues that preferences over who controls the welfare state depend on the trade-off between administrative costs and discretion over compensation packets. On the one hand, internalizing the costs of social policy administration is expensive and state control spreads these costs more widely. On the other hand, firms that internalize the costs of social policy also have more control over programs and can use them to reinforce their labor market strategies. Mares (2003a) predicts that large firms, whose size allows them to achieve economies of scale, will support employer controlled social policy.

To understand how poor institutions alter the predictions above, it is first important to note that there are commonalities between models of individual and firm level preferences for social policy. As with the prevailing (Meltzer and Richards, 1981) model, firms look to maximize their net gains from social policy contingent on their tax contributions and any dead-weight costs of taxation.[7] Whereas for individuals the benefits come in the form of direct transfers, for firms benefits accrue through the indirect effect of transfers on the labor market and labor costs. Where workers receive high rates of transfers (directly or in expectation) or are encouraged to invest heavily in skills, firms with high-skill production strategies benefit more (Estevez-Abe, Iversen, and Soskice, 2001, Iversen and Soskice, 2001, Moene and Wallerstein, 2001). The relative ratio between these benefits, taxes, and the extent to which contributions are subject to wastage (i.e. dead-weight costs) can be thought of as determining whether a given firm supports generous social policies. Control enters into this framework in that it governs the extent to which firms can explicitly use social policy

---

[6]For an elaboration of the theoretical underpinning the argument with respect to the openness of the economy, *c.f.* Adsera and Boix (2002), Cameron (1978), Garrett and Mitchell (2001), Rodrik (1998, 1997). Swensen (2002) provides an elaboration of this argument during economic downturns, providing evidence with respect to the strategies of high-skill US firms during the Great Depression, *c.f.* pp. 38-40 and Ch. 9 – 10.

[7]For more modern extensions of this model, *c.f.* Alt and Iversen (2013), Iversen and Soskice (2001), Mares (2005), Moene and Wallerstein (2001).

to reward skilled workers, which is one component of the labor market's structure and costs.

An implicit assumption of existing models of both firm and individual level preferences for social policy is the notion that contributions today will be collected and paid out tomorrow as prescribed by law.[8] Weak institutions challenge this assumption, however, by weakening the accountability links between lower level state officials and politicians, on the one hand, and between politicians and the populace, on the other (North, 1990, North, Wallis, and Weingast, 2009, North and Weingast, 1989). The inability to hold these groups accountable, leads to two related problems for the welfare state that in turn shape preferences for social policy.

First, in the absence of constraints on their behavior state officials are faced with temptation to engage in direct rent-seeking at the expense of the populace (Boix and Svolik, 2013, Brownlee, 2007, Geddes, 1999, Gehlbach and Keefer, 2011, Magaloni, 2008, Olson, 2000, 1993, Reuter and Remington, 2009) and to alter policy commitments made today if changing circumstances decrease their utility from these policies tomorrow (Frye, 2010, Kydland and Prescott, 1977). Consequently, neither firms nor individuals can be sure that social policies will not be abused today or altered tomorrow in ways that generate rents for state officials at the expense of the populace. If one adapts and extends the logic of dead-weight costs from existing models to cover the costs of weak institutions, then this suggests that bad institutions decrease the pool of benefits to be distributed to individuals. Because most (including firms) expect fewer net benefits due to these costs, they are more likely to oppose social policy (Becker, 1985, 1983, Meltzer and Richards, 1981). Only where social policy is taken out of the hands of the state (i.e. privately controlled) might actors be able to expect their contributions will be safe.

Second, even where rent-seeking is not the primary motivation of officials, weak institutions also make it difficult to monitor the implementation of public policy by state officials. Without strong oversight and accountability mechanisms, low-level bureaucrats are free to shirk their duties and selectively enforce laws and regulations in ways that minimize their effort and maximize their rents (Beazer, 2012, McNollGast, 1987, Weingast and Moran, 1983). Mares (2005) develops the implications of this argument for social policy, arguing that as institutional quality declines low-level bureaucrats are less likely to fulfill basic duties, such as tax collection. As with the rent-seeking logic above, rampant tax evasion decreases the available pool of funds for social policy, forcing those who are unable to evade taxes to pay more for fewer benefits.

---

[8]Although for an important exception, *c.f.* Kato (2003), who emphasizes the extent to which the government can credibly commit to using additional revenue to expand welfare state generosity as a factor for explaining welfare state funding reforms in the OECD. Pierson (2001) also discusses expectations about the solvency of the welfare state as an important factor motivating reforms.

As before, only where private actors are able to control the collection and distribution of social policy might they be able to escape the problem of weak institutions. Again, extending and adapting the logic of dead-weight costs, this shirking logic suggests that support for social policy decreases as bureaucrats are more able to shirk.

These perspectives both suggest that a simple extension of existing models of preferences for social policy to handle institutional quality would predict:

H_1: *As institutional quality deteriorates, firm support for generous, state controlled social policy decreases (unconditional opposition logic).*

While extending existing models of preferences for social policy to weak institutional settings yields clear testable predictions, it rests on strong assumptions. All actors are assumed to be bearing an evenly distributed tax burden and to share equally in the dead-weight costs of social policy. This need not be the case, however. Those that are able to reduce their dead-weight costs or that are able to contribute less, relative to others, may benefit more from poor institutions (or at least lose less) than they would otherwise. Put another way, poor institutions create unique opportunities to shift costs for those able to take advantage of them. While such firms may exist in settings with good institutions, poor institutions make it easier to engage in such strategies by loosening constraints meant to check such behavior.

In this paper, I explore two groups who can engage in such cost-shifting. First, some firms can create relationships with politicians that create *de facto* accountability, allowing them to protect themselves and take advantage of others. As a general rule, a large body of work has shown that firms with strong political connections generally seem to prosper in settings with poor institutions (Faccio, 2006, Faccio, Masulis, and McConnell, 2006, Frye and Iwasaki, 2011, Hellman, 1998). For politicians, such well-connected firms can provide the necessary resources to insure stable revenues (and sources of rents) they need to retain power. Given their importance to bureaucrats, such firms can often count on their connections to ensure privileged access to public goods, such as social policy, and measures to protect their investments (Gehlbach, 2008, Slinko, Yakovlev, and Zhuravskaya, 2005). Consequently, *ceteris paribus* politically connected firms can use the privilege of connections to defray the dead-weight costs of poor institutions, which in turn should increase their support for social policy relative to the unconnected.

H_2: *Firms' preferences for generous, state-controlled social policy increases along with their ability to use connections to defray the dead-weight costs of poor institutions (privilege logic).*

7

Second, as noted above, the absence of constraints on government officials encourages them to shirk responsibility and cut-back on effort. Consequently, those who are harder for the state to track and monitor – those with mobile assets and those in the informal economy – can take advantage of bad institutions to free-ride on whatever benefits are provided, since officials have few incentives to find tax evaders and compel them to pay. Thus, poor institutions allow some firms to decrease their contributions towards social policy. So long as there are universal or quasi-universal benefits being offered, they can free-ride on the social policy system. If savings from tax evasion outweigh the dead-weight costs of poor institutions, such firms will *ceteris paribus* support social policy more than the average firm.

H_3: Firms' preferences for generous, state-controlled social policy increases along with their ability to free-ride on social policy (free-riding logic).

Before moving on, it is important to make one caveat about the relationship between privilege, free-riding, and poor institutions. In this paper, I motivate my discussion of privilege and free-riding by pointing to the fact that both of these strategies are enabled in poor institutional settings, where there are few constraints on government officials. This need not be the case, however. Even in relatively well-institutionalized settings such as the United States and Western Europe, the ability to glean favors from political friends and to evade taxes is not entirely absent. Consequently, one could easily observe a relationship between well-connected firms and tax-evaders in these countries and support for social policy. I do not discount this possibility theoretically and, due to data limitations, I cannot test it directly. Nonetheless, I argue that the magnitude of the effect of privilege and free-riding should be stronger in settings with poor institutional constraints, which provide more fertile ground for firms to turn connections and tax evasion into benefits.[9]

3   Contextualizing Russian Social Policy and Institutions

Before turning to the empirical section of the paper, it is worth providing a bit of context for the survey. At the time of the firm survey used here (2005), Russia's institutional environment was rather bleak in comparison to international averages in 2005, as noted above. The poor quality of national institutions was reflected at the sub-national level. Figure 1 shows some of this variation, by employing regionally aggregated data from a 2005 survey of 4,350 firms in 80 Russian regions that asked firms whether regional bureaucrats "often" engage in illegal activity. The survey organization reported that this was generally perceived as a

---

[9]I take this question up again in the conclusion of this paper.

question about the extent of corruption (Vainberg and Rybnikova, 2006).[10] On average (the blue line in the figure), 16% of firms reported that their regional bureaucrats were engaged in illegalities. As the figure demonstrates, however, there was a wide degree of variation, with 11 regions having shares higher than 30% and 25 reporting below 10%. Importantly, though, the rates are generally high for most regions.
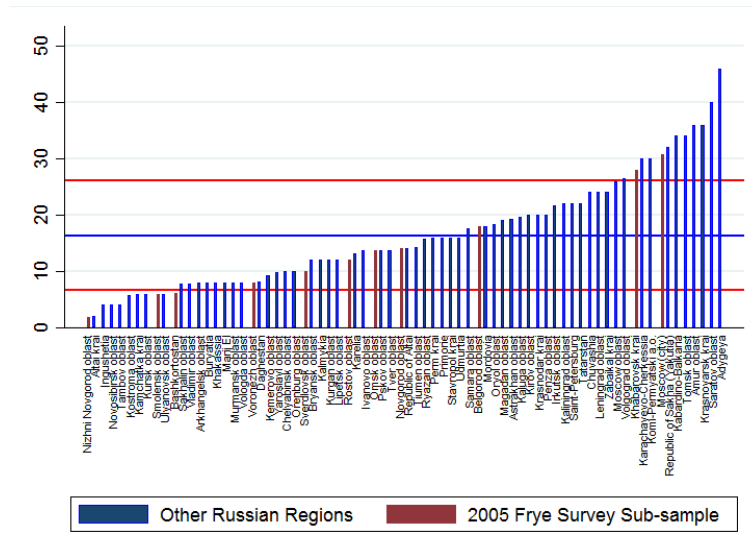

Figure 1: Corruption: Regional Average of Firms who Often Face Illegal Action When Dealing with Regional Bureaucrats

Turning attention to another facet of poor institutions, Figure 2 shows variation across Russia's 89 regions in investment risk ratings given by the financial consulting firm RA Expert.[11] The average rating on the index is 1.2 (the blue line in the figure), with most regions falling below that. Variation is quite low, since most regions tend to cluster narrowly around 1, which is the level of investment risk for Russia as a whole.[12] Nevertheless, considering investment in Russia as a whole was considered quite risky in 2005, this is an indication of generally poor institutions (*c.f.* **?**).

3.1   Russian Social Policy

The weak institutional environment noted above forms the backdrop for understanding how firms preferences for social policy in Russia. In 2005 the Russian welfare state had just undergone an extended period

---

[10]While not ideal, this survey is one of the few contemporaneous surveys to ask questions about corruption in a large number of Russian regions.

[11]The rating encapsulates political, legal, economic, financial, social, and ecological risks into an index that rates the total risk of Russia (as a country) as 1 and all regions in relation to that.

[12]The main outlier regions are the Caucuses, where conflicts and insurgency in the 1990's and early 2000's created massive investment risks.

Figure 2: Investment Risk: RA Expert Investment Risk Rating Index – 2004

of transition and reform. The massive economic shock of the early 1990s placed enormous fiscal strains on the government at the same time it dried up revenue streams. Sharp declines in wages, rapid population aging, widespread unemployment, and rapid expansion of the informal economy undermined state financing designed to provide social benefits for a command economy (Dobronogov and Mayhew, 2000, Haggard and Kaufman, 2008, Williamson, Howling, and Maroto, 2006, ?). At the same time, weak institutional controls over the bureaucracy responsible for collecting taxes allowed officials to turn a blind eye to tax evasion in exchange for rent-seeking opportunities and political favors (Cook, 2007, Gehlbach, 2008, Shleifer and Treisman, 2000, Treisman, 1999). These issues were exacerbated by the vast expansion of the informal sector during the transition, as individual responded to unemployment and new market opportunities by entering the shadow economy, which made it hard for a country with weak state capacity, like Russia, to police evasion. Indeed, state capacity was so weak in Russia that many employers in the formal sector also created tax evasion schemes to save on payroll taxes (Dmitriev and Maleva, 1997, Ovtcharova, and Popova , 2001, Treisman, 1999, Yakovlev , 2001). At the same time, weak institutional controls over the bureaucracy responsible for collecting taxes and administering social policy exacerbated these problems, as officials were willing to turn a blind eye to tax evasion in exchange for rent-seeking opportunities and political favors (Cook, 2007, Shleifer and Treisman, 2000, Treisman, 1999)

The solution adopted by the Russian government in the early 1990s was to move the bulk of its social responsibilities into four off-budget funds – for pensions, health care, disability and childcare, and unemployment – financed through a 37% payroll tax for employers and 1% for employees (Remington, 2011,

10

Twigg, 1998). While this shifted social policy off the government's balance sheet and resolved the fiscal drain, it did little to solve the underlying problems with the system. The replacement rate of pensions through much of the 90s for most pensioners was between 30 and 40% of their average wage, which by 1999 was only around 60 to 70% of the subsistence minimum (Buckley, 1997, Williamson, Howling, and Maroto, 2006). Only a small percentage of individuals received unemployment benefits, which were set far below subsistence minimums due to underfunding. Most did not even bother to apply (Cerami, 2009, Cook, 2007).

Most of the problems with the social policy system in the 1990's stemmed from the inability of the government to collect taxes properly. On the one hand, many individuals responded to unemployment and new market opportunities by entering the shadow economy, causing massive revenue shortfalls. On the other hand, many employers in the formal sector responded to high payroll taxes and new competitive pressures with tax evasion (Ovtcharova, and Popova , 2001, Yakovlev , 2001). Such evasion was normally accomplished through collusion between employers and employees, where official wages were under-reported in exchange for premiums in the form of unreported cash payments or income from untaxable sources (Dmitriev and Maleva, 1997, Treisman, 1999). Evasion was so rampant that Cook (2007) estimates that between a third and half of all workers avoided making contributions to the social funds during the 1990s. Poor institutional oversight exacerbated these problems, as employers were often shielded from formal taxation by regional authorities (Gehlbach, 2008)

In response to growing concern, the Russian authorities embarked on an audacious series of reforms in the early 2000s. First, the system of payroll tax payments was substantially simplified. Rather than paying separately into four different funds, each with its own bureaucracy, employers switched to single Unified Social Tax. Further, the government decided to set a lower, flat payroll tax in order to streamline payment and lower incentives for evasion (Cook, 2007, Nies and Walcher, 2002). Combined with other modifications to the tax code, the Unified Social Tax resulted in a 30% increase in tax collections in the first five months after the reform, an effect widely attributed to firms being incentivized to exit the shadow economy (Remington, 2011).

Second, in conjunction with the tax reforms, the government also altered the relationship of social policy to the federal budget and created opportunities for private sector involvement. Health care, for example, was removed from the purview of the national budget and devolved to regional off-budget funds with dedicated tax revenues. Private insurance funds were brought in to negotiate with local service providers on behalf of these regional funds (Burger, Field, and Twigg, 1998, Twigg, 1998). Pensions were also nominally

11

extracted from the federal budget and placed under the responsibility of a central fund: the Pension Fund of the Russian Federation (PFRF). The PFRF continued to manage the existing universal, solidaristic minimum benefit payments, while citizens were given a choice between public (i.e. PFRF) or private management of a newly introduced notional defined contribution (Afanasiev, 2003, Williamson, Howling, and Maroto, 2006). Adoption of the private system was somewhat hampered, however, by the unwillingness of the state to guarantee funds outside the PFRF's control (Chandler , 2004, Sokhey , 2010).

These reforms, along with centralizing reforms that gave the federal government more control over regional tax authorities, went a long way towards solving the revenue crisis (Remington, 2011, ?, ?, ?). In conjunction with the tax reforms, the government also altered the relationship of social policy to the federal budget and created opportunities for private sector involvement in areas beyond pensions. Health care, for example, was removed from the purview of the national budget and devolved to regional off-budget funds with dedicated tax revenues. Private insurance funds were brought in to negotiate with local service providers on behalf of these regional funds in order to introduce an element of privatization (Burger, Field, and Twigg, 1998, Twigg, 1998). Nonetheless, reforms outside of the pension system remained rather limited both in scope and in their effects. Many of the improvements to the Russian social policy system stemmed from tax reform and improvements to the general economy, although specific policy changes did help somewhat (Cook, 2007).

What were the implications of the Russian system for preferences over social policy in 2005? Prior to reform, the populace almost universally regarded the pension system as inadequate for providing old-age security. Although the reforms were helpful in resolving some of the most blatant problems with the pension system, the ratio between nominal average pensions and wages for the median region was about half in 2000 and fell to less than one-third in the mid-2000s. Repeated efforts by the government to cope by raising minimum guaranteed payouts were largely unsuccessful, although they helped somewhat (Remington, 2011). For health care, the obligatory basic insurance coverage promised by the state did not provide much in the way of advanced care, nor did the quality of care provided improve much (Cerami, 2009). More importantly, regional governments were often left in charge of covering health insurance for the unemployed, exposing these groups to the vagaries of regional budgeting (Wagstaff, 2009). Institutionally both the health-care and pension systems were plagued by accusations of corruption, mis-management of funds, and outright theft on the part of both public and private providers (Burger, Field, and Twigg, 1998, Cook, 2007, Twigg, 1998). Both systems also retained universal components, making them vulnerable to free-riders even in the face of the UST reforms attempts to make paying taxes attractive to individuals and firms.

From employers' perspective, the social policy system circa 2005 therefore provided uncertain labor market benefits. On the one hand, the relative inadequacy of the basic state-run system meant that firms were forced to offer supplementary benefits or wage premiums in order to attract highly skilled workers (Remington, 2011). The mixed system facilitated high-skill labor market strategies for larger, profitable firms, particularly state-owned or partially state owned firms that could draw on government resources to defray costs. For such firms, the public component was not crucial to the labor market value of the programs, but several of the business association leaders I interviewed emphasized to me that the marginal benefits of the universal component of the welfare state were worthwhile to firms, particularly government affiliated ones, with weak budget constraints (Interviews BA20130613, BA20130716, BA20130801). For others, however private provision was too expensive and the existing system remained vulnerable to predatory officials and opportunistic policy reversals designed to favor the state-run system.[13] On the other hand, because many of the problems of the system stemmed from inadequate benefits provision, an increase in funding could *ceteris paribus* make it an efficacious part of broader labor market strategy. Again, though, poor institutions made such a strategy dangerous, as participants would be vulnerable to the costs of poor institutions.[14] In either case, however, the framework introduced above suggests that firms that could protect themselves or free-ride might be able to derive benefits despite the drawbacks of poor institutions.

4   Data and Methodology

In order to test the hypotheses laid out in section 2, I employ a survey of 666 Russian executives[15] in eleven regions that was conducted in 2005. The survey covers 23 industrial sectors, excluding agriculture and communal, health, and social services. Firms were randomly selected based on a stratified design, resulting in a survey that roughly mirrors the size and sectoral composition of the national economy.[16]

The timing of the survey is of particular note, because the survey was conducted after reforms to the health care system and final enabling legislation for the 2001 pension reform had been passed. As noted

---

[13]For example, the vice-president of Russia's largest employer association, Igor Iorens, complained three years after the pension reform that government officials effectively eliminated the private system as a real choice by manipulating regulations to slow down transfers from the government to private system (*Russkii Polis* (05/01/2003). "Dokazatel'stvo obratnovo".) [1061].

[14]For examples of this in the Russian press, Selivanovna, M. (05/05/2002). "Interv'ju s Aleksandrom Shohinom". *BOSS* [19]; Golikova, L. (11/27/2001). "Posle reformy budet tol'ko huzhe". *Kommersant"* [612]; Korobkova, I (07/15/2002). "Lakomyj pensioner". *Kompanija*. One labor union head indicated the magnitude of the problem to me, noting that it was almost impossible to audit whether contributions were properly credited. Employers or unions would have had to know someone important to get access to the data (Interview LU20130723).

[15]Chief executive officers, chief financial officers, and chief legal officers

[16]More details on the sample selection, composition, and representativeness can be found in Frye (2006). Summary statistics are presented in table 4.

above, this made private control a realistic possibility for the first time and gave firms exposure to private and public systems of controlling social policy. Survey instruments designed to parse out preferences for government control would therefore have been salient and topical to respondents. At the same time, because the survey was conducted during controversies over the withdrawal of non-monetary social benefits and the implementation of pension reforms, social policy generosity was salient for both the populace and enterprises (Cook, 2007).

I make use of the following survey instrument to measure preferences for social policy:

In society there are different views about the scale of funding for the social sphere and the direction of its development. Which of the following statements do you agree with?

1. It is necessary to increase social spending by increasing taxes and mandatory payments

2. It is necessary to maintain social spending at the same level, leaving taxes and mandatory payments at the same level

3. It is necessary to reduce social spending while reducing taxes and mandatory payments

4. Hard to say

For my purposes, this instrument has several valuable features. First, the reference in the original Russian to "the social sphere" primes respondents to think about state control, as the term is rarely used with private programs or funds. Expansion of the system and state control are therefore at the heart of this question. Second, the instrument directly evokes taxation policy. This primes respondents to think carefully about the cost trade-offs inherent in providing more generous social policies (Kenworthy and McCall , 2008). Finally, this question is also helpful in that it is rather vague about social policy. Normally, respondents may have very different programs in mind when answering this type of question. Here, this ambiguity is helpful, as it narrowly focuses the question on control, rather than different risk types. The cost is masking potential heterogeneity due to variation in the risk profile of firms, but this is a small issue given the focus here on control.

There are two main challenges when interpreting this instrument. First, the question wording makes it difficult to distinguish between firms who do not trust the state to provide social policy and those who simply believe taxes are too high. Fortunately, the survey includes questions that allow for controls on the appetite of firms for spending and for ideological attitudes. Second, many firms availed themselves of the "hard to say" option (26%). On the one hand, firms simply may not care whether social spending is altered
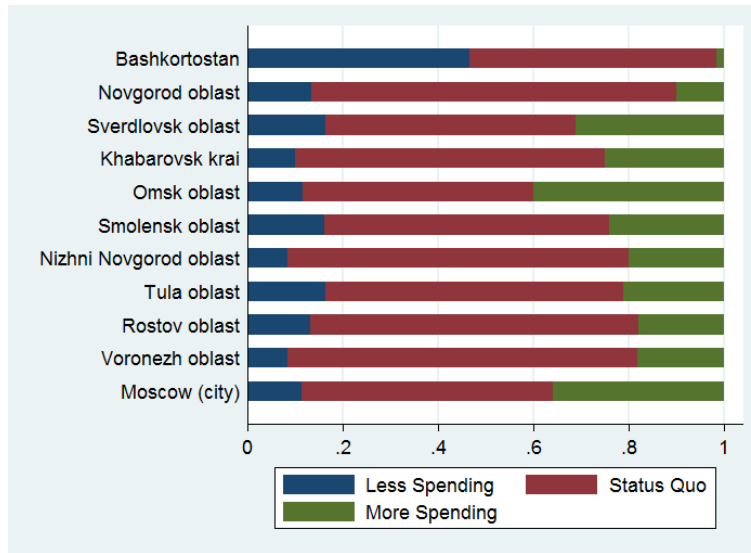
Figure 3: Support for Social Policy Spending Increases

along with taxes or may not know enough to judge. On the other hand, firms may have found this question to be sensitive.

In this paper, I take the former view. First, analysis of "hard to say" answers fail to turn up systematic predictors (see Table 1 below), which is implausible if the question is sensitive. Second, qualitative evidence gathered during interviews with business associations during my field work suggests many firms do not think about social policy until asked and tend to find the status quo adequate (BA20130613, BA20130801). Indeed an informal poll of over 200 Moscow business associations I conducted supports this supposition: only a handful of (usually large) associations reported being interested in social policy issues. Moreover, in none of my interviews did it ever seem that business owners or business association leaders lacked knowledge of social policy, another possible explanation. Finally, it seems implausible that the question was sensitive. Questions dealing with corruption – a clearly sensitive question – elicited far fewer missing responses. Consequently, I deal with this issue by lumping "hard to say" answers in with those who answered that the status quo is appropriate. [17]

All told approximately 22% of the sample of firms supported increases in social spending along with a higher tax burden to support it, while about 15% of firms preferred a decrease in both social spending and the tax burden. Figure 3 summarizes the dependent variable across all regions in the sample and sorts regions according to aggregated responses to a question about perceptions of corruption on the survey.[18]

---

[17]Reported results are also robust to alternative means of dealing with these missing responses, such as list-wise deletion or assuming these firms oppose social policy. Results available upon request.

[18]This variable comes from a question asking firms about the extent to which regional bureaucrats are corrupt or take bribes from

15

The regional distribution of answers is quite striking. In the Republic of Bashkortostan, for example, only 2% of firms support increases in government controlled social spending, whereas in Moscow 36% of firms do. Strikingly, these are the regions with the highest and lowest levels of perceived corruption according to this survey. Nonetheless, the relationship is not straightforward, as figure 3 indicates. As noted above, this is likely because Russian institutions are uniformly poor.

Section 2 posited a number of hypotheses about the ways in which firms win and lose from social policy under poor institutional conditions. In order to explore firms' preferences for social policy, I begin by estimating a simple ordered probit model with fixed effects for regions and sectors and cluster corrected standard errors.[19] The probit model has the structural form:

$$Y_i = \alpha + \beta D_i + \gamma X_i + \rho I_r + \chi_r + \epsilon_i \tag{1}$$

where D_i is a vector of individual, firm-level characteristics of interest for firm i, X_i is a vector of firm-level controls (discussed below), ρ_r and χ_s are vectors of regional fixed effects (for region r) and sector fixed effects (for sector s), and ϵ_i is the error term.

4.1 Measuring Privilege and Free-riding

The hypotheses developed in Section 2 suggest that in poor institutional environments, firms will be more likely to support social policy if they are insulated from the dead-weight costs of poor institutions. I argued that well-connected firms and those able to evade taxes are uniquely insulated. To test this argument, I make use of several measures. First, the misappropriation mechanism suggests that firms may be able to mitigate the costs of poor institutions by taking advantage of political connections. Unfortunately, in this survey there are no direct questions about the relationship of the firm manager to regional officials or the presence of state officials on the firms' executive board. To get at these connections, I make use of questions about the ownership structure of firms to create a dummy variable indicating state ownership. My survey allows me to distinguish between four types of firms: those originally registered as private, formerly state-owned firms that were fully privatized, state-owned firms with some private ownership, and fully state-owned firms.[20] I

the same survey that provides the dependent variable.

[19] Results in this paper are robust to alternative specifications including OLS, Multi-level linear regression using cluster corrected, bootstrap standard errors (Cameron, Gelbach, and Miller, 2008, Harden, 2011, Leoni , 2009).

[20] Firms were first asked if they were formed as a state or private enterprise. If formed as a state-owned enterprise, they were then asked if they were privatized. This distinguishes de novo and formerly state-owned firms. To distinguish between firms with residual state ownership and fully privatized firms, I make use of a question that asks about the make-up of firms' stock holders. Firms that indicated ownership by municipal, regional, or federal authorities were coded as having residual ownership. This coding

construct my state-ownership dummy using the latter two categories.

Firms with state ownership should be strongly connected to key politicians, since the latter – in their role as public servants – own the former outright. Government (and government appointed) officials typically hold seats on the boards of directors for these firms (Frye and Iwasaki, 2011). Moreover, existing work provides some evidence that state ownership is enough of a political connection to allow firms to derive benefits unavailable to others. In Russia, evidence indicates that state-owned firms are more likely to benefit from the selective provision of public goods and additional property rights protections (Gehlbach, 2008, Juurikkala and Lazareva , 2006). They are also more likely to receive preferential tax treatment, better access to government orders, and access to credit, all of which can help them to mitigate both the actual costs of social policy and weakened competitiveness from having to pay for it (Frye and Iwasaki, 2011). Indeed, when asked about how different companies would react to tax increases to pay for greater social policy, the head of a major Russian business association said:

> All employers are well aware that increases in taxes – this is a decrease in their income. Maybe not by 100%, but by 50 for sure. Especially in small companies and in companies in the private sector. Everyone understands that this doesn't concern large government firms, they can just absorb the new rates. But what can the rest of us do? (Interview BA2-20131007)

At the same time, in Russia flows from the funded component of pensions were available to the government as cheap credit (Entry 19, 205, 259, 330, 526, 700). During debates about pension reform in the early 2000's there was a great deal of fear that this would be misused by the government as a means of rapidly increasing spending and increasing support for, and investment in, state-owned firms.[21] As Andrei Godzinski, president of the Eastern Finance Company notes, there were few controls on such funds:

> The reform (of the pension system) has created one outrage. This is that money is being transfered to Vnesheconombank (a major government owned investment bank) – this is an outrage squared. Why did they (the government) do this? To collect for themselves massive resources that they can spend without control. (Entry 902)

Indeed, one of the government's major responses to the 2008 financial crisis was to engage in massive deficit spending in order to provide bailouts to troubled state-owned firms, among other measures (Gurvich et al.,

---

matches reasonably well with an alternative approach that looks at the legal status of companies, but captures cases where the state has an equity stake in public companies.

[21]I discuss this fear in greater depth in a chapter of my dissertation, which uses content analysis of the Russian press to explore the logic linking institutional quality and social policy preferences

2010, Vartapetov, 2011). With respect to social policy, these types of benefits – privileged access to public goods, property rights, credit, and government support – are all important, because they provide state-owned firms with comparative advantages vis-a-vis other firms that help them lower costs and risk.

It is important to note that a dummy for state owned firms is a somewhat noisy measure. Fully state-owned firms, in particular, are likely to differ from their private counterparts on a host of dimensions – ideology, competitiveness, budget constraints – that may influence preferences for social policy through channels other than privilege. Nonetheless, this is one of the easiest and most reliable measures of connections.[22] I explore alternative interpretations of this variable, as well as attempt to illustrate what types of advantages state-owned firms are receiving in Section 5.1.

I also measure privilege more indirectly by looking at outcomes that should be associated with political connections. One proxy is through the use of a survey instrument that asks firms whether they make sales to the government. In Russia, government sales are often used as a way of rewarding firms for good behavior, particularly with respect to mobilizing the electorate in favor of Kremlin-supported candidates (**??**). That firms receive these rewards is both a reflection of the importance of the firms to the government, and the possibility that these firms may be of sufficient value to receive other government favors. Again, however, I expect this measure to be somewhat noisy, since some firms will win government sales on the merits of their products.

Another indirect proxy is through a survey instrument that asks firms if they attempt to influence new laws and normative acts important to their business and to what extent they are successful. Intuitively, firms who lobby and believe they exert great influence are likely to benefit from political connections. Previous work on the effect of political connections has used survey instruments of this type in analysis (Slinko, Yakovlev, and Zhuravskaya, 2005). Because social policy is mostly overseen at the federal levels, I include a dummy variable equal to one if firms report having lobbied the federal government.[23]

A second proxy is firms' confidence in being able to successfully resolve disputes against the government. Protection of property rights *from the state* is one of the most important privileges firms can receive from connections in poor institutional environments and an important determinant of investment (Gehlbach, 2008, Gehlbach and Keefer, 2011, Haber, 2007, Haber, Maurer, and Razo, 2003). I capture this by using

---

[22]Compare studies such as Frye and Iwasaki (2011), Gehlbach (2008) to studies that use more elaborate criteria, such as Faccio (2006). The latter make strong assumptions about ownership and connections while also relying on a non-anonymous sample. Such techniques are difficult to replicate with survey data.

[23]For robustness, however, I also tried variables indicating whether the firm had lobbied at the regional or municipal level. Results remain the same for any permutation of this variable.

an instrument that asks firms about their confidence in winning in court against the regional government [24] Although this measure does not directly reflect connections between the firm and government, the ability to successfully defend oneself from regional governments implies some sort of alliance with key officials given the relative dependence of the judicial system on executives at the regional level. While, this variable is strongly associated with other forms of leverage (size, market power, etc.) that might help in protecting firms, once one controls for these features, it can provide evidence that firms' ability to defend themselves from predation – rather than ability to free-ride – governs preferences for social policy.

Testing the free-rider perspective is a bit more complex, as the survey used offers no instruments that directly tap traditional measures of the ability to free-ride. Factor mobility, for example, can only be measured using coarse sector fixed effects, which are themselves highly correlated with other determinants of preferences for social policy such as skill profile. Similarly, firm size is highly correlated with sector, with the largest firms in the sample generally belonging to the oil and gas sector and heavy manufacturing and the smallest to the retail sector.[25] Moreover, firm size is likely to be correlated with other factors – the ability of firms to take advantage of economies of scale, lobbying capacity, ability to provide officials with rents, political connections – that may influence preferences for social policy along other channels.[26] Indeed, existing work has found that large firms are more likely to capture and be captured by state officials, particularly in post-communist states like Russia (Gehlbach, 2008, Hellman, 1998). Consequently, firm size is difficult to interpret and could actually proxy for both political connections and ability to evade taxes.

One available proxy, however, is the extent to which firms are visible to regulatory authorities. The more interaction a firm has with government officials, the more difficult it is to hide critical tax-related information – sales, number of employees, and employee salaries – from the authorities and the harder it should be to evade taxes. To capture this, I make use of a question that asks firms, " In the last year, how many times was your firm subjected inspections from government organs (fire safety, sanitary, etc.)?", to generate a measure of the logged number of inspections experienced by the firm. An important feature of this measure is that it captures inspections generally, rather than specifically those carried out by tax authorities. While the former indicate the ease with which government can find firms, a large body of evidence suggests that the latter tends to lead to collusive arrangements to evade taxes (**?**). Thus, eliminating these inspections from the variable is important for cleanly capturing firms' visibility, rather than opportunities to bribe tax officials

---

[24]The survey instrument asks, "Can your firm defend its legal interest through negotiations, without use of the arbitration courts, in economic disputes with [the executive branch of your region/federal agencies]?"

[25]Pairwise correlations between firm size and these sectors are 0.2756 (oil and gas), 0.2646 (heavy manufacturing), and -0.2753 (retail). All these correlations are significant at the 99.9% level.

[26]Section 5.1 demonstrates the multi-faceted effects of firm size empirically.

19

into looking the other way.

It is important to note, however, that this measure is not a perfect proxy and has potentially ambiguous interpretations in the same way firm size does. While I argue that firms that can avoid inspection by the authorities are less visible (and therefore more able to evade taxes) than other firms, they might simply be using political connections to avoid inspection. This would be inconsistent with the free-riding mechanism. I address this ambiguity directly in the Section 5.1 with some tests designed to validate this measure as one of visibility and not political connections.

4.2   Controls

In addition to the variables of substantive interest noted above, I also include controls for a number of basic firm level characteristics: the logged number of employees at the firm, whether the firm exported products in the previous year, firms' labor costs as a percentage of total production costs, whether competition from other firms poses a problem for firm development, and whether or not the firm provides supplementary pensions and health care policies.[27] I also include a measure of competitiveness – whether the firm reported profits in the previous year. I supplement this with a question about the degree to which credit constraints hamper the firms' development, as this variable is important to understanding the degree of flexibility firms have in meeting competing priorities (expansion, wage bills, taxes, etc.) while under budget constraints. In addition, ownership structure is an important predictor of firm behavior in a wide variety of surveys of Eastern European firms.[28] Consequently, I include the dummy variable described above for state-ownership in all specifications. Finally, as a means of controlling for potential unobserved heterogeneity due to selection of certain types of executives into certain types of firms, I also control for key individual level characteristics that have proven robust in nearly all studies – manager's age, level of education, and gender – in my main specifications (Alesina and Guiliano , 2011).[29] I explore managerial characteristics in further detail in the robustness section of this paper, as the selection problem is a potentially important alternative explanation for my findings.

I also include control variables of greater substantive interest. Existing studies posit that firms' preferences for social policy are governed by firms' labor market needs (Mares , 2003a, Swensen, 2002). Conceptually, existing work tends to treat this variable as a means of measuring the relative skill intensity of firms and their demand for skilled labor (Thelen, 2004). Unfortunately, no such measure exists on my survey

---

[27] These are generally offered as complements to the universal government programs in Russia.

[28] For examples, *c.f.* Beazer (2012), Frye (2006), Frye and Iwasaki (2011), Gimpel'son and Zudina (2012), **?**.

[29] See Table **??** for a complete list of supporting studies

instrument. Instead, I make use of a related measure that captures firms' bargaining power vis-a-vis their employees. Conceptually, the easier it is for a given firm to meet its demand for skilled labor, the less labor market constraints should govern its preferences.

As a simple proxy for the degree to which labor market considerations bind, I use a variable which captures the difficulty that firms have in finding qualified managers. I select this measure for two reasons. First, the survey uses a term for qualified specialists (*kvalifitsirovannie rabotchi*) that can applies broadly to both workers with advanced education and those with small amounts of on-the-job training. As work on labor markets in Russia has amply demonstrated, however, the labor market needs of firms for these more narrowly defined types of specialists varies considerably: the former tend to be scarce, while the latter are abundant (Gimpel'son, Kapeliushnikov, and Lukiyanova, 2010, Tan et al. , 2007). Because of the question wording, it is therefore impossible to know what type of worker managers are thinking about when they answer this question. Consequently, two firms with similar skill profiles in the same labor market may answer this question differently based on what the manager perceives "qualified workers" to mean. Second, the question on difficulties in finding qualified managers is helpful, because the category is relatively well-defined in Russia and represents a relatively scarce variety of skill that firms traditionally have difficulty finding on the labor market (Gimpel'son, Kapeliushnikov, and Lukiyanova, 2010, Tan et al. , 2007, **?**, **?**). As such, this measure is a good proxy for firms' bargaining power vis-a-vis local labor markets and other firms. To the extent that managers are in high demand, success in finding managers is likely to be strongly correlated with the ability to find the sorts of high skill individuals that existing literature highlights.

5 Results

Table 1 presents the main results, which are consistent with both the misappropriation and free-rider hypotheses discussed above. Model 1.1 introduces the baseline model, which includes the full set of controls outlined in section 4.2 and the state ownership dummy variable. The co-efficient of the state ownership dummy is positive and significant at conventional levels, indicating that state-owned firms are more likely to support government control of social policy. To the extent that state ownership is a proxy for political connections, this result is consistent with the misappropriation hypothesis.

With respect to the control variables, Model 1.1 indicates that labor market concerns are statistically significant predictors of firms' support for state-controlled social policy at the 5% level. As expected, firms with difficulties in attracting qualified managers are more likely to support increases in state-controlled

social policy spending. This is consistent with work that highlights the importance of labor market demand for skills in social policy preferences (Mares , 2003a, Swensen, 2002). Labor costs as a share of total revenue are also a significan predictor of social policy preferences at conventional levels, but have the opposite effect. Firms that spend a larger share of revenue on labor being more likely to oppose increases in social policy spending. This result is also unsurprising, since firms with high labor costs are unlikely to be sympathetic to tax increases that would further increase labor costs.

Other control variables, such as firm size and export orientation, are not significant at conventional levels in most specifications of Table 1. These results are somewhat odd, given predictions in the existing literature, particularly for firm size. This may be partially due to the fact, noted above, that firm size is simultaneously correlated with political power in Russia and visibility to tax authorities – potentially countervailing effects. Indeed, only when one controls for inspections (model 1.5), a measure of visibility, does firm size become a significant (positive) predictor of support for social policy. I discuss this result further below, when I validate my interpretation of the other substantive variables of interest. Finally, it should be noted that managers' characteristics were insignificant predictors of firms' attitudes towards social policy.[30] This result mitigates some concerns that answers to the social policy question reflect the personal preferences of managers, since age, gender, and education are typically all extremely robust predictors of individuals' preferences for social policy and redistribution (*c.f.* Alesina and Guiliano (2011)). Here, the evidence suggests managers are answering with their firms' strategic goals and limitations in mind.[31]

Model 1.2 introduces the dummy variable indicating whether the firm sells products to the government. Recall that government sales can be highly political in Russia and are often used as a way to reward firms. As suggested by the misappropriation mechanism, firms with government sales are indeed more likely to support social policy, although the result is only significant at the 10% level. By contrast, the measures indicating that firms lobby the government and confidence in their ability to protect their property rights vis-a-vis regional governments in court (models 1.3 and 1.4 respectively) are not significant at conventional levels. Taken together, therefore, the first four models in table 1 provide some support for the misappropriation mechanism, although they suggest that the types of privileges firms receive due to their connections are important. Property rights protection seems to matter less than other privileges.

Model 1.5 introduces the proxy for free-riding, the log number of inspections the firm has experienced in the last year. As expected, log inspections are a negative and significant predictor of support for social

---

[30]These are omitted from the reported results in table 1, but are available upon request.

[31]This does not eliminate the possibility that managers' ideological leanings shape their answers. I deal with this possibility in greater detail in the next section.

policy: the more a firm has been inspected, the less it supports state-controlled social policy spending. As noted above, this result is consistent with both the misappropriation and the free-riding mechanisms. On the one hand, firms that are inspected more often may not face government inspections due to protection from state allies, a form of privilege that allows them to deflect the costs of poor institutions. On the other hand, firms that are less subject to inspection may also be better at hiding themselves from the government, allowing them to evade taxes and free-ride. I attempt to distinguish between these two in the next section.

It is worth briefly noting here that these results buttress (and are butressed) the findings of ?, which shows that the self-employed are more supportive of social policy in settings with weak institutions. Although I treated those results as individual level results, one could also argue that they say something about the preferences of the smallest firms, who indisputably have advantages in hiding from the tax authorities. Obviously, one must be cautious in conflating individual business owners' preferences with their firm due to the lack of firm level controls. Nevertheless, the fact that results for firms with a comparative advantage in tax evasion in weak institutional settings are similar across these different tests is reassuring.

Finally, model 1.6 checks whether the results of the previous models may have been due to selection effects related to non-response. I make use of a simple logit model, in which the dependent variable is a dummy equal to one if the firm responded "hard to say" to the social policy expansion question and the right hand side consists of the set of controls from the previous models and the two main, significant independent variables of interest: the state ownership dummy and log inspections. None of these variables is a significant predictor of answering "hard to say", indicating that results are unlikely to be due to systematic selection effects.[32]

To put the results into context, Figure 4 provides a sense of the relative predictive power of the log inspections variable and the state ownership dummy in comparison to the other statistically significant controls.[33] For continuous variables, the figure shows the first difference in the predicted probability that the median firm supports more social policy spending and higher taxes and the continuous variable of interest moves from the median to the 90th percentile value. First differences for the state ownership dummy variable were taken between state owned firms and private firms, with all other variables held at the median.

Interestingly, the substantive effect of the state ownership variable is by far the largest, with state owned firms being about 9.8% more likely to support state-run social policy than other firms. Log inspections

---

[32]These results are also consistent with the fact that these results are more or less missing at random. In unreported regressions, I engage in list-wise deletion of firms that answered "hard to say", which does not substantially alter results.

[33]The figure was constructed using quasi-bayesian simulated predicted probabilities (and their 95% confidence intervals) derived from models 1.5. Simulations were obtained in R.
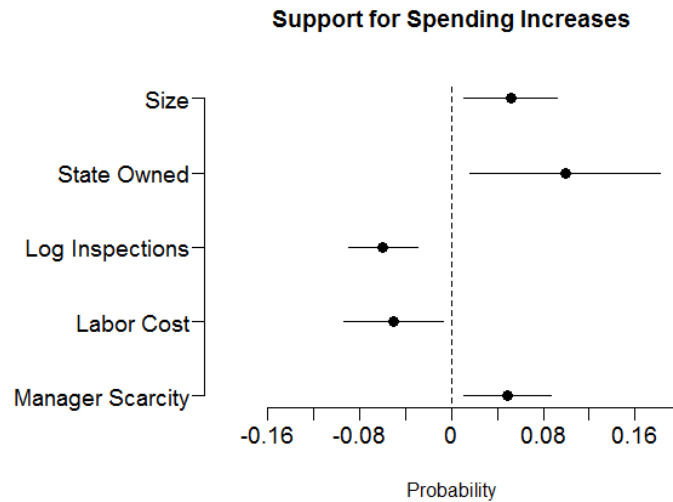
Support for Spending Increases

Figure 4: Substantive Effects of Individual Level Predictors of Support or Social Policy

had a smaller, but still large effect, making firms about 6% less likely to support social policy spending as one goes from a median level of inspections to the 90th percentile. These effects are as strong or stronger than the effects of going from a median to an acute level of need for managers (4.9% more likely to favor social policy), from a median to a particularly large firm size (5.1% more likely to favor social policy), and from median to particularly high labor costs (5.1% less likely to support social policy). While most of these effects may seem objectively small, it is important to note that effect sizes of 3-4% are large in comparison to the types of substantive effects generally identified in the individual level literature, even when going from the median to the 90th percentile of income. Rehm (2009), for example, estimates the probability of support for social policy to decreases by about 5% as one goes from the median to the 90th percentile in income and increases by 6% and and 3% as one goes from the median to the 90th percentile in occupational unemployment rates and skill specificity respectively.

In order to insure the robustness of these results, I ran some additional tests. First, I recreated the above specifications with the full set of ownership dummies – private firms, fully privatized firms, partially privatized firms, and fully state-owned firms – instead of the more coarse state-ownership dummy used in the main specifications. Results remain mostly robust, although these tests suggest that much of the effect of the coarse state-ownership dummy comes from the strong (both substantively and statistically) preferences of fully state-owned firms. Partially state-owned firms tend to support government control more than other types of firms, but reach conventional levels of statistical significance in only a few specifications.

Second, I guard against the possibility that variation in the tightness of local labor markets shapes firm preferences for social policy by rerunning the models above using multi-level models that account for local labor market conditions. I introduced regional level unemployment into the above specifications and controlled for social policy spending as a percentage of total regional spending. Since the legal framework for Russian social policy is set by the central government and formally the same across regions, the latter is a good measure of variation in social policy.[34] These additions do not substantially change the results.

I also took advantage of the fact that the survey was conducted in each region's capital city to explore labor markets at the micro-level. In particular, I introduce a measure of net migration into the city, a proxy for labor mobility, and of the employed share of the working age population. Again, neither variable changes the main results. Substantively, these tests yielded little insight into the effect of regional labor markets on preferences for social policy. This is to be expected, as the small number of 2nd level (here regional) units severely biases estimates of both standard errors and co-efficients. While corrections exist, they tend to work poorly for applications with fewer than 20 observations (Cameron, Gelbach, and Miller, 2008, Leoni , 2009).

5.1 Evaluating Alternative Interpretations

Two of the main variables of interest – the state ownership variable and the log inspections variable – are potentially subject to endogeneity and interpretation issues. In this section, I provide some additional tests in order to show that the interpretations offered in the previous section are valid, that both variables are capturing the intended concepts, and that the results of the previous section offer some support for both the privilege and free-riding perspectives.

Table 2 begins by offering a few tests designed to insure that the results attributed to the state-ownership and inspections variables are not due to factors unobserved in those tests. Unfortunately, there is no way to create good instruments for either of these variables from the survey, therefore the only option is to attempt to control for major categories of unobservables. One of the main differences between state and privately owned firms is that the former may be able to count on state support, relaxing their budget constraints and allowing them to support otherwise unprofitable policies (Kornai, 1986). Model 2.1 attempts to account for soft budget constraints by introducing a measure of the extent to which firms are confident that authorities will provide aid in the event of financial difficulties.[35] The more certain firms are that aid is forthcoming, the

---

[34]Results are omitted due to space concerns but are available upon request.

[35]Firms could respond "certainly not", "probably not", "probably yes", "certainly yes". Higher values imply greater certainty of

more likely that soft budget constraints are guiding their decisions. This variable is positive, as expected, but insignificant at conventional levels. It does decrease the significance and magnitude of the state ownership dummy (although not below the 10% level), however. This is consistent with the notion that fully state owned firms believe that their political connections will allow them to mitigate the costs of social policy expansions in a poor institutional setting.

One may also worry that state-owned firms are less competitive than other firms, leading them to seek out government subsidies. The main specification includes a measure of profitability, but this may not fully capture differences in the ability to compete. Model 2.2 includes additional measures of competitiveness, including whether firms were able to engage in capital investment, open new product lines, or received foreign investment in the last two years. None of these variables are significant and they have no effect on the state dummy variable. This suggests that variation in competitiveness is not driving the results.

State owned firms might also differ from the private sector in that they may have to informally contribute to regional budgets and programs in exchange for favors (Gehlbach, 2008, Treisman, 1999). On the one hand, this may cause them to favor state-run social policy as a way of decreasing their burden. On the other hand, it might not make a difference in what the firm is asked to provide and instead just increase costs. Model 2.3 introduces a series of dummy variables equal to one if firms reported that they provided aid to regional agencies, pension funds, unemployment programs, or construction programs. None of the new variables are significant at conventional levels and they have no effect on the sign or significance of the state-ownership dummy.

Managers of state-owned firms might also have different ideological leanings than their counterparts in private firms. In this case, differences between state-owned firms and private ones reflect the ideology of managers, not characteristics of the firms themselves. While the main specifications control for manager level characteristics, Model 2.4 introduces additional measures related to government spending. Firms were asked whether they supported increases, decreases, or status quo levels of spending on police forces, the judiciary, and education.[36] Of these, only preferences for education spending are a significant predictor of support for social policy spending at conventional levels, with the co-efficient being positive, as expected. Even with these additions, however, the state-ownership dummy remains positive and significant. Model 2.5 tackles ideology from a different direction, including dummy variables if respondents voted for the Communist Party, liberal parties (Yabloko or the Union of Right Forces), and a variable indicating the extent to which the respondent supports WTO accession. All are reasonable proxies for attitudes towards the market.

support.

[36] Note that these questions do not evoke taxation, so individuals are not reminded of the consequences of increased spending.

Again, these have little effect on the state ownership dummy and none are significant at conventional levels. Managers do not appear to be answering based on their own ideological predilections.

Model 2.6 and 2.7 shift focus to the proxy for visibility – log inspections – in order to assess whether the effect attributed to this variable is due to other factors. Model 2.6 first verifies that inspections are not related to general perceptions of government competence, an alternative explanation inconsistent with the institutions based framework advanced here. I introduce two variables into the baseline model, which capture respondents' evaluation of the performance of their regional governor and regional executive bodies. In this specification, the magnitude of the log number of inspections is actually *larger* than in previous estimates and remains significant at conventional levels. Moreover, the two proxies for firms' evaluation of local officials fail to reach significance at conventional levels. The link between inspections and opposition to government-controlled social policy does not appear to be related to negative evaluations of the government.

Model 2.7 is a similar exercise that checks whether log institutions are a proxy for local bureaucratic discretion, a variable linked to expectations of rent-seeking and opportunism in the Eastern European context (Beazer, 2012). I include an instrument indicating whether firms believe local bureaucrats have a high degree of discretion. Again, this variable alters neither the magnitude or the sign of the inspections variable. Interestingly, the measure of perceptions of local bureaucratic discretion is a significant, positive predictor of support for social policy. While this is a somewhat puzzling result, it may be explainable if firms are able to make use of local corruption and bureaucratic discretion to attempt to ease their costs (or enhance their benefits) from social policy, even if such policies may exacerbate free-rider problems at the regional level.[37]

While the results presented in table 2 mitigate concerns over unobservables somewhat, they do little to address whether the state-ownership dummy and the inspections variable are valid measures of the privilege and visibility concepts. Table 3 attempts to get at these concerns directly. First, if the state ownership variable accurately captures the privilege logic, then we would expect it to be a significant predictor of the types of privileges that enable firms to mitigate costs associated with increased social policy spending: preferential protection of property rights, protection against corruption, and access to government subsidies in case of economic difficulties. Similarly, if the inspections variable captures power derived from political connections, rather than visibility, it should be associated with these variables as well.

Model 3.1 introduces as the dependent variable the ordinal measure of the degree to which firms are confident they can prevail in court when the regional government is a counter-party used in Model 1.4.

---

[37]Local level discretion, in particular may insulate firms from capricious local politicians, *c.f* (Lewis, 2003, Miller, 2000, Rauch and Evans, 1999, Rauch, 1995).

Neither inspections or the state-ownership dummy are significant predictors, although both have the signs the privilege logic would predict. Model 3.2 introduces as a dependent variable a measure of the extent to which firms believe regional level bribery is a problem for firms with related economic activity, a formulation typically use by the World bank to mitigate sensitivity concerns about questions on corruption (*c.f.* BEEPS 2012). Consistent with the privilege perspective, state-owned firms are less likely to believe that corruption is a problem for their peer firms at the 1% level, implying they likely have some protection from regional predation.

Models 3.3 and 3.4 look at another privilege, often associated with political connections: government support. Models 3.3 and Models 3.4 introduce dummy measures that capture whether firms have received aid from regional and municipal governments (respectively) over the last two years. In Model 3.3, neither the state dummy or the inspections variable is significant at conventional levels. In Model 3.4, however, the state ownership dummy is significant, indicating that state-owned firms are more likely to receive aid from municipal governments than other types of firms. Given that the regression controls for potential correlates of poor performance and the firms share of the labor pool (both of which might drive support even in the absence of political connections), this finding is consistent with the notion that state-owned firms can make use of connections to gain privileges for themselves that can mitigate their costs. The inspections variable is not significant at conventional levels, however.

Finally, models 3.5 examines whether state-owned firms and those that are inspected often are more likely to make sales to the government. Again, consistent with the privilege perspective, state-owned firms are more likely to sell to the state, a potentially important source of rents and financial support even in tough times (Frye and Iwasaki, 2011). Taken together and combined with results from table 2 that rule out the most obvious sources of omitted variable bias, models 3.1 – 3.5 provide some support for the notion that the state-ownership dummy proxies for political connections. Consistent with work on the benefits of connections, state-owned firms are more likely to believe corruption is not a problem for firms like them, more likely to receive aid from local government, and more likely to make sales to the government. Inspections, however, are unrelated to any potential privileges.

Turning to visibility, we would expect that firms with higher visibility are more likely to have conflicts with the government over taxes. Model 3.6 introduces as the dependent variable a dummy variable that captures whether firms have had tax conflicts with the authorities in the last two years. Unsurprisingly, the fewer times a firm was inspected the less likely it was to have tax conflicts at the 1% level. At the same time, state-ownership does not make for fewer tax conflicts, at least not at conventional significance levels. Taken

together, these results suggest that the number of inspections are capturing something quite different than the state-ownership dummy and is consistent with (or at least fails to contradict) the notion that this variable measures visibility.

The fact that firms that are inspected less have fewer conflicts with the tax authorities could simply mean that such firms are law abiding and more likely to avoid situations that could cause conflict with the authorities. To assess this possiblity, Model 3.7 introduces a measure of the extent to which firms believe following the law should be conditional on agreeing with it. Inconsistent with the notion that firms that are inspected at low rates are more "law-abiding", the more often a firm is inspected, the more likely it is to believe that laws should be followed regardless of whether one agrees with it, a result which holds at the 5% level. Again, this result is consistent with an interpretation of the inspections variable as a measure of visibility.

As a final test of the interpretation of the inspections variable, model 3.8 uses this measure as the dependent variable to explore the determinants of being inspected. If the number of inspections a particular firm experiences are a function of the firms' ability to leverage political connections as a defensive mechanism, then it should be correlated with other potential measures of privilege such as state-ownership once one controls for regulatory variation across firms.[38] The dummy variable for state ownership is negative in model 3.8, consistent with the notion that connections may lower the number of inspections; however, the variable is insignificant at conventional levels. Consequently, it does not appear that firms that are well-connected are able to use these connections to prevent inspections. Taken together with the other results presented in table 3, this lends support to my argument that the inspections variable measures firms' visibility to state organs, which is in turn a proxy for firms' ability to free-ride.[39]

Before concluding, it is worth pointing out that table 3 helps to illustrate some of the ambiguities of the effect of firm size. Recall that section 4.1 claimed that firm size might be simultaneously a measure of privilege and of visibility. Consistent with the notion that large firms may benefit from political connections, firm size is positive and significant in model 3.1, indicating that larger firms are more likely to be able

---

[38]I do this by introducing the variable measuring firms' perceptions of their regulatory burden discussed above. This is likely endogenous, but is the only way to measure variation in the extent to which sectors are regulated. Omitting this term does not change the results.

[39]Another potential test is to look at whether sectors traditionally associated with tax evasion are also less likely to be inspected. In Russia, tax evasion tends to be correlated with particular (especially service sector) industries and firm size (i.e. small firms) (Gimpel'son and Zudina , 2012). One must be cautious, however, since tax evasion and informality in Russia is characterized by both formal and informal components working side-by-side, which often results in both hidden production and hidden wages in unexpected places, such as large industrial firms (Dolgopiatova, 1998, Johnson, McMillan, and Woodruff , 2000, Kaufman and Kaliberda , 1996, Ovtcharova, and Popova , 2001, Yakovlev , 2001). Here I reject this approach, however, since sector dummies also proxy for a large number of factors other than propensity for tax evasion that may shape propensity to be inspected.

to prevail against regional government bodies in court. Similarly, large firms are more likely to receive government aid (at local and regional levels), results which hold at conventional levels (Model 3.3 and 3.4). All of these results are subject to alternative interpretations, of course, but they are at least consistent with the notion that large firms have political connections and use them to receive privileges from the state. As noted above, existing work on business-state relations in the post-Soviet space is also consistent with this story (*c.f.* Gehlbach (2008), Hellman (1998)). Somewhat predictably, however, firm size is also associated with visibility. In models 3.6 and 3.8, firm size is a significant predictor of both a higher probability of tax conflict and a greater number of inspections (respectively). Given that firm size is associated with both privilege and free-riding, which generate opposite predictions about the effect of firm size on social policy preferences, it is unsurprising that this variable proved mostly insignificant at conventional levels in table 1, except for when we control for visibility directly (model 1.6). Firm size captures two countervailing effects.

6 Conclusion

This paper argues that poor institutional settings create opportunities that allow some firms to profit despite (or possibly because of) them. While the direct effect of institutions could not be tested due to data constraints, I develops implications of the argument to suggest that two groups are particularly well-positioned to take advantage of the loosening of constraints that goes hand-in-hand with poor institutions. On the one hand, individuals with privileged connections to the state can take advantage of these connections to protect themselves from abuses of the social policy system or to gain access to resources that mitigate any costs associated with poor institutions. On the other hand, individuals who can hide from state officials and evade taxes can free-ride on social policy – letting others pay the cost while they reap the benefits. While such groups may always be able to shift costs and free-ride, I argue this type of strategy is more likely in poor institutional settings, where officials are weakly constrained. Consistent with this argument, I find that well-connected firms – specifically state-owned firms – and those likely to be able to hide from the state – firms that experience low inspection rates – are more likely to support social policy in Russia in 2005, a setting with particularly poor institutional quality. These findings remain robust and consistent in the face of leading alternative interpretations of them and tests of the conceptual validity of the measures.

This paper's findings provide two contributions. First, it joins a growing body of work that shows that some actors are able to adapt to poor institutional settings and find ways of profiting from the uncertainty and risk they bring (Boix and Svolik, 2013, Gehlbach, 2008, Gehlbach and Keefer, 2011, Haber, Maurer,

and Razo, 2003, Magaloni, 2008). These "winners" in poor institutional settings provide important and counterintuitive reservoirs of support for policies that seem particularly vulnerable to rent-seeking or time inconsistent preferences on the part of authorities, such as social policy. Second, in the case of social policy particularly, this paper advances our understandings of who supports the extension of government controlled social policy. Understanding who can profit from social policy even in the face of poor institutions is critical for understanding which groups form or join coalitions in support of the welfare state in such settings. As these coalitions appear to differ from those in the developing world, where strong institutional constraints make it harder to trade on political connections or evade taxes, we might expect very different outcomes. This research direction is a promising one for understanding the development and evolution of the authoritarian welfare state (Mares and Carnes , 2009).

An important caveat must be made, however. This paper took regional institutional quality as uniformly poor when examining the preferences of the politically connected and free-riders. This leaves the question of whether preferences vary according to institutional setting open. At various points in this paper, I have suggested that that free-riders everywhere may support the welfare state, so long as it is set up in ways that allow them to benefit. Similarly, the politically well-connected may be able to trade on the privileges of their connections to derive additional benefits from the welfare state regardless of institutional quality. Viewed in this light, institutional quality conditions preferences only in so far as it makes it easier to evade taxes or to trade on one's privileges. That is, tax evaders and the well-connected have the same preferences in strong and weak institutional settings, there are just more of both groups were institutions are poor. Unfortunately, the data at hand for this study is insufficient to resolve this difficulty. Future research must answer whether institutions condition preferences directly or merely create opportunities for certain groups to free ride.

References

Adsera, A., and Boix, C. (2002). Trade, Democracy, and the Size of the Public Sector: The Political Underpinnings of Openness. *International Organization*, 56: 229-262.

Acemoglu, D., and Robinson, J. A. (2006). *Economic Origins of Dictatorship and democracy*. New York: Cambridge University Press.

Afanasiev, S. A. (2003). Pension reform in Russia: First year of implementing. *Paper presented at the Institute of Economic Research's PIE International Workshop on Pension Reform in Transition Economies*. Hitotsubashi University, Japan.

Alesina, A., and Guiliano, P. (2011). Preferences for Redistribution. In J. Benhabib, A. Bisin, and M. Jackson (Eds.), *The Handbook of Social Economics*. Elsevier Press.

Alt, J. and Iversen, T. (2013). Inequality, labor market segmentation, and preferences for redistribution. *mimeo*.

Berens, S. (2012). Weak States-Strong Preferences? A Multilevel Analysis of Social Policy Preferences in the Context of Uncertainty and Depletion. Unpublished Manuscript. New York.

Beazer, Q. (2012). Bureaucratic Discretion, Business Investment, and Uncertainty. *The Journal of Politics*, 74 (3): 637-652.

Becker, G. S. (1985). Public Policies, Pressure Groups, and Dead Weight Costs. *Journal of Public Economics*, 28 (December): 329-47.

Becker, G. S. (1983). A Theory of Competition among Pressure Groups for Political Influence. *Quarterly Journal of Economics*, 98(August): 371-400.

Boix, C. (2003). *Democracy and Redistribution*, Cambridge University Press.

Boix, C. and Svolik, M.W. (2013). The Foundations of Limited Authoritarian Government: Institutions, Commitment, and Power-Sharing in Dictatorships. *The Journal of Politics*, 75 (02): 300-316.

Brownlee, J. (2007). *Authoritarianism in an Age of Democracy*. Cambridge: Cambridge University Press.

Burger, E.J., Field, M. G., and Twigg, J.L. (1998). From Assurance to Insurance in Russian health Care: The Problematic Transition. *American Journal of Public Health* 88(5): 755-758.

Cameron, D. (1978). The expansion of the public economy: A comparative analysis. *American Political Science Review*, 72(4): 1243-1261.

Cameron, A.C., Gelbach, J.B., and Miller, D.L. (2008). Bootstrap-Based Iprovemnts for Inference with Clustered Errors. *The Review of Economics and Statistics* 90(3): 414-427.

Cerami, A. (2009). Welfare State Development in the Russian Federation: Oil-led Social Policy and the 'Russian Miracle'. *Social Policy and Administration* 43(2): 105-120.

Chandler, A. M. (2004). *Shocking Mother Russia: Democratization, Social Rights, and Pension Reform in Russia, 1990-2001*. Toronto: University of Toronto Press.

Cook, L. J. (2007). *Postcommunist Welfare States: Reform Politics in Russia and Eastern Europe*. Ithaca, NY: Cornell University Press.

Dmitriev, M. and Maleva, T. (1997). Russian labor Markets in Transition: Trends, Specific Features, and State Policy. *Social Research* 64(4).

Dobronogov, A. V. and Mayhew, L. D. (2000). Pension reform in a highly informalized post-Soviet economy. *Working Paper* No. IR-00-41/July. International Institute for Applied Systems Analysis: Laxenburg, Austria.

Dolgopiatova, T. (1998). *Neformal'nyi Sektor v Rossiiskoi Ekonomike*. Moscow: Institute for Private Sector Development and Strategic Analysis.

Estevez-Abe, M., Iversen, T. and Soskice, D. (2001). Social protection and the formation of skills: A reinterpretation of the welfare state, in Iverson, T., Soskice, D. and Hall. P. (Eds.), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*. London: Oxford University Press.

Faccio, M. (2006). Politically Connected Firms. The American Economic Review , 96 (1), 369-386.

Faccio, M., Masulis, R. W., and McConnell, J. J. (2006). Political Connections and Corporate Bailouts. The Journal of Finance , 61, 2597-2635.

Finseraas, Henning (2008a). Income Inequality and Demand for Redistribution: A Multilevel Analysis of European Public Opinion. *Scandinavian Political Studies*, 32(1): 94-119.

Frye, T. (2010). *Building States and Markets After Communism: The Perils of Polarized Democracy*. New York: Cambridge University Press.

Frye, T. (2006). Original Sin, Good Works, and Property Rights in Russia. *World Politics* 58(8): 479504.

Frye, T. and Iwasaki, I. (2011). Government Directors and Business-State Relations in Russia. *European Journal of Political Economy*, 27: 642-658.

Frye, T. and Yakovlev, A. (2013). Elections Protest and Investment Plans: Evidence from a Natural Experiment in Russia. *Mimeo*.

Frye, T., Reuter, O.J., and Szakonyi, D. (2014). Political Machines at Work: Voter Mobilization and Electoral Subversion in the Workplace. *World Politics*, 66 (2).

Garrett, G. and Mitchell, D. (2001). Globalization, government spending and taxation in the OECD. *European Journal of Political Research*, 39(2), 145177.

Geddes, B. (1999). What Do We Know About Democratization after 20 Years. *Annual Review of Political Science*, 2.

Gehlbach, S. (2008). *Representation Through Taxation: Revenue, Politics, and Development in Postcommunist States*. New York: Cambridge University Press.

Gehlbach, S. and Keefer, P. (2011). Investment Without Democracy: Ruling-Party Institutionalization and Credible Commitment in Autocracies. *Journal of Comparative Economics*, 39(2):123-139.

Gelman, A., and Hill, J. (2007). *Data Analysis: Using Regression and Multilevel/Hierarchical Models*. New York: Cambridge University press.

Gimpel'son, V. and Zudina, A. (2012). "Informals" in the Russian Economy: How Many of Them and Who are They?

Gimpel'son, V., Kapeliushnikov, R. and Lukiyanova, A. (2010). Stuck between Surplus and Shortage: Demand for Skills in Russian Industry. *Labour* 24(3): 311-332.

Gurvich, E., Lebedinskaya, E., Simachev, Yu., Yakovlev, A. (2010) Russia Country Report. In: Bertelsmann Stiftung (ed.), Managing the Crisis. A Comparative Assessment of Economic Governance in 14 Economies. Gotersloh: Bertelsmann Stiftung, 2010.

Haber, S. H. (2007). Authoritarian Regimes. in Weingast, B. R. and Wittman, D. (eds.), *The Oxford Handbook of Political Economy*. New York: Oxford University Press: 693-707.

Haber, S., Maurer, N., and Razo, A. (2003). *The Politics of Property Rights: Political Instability, Credible Commitments, and Economic Growth in Mexico, 1876-1929*. Cambridge: Cambridge, University Press.

Hacker, J.S. and Pierson, P. (2002). Business Power and Social Policy: Employers and the Formation of the American Welfare State. *Politics & Society* 30 (2): 277

Haggard, S. and Kaufman, R. R. (2008). *Development, Democracy, and Welfare States: Latin America, East Asia, and Eastern Europe*. Princeton: Princeton University Press.

Harden, J.J. (2011) A bootstrap method for Conducting Statistical Inference with Clustered Data. *State Politics and Policy Quarterly* 11(2): 223-246.

Hausermann, S. (2010). *The Politics of Welfare State Reform in Continental Europe: Modernization in Hard Times*. Cambridge: Cambridge University Press.

Hellman, J.S. (1998). Winners Take All: The Politics of Partial Reform in Postcommunist Transitions. *World Politics* 50(2): 203-234.

Iversen, T., and Soskice, D. (2001). An Assett Theory of Social Policy Preferences. *American Political Science Review*, 875-893.

Jensen, R. T. and Richter, K. (2004). The health implications of social security failure: Evidence from the Russian pension crisis. *Journal of Public Economics* 88: 209236.

Johnson, S., McMillan, J., and Woodruff, C. (2000). Why do Firms Hide?: Bribes and Unofficial Activity after Communism. *Journal of Public Economics*, 76: 495-520.

Juurikkala, T. and Lazareva, O. (2006). Lobbying at the Local Level: Social Assets in Russian Firms. *BOFIT Discussion Papers* 1/2006.

Kaufmann, D. and Kaliberda, A. (1996). Integrating the Unofficial Economy Into the Dynamics of the Post-Socialist Economies: A Framework of Analysis and Evidence, in *Economic Transition in Russian and the New States of Eurasia*. Kaminski, B., ed. Armonk, NY: M.E. Sharpe.

Kaufmann, D., Kray, A., and Mastruzzi, M. (2007). Governance Matters VI: Updated Indicators for 1996-2006. *World Bank Institute Working Paper*.

Kato, J. (2003). *Regressive Taxation and the Welfare State: Path Dependence and Policy Diffusion*. Cambridge: Cambridge University Press.

Kenworthy, L., and McCall, L. (2008). Inequality, Public Opinion, and Redistribution. *Socio-Economic Review*, 6, 35-68.

Kornai, J. (1986). The Soft Budget Constraint. *Kyklos* 39: 3-30.

Kuo, A. (2010). *Political Origins of Firm Strategies*. Doctoral Dissertation: Stanford University.

Kydland, F.E. and Prescott, E.C. (1977). Rules Rather than Discretion: The Inconsistency of Optimal Plans. *Journal of Political Economy*. 85(3): 473-492.

Lewis, D. E. (2003). *Presidents and the Politics of Agency Design: Political Insulation in the United States Bureaucracy, 1946-1997*. Palo Alto, CA: Stanford University Press.

Leoni, E. (2009) Analyzing Multiple Surveys: Results from Monte Carlo Experiments. *Mimeo*.

Magaloni, B.(2008) Credible Power-Sharing and the Longevity of Authoritarian Rule. *Comparative Political Studies*, 41 (4–5), 715–741.

Manow, P. (2001). Comparative Institutional Advantages of Welfare State Regimes and New Coalitions in Welfare State Reforms, in Pierson, P. (ed.), *The New Politics of the Welfare State*. Cambridge, Mass.: MIT Press.

Mares, I. and Carnes, M.E. (2009). Social Policy in Developing Countries. *Annual Review of Political Science*, 12: 93-113.

Mares. I. (2005). Social Protection Around the World: External Insecurity, State Capacity, and Domestic Political Cleavages. *Comparative Political Studies*. 38(6), 623-651.

Mares. I. (2005). *Taxation, Wage bargaining and Unemployment*. New York: Cambridge University Press.

Mares, I. (2003a). *The politics of social risk: Business and welfare state development*. Cambridge: Cambridge University Press.

Mares, I. (2003b). The Sources of Business Interest in Social Insurance: Sectoral versus National Differences. *World Politics*, 55 (2): 229-258.

Mares, I. (2001) "Firms and the Welfare State: When, Why, and How Does Social Policy Matter to Employers?" in Hall, P.A. and Soskice, D., eds. *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, pp. 184212. Oxford: Oxford University Press.

Mares, I. and Zhu, B. (2012). Electoral intimidation. *Mimeo*.

Marques, I. (2012). Who Wants to Level the Field? Autocracy, Democracy, and Redistribution. Working Paper presented at *the Ronald Coase Institute Workshop*, December 2012, Santiago, Chile.

Martin, C.J. (2005). Corporatism from the Firm Perspective: Employers and Social Policy in Denmark and Britain. *British Journal of Political Science* 35: 127-148.

McMann, K. and Petrov N. (2000). A Survey of Democracy in Russias Regions. *Post-Soviet Geography and Economics* 41(3): 155-82.

McCubbins, Matthew, Roger Noll, and Barry Weingast (1987). Administrative Procedures as Instruments of Political Control. *Journal of Law, Economics, and Organization*, 3 (2): 24377.

Meltzer, A., and Richard, S. (1981). A Rational Theory of the Size of Government. *Journal of Political Economy*, 89(5): 914-927.

Miller, G. J. (2000). Above Politics: Credible Commitment and Efficiency in the Design of Public Agencies. *Journal of Public Administration Research and Theory* 10(2): 289328.

ironov, M. and Zhuravskaya, E. (2014). Corruption in Procurement: Evidence from Financial Transactions Data. Mimeo.

Moene, K. O. and Wallerstein, M. (2001). Inequality, social insurance, and redistribution, *American Political Science Review*, 95(04), 859874.

Myles, J. and Pierson, P. (2001). The Comparative Political Economy of Pension Reform, in Pierson, P. (ed.), *The New Politics of the Welfare State*. Oxford: Oxford University Press. Cambridge, Mass.: MIT Press.

Nies, S. and Walcher, G. (2002). The Unified Social Tax and its Impact on Social Policy in Putin's Russia. *Working Papers* No. 34. Bremen: Research Centre for Eastern European Studies

North, D. (1990). *Institutions, Institutional Change, and Economic Performance*. Cambridge: Cambridge University Press.

North, D. (1981). *Structure and Change in Economic History*. New York: W.W. Norton.

North,D., Wallis, J.J., Weingast, B.R. (2009). *Violence and Social Orders: A Conceptual Framework for Interpreting Recorded Human History*. New York: Cambridge UP.

North, D., and Weingast, B. (1989). Constitutions and Commitment: The Evolution of Institutions Governing Public Choice in Seventeenth Century England. *Journal of Economic History*, 49, 803-832.

Olson, M. (2000). *Power and Prosperity: Outgrowing Communist and Capitalist Dictatorships*. New York: Basic Books.

Olson, M. (1993). *Dictatorship, Democracy, and Development*. American Political Science Review , 87 (3), 567-576.

van Oorschot, W., and Meuleman, B. (2006). Welfarism and the multidimensionality of welfare state legitimacy: Evidence from The Netherlands, 2006. *International Journal of Social Welfare*, 21: 79-93.

Ovtcharova, L., and Popova, D. (2001). What Kind of Poverty Alleviation Policy Does Russia Need. *Russian Economic Trends*, 10 (1), 7-14.

Paster, T. (2013). Business and Welfare State Development: Why Did Employers Accept Social Reforms. *World Politics* 65 (3): 416-51.

Pierson, P. (2001). Coping with Permanent Austerity: Welfare State Restructuring in Advanced Democracies, in Pierson, P. (ed.), *The New Politics of the Welfare State*. Oxford: Oxford University Press. Cambridge, Mass.: MIT Press.

Rauch, J. and Evans, P. (1999). Bureaucracy and Growth: A Cross-National Analysis of the Effects of 'Weberian' State Structures on Economic Growth. American Sociological Review 64(5): 74865.

Rauch, J. (1995). Bureaucracy, Infrastructure, and Economic Growth: Evidence from U.S. Cities During the Progressive Era. *American Economic Review* 85(4): 96879.

Rehm, P. (2009). Risks and Redistribution: An Individual-Level Analysis. *Comparative Political Studies*, 42, 855-881.

Remington, T. (2011). *The Politics of Inequality in Russia*. Cambridge: Cambridge University Press.

Reuter, O.J. and Remington, T. (2009) Dominant Party Regimes and the Commitment Problem: the Case of United Russia. *Comparative Political Studies*, 42(4), 501–526.

Rhodes, M. (2001). The Political Economy of Social Pacts: 'Competitive Corporatism' and European Welfare Reform, in Pierson, P. (ed.), *The New Politics of the Welfare State*. Cambridge, Mass.: MIT Press.

Rodrik, D. (1998).Why do more open economies have bigger governments? *Journal of Political Economy*, 106(5): 997-1032.

Rodrik, D. (1997). *Has globalization gone too far?* Washington, DC: Institute for International Economics.

Sabbagh C, Vanhuysse P (2006). Exploring Attitudes Towards the Welfare State: Students Views In Eight Democracies. *Journal of Social Policy*, 35(4): 607628.

Schneider, F. (2005). Shadow economies around the world: What do we really know? *European Journal of Political Economy* 21(3): 598642.

Swensen, P. A. (2002). *Capitalists Against markets: The Making of Labor Markets and the Welfare States in the United States and Sweden*. Oxford: Oxford University Press.

Swensen, P. A. (1997). Arranged Alliance: Business Interests in the New Deal. *Politics Society*, 25: 66.

Swensen, P. A. (1991). Bringing Capital Back In, or Social Democracy Reconsidered: Employer Power, Cross-Class Alliances, and the Centralization of Industrial Relations in Denmark and Sweden. *World Politics*, 43.

Thelen, K. (2004). *How Institutions Evolve: The Political Economy of Skills in Germany, Britain, the United States, and Japan*. New York: Cambridge University Press.

Shleifer, A. and Treisman, D. (2000). *Without a Map: Political Tactics and Economic Reform in Russia*. Boston: MIT Press.

Slinko, I., Yakovlev, E . and Zhuravskaya, E. (2005). Laws for sale: evidence from Russia. *American Law and Economics Review* 7(1): 284-318.

Sokhey, S. (2010). The Politics of Post-Communist Pension Reform: The Influence of Business Lobbying on Policy Outcomes. *Dissertation*. The Ohio State University.

Tan, H., Savchenko, Y., Gimpelson, V., Kapelyushnikov, R., and Lukyanova, A. (May 2007)Skill Shortages and Training in Russian Enterprises. *World Bank Policy Research Working Paper* 4222.

Treisman, D. (2007). What Have We Learned About the Causes of Corruption From Ten Years of Cross-National Research? *Anual Reveiw of Political Science*, 10, 211-244.

Treisman, D. (1999) *After the Deluge: Regional Crises and Political Consolidation in Russia*. Ann Arbor: University of Michigan Press.

Twigg, J.L. (1998). Balancing the State and the Market: Russias Adoption of Obligatory Medical Insurance. *Europe-Asia Studies* 50(4): 583-602.

Vainberg, A. and Rybnikova, T. (2006). *Institutsionalnye i geograficheskie faktory razvitiia regionov Rossii*. Moscow: CEMI RAN.

Vartaptetov, K. (2011) Russian Fiscal Federalism under Stress: Federal Support of Regions during the Global Financial Crisis. *Eurasian Geography and Economics*, 4, 529–542.

Wagstaff, A. and Moreno-Serra, R. (2009). Europe and central Asias great post-communist social health insurance experiment: Aggregate impacts on health sector outcomes. *Journal of Health Economics* 28: 322-340.

Weingast, B., and Moran, M. (1983). Bureaucratic Discretion or Congressional Control? Regulatory Policymaking by the Federal Trade Commission. *Journal of Political Economy*, 91: 765800.

Williamson, J.B., Howling, S.A, and Maroto, M.L. (2006). The Political Economy of Pension Reform in Russia: Why Partial Privatization? *Journal of Aging Studies* 26: 165-175.

Yang, J. (July 2013). Parochial Welfare Politics and the Small Welfare State in South Korea. *Comparative Politics*: 457-474.

Yakovlev, A. (2001). 'Black Cash' Tax Evasion in Russia: Its Forms, Incentives, and Consequences at Firm Level. *Europe-Asia Studies*, 53(1): 33-55.

Table 1: Firms' Preferences for Increased Spending on State-controlled Social Policy

	(1) Social Policy	(2) Social Policy	(3) Social Policy	(4) Social Policy	(5) Social Policy	(6) Hard to Say (social policy)
Log employees	0.037	0.030	0.042	0.038	0.079***	0.031
	(0.028)	(0.031)	(0.031)	(0.030)	(0.028)	(0.063)
Credit problems	-0.023	-0.023	-0.023	-0.020	-0.023	0.004
(1=Yes)	(0.025)	(0.024)	(0.026)	(0.023)	(0.027)	(0.060)
Profitability	-0.034	-0.031	-0.031	0.006	-0.038	-0.083
(1=Profitable last year)	(0.073)	(0.073)	(0.074)	(0.073)	(0.082)	(0.105)
Degree of competition	0.027	0.027	0.028	0.029	0.029	-0.011
(Higher=More problematic)	(0.036)	(0.036)	(0.035)	(0.037)	(0.038)	(0.051)
Exporting firm	-0.236	-0.271*	-0.225	-0.240	-0.241	0.056
(1=Yes)	(0.154)	(0.161)	(0.139)	(0.151)	(0.159)	(0.139)
Firm provides social benefits	0.099	0.099	0.104	0.067	0.085	-0.185
(1=Yes)	(0.126)	(0.123)	(0.126)	(0.138)	(0.128)	(0.152)
Problems finding managers	0.072**	0.077***	0.071**	0.065**	0.078***	-0.044
(Higher=More problematic)	(0.029)	(0.030)	(0.029)	(0.032)	(0.029)	(0.055)
Labor costs	-0.205*	-0.208*	-0.203*	-0.242**	-0.213*	0.148
(Higher=Larger share of revenue)	(0.107)	(0.108)	(0.107)	(0.105)	(0.109)	(0.105)
State ownership	0.299**	0.303**	0.303**	0.274**	0.310**	0.068
(1=Yes)	(0.128)	(0.137)	(0.126)	(0.123)	(0.135)	(0.146)
Government Sales		0.200*				
(1=Yes)		(0.119)				
Firm lobbies			-0.084			
(1=Yes)			(0.145)			
Confidence in courts vs. regional				0.006		
(Higher=Firm more likely to win)				(0.068)		
Log inspections					-0.171***	-0.074
					(0.039)	(0.086)
Cut-point 1	-1.078	-0.855	-1.114*	-1.394	-1.019	1.219
	(0.664)	(0.695)	(0.625)	(0.932)	(0.637)	(0.923)
Cut-point 2	0.935	1.173*	0.900	0.592	1.013*	
	(0.655)	(0.691)	(0.618)	(0.927)	(0.614)	
Manager Characteristics	Yes	Yes	Yes	Yes	Yes	Yes
Sector fixed-effects	Yes	Yes	Yes	Yes	Yes	Yes
Region fixed-effects	Yes	Yes	Yes	Yes	Yes	Yes
Number of Groups	11	11	11	11	11	11
Observations	544	531	544	495	544	544
Pseudo R-squared	0.0999	0.0936	0.100	0.0913	0.109	0.0876

Model 1 - 6: Dependent variable is preferences for State-controlled social policy expansion.

Model 7: Dependent variable is those who answered "hard to say" to social policy instrument.

Manager characteristics are education, log age, and gender.

Cluster corrected (region) standard errors in parentheses.

*** p<0.01, ** p<0.05, * p<0.1

Table 2: Evaluating Alternative Interpretations for State Ownership and Inspections

	(1) Social Policy	(2) Social Policy	(3) Social Policy	(4) Social Policy	(5) Social Policy	(6) Social Policy	(7) Social Policy
State ownership	0.283*	0.318***	0.288**	0.332**	0.294**	0.259**	0.363***
(1=Yes)	(0.145)	(0.123)	(0.129)	(0.149)	(0.132)	(0.129)	(0.135)
Log inspections						-0.194***	-0.148**
						(0.044)	(0.057)
Probability of getting aid	0.073						
(Higher=More Confident)	(0.067)						
Recent Foreign investment		-0.183					
(1=Yes)		(0.253)					
Recent Capital Investment		-0.060					
(1=Yes)		(0.144)					
Product line innovation		-0.026					
(1=Yes)		(0.148)					
Aid regional unemployment			-0.026				
(1=Provide aid)			(0.143)				
Aid regional construction			0.166				
(1=Provide aid)			(0.166)				
Aid regional agencies			-0.036				
(1=Provide aid)			(0.160)				
Aid Regional pensions			0.124				
(1=Provide aid)			(0.123)				
Police spending				-0.094			
(1=Should be Higher)				(0.093)			
Judicial spending				-0.050			
(1=Should be Higher)				(0.178)			
Education spending				0.291*			
(1=Should be Higher)				(0.167)			
Voted for KPRF					-0.238		
(1=Yes)					(0.252)		
Voted for Liberal Parties					0.172		
(1=Yes)					(0.134)		
WTO Accession					-0.022		
(Higher=Higher support)					(0.037)		
Regional bureaucracy rating						0.035	
(Higher=Higher approval)						(0.087)	
Regional executive rating						-0.101	
(Higher=Higher approval)						(0.082)	
Bureaucratic Discretion							0.125**
(Higher=More discretion)							(0.054)
Cut-point 1	-0.966	-1.214*	-1.182*	-0.971	-1.054	-1.314*	0.420
	(0.632)	(0.659)	(0.669)	(0.703)	(0.724)	(0.748)	(0.882)
Cut-point 2	1.049*	0.807	0.834	1.083	0.962	0.690	2.551***
	(0.624)	(0.678)	(0.656)	(0.715)	(0.706)	(0.733)	(0.819)
Firm Level Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Manager Characteristics	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sector fixed-effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Region fixed-effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	532	526	540	491	498	488	376
Pseudo R-squared	0.0987	0.106	0.103	0.121	0.104	0.116	0.151

Dependent variable is preferences for State-controlled social policy expansion.

Firm level controls as in Table 1.

Manager characteristics are education, log age, and gender.

Cluster corrected (region) standard errors in parentheses.

*** p<0.01, ** p<0.05, * p<0.1

Table 3: Validating Measures of Privilege and Visibility

	(1) Confidence in courts vs. regional	(2) Regional Corruption Burden	(3) Government support (Regional)	(4) Government support (Municipal)	(5) Government sales	(6) Tax conflicts	(7) Conditionality of legal compliance	(8) Log inspections
Log employees	0.144***	-0.031	0.250***	0.152**	0.023	0.239***	-0.015	0.210***
	(0.028)	(0.060)	(0.085)	(0.067)	(0.060)	(0.058)	(0.050)	(0.041)
Credit problems	-0.140***	0.032	0.012	0.052	-0.006	-0.035	-0.029	-0.024
(1=Yes)	(0.025)	(0.033)	(0.040)	(0.046)	(0.037)	(0.040)	(0.033)	(0.026)
Profitability	-0.234***	0.088	0.107	0.088	-0.029	-0.050	-0.008	-0.018
(1=Profitable last year)	(0.065)	(0.124)	(0.125)	(0.116)	(0.101)	(0.099)	(0.113)	(0.084)
Exporting firm	0.131	0.129	0.218	-0.045	0.206	-0.081	0.221*	0.002
(1=Yes)	(0.125)	(0.108)	(0.133)	(0.148)	(0.161)	(0.175)	(0.120)	(0.076)
Labor costs	-0.021	-0.083	-0.035	0.244***	0.035	0.015	0.021	-0.050
(Higher=More problematic)	(0.076)	(0.155)	(0.152)	(0.083)	(0.081)	(0.178)	(0.089)	(0.058)
State ownership	0.083	-0.282***	0.005	0.384**	0.237**	-0.109	0.045	-0.011
(1=Yes)	(0.162)	(0.106)	(0.296)	(0.185)	(0.106)	(0.215)	(0.152)	(0.104)
Log inspections	-0.020	0.100	0.026	0.095	0.033	0.245***	0.101**	
	(0.057)	(0.068)	(0.114)	(0.078)	(0.041)	(0.077)	(0.047)	
Regulatory Burden								0.103**
(Higher=More problematic)								(0.046)
Manager characteristics	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Sector fixed-effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Region fixed-effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	510	469	542	490	545	561	529	556
Pseudo R-squared	0.0634	0.0451	0.142	0.100	0.138	0.189	0.1063	
R-squared								0.235

Dependent variables listed above model. See text for Descriptions

Cut-points for ordered probit models (Models 1-7) and intercept for OLS model 8 omitted due to space. Results available upon request.

Manager characteristics are education, log age, and gender.

Cluster corrected (region) standard errors in parentheses.

*** p<0.01, ** p<0.05, * p<0.1

Table 4: Summary Statistics

Variable	Obs	Mean	Std. Dev.	Min	Max
Log Employees	666	4.989	1.532	1.386	11.156
Credit Problems	629	3.431	1.486	1	5
Profitable	650	.602	.65	-1	1
Degree of Competition	657	2.376	1.347	0	4
Exporting Firm	666	.255	.436	0	1
Firm Provides Social Benefits	655	.631	.483	0	1
Problems finding managers	658	3.488	1.407	1	5
Labor costs	599	.938	.663	0	2
Log of respondent's age	666	1.041	.288	0	1.386
Respondent's Education	666	2.925	.581	1	4
Respondent's Gender	666	.207	.406	0	1
State Ownership	665	.22	.414	0	1
Government Sales	644	.651	.477	0	1
Firm Lobbies	666	.523	.5	0	1
Confidence in courts vs. regional government	598	2.704	.995	1	4
Regional Corruption Burden	544	2.711	1.393	1	5
Government Support: Regional	649	.125	.331	0	1
Government Support: Municipal	584	.14	.348	0	1
taxconflict	666	.194	.395	0	1
Conditionality of Legal Compliance	627	3.396	.781	1	4
Regulatory Burden	651	3.465	1.332	1	5

7 Appendix: Regional Level Determinants of Social Policy Support

The main paper made the assumption that Russian firms face a poor institutional environment regardless of where they are located in the country. In this section, I relax this assumption in order to take advantage of regional level variation in the quality of institutions across Russia's regions. Although it is difficult to argue that institutions are truly good in any Russian region some regions are certainly worse than others.

This being said, there are three important caveats that must be made before proceeding to analysis. First, the survey data on firm preferences that I have is quite limited in its scope: there are only 11 regions in the sample. While it is still possible to recover meaningful effects on second-level characteristics (i.e. at the region level) from such a small sample, it represents a very hard test (Cameron, Gelbach, and Miller, 2008, Gelman and Hill , 2007, Leoni , 2009). Second, endogeneity is also a concern. Acemoglu and Robinson (2006) and Boix (2003) argue that democratization and regime change come about as a consequence of class

conflicts and the redistributive pressures they place on the state. This implies that the quality of institutions today may have a lot to do with the preferences of the population for social policy in the past and that institutional quality and preferences for redistribution are co-determined. Consequently, any direct effect of institutional quality on preferences for redistribution must be interpreted with caution.

Finally, there is some question as to the extent to which variation in the small sub-sample of Russian regions presented here is representative of the whole and sufficient to capture the effect of regional level variables. The regions in my survey sample are indicated in red in figures 1 and 2. The population mean is denoted in blue, while the red lines denotes one standard deviation above and below the mean. There is a great deal of variation in perceptions of corruption (figure 1) among the sample regions, but they tend to be relatively tightly clustered with respect to investment risk (figure 2). Consequently, it may be possible to see how expectations about rent-seeking and the ability to monitor bureaucrats shape social policy preferences in this sample, but doing the same for expectations about state capacity would be hard.

In order to capture different aspects of institutional quality and their effect on social policy, I make use of several alternative measures. First, in order to measure the extent to which perceived corruption shapes preferences for social policy, I take the regional average response to an item on the firm survey that asks respondents to what extent they believe local bureaucrats are corrupt. This focus on perceived, rather than actual corruption, stems from a similar focus in existing models of institutional quality and investment, where rational individuals who perceive institutional quality to be poor should never invest in the first place (North, 1990, North and Weingast, 1989). Empirical work focusing on the effect of various pathologies of poor institutional environments – bureaucratic discretion (Beazer, 2012) and uncertainty for well-connected firms (Frye and Yakovlev , 2013) – have also tended to support the notion that perceptions matter a lot for investment.[40]

Second, I measure problems with monitoring local officials more generally by including region average responses to an item on the firm survey asking about the extent of local bureaucratic discretion. As noted above, where officials have discretion, they may be able to manipulate laws in ways that generate rents at the expense of business (Beazer, 2012). Social policy, underpinned by complex tax and benefit distribution laws is potentially particularly vulnerable to such discretion. Third, I include a measure of regional investment risk as a proxy for fears of grand corruption and expropriation by regional authorities. The Russian consulting firm, RA Expert, releases yearly risk ratings of all Russian regions based on expert assessments of political, legal, economic, financial, social, and ecological risks.[41] The higher a region scores on RA

---

[40]For a discussion of this distinction, *c.f.* Treisman (2007).

[41]Unfortunately, disaggregated assessments of each sub-component of the index are not available.

Expert's index, the lower the quality of institutions and the higher the investment risk.

Fourth, I test (Mares, 2005)' theory that state capacity is critical to support for social policy. I measure state-capacity by including a measure of the total share of non-resource taxes in regional budgets. The higher a regions' share of non-tax revenue, the more likely evasion is rampant and the weaker state capacity. Finally, drawing on the notion that low levels of political accountability may exacerbate deficiencies in the ability of firms to effectively monitor, prevent shirking, and control corruption on the part of regional bureaucrats, I also introduce a measure of political competition (Beazer, 2012). My measure comes from the Moscow Carnegie center, which rates the quality of elections (freeness and fairness), the transparency of the political sphere, and pluralism (number of parties) (McMann and Petrov, 2000).[42]

Table 5 reports the results of incorporating regional level variables. For the purposes of increasing the efficiency of convergence, all regional level variables have been mean-centered (*c.f.* Gelman and Hill (2007)). With this transformation, higher positive values indicate that regions are institutional over-achievers, while regions with negative values are under-achievers. Models include all variables from section 4.2, which are unchanged.

Of the models presented in Table 5, only Models 5.2 and 5.3 suggest that institutional variables *ceteris paribus* shape the preferences of firms. Model 5.2 indicates that firms in regions whose aggregate belief that bureaucratic discretion is high are more likely to oppose expansions in state-controlled social policy spending, with the discretion variable reaching significance at the 99% level. This is in line with the prediction that increased discretion makes it harder for firms to monitor bureaucratic effort and to protect themselves from rent-seeking behaviors. Similarly, Model 5.3 also suggests that as democracy, and therefore accountability, increase, firms are more likely to support social policy, although this result only holds at the 90% level. By contrast, the institutional measures in models 5.1 and 5.4, and 5.5 are not significant at conventional levels. Perceptions of corruption, investment risk, and state capacity appear to have no significant relationship to preferences for social policy in this sample. All three variables do have the expected positive sign, however: better institutional quality implies more support for social policy,

To reiterate the point made at the beginning of this section, finding significant results is both unlikely and surprising given the small number of regions available for analysis. That being said, results mostly conform to expectation that poor quality institutions decrease the willingness of firms to support social policy. It is interesting to note that of the institutional variables that were statistically significant in Table 5

---

[42]While the original index includes ten sub-components, I focus on these three as the most relevant for assessing political competition. The results reported below remain largely the same if the full index is used.

– bureaucratic discretion and regional democracy levels – both are linked to the notion of accountability. Independence from regional politicians (the discretion measure) makes it harder for businesses to sanction bureaucrats for implementation failures related to social policy, while weak democracies sap the incentives of politicians to hold lower level bureaucrats accountable. Nonetheless, the small number of regions available for analysis makes it difficult to conclude that this is the only mechanisms governing the relationship between institutional quality and preferences for social policy.

Table 5: Firms' Preferences for Increased Spending on State-controlled Social Policy and Regional-level Institutions

	(1) Social Policy	(2) Social Policy	(3) Social Policy	(4) Social Policy	(5) Social Policy
Log Employees	0.035**	0.037**	0.038**	0.036**	0.037**
	(0.017)	(0.016)	(0.017)	(0.016)	(0.017)
Credit Problems	-0.011	-0.013	-0.011	-0.011	-0.010
(1=Yes)	(0.011)	(0.011)	(0.012)	(0.012)	(0.012)
Profitable	-0.013	-0.024	-0.012	-0.016	-0.015
(1=Yes)	(0.033)	(0.034)	(0.033)	(0.033)	(0.034)
Degree of Competition	0.015	0.011	0.016	0.016	0.014
(Higher=More problematic)	(0.017)	(0.017)	(0.017)	(0.017)	(0.017)
Exporting Firm	-0.124*	-0.118	-0.120*	-0.108	-0.117
(1=Yes)	(0.074)	(0.078)	(0.072)	(0.071)	(0.075)
Firm Provides Social Benefits	0.081	0.074	0.074	0.094*	0.080
(1=Yes)	(0.057)	(0.057)	(0.058)	(0.057)	(0.057)
Problems finding managers	0.043***	0.037***	0.041***	0.041***	0.041***
(Higher=More problematic)	(0.015)	(0.014)	(0.014)	(0.013)	(0.014)
Labor costs	-0.134***	-0.119**	-0.123**	-0.125**	-0.122**
(Higher=Larger Share)	(0.051)	(0.047)	(0.050)	(0.050)	(0.050)
State	0.190**	0.191**	0.186**	0.169**	0.183**
(1=Yes)	(0.084)	(0.086)	(0.086)	(0.085)	(0.086)
privatized	0.032	0.038	0.028	0.028	0.032
(1=Yes)	(0.057)	(0.060)	(0.060)	(0.058)	(0.059)
Reaction to contract breach	-0.044*	-0.040	-0.042*	-0.041*	-0.041
(Higher=More likely to break)	(0.025)	(0.025)	(0.025)	(0.024)	(0.025)
Log inspections	-0.072***	-0.076***	-0.073***	-0.075***	-0.072***
	(0.021)	(0.020)	(0.021)	(0.020)	(0.021)
Regional social policy spending	3.001	2.153	3.221	3.552	2.447
	(2.738)	(2.970)	(2.777)	(2.585)	(2.685)
Regional perceptions of corruption	0.389				
(Higher=More corrupt)	(0.249)				
Regional Discretion		-0.434**			
(Higher=More discretion)		(0.186)			
Regional investment rating			0.108		
(Higher=More risky)			(0.401)		
Tax income in revenue				1.222	
				(0.946)	
Democracy					0.031
(Higher=More democratic)					(0.026)
Constant	-0.000	0.004	-0.126	-0.172	-0.029
	(0.346)	(0.341)	(0.524)	(0.376)	(0.357)
Sector fixed effects	yes	yes	yes	yes	yes
Region Random Intercepts	yes	yes	yes	yes	yes
Observations	526	526	526	526	526
Number of groups	11	11	11	11	11
Log-liklihood	-487.8	-483.7	-489.0	-444.6	-491.0

Dependent variable is preferences for State-controlled social policy expansion.

Bootstrap standard errors in parentheses (5000 repetitions).

*** $p<0.01$, ** $p<0.05$, * $p<0.1$