SECURE PROPERTY AS A BOTTOM-UP PROCESS
Firms, Stakeholders, and Predators in Weak States

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> Raiding [private expropriation] is choking our economy . . . . We must beware of those [state officials] obligated to protect firms who join raider brigades.
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> —*Dmitri Medvedev, president of Russian Federation, Rossiyskaya Gazeta, July 2, 2010*

> There are two types of state officials in Ukraine: thieves and grafters.
>
> —*Ministry of Internal Affairs official, Economic Crimes Unit, Ukraine, author's interview, March 15, 2007*

Introduction

SECURE property rights limit governmental and private predation and are thus an essential ingredient in the elusive ideal of "rule of law."[1] Yet the emergence of secure property rights poses a problem. Ownership claims remain unsettled in much of the developing world. The specter of forceful interference with property rights ruins legitimate businesses, triggers revolutions, and drains the global economy of immeasurable riches. Answering the question of how societies might escape the equilibrium of predation has emerged as the key to "interpreting recorded human history."[2]

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[1] E.g., Greif 2006; North and Weingast 1989.

[2] North, Wallis, and Weingast 2009.

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The literature treats the state as the only actor able to enforce property rights: in this view, firms are mere policy takers that must resort to capital flight, bribing, or asset concealment when faced with predation. I argue, by contrast, that firms can enforce their property rights through alliances with stakeholders such as foreign investors, local communities and labor, or other domestic firms. Constructive strategies of economic actors to address poor enforcement of property rights are critically undertheorized. This is regrettable because firms' alliance-based resistance to property rights infringements—unlike the defenses based on concealment, corruption, or violence—may contribute to the rule of law taking hold in rent-seeking economies. To demonstrate the impact of stakeholder alliances on enforcement of property rights, I use original survey data of 516 firms in Russia and Ukraine, as well as qualitative data from 67 interviews with entrepreneurs and policymakers.

Orthodoxy Redux: Literature and Critique

"Property rights" (PR) are defined as a bundle of rights containing (1) the right to use and manage assets; (2) the right to derive income from assets; and (3) the right to transfer (1) or (2) to someone else.[3] A study of rights can focus either on their allocation (who has the right?) or on enforcement (how is the right secured?). The dependent variable of my study is the *enforcement* or *security* of property rights: private allocation is taken as given. The terms "expropriation," "PR threat," and "predation" will be used interchangeably: these phenomena are defined as illegal interference with *any* part of the PR bundle by governmental or private actors. This definition covers the outright takeover of use and management rights as well as the more subtle impediments to rightful income streams and ownership transfers. Such an encompassing definition is consistent with the literature.[4]

Two paradigms address the emergence of PR security. First, the "strategic interaction" school puts faith in the self-enforcing effects of reputation: to raise tax revenue tomorrow, governments will abstain from expropriating businesses today.[5] In Olsonian terminology, the state qua "stationary bandit" will forgo present predation (unlike a "roving bandit") so as to motivate the victims to increase output and the bandit's

[3] Barzel 1997.

[4] In their seminal piece, North and Weingast 1989 conceptualize the arbitrary raising of customs revenues, the use of threats to secure loans, and the sale of monopolies by the British Crown as expropriation.

[5] E.g., Diermeier et al. 1997; Olson 1993; Timmons 2006.

revenues in the long run. Such a felicitous outcome, as the literature recognizes, depends on the time horizon of the potentially predatory government: wars or merely a high probability of incumbency change may put the survival of the regime at risk and prompt the sovereign to expropriate. The strategic interaction paradigm is also used to explain the emergence of PR security in the face of *private* expropriation in the tightly knit communities where the state is largely absent: here, culture and the logic of repeated games between private agents serve as strong behavioral constraints.[6]

Second, the "state commitment" paradigm, by far the dominant school of PR research, extols the virtues of institutional safeguards.[7] This literature proceeds from the premise of a *profound power imbalance between state and business*, the former possessing coercive resources and the latter being exposed to their arbitrary use. To reassure private owners, the literature argues, the state must be institutionally constrained. But how? Like the strategic interaction school, this tradition relies on the *rationality of the fiscally dependent sovereign*: to signal its benevolent disposition to prospective investors and taxpayers, the state binds its own hands. The core debates in the literature discuss various ways in which states can commit.[8] Some accounts stress macrolevel checks and balances, for example, separation of the legislative and executive branches or "market-preserving federalism."[9] Others point to policies that can act as bridge-burning tactics: for postcommunist countries, both shock therapy and voucher privatization have been treated as "commitment devices."[10] Finally, hybrid state-private property rights and informal state-business ties can also help rulers to commit.[11] Joint state-private ownership, for example, can give state actors direct incentives to honor extant property rights. The state may also choose to selectively enforce property rights for particular industries or elites in exchange for rents or political support.

Both strategic interaction and state commitment paradigms imply that firms cannot improve systemic PR security if the state fails to restrain itself. Faced with an unruly sovereign, firms must collude with state actors or hide. Bribes, capital flight, or the resort to mafias' enforcement services are the coping strategies of firms faced with the

[6] E.g., Ostrom 1990; Ensminger 1997; Ellickson 1989.
[7] E.g., Acemoglu and Johnson 2005; Frye 2004; Firmin-Sellers 1995.
[8] E.g., Weimer 1997.
[9] Qian and Weingast 1997; North and Weingast 1989.
[10] Frye 1997; Przeworski 1991.
[11] Oi 1992; Maurer, Haber, and Razo 2003; North, Wallis, and Weingast 2009.

threat of expropriation.[12] Not all firms are victims, as the research on "state capture" and "businessman candidates" argues: the best-positioned companies can change the rules of the game, including those regulating property rights, to their advantage.[13] From the systemic viewpoint, such strategies, available to only a few players, are typically counterproductive. Overall, both paradigms of PR enforcement agree on the state's exclusive capacity for protecting private property in a legitimate, predictable fashion.

Two fundamental objections can be raised vis-à-vis the extant scholarship. First, the concept of the state underlying the literature on PR is flawed. The state appears curiously bifurcated: the government is either omnipotent or atrophied. On the one hand, the program on state commitment assumes a strong state that is both relatively autonomous in its goal formulation and possessed of sufficient capacity to carry out formulated policies. Like Ulysses fearing his own weakness, the state imposes institutional shackles upon itself to resist the temptation of expropriation. On the other hand, the literatures on state capture and mafias assume an incapacitated government. Oligarchs or thugs usurp the process of rule making and enforcement, virtually privatizing the government. Thus, although the "strong versus nonexistent" dichotomy of state subsets does provide analytical value in terms of ideal types, its empirical and conceptual limits must also be recognized. The largest set of transition states, for example, falls into neither subset, as evidenced by the annual Freedom House Nations in Transit reports. Furthermore, state bifurcation in the literature often produces a similarly dichotomous treatment of firms that conceptualizes them as either politically irrelevant (in a strong state) or oligarchic (in an atrophied state).

Apart from the conceptual bifurcation, there is a chasm between the *theoretical emphasis on the role of the state* in securing PR and the *data on the actual characteristics of most developing states*. While the government can, theoretically, protect private property more efficiently than can private actors on their own, few states resemble the rational, power-wielding sovereign with long-term horizons that would allow effective self-restraint on predation. Instead, state officials from Moscow to Mogadishu are driven by short-term private gains that barely overlap with long-term "state interests" in tax collection or investment. In much of the world, Olson's state "bandits" are "stationary" in the physical sense only—conceptually, they are very much "roving."[14]

[12] E.g., Volkov 1999.
[13] E.g., Hellman, Jones, and Kaufmann 2003; Gehlbach, Sonin, and Zhuravskaya 2010.
[14] Stoner-Weiss 2006; Dimitrov 2009.

My second critique of the conventional wisdom is rooted in the fact that property rights are inherently political: their design determines the distribution of wealth and power in a society.[15] Yet, ironically, both perspectives on PR enforcement miss the *ongoing politics* through which PR become secure. The strategic interaction school downplays the necessity of politics as such. Sovereigns, driven by their long-term interests, voluntarily abstain from expropriation in the short run. The studies focusing on private conflicts in traditional communities sans state may, in turn, be appropriate for the whaling industry of the eighteenth century or Kenyan rural clans, but they miss the presence of relatively extensive, potentially predatory governments in many developing countries.[16]

The state commitment paradigm does allow for some state-business interaction. However, the latter is often limited to a single showdown between the elites, as in the famous narrative of seventeenth-century England, in which the Crown accepts constraints on its discretion under pressure from the Parliament. The shift from predation to rule of law through such an *act* of commitment corresponds poorly with reality, as economic historians have begun to argue.[17]

To the extent firms' alliances with nonstate actors are discussed in the literature, they are limited to alliances between business owners. More importantly, the literature assumes that such "merchant groups" *are supported or even initiated by the sovereign*, providing the latter with a commitment device: "a powerful party might find it advantageous to help weaker parties organize themselves . . . in order to allow itself to commit to . . . mutually beneficial arrangements."[18] However, if predation is fundamentally a local phenomenon, as will be argued here, we should not expect such top-level state-business cooperation to impact PR security.

The recent work by Timothy Frye is a welcome advance in this context.[19] The author argues that formerly state-owned firms privatized in Russia through murky deals can improve their PR security by investing in public goods: this earns the companies public legitimacy and decreases the probability of renationalization. Frye's argument is an effective response to the state capture literature: tycoons can pursue

[15] Libecap 1989.

[16] Furthermore, this literature focuses on the common-pool resources under common ownership where clear win-win strategies exist. (If the goal is to prevent the overdepletion of the commons, everybody can win.) Hence, the role of conflict is downplayed. This does not apply to private assets whose ownership is a zero-sum game: either the predator succeeds in expropriating or the target succeeds in defending its property rights.

[17] Clark 2007.

[18] Greif, Milgrom, and Weingast 1994, 773; Maurer, Haber, and Razo 2003.

[19] Frye 2006.

constructive strategies improving PR enforcement in the economy. Yet the argument is limited to the enterprises that had been owned by the government and were privatized through legally dubious means. The overwhelming majority of firms facing PR threats in the developing world do not fit this category. Dealing exclusively with state threats, the analysis also overlooks private predators. Furthermore, the causal mechanism is underspecified. Firms' legitimacy, as such, cannot improve PR security, unless one assumes considerable governmental accountability to the public. The lack of case studies in Frye's statistical analysis leaves open the question of how exactly public goods translate into PR security. Nevertheless, this article subscribes wholeheartedly to the key intuition behind Frye's work—that what firms do matters for systemic PR security. My argument develops this intuition further.

Alternative Approach

The bottom-up approach to PR security offered here proceeds from one premise: most developing states are weak, that is, defined by intermediate autonomy and capacity, as compared with the strong or failed states assumed by extant theorizing. This premise generates three implications.

First, state weakness makes it *difficult for the state principal to commit to PR security on behalf of state agents*. The threat of expropriation by *lower-level* bureaucrats is the norm in weak states, which exhibit severe principal-agent problems within the state bureaucracy. Such threats may include a corrupt municipal court issuing an injunction paid for by a competitor; a policeman harassing retailers for bribes; a local official pressuring a firm to give a job to his relative lest the company lose its operation license; and so forth. The lack of effective intrastate control structures weakens the much-praised commitment by the upper executive since it does not translate into commitment on the ground. President Yushchenko of Ukraine, for example, committed to secure property rights through several presidential decrees after the 2004 Orange Revolution. That, however, did not stop the wave of regional expropriations by the new local administrations.[20] In an interview with the author, a top official from Ukraine's State Property Fund even complained about "local governments expropriating the [central] state" by unilaterally and illegally reassigning rights over the central state's locally situated real estate (for example, sanatoriums). For Russia, while

[20] Paskhaver, Verkhovodova, and Ageeva 2006.

the executive is perceived to control the judiciary informally through "telephone law," such control may be limited to the high-profile politicized cases[21] and, more importantly, does not effectively extend to the lower levels of the executive branch itself.[22] The example of China, where Beijing has been unable to control the land seizures by local governments, demonstrates that even for developing states traditionally viewed as "strong," the top-down perspective on PR security can be inappropriate. The same holds for the strongly socialized rural communities where informal norms may ensure bureaucrats' accountability to the local public:[23] such accountability by no means prevents local officials from sabotaging PR-related "commitments" by the central state.[24]

Second, the inability of the state principal to control her agents exacerbates the problem of *privately* initiated expropriation, too. Officials on the ground become powerless bystanders or willing accomplices to illegal intrabusiness takeovers, rackets, and so on. Italy provides a striking example of the central executive's inability to control extortion by local mafias. The point is all the more valid for the developing world, where threats to private PR can stem from *a variety of public and private predators*. This warrants a more comprehensive approach to the problem of expropriation in weak states.

Third, and crucially, a weak state *can be disciplined by business actors*. Both the "omnipotent state" and the "atrophied state" perspectives are elite based: the fate of PR security is determined by the central executive or the private oligarchs. Weak states, however, reside between these hypothetical extremes. *Even if* the central executive is insulated from society or captured by oligarchs, many firms in weak states interact with relatively independent lower-level state agencies: these interactions directly shape PR security. State principals and the biggest tycoons are the proverbial tip of the iceberg—the politics of PR security also occurs below the water's surface. The literature tends to neglect the potential that firms have to improve PR security *at the company level*. Yet if PR security varies because of the institutions created by firms, then the fundamental puzzle of PR theorizing must be: what are these institutions?

To address this puzzle, we can apply Hirschman's[25] categories of exit, voice, and loyalty to firm's behavior under PR threat. In choosing "exit,"

[21] Hendley 2009.

[22] As the U.S. diplomats on the ground conveyed in secret cables made public by WikiLeaks, "while Mr. Putin enjoys supremacy over all other public figures in Russia, he is undermined by an unmanageable bureaucracy that often ignores his edicts." *New York Times* 2010. See also Stoner-Weiss 2006.

[23] Tsai 2007.

[24] Allina-Pisano 2004.

[25] Hirschman 1970.

the company throws in the towel: it reduces its operations in the official economy by investing abroad or by shifting funds to the illegal shadow economy. In selecting "loyalty," the firm appeases the aggressor: it may offer the state monetary payments or an equity stake in the firm, for example, hoping to retain most of its PR and continue business.[26] Both exit and loyalty have been widely used by companies, as the literature on capital flight, underground economy, and corruption demonstrates.[27]

However, the "voice" option—under which the firm *resists* the aggressor—has received little attention. What, indeed, can a beleaguered firm do against the unruly state or a private predator? Does the hide-or-collude dilemma exhaust the options? No, I argue: firms can resist PR threats through alliances with stakeholders who can impose costs on potential trespassers on behalf of the firm. Often extending beyond a firm's boundaries, such alliances engage diverse groups, pool resources, and effectively outsource the task of PR enforcement to third parties. To secure their PR, majority owners can build alliances with the following stakeholders: neighboring communities, labor, and foreign actors, such as investors, media, NGOs, and governments. I define alliances as groups with common interests of which they are aware. Such groups can be institutionalized or informal. Stakeholder alliances can emerge for a variety of economic, political, or social reasons: it is the shared interest in the continuation of the firm as a going concern that unites the firm's owners and stakeholders. Consider, for example, the alliance between majority owners and foreign creditors. The latter have a clear financial interest in supporting majority owners' struggle against expropriation because the financiers' investments become progressively sunk as the threat of expropriation increases. Labor and the adjacent communities may protect the firm owners' PR if the material benefits the company has provided to its employees and the region would cease after expropriation. Such benefits are anchored through corporate social responsibility, including the financing of regional development and charity projects, environmental initiatives, and firm-sponsored insurance and benefit packages for labor.

How can alliances secure a firm's PR? Depending on their resources, alliance members can impose financial or political types of costs on potential aggressors. Accordingly, a firm's defense can make the ex-

[26] Hirschman focuses on *individuals*—qua citizens or customers—in his conceptualization of responses to organizational decline. When applied to *firms*, Hirschman's notion of loyalty loses its emotional component (as patriotism or brand loyalty in its original formulation) but retains its analytical rationale as continued participation in the official economy without countermeasures *despite* deteriorating conditions. A firm's acceptance of PR aggressors' terms enables such participation.

[27] E.g., Hellman, Jones, and Kaufmann 2003.

propriation itself, or its consequences, more expensive and hence less profitable for the aggressors. In the case of state predators, for example, domestic firms and foreign investors, as allies of the target enterprise, can impose costs through investment withdrawal. Political costs, in turn, decrease the power of the expropriator, that is, her menu of feasible options. In the case of state expropriation, this can involve electoral pressure, public protests, or behind-the-scenes lobbying by the allies of the target firm. State expropriators below the top executive level are also sensitive to negative publicity, as the latter can trigger their demotion in the bureaucracy. The threat of public protests, for example, is particularly important for nondemocratic countries such as China. Private predators must also consider the political costs when planning expropriation. Employees, for example, can either join an aggressor by expressing dissatisfaction with the status quo owners or form a human fence around the enterprise to prevent its violent occupation by raiders. Less dramatically, vocal support of the owners by the community where the firm is located makes collusion between private predators and the local government less likely.

The preceding discussion generates the key hypothesis of this study: *ceteris paribus, firms with stakeholder alliances will have more secure property rights*.

To sum up my approach, property rights emerge through a *process* with substantial *bottom-up* initiative by the potential victims of expropriation, rather than a single *top-down act* by the state executive (commitment) or a few oligarchs (capture). While firm initiatives in PR enforcement have been discussed by some scholars, my approach adds theoretical and empirical value along three dimensions. First, by relaxing the assumption that firms' strategies must benefit the sovereign in order to succeed, I investigate bottom-up voice strategies *in the absence of* win-win solutions. Second, most treatments of PR security focus *either* on state-business struggles *or* on the intrabusiness disputes in the absence of state. My approach integrates a wide array of PR threats as seen from the perspective of a a modern firm. Finally, I offer an empirical contribution by providing survey data and case studies from contemporary weak states, complementing the historical narratives and game-theoretic treatments prevalent in the literature.[28]

Case Study: Alliances in Action

To illustrate the *causal mechanism* translating stakeholder alliances into secure property, this section presents a case study of Oleyna factory,

[28] E.g., Bueno de Mesquita and Hafer 2008; North, Wallis, and Weingast 2009; Greif 2006.

whose owners—thanks to alliances with a foreign bank, labor, and community stakeholders—successfully repelled an expropriation attempt by private raiders and the local state actors. To demonstrate the *limits* of alliances' impact, I also discuss the case of Yukos, whose main shareholder was expropriated by the Kremlin administration. The section is based on semistructured interviews in the region, supplemented by analysis of the local media.

Oleyna is a factory producing vegetable oil in the city of Dnepropetrovsk, Ukraine. Founded in 1947, Oleyna was bought out by the employees in 1993, establishing a "closed joint-stock company." In 1995 the company received loans for technological modernization from the European Bank of Reconstruction and Development.

In 2006 the financial-industrial empire Privat Group launched a complex attack on the property rights of Oleyna's majority owners, ultimately aiming to expropriate a 60 percent equity stake in Oleyna by nullifying the 2002 legal sale of this stake to an investor. To do so, Privat Group attacked Oleyna both directly and through the local state administration. To begin, Oleyna's majority owners noticed that large chunks of shares were changing hands without being officially registered as purchases; Privat Group, that is, was buying up shares illegally.[29] Afterward Privat Group unleashed a "cascade of harassment" on Oleyna through the local government, so as to intimidate the majority owners. Oleyna was swamped with lawsuits and investigations by the local prosecutor's office, covering issues ranging from alleged environmental transgressions to a criminal case against the CEO. Meanwhile, Privat Group started spreading misleading information about Oleyna to the press, in order to discredit the majority owners and the executive management. Some local newspapers embarked on a shrill campaign against Oleyna, charging that the firm is "helping . . . to plunder the state budget of Ukraine" and speculating that Oleyna's oil, a winner of numerous quality contests, might contain heavy metals and arsenic. After preparing the ground in terms of public opinion and state agencies' readiness (not without financial incentives), the raiders filed their main lawsuit on behalf of people previously affiliated with Oleyna. Although intimately familiar with Oleyna's affairs, the raiders claimed that they were "unaware" that the firm had a new investor and that the sale of 60 percent equity stake should be reversed.

[29] Oleyna's legal status provides for "preemptive rights": shares must first be offered to existing shareholders before being sold to outsiders. Privat Group abused a gift-giving clause to buy shares surreptitiously. If shares are given as a gift, the ownership change does not need to be registered; corporate raiders often use this clause *to buy up* shares illegally by making concealed payments to "gift givers."

What could Oleyna's majority owners do, considering the clout of Privat Group? Due to its prior efforts, Oleyna was blessed with a diverse range of stakeholders whose support it could enlist. The firm had modern standards of corporate governance, that is, empowered shareholders, various labor-supporting programs, a variety of social initiatives in the region (particularly with respect to children), and, as previously noted, a large foreign creditor. Oleyna's reaction to the attack was multidimensional, as the firm drew on the capacities of its different stakeholders. First, the firm called for assistance from the European Bank of Reconstruction and Development. Together with the EBRD, Oleyna prepared a detailed chronology of the attack and convened a joint press conference. The presence of the EBRD director for Ukraine at the conference guaranteed that the information would be viewed as credible. The conference had a tremendous media response, with over twenty articles appearing in major national and foreign newspapers. Second, Oleyna's employees joined to defend the majority owners by writing a letter to the Ukrainian president. The letter was also signed by two-thirds of minority shareholders and then disseminated to the press. Finally, Oleyna moved to make its community work visible by spreading Oleyna banners on the playgrounds it had built. Through its stakeholders, Oleyna created substantial pressure on the local government to stop assisting the raiders. Given that the case was in the spotlight, it was clear there would be both retribution at the voting booth and likely administrative sanctions from Kiev if the local politicians, the prosecutor's office, and the courts helped Privat Group expropriate the majority stake in Oleyna. As a result, the fabricated case against the firm was dropped by the prosecutor's office, due to the lack of body of crime (a corpus delicti clause), practically an admission that the prosecutor had had no grounds for opening the case in the first instance. Without political support, the raiders lost interest and did not resort to the criminal tactics they had threatened. According to an Oleyna executive, "we had threats that they will crush our gates with a Kamaz [a large truck], and we're lucky it did not come to this . . . we strengthened security but that's not what saved us."

Oleyna's case is not exceptional, and the range of defense strategies employed by various firms' nonstate stakeholders deserves closer attention. In 2006, in Russia's Saratov, municipal fire inspectors provided the official cover for cutting off electricity to a lamp-making factory, EkspoPUL, paralyzing its production, in an effort to pressure its owners into yielding control over the enterprise to a rival. In breaking several laws of the Russian Federation (as confirmed by a court decision later), this act constituted the climax of a five-month legal battle waged by EkspoPUL. The solution did not come from lawyers. The factory's directors organized more than a thousand workers to protest in Saratov's main square, where the workers publicly signed a petition to (Russia's former president) Putin stating that "representatives of the . . . [state] organs are handing over Saratov's industry to financial criminals . . . escalating social tensions with unpredictable consequences."[30] The oblast [county-level] procuracy intervened on behalf of EkspoPUL and the supply of electricity was reestablished.

In addition to potential sanctions from the central government, the financial mechanism can play a role in protest-based defenses. As the deputy CEO of Russia's premier antiraider consulting firm, RosRazvitie, notes: "for the aggressor, it's . . . a business project. *Bribes can triple if officials are afraid of public [protest] campaigns*: when the raider is exceeding his projected costs, that's when the expropriation order is canceled."[31] Furthermore, organized community and labor can prevent a physical confrontation, as in the case of the Ukrainian plant NZF, where, in 2005, the workers faced down a cordon of special police forces (the latter trying to implement a politically motivated takeover of NZF). As the wider town community of Nikopol' joined the protests, reporting on the conflict invariably mentioned NZF's desirability as employer: "Last week, Nikopol' was Ukraine's second capital: thousands of protesters, dozens of TV cameras. . . . The special forces left the territory of the world's largest ferroalloy producer . . . [where] the standard salary . . . is 1600–2000 hryvnia."[32] The chief editor of IA Advisers, Russia's private information agency reporting on corporate conflicts, says: "[B]y far not every armed detachment [*silovoe podrazdelenie*] will want to fight with a crowd of workers in front of cameras. But . . . you have to establish a relationship with your employees in advance. You cannot just get . . . them to go out there for you on 'ready, set, go': workers usually hate their managers."[33]

Foreign alliances often work through backdoor lobbying. According to the EBRD director for Ukraine, in the cases of state or private predation vis-à-vis affiliated firms, "EBRD support takes the form of official demarches, public support, and unofficial approaches."[34] In 2004 Russia's telecom company Vimpelcom was subjected to regulatory pressure

[30] *Kommersant (Volgograd)* 2006.
[31] Presentation at business forum "AntiReider 2007" in Kiev, Ukraine, March 29, 2007.
[32] *Gazeta Po-Ukrains'ky* 2005.
[33] Presentation at business forum "AntiReider 2007" in Kiev, Ukraine, March 29, 2007.
[34] Personal communication with author, March 3, 2007.

(through the groundless cancelation of its licenses) and outsize tax bills, due to a conflict between Vimpelcom's owners and Russia's former minister of communications. After the firm's Norwegian investors weighed in on Vimpelcom's behalf through Norway's prime minister, the firm's tax bill was reduced tenfold, the firm's licenses were reinstated, and the minister of communications was fired.[35]

Alliances can also fail to protect firms. A sensational failure was demonstrated by Yukos, Russia's former oil giant, in 2003. The company's main shareholder, Khodorkovsky, the richest man in Europe at the time, had mastered the art of alliance building like no other. Khodorkovsky's charitable donations exceeded $50 million annually across a broad range of causes. The magnate also gained access to top-level US policymakers and foreign investors. And yet the state expropriated Khodorkovsky's entire 59 percent stake in Yukos in a politicized trial ending with the tycoon's imprisonment. Why did Yukos's alliances fail? It is certainly *not* because the allies did not intervene on behalf of the firm. Domestic NGOs sprang up to defend Khodorkovsky. One NGO, Sovest' [conscience], put public pressure on Duma deputies, organized televised demonstrations in front of the headquarters of the FSB (security service), and enlisted Amnesty International in Khodorkovsky's cause. Foreign stakeholders also weighed in. Senator John McCain told the Senate that the Yukos case was jeopardizing the U.S.-Russia relationship and called for an investment blockade of Russia. Most spectacularly, Yukos was allowed to file for Chapter 11 bankruptcy protection in the United States. A U.S. court ordered a ten-day delay in the auction of Yukos's key asset, Yugansk, a verdict that prompted an international banking consortium to cancel its deal with the Russian state proxies aiming to finance the government's purchase of Yugansk. Since Khodorkovsky's political ambitions had directly and repeatedly crossed Putin's plans, however, the firm was expropriated.

The Yukos case suggests that no matter how strong its nonstate alliances, business is likely to lose in a head-to-head confrontation with the central executive. However, the key threat to many entrepreneurs in the developing world is not the central executive but local state actors or private predators. The study of Oleyna implies that stakeholder alliances can increase PR security against such threats. But how generalizable is this case? This question is explored below using a new survey of businesses in Russia and Ukraine.

[35] Markus 2008.

Survey Results: Measurement and Analysis

What exactly threatens property rights? What contributes to their security? The bottom-up approach suggests answers to these questions that are different from those offered by the frameworks of strategic interaction and state commitment. To evaluate these theories, I designed a survey that was implemented in Russia and Ukraine between February and May 2007. If the key question is whether property rights can be secured in the absence of state enforcement, then Russia's low rule-of-law rankings in cross-national studies make that country a good testing ground. Data from Ukraine provide a preliminary portability check. In addition, since the central executive is more institutionally constrained in Ukraine than in Russia, even though both countries share similar legacies, this dyad is particularly promising for our purposes.

In Russia, the data were collected through a mail survey by the Institute for the Economy in Transition (IET). In Ukraine, the data were collected through face-to-face interviews by the Institute for Economic Research and Policy Consulting (IERPC). IET and IERPC count among the most reputable business survey organizations in the region. Both organizations rely on representative panels of firms constructed via stratified random sampling. The analysis here represents a one-year slice of the panel. There are twelve hundred firms in the Russian panel and three hundred firms in the Ukrainian panel. (Due to budget constraints, the Russian panel for this project was restricted to eight hundred firms, randomly selected from the twelve hundred.) The important advantage of using a relatively stable set of companies is data quality. Over the years, substantial trust has developed between these firms and the organizations surveying them, reducing dissembling and nondisclosure. It is also noteworthy that the respondents consist almost exclusively of top management (92 percent). The panels cover all regions of Russia and Ukraine but are restricted on size and sector: they are somewhat skewed toward medium-size and large enterprises and include industrial sectors only. Hence, the results may apply less to the service sectors or small firms.

The overall response rate is 47 percent, which is reasonably good for business elites.[36] In Russia, responses were collected from 396 firms out of 800 that were contacted. The respondent firms cover 68 regions out of Russia's 83 federal regions. In Ukraine, the interviews were conducted with 120 firms from 5 regions out of Ukraine's 27 regions,

[36] For comparison, a McKinsey survey of top managers in fourteen OECD countries plus China and India in 2003 obtained a 44 percent response rate.

including 2 eastern, 2 western, and 1 central region, to reflect the economic diversity of the country. Of the 15 sectors in the sample, the largest are machinery (34 percent of firms), food processing (13 percent), light industry (12 percent), construction (11 percent), and wood processing (5 percent). An average firm in the sample employs 1,150 workers (sample minimum is 2 employees; maximum is 20,000 employees). Firms in the sample are owned by individuals (51 percent), a board of directors (22 percent), a group of other firms (13 percent), the state (8 percent), managers (5 percent), employees (3 percent), foreigners (1 percent), and banks (1 percent).

An inquiry into the sources of PR security should be based on a nuanced understanding of PR threats. As suggested previously, such threats may stem from a range of public and private actors rather than from a single sovereign. Furthermore, while the literature measures PR security along a single dimension, the very definition of PR as a *bundle* of rights implies that the components of the bundle could be threatened individually. To capture these differences, the survey fielded questions on the extent of specific types of PR infringements. Informal interviews throughout the region helped us establish a list of eleven typical PR infringements, including seven infringements by the state and four by private entities. The entrepreneurs evaluated the seriousness of each infringement for their business on a 1–4 Likert scale (1 means "no threat at all"; 4 means "very high threat"). Table 1 presents the results, listed in decreasing order of threat intensity. Extortion by taxation agencies is the top-ranked state threat. In the author's semistructured interviews, for example, owners of small businesses complained that the municipal tax police officials "are pseudo-professionals with purchased diplomas ... [who] call you up and say 'come on, give us something.'" A director of a large supermarket chain observed that "although it is easier for the tax folks to harass smaller businesses, they [the tax officials] must also fulfill a plan for sanctions: that's why we get anxious when all of our documents are in order. Looking clean is an invitation for trouble."

The disaggregation of threats allows us to identify *which component* of the PR bundle is most jeopardized. On average, threats to ownership transfer are higher (2.41) than threats to income procurement (2.38), which, in turn, are higher than threats to asset management (2.31), the differences being significant at the 0.05 and 0.01 levels, respectively. This finding suggests that the most serious threats to property rights are subtle: private and public predators thwart the exchange of assets on the market and target the income streams deriving from ownership. While direct attacks on asset management are also present and certainly

TABLE 1
AVERAGE THREATS TO FIRMS' PROPERTY RIGHTS ON A 1–4 SCALE[a]

PR Type	*Threat*	*Threat Intensity*
Income	extortion by taxation agencies	2.88
Management	illegal inspections by state organs	2.66
Income	nonpayment of legal obligations by firms	2.63
Management	illegal administrative barriers to obtaining licenses, operating permissions, etc.	2.55
Transfer	illegal administrative barriers to purchase or sale of land, real estate, productive assets, etc.	2.41
Management	hostile use of state resources by competitors	2.22
Management	illegal ownership capture by private entities	2.19
Income	administrative pressure for financial contributions to various social funds	2.18
Income	administrative pressure for informal payments	1.98
Income	racket, extortion by private entities	1.60
Transfer	illegal administrative interference with hiring or firing of labor, including top management	1.59

[a] Based on a survey of 516 firms in Russia and Ukraine. The seriousness of a given threat was reported on a 1–4 scale from least to most serious. Threat Intensity column reports averages for all firms.

well covered in the media, they appear somewhat less significant. To what extent do PR threats differ across the two countries? The average overall threat to property rights is higher in Russia (2.49) than in Ukraine (1.94). This difference is significant at the 0.01 level and holds for the averages of state-initiated as well as private threats. Comparing state threats to private threats *within* each country yields an interesting result: while average *private* threats (2.56) are *higher* than those from state agencies (2.45) in Russia, in Ukraine, *state* threats (2.13) are *higher* than privately initiated ones (1.60). (Both differences are significant at the 0.01 level.) The author's fieldwork suggests that this asymmetry, while surprising if one were to rely on Russia's reputation for state misconduct, underscores the continuing importance of two phenomena: the spread of "corporate raiding" in Russia and the poorly managed administrative turnover in Ukraine following the 2004 Orange Revolution.[37]

[37] After 2000 the oil boom and rising asset prices have increased the attraction of illegitimate, increasingly sophisticated property takeovers in Russia, generating a formidable "raiding" industry fielding top lawyers, financiers, politically connected middlemen, and specialists in violence. The Orange Revolution in Ukraine, for its part, has led to a wholesale replacement of local government cadres (for example, up to 90 percent of the police force has been replaced), whose lack of professionalism, combined with political uncertainty, has led to widespread self-enrichment schemes by government actors.

The data imply that at least two fundamental assumptions behind the state commitment paradigm are problematic. In arguing that PR become secure once the state imposes limits on its own discretion, extant theories assume that (1) the central executive is the only real threat to PR security and (2) the key variation in PR security occurs at the country level. These assumptions are not supported by the data. First, *private* threats to PR appear as serious as state threats. At the pooled level, the average intensities of private and state threats are 2.32 and 2.38, respectively, a difference that is *not* significant at the 0.05 level. Second, the data show that substantial *interfirm variation* in PR security exists within countries and even within regions, that is, *within* the macroinstitutional settings viewed as decisive for PR security in the literature. The question of why firms *faced with the same sovereign* report diverging levels of PR security cannot be addressed within the state commitment framework. This brings our analysis to the firm-level sources of PR security.

An empirical proxy for PR security, to be consistent with the bottom-up theoretical framework, would have to distinguish between the public and private threats to property rights and be allowed to vary across firm units. The measures of eleven threats to PR, as evaluated by respondent firms (Table 1), fit these requirements well. I construct two measures of the dependent variable *Threat*: one is the average of seven measures of state-based threats; the other is the average of four threats from private actors.[38]

The *Threat* variables here have significant advantages over alternative proxies for PR security in the literature, such as country risk indices, self-reported investment levels, and direct survey questions about "property rights." Available country risk indices compile the subjective opinions of relatively few experts on the probability of government expropriation. Such indices essentially estimate the constraints on the upper executive ignoring the threats from unaccountable lower-level bureaucrats or private actors. Investment reported by firms as a proxy for PR security likewise does not differentiate between public and private sources of insecurity. Moreover, investment is contingent on macroeconomic, product-specific, and psychological factors unrelated to PR. Finally, instruments such as the World Bank's BEEP surveys use the actual term "property rights" in questionnaires: this term, as the testing

[38] It should be noted that the averaging of Likert-derived data, while common in social science research, relies on the assumption of interval status for ordinal measures. This assumption is reasonable here since the phrasing of our question suggests that the space between two successive ordinal categories, while not strictly constant, is of the same order of magnitude. In addition, the threat-intensity scale possesses a natural zero point ("no threat"). See Wang et al. 1999.

in my own survey shows, is likely to be interpreted very differently by respondents, resulting in a serious concept misidentification.[39] Overall, despite its theoretical superstatus, PR security remains an empirical black box. In this context, the *Threat* variables tangibly improve extant concept measurement: these proxies reduce incentives to dissemble since no self-reporting of sensitive activities is involved (as in the case of investment, for example), while also ensuring interfirm comparability via eleven detailed, easy-to-understand questions (as opposed to a an ambiguous question on "property rights," for example).

The equation to be estimated is

$$\begin{aligned} Threat_j = \beta_0 + \beta_1 Community + \beta_2 Foreigners + \beta_3 Country + \\ \beta_4 MerchantGroup + \\ + \beta_5 TaxShare + \beta_6 Loyalty + \beta_7 Legitimacy + \beta_8 ForcedFunding + \\ \Sigma\beta_9 Size + \\ + \Sigma\beta_{10} Sector + \Sigma\beta_{11} Ownership + \Sigma\beta_{12} Region + e. \end{aligned} \quad (1)$$

For summary statistics on all variables, please see Table A1 in the appendix. $Threat_j$ is the jth measure of threat averages where j = 1, 2 (referring to state and private threats). Since threat averages refer to a continuous latent variable, an OLS model is used. Robust standard errors are used to account for heteroskedasticity. *Community* and *Foreigners* are proxies for alliances. *Community* equals 1 if a firm considers its "support of regional community and labor" to be "very significant" and 0 otherwise.[40] *Foreigners* equals 1 if the firm has a foreign creditor or a foreign investor and 0 otherwise. Theoretically, credit relations and ownership stake are good proxies for meaningful alliances since threats to PR would likely affect the creditors or co-owners of the firm. The foreign identity of these allies is important due to selection effects, since

[39] Our questionnaire asked respondents to *define* "property rights." The respondent could select multiple answers from among a menu of six suggested PR components, only three of which described the actual parts of the PR bundle. Twenty percent of respondents did *not* include the right to manage assets in their definitions of property rights. Forty percent did *not* include the right to derive income from assets, and 65 percent did *not* include the right to ownership transfer in their definitions.

[40] Firms were asked to evaluate their support on a 1–4 scale ("no support" to "very significant support"). My theoretical framework suggests that only a substantial volume of benefits transferred by the firm to its community stakeholders would incentivize the latter to protect the firm in case of expropriation. Dissembling by firms is also less likely to occur at extreme response values, which are easier to verify. Accordingly, the dummy equals 1 if the firms rated their support as being very significant. Specific forms of support listed by firms in the follow-up questions include sponsorship of cultural events, support of child-related facilities, support of church charities, subsidizing housing or mortgages, payment for medical care, payment for holiday packages, and others.

bigger and more powerful foreign firms are more likely to invest in the Russian market. The numbers on discrete alliances[41] are in line with the available data on the region.[42]

A number of control variables that could influence both a firm's extent of stakeholder alliances and the security of its property rights are included. First, the macroinstitutional environment could play a role. The *Country* variable is used to control for macroinstitutional design: this is a dummy coded as 0 for Russia and 1 for Ukraine. Since constraints on the executive branch are significantly higher in Ukraine than in Russia,[43] this variable also provides a tentative test of the state commitment paradigm.

The literature on state commitment views business organizations supported by the sovereign as capable of improving PR security. *MerchantGroup* equals 1 if the company participates in a *national* business association and 0 otherwise. The Russian data are particularly appropriate for testing the merchant-group perspective. Putin's administration has welcomed or actively supported Russia's federal-level business associations.[44] Conversely, national associations in Ukraine had emerged through bottom-up initiative and were snubbed by the government of Prime Minister Yanukovich.[45] While Ukrainian results cannot be interpreted as a test for the merchant-group theory, they might indicate whether genuine bottom-up business organizations can improve local PR security in the absence of sovereign support. (Both Russian and Ukrainian national associations have regional offices.)

According to the strategic interaction school, firms may be protected from state expropriation by virtue of paying taxes, since the government would not want to jeopardize its revenue source. *TaxShare* provides a rough estimate of the firm's share of total tax revenue levied from enterprises in the region (*oblast'*). This variable equals 1 if the share is below 5 percent; 2 if the share is in the 5–19 percent range; and 3 if the firm pays above 20 percent of taxes collected in the region.

[41] Eighty-two percent of firms support communities and labor in some form, with 7 percent reporting "very significant support"; over 3 percent have found foreign investors or creditors; about one-third of firms are members of federal business associations ("merchant groups").

[42] Starodubskaya 2005; Dolgopyatova, Ivasaky, and Yakovlev 2007.

[43] Ukraine was rated "free" by the Freedom House in 2007, as the only post-Soviet non-Baltic state, while Russia was rated authoritarian with a score close to China's. In terms of parliamentary power, court independence, and media freedom, Ukraine scores significantly better than Russia.

[44] Markus 2007.

[45] In December 2006, the Cabinet of Ministers of Ukraine unilaterally liquidated the Business Council, which had been the primary interface between federally organized business and the government. Business leaders widely perceived the act as government's refusal to institutionalize cooperative relations. (Author's interviews with Parliament deputies, government officials, business association directors, and company managers in Kiev and four Ukrainian regions, February 2006–April 2007.)

The firms' propensity for "loyalty" strategies vis-à-vis state officials (for example, bribe payments or the establishment of government connections) could be a confounding factor. An attitudinal proxy is particularly appropriate here. On the one hand, a company's *endorsement* of loyalty strategies, either because of their perceived effectiveness or on normative grounds, can be expected to correlate with a firm's behavior (which is difficult to elicit with a direct question). On the other hand, even if the firm is not actually pursuing a loyalty strategy, its attitude toward such strategies as such may influence the firm's perception of PR threats as well as its readiness to pursue stakeholder alliances. Survey respondents were asked to estimate the effectiveness of voluntary "informal payments" [*neformal'nye otchisleniya*] to state officials in protecting the firms in respondent's region from state predation. [46] *Loyalty* equals 1 if a firm considers such payments ineffective; 2, if somewhat effective; and 3, if very effective. As a robustness check for this control variable, I used several other questions, including (1) perceived "effectiveness of government connections in protecting firms in your region from state predation"; (2) membership of firm owners in a political party; and (3) perceived "importance of closer cooperation with the regional government for the enforcement of firm owners' legal rights."[47] These alternative questions serve as a validity check for *Loyalty* and decrease the probability of reverse causation for this variable.

Public legitimacy of the private sector with its inherent inequities could be a potential determinant of PR security in the postcommunist economies; firms perceived as broadly legitimate may also feel less need to invest in alliances with the public. My survey inquires how the public perceives successful and wealthy entrepreneurs in the region. The *Legitimacy* dummy equals 1 if respondents think that the public approves of such entrepreneurs or sees them as role models.

In the case of communities and labor, companies may be pressured by the state to invest in welfare-related projects. *ForcedFunding* is a dummy that equals 1 for companies that have felt pressured by the regional government to incur nonobligatory expenses for public projects, charity, or employee support.

I also control for the size, sector, and ownership of firms. *SizeMedium* and *SizeLarge* are dummies for firms that have over one hundred and over five hundred employees, respectively. *Sector* and *Ownership* are

[46] Such voluntary "incentive payments," *initiated by firms* to cope with legal uncertainty, should not be confused with the bribes extracted under pressure by officials.

[47] Note that (2) offers a *behavioral* proxy as compared with the original attitudinal proxy, while (3) also ensures that the endorsement of loyalty vis-à-vis *local* officials is tested.

dummies for industrial sectors and key ownership categories. Regional dummies control for potential cross-regional heterogeneity.

Table 2 presents the effects of alliance variables on *Threat_State* and *Threat_Private*. Models 1 and 2 report the results at the pooled level; models 3 and 4 show the results for Russia; models 5 and 6 show the results for Ukraine.

In all model specifications, alliance variables display the expected sign. At the pooled level, both alliance types reduce threats from state actors *as well as* from private predators at a statistically significant level. Among proxies for rival hypotheses, only *Country* has a significant negative impact on PR threats. With respect to threats from state actors, alliances with foreigners have a similar substantive impact as alliances with communities and labor, though foreign alliances are more statistically significant. Regarding threats from private predators, alliances with community and labor, conversely, display higher significance *and* coefficient size as compared with foreign alliances. In Russia foreign allies protect against state threats while both foreign and community stakeholders help reduce private threats to property rights. In Ukraine alliances with community and labor protect against state predation. While *Community* and *Foreigners* barely miss significance level for private threats in Ukraine, note that the significance of *MerchantGroup* in model 6 is fully consistent with the bottom-up voice theory, since national business associations in Ukraine had not enjoyed sovereign support and can be properly conceptualized as another form of stakeholder alliances. (The discussion section provides a qualitative example of the bottom-up activity by a Ukrainian association.)

The substantive impact of alliances is large. Taken together, alliances with foreigners and with community and labor reduce threats from the state by more than half a point and threats from private actors by about one full point on a 1–4 threat intensity scale (models 1 and 2). Given that the maximum hypothetical threat reduction equals 3 points (from 4 to 1, that is, from "very high threat" to "no threat"), this impact of alliances amounts to 20–30 percent of the maximum possible threat reduction and is larger than the reduction provided by macroinstitutional constraints (that is, the coefficient on the *Country* variable). Taken separately, alliances with foreigners and community and labor still reduce PR threats by 60–70 percent of the threat reduction provided by macroinstitutional constraints.

For a more nuanced picture of the impact of alliances on specific PR threats, as well as a robustness check, I use the original eleven measures of individual threats in Table 1 as dependent variables. An ordered

TABLE 2

THE EFFECT OF ALLIANCES ON THE SECURITY OF PROPERTY RIGHTS IN RUSSIA AND UKRAINE

	Both Countries		*Russia*		*Ukraine*	
	(1) *Threat_State*	*(2)* *Threat_Private*	*(3)* *Threat_State*	*(4)* *Threat_Private*	*(5)* *Threat_State*	*(6)* *Threat_Private*
Community	–0.28* (0.16)	–0.51*** (0.19)	–0.17 (0.2)	–0.57** (0.26)	–0.59** (0.22)	–0.43 (0.32)
Foreigners	–0.28** (0.13)	–0.46** (0.19)	–0.36*** (0.13)	–0.46* (0.26)	–0.27 (0.3)	–0.46 (0.33)
Country	–0.44** (0.21)	–0.75*** (0.2)				
MerchantGroup	0.07 (0.08)	–0.03 (0.11)	0.06 (0.09)	0.03 (0.12)	0.16 (0.22)	–0.37* (0.21)
TaxShare	0.06 (0.06)	0.13* (0.08)	0.03 (0.06)	0.14 (0.09)	0.28** (0.12)	0.23 (0.14)
Loyalty	0.07 (0.06)	0.04 (0.08)	0.08 (0.07)	0.00 (0.1)	–0.07 (0.11)	0.11 (0.13)
Legitimacy	–0.04 (0.07)	–0.13 (0.08)	–0.02 (0.08)	–0.14 (0.13)	–0.06 (0.13)	–0.03 (0.15)
ForcedFunding	0.06 (0.07)	–0.16* (0.09)	0.04 (0.08)	–0.15 (0.11)	0.23 (0.17)	–0.14 (0.16)
SizeMedium	0.18 (0.13)	–0.19 (0.17)	0.04 (0.17)	–0.26 (0.27)	0.07 (0.22)	–0.25 (0.29)
SizeLarge	0.09 (0.13)	–0.11 (0.17)	–0.04 (0.17)	–0.22 (0.26)	–0.02 (0.26)	0.22 (0.23)
N	298	286	232	221	66	65
P > F	0.0000	0.0000	0.0118	0.0000	0.0009	0.0062
R^2	0.2	0.37	0.15	0.18	0.46	0.4
Dummy Variables	Sector Ownership Region	Sector Ownership Region	Sector Ownership Region	Sector Ownership Region	Sector Ownership Region	Sector Ownership Region

* p<0.10, ** p<0.05, *** p<0.01; OLS model with robust standard errors (in parentheses); dependent variables are averages of respondents' estimates of threat intensity

probit model with robust standard errors is used to reflect the ordinal status of individual threat measures.

I estimate an equation identical to equation 1 except for the dependent variable, which is now *Threat*$_i$, the *i*th measure of threat intensity where i = 1, 2, . . . 11. Stakeholder alliances have a statistically significant impact on nine out of eleven PR threats, as summarized in Table 3. Simulation is used to translate ordered probit coefficients into substantive quantities of interest.[48] Along with coefficients' significance levels, Table 3 reports the *change in the probability* of a firm reporting "no threat" (that is, of obtaining 1 on a 1–4 threat intensity scale) *as a result of* a particular alliance. This marginal effect is the change in the likelihood of an alliance *eliminating* a perceived threat altogether.

As before, the size of the impact of alliances is considerable. Depending on the threat, alliances with community and labor increase the probability of a "no threat" response by 7–69 percent; alliances with foreigners make a "no threat" response more likely by 7–42 percent. On average, firms with alliances are 27 percent more likely to report "no threat" for the nine threats on which alliances exert a significant impact; for eight out of these nine threats, alliance variables are significant at the .01 level. Alliances with community and labor contribute to eliminating eight perceived threats, as compared with five threats eliminated by alliances with foreigners. For comparison, the table also includes "merchant groups," which eliminate two threats. Alliances with community and labor provide the most universal defense, increasing the probability of a "no threat" response for three out of four private threats and for five out of seven state threats. Alliances with foreigners are more effective vis-à-vis government officials than vis-à-vis private predators: out of five threats reduced by this alliance type, the four largest impacts are on public threats. Overall, disaggregated threat-level analysis supports the efficacy of stakeholder alliances in the protection of property rights.

What about the rival hypotheses (Table 2)? The significance of the *Country* variable with respect to both *Threat_State* and *Threat_Private* suggests that macroinstitutional constraints on the executive do play an important role in establishing PR security. The concurrent significance of the bottom-up nonstate alliances and the top-down "commitment devices" of the sovereign implies equifinality: the reduction of public and private threats to PR security can be achieved via multiple paths. At the same time, the insignificance and "wrong" sign of *MerchantGroup* in

[48] Stata's *Clarify* package is used to simulate one thousand coefficients for all model parameters and convert these into marginal effect estimates (first differences). See King, Tomz, and Wittenberg 2000.

TABLE 3
THE SUBSTANTIVE IMPACT OF ALLIANCES ON DISCRETE THREATS
(ORDINAL PROBIT FIRST DIFFERENCES)[a]

Firms Having Alliances with …	*Are …% More Likely to Report*	*That They Do Not Perceive Any Threat Relating to …*	*N*	$P > \chi^2$
Community and Labor	69*** (19)	state pressure for financing various social funds	65	0.0000
	38*** (14)	illegal ownership capture by private entities	209	0.0000
	38*** (13)	racket, extortion by private entities	199	0.0000
	31*** (12)	state barriers to transfers of land, productive assets, etc.	255	0.0000
	31** (19)	illegal inspections by state organs	66	0.0001
	19** (13)	state interference with hiring or firing of labor	265	0.0000
	13*** (17)	extortion by taxation agencies	66	0.0000
	7* (5)	nonpayment of legal obligations by firms	278	0.0000
Foreign Creditors and Investors	42*** (11)	state interference with hiring or firing of labor	265	0.0000
	25*** (10)	administrative pressure for informal payments	292	0.0001
	20** (12)	illegal inspections by state organs	215	0.0000
	8** (7)	extortion by taxation agencies	214	0.0002
	7** (6)	nonpayment of legal obligations by firms	278	0.0000
Merchant Groups	49*** (19)	illegal ownership capture by private entities	57	0.0000
	10** (5)	state pressure for financing various social funds	205	0.0104

p<0.10, ** p<0.05, *** p<0.01

[a] Summary of ordered probit regression results with corresponding marginal effects. Second table column reports how the *probability of a firm reporting "no threat"* changes *as a result of* having an alliance (standard errors in parentheses). For example, companies that have alliances with community and labor are 69 percent more likely to report that state pressure for financing various social funds is not a threat. Stata's *Clarify* package used for simulation of first differences.

the Russian subset (where the central executive has worked closely with organized business) indicate the limits of the state commitment paradigm. The reason is readily apparent: while the literature expects such high-level collaboration to ensure business against threats by the sovereign, my survey inquires into *local* predation by less-than-accountable officials. The Yukos case, moreover, strongly suggests that sovereign-supported merchant groups do not protect firms against today's *central* executives either. Yukos was an active participant in RSPP, Russia's federal big-business association. The association wrote three official letters to Russia's president, decrying the state's attack. Putin rejected any negotiations with RSPP over Yukos. The association, in other words, could not protect one of its most influential members from being expropriated.

TaxShare does not improve PR security, providing evidence against the "strategic interaction" paradigm. In fact, *TaxShare* significantly *amplifies governmental PR threats* in Ukraine. Far from being untouchable, companies with larger tax contributions may be signaling larger cash flows for potential expropriation. This supports my theory's emphasis on principal-agent dilemmas within the state apparatus driving a wedge between sovereign rationality and state actors' behavior. *Legitimacy* is consistently insignificant. A positive public perception of local business leaders per se does not reduce PR threats. *Loyalty* is likewise insignificant in all models. Alternative codings yield the same result: regardless of whether *Loyalty* refers to a firm's stance on bribe payments or government connections or to the owners' actual membership in a political party, it does not mitigate PR threats. Based on interviews, the insignificance of loyalty seems to stem from political instability. In Russia, Moscow's unprecedented criminal prosecution of the governor of the Nenets Autonomous Region coincided with the Kremlin's consideration of an "antigovernor bill" (simplifying the firing of regional government heads).[49] This alarmed regional cadres at the time of the survey. In Ukraine instability stemmed from the protracted executive-legislative standoff and the rapaciousness of the newly appointed regional cadres, whom one interviewed entrepreneur labeled "hungry have-nots" [*golodrancy*], juxtaposing them to the former regional elites who had accumulated enough personal wealth to focus on the long run.

What if the causal relationship between alliances and PR security flows in the opposite direction? One could argue that more protected firms have more resources to invest in community projects and are more attractive to foreign investors. Firms that do better financially could also hire better lawyers, spend more on political connections, and so on—hence reducing PR threats—while, at the same time, they could spend more on alliance building. My reply is based on conceptual considerations, survey data, and qualitative interviews.

[49] While regional governors' elections had been replaced by presidential appointments in 2004, governors' *dismissals* by Moscow remained strikingly rare despite evidence of massive legal violations by some governors. The bill, proposed at the end of 2006, would have allowed the president to fire governors for criminal code violations regardless of their severity, potentially making *kompromat* (documented malfeasance) more effective as a means of informal pressure on regional administrative networks.

To begin, note that conceptually there is less reason to expect endogeneity once the characteristics of the examined environment are accounted for. One should not expect firms in most developing countries to invest in corporate social responsibility just because they have more resources. While in Western markets such investments can boost a firm's profits through consumer preferences, consumers in countries like Russia or Ukraine do not take these considerations into account.[50] Furthermore, while foreign investors would naturally prefer well-protected companies, both foreign investors and predators are usually attracted to the same type of companies: those with high cash flows and significant upward potential. One Russian CEO interviewed by the author expressed this paradoxical relationship between profitability and PR security as follows: "if you are not a target, something is wrong with your business."

While the risk of endogeneity is unlikely in these circumstances, an empirical proxy for firms' financial condition would considerably strengthen my case. I have such a proxy for the Russian subset: enterprises were asked to evaluate their "current financial and economic performance" on a 1–4 scale, with increasing values indicating better performance. The question was not included in the Ukrainian survey. I rerun equation 1 for the Russian data but include the variable *Financial*, coded 1–4, among the controls. Alliance variables that were significant before the inclusion of *Financial* (models 3 and 4 in Table 2) retain their significance and actually increase in size after the firms' financial condition is controlled for (Table 4). These results are robust to dichotomous recodings of *Financial* based on various thresholds. The Russian data allow us to rule out firms' financial condition as the most plausible source of bias.

Finally, the problem of endogeneity was a key focus of my informal interviews in the region. The interview data convey that to the extent PR security influences alliances, it should bias results *against* finding the effect in Tables 2–4. Specifically, reverse causation evident in the interviews begins with *less* protected firms investing more in alliances so as to protect themselves against PR threats (more on this in the next section). This initially reverse relationship between alliances and PR threats conforms fully with my theory and results: at time t-1 a firm may experience a negative shock to its PR security; at time t the owners build alliances; at time t+1 the threat to a firm's PR abates. In fact, such a causal mechanism implies that my results *underestimate* the long-term

[50] Starodubskaya 2005.

TABLE 4
THE EFFECT OF ALLIANCES CONTROLLING FOR FINANCIAL CONDITION IN RUSSIA

	(1) *Threat_State*	(2) *Threat_Private*
Community	–0.12 (0.28)	–0.65* (0.33)
Foreigners	–0.48*** (0.14)	–0.57** (0.27)
MerchantGroup	0.16 (0.10)	0.04 (0.13)
Financial	–0.11 (0.08)	–0.16 (0.10)
TaxShare	0.04 (0.07)	0.15 (0.10)
Loyalty	0.04 (0.08)	–0.07 (0.11)
Legitimacy	–0.04 (0.09)	–0.14 (0.14)
ForcedFunding	0.08 (0.10)	–0.12 (0.14)
SizeMedium	–0.03 (0.17)	–0.29 (0.28)
SizeLarge	–0.06 (0.17)	–0.18 (0.27)
N	196	189
P > F	0.0004	0.0001
R^2	0.17	0.17
Dummy Variables	Sector Ownership Region	Sector Ownership Region

* p<0.10, ** p<0.05, *** p<0.01; OLS model with robust standard errors (in parentheses); dependent variables are averages of respondents' estimates of threat intensity

impact of alliances because the survey ignores the time gap required between the owners' investment in alliances and the capacity of alliances to deter or resolve PR conflicts. Once established, alliances seem to have a clear protective impact, as per the head manager of the Emerging Markets Equity Funds at Fidelity Investments:

> a lot of Russian companies like to have EBRD [European Bank for Reconstruction and Development] as a shareholder because it provides protection . . . if you find that EBRD has a stake in a company, it's hard to shake down a company because you'll have all EU governments involved, and it's a pain . . . , so they [the Russian state officials] don't do it.[51]

Overall, for conceptual and empirical reasons, endogeneity appears to be a relatively small concern.

[51] Author's interview, Boston, June 1, 2005.

Discussion: Theoretical Ramifications

Firm-level strategies, in addition to macroinstitutional design, define the security of property. The empirical findings warrant a reconceptualization of the emergence of secure property rights as such. The literature tends to view conflicts over property as epic elite battles whose institutionalized outcome determines national PR security. Yet the significance of bottom-up "voice" strategies implies that PR conflicts resemble guerrilla warfare, in which local alliances matter and victory is incremental. This section discusses external validity, equilibrium conditions, and the relation of my argument to rule of law.

To begin, where would the theory apply? It is promising that the results hold for both Russia and Ukraine. These countries diverge widely in their constraints on the executive branch (at least during the examined time period) and on the availability of natural resources, two factors that could have an impact on the political economy of property rights. Hence, the theory should apply in different settings. Prima facie, there is no reason for the findings to be limited to postcommunist countries. If anything, the theory can be expected to apply even better to many economies in Africa and to some in Latin America, where firms' property rights are less likely to be jeopardized by an omnipotent sovereign than by a nonstate predator, a local state agency, or simply a policeman looking for some extra cash. As long as the firm does not face the Leviathan itself, allies matter. Consider the case of China, where many private firms seek to list their equity abroad to prevent the local government from interfering with the management of the firm's assets: foreign regulators would publicize any state interference inflicting credible reputational damage on the relevant state actors (author's interviews at Chinese and foreign investment banks, Beijing, October 2005).

The key boundary condition for the theory involves political stability and state capacity. Higher political stability and state capacity make the firms more likely to rely on state-oriented (rather than stakeholder-oriented) strategies because the state actors have longer time horizons, as well as stronger incentives and a better ability to shield the firm from expropriation. Longer time horizons of state actors create space for a strategic dialogue with firms and allow the state employees to behave like "stationary bandits." Higher state capacity, in turn, decreases agency costs within the state apparatus: if the state principal controls her agents, the latter have less leeway to engage in predation. However, the threshold at which political *in*stability or *low* state capacity renders state-oriented firm strategies futile is such that stakeholder alliances could improve PR security in many developing countries.

Do the firm-based arrangements discussed here amount to more than being spatially limited and temporary solutions to the problem of PR insecurity? Yes, based on two factors.

First, dynamic learning *across firms* occurs as enterprises that are more successful at defending their rights are emulated by others. There is extensive evidence of firms using alliance building as a *conscious strategy* to secure PR, and there is no reason to assume that PR protection would be different from other business strategies that, as a rule, spread widely once shown to be effective. [52] The intentionality of alliance building is particularly visible when firms invest in this strategy following a clear shock to PR security. Russia's corporations, for example, started investing more in alliances with foreigners after Putin's administration signaled a credible threat to their PR.[53] A similar dynamic of conscious hedging against expropriation via stakeholder alliances took place in Ukraine during the 2004 Orange Revolution. The new populist government had promised selective nationalization as a way to restore social justice, sending business circles into a panic—and into impressive alliance building. For example, the magnate Viktor Pinchuk, not heretofore known for philanthropy or cosmopolitanism, launched grand charity projects, partnered with the Clinton Foundation, and began promoting EU integration. When interviewed by the author, the CEO of the Victor Pinchuk Foundation shared that "Victor's philanthropic projects and international activities have an impact on business because things are so personal in this part of the world. At the beginning Ukraine's political leaders were suspicious. But then they said 'wow!' You don't [just] change the image . . . you do projects that make a difference."[54] Presumably, this "impact on business" was not lost on Pinchuk's rival, Rinat Akhmetov, who launched his own SKM Foundation only months after the establishment of the Pinchuk Foundation. Importantly, smaller firms appear to be learning, too. In an explicit effort to "teach" such strategies, one of the most respected leaders of Russian business, Igor Yurgens, noted at a 2008 business forum that "small and medium-sized businesses, unlike large companies, are

[52] Purposeful alliance building can be juxtaposed with exogenous sources of variation in alliances, such as levels of trust, presence of civil society institutions, the socialist legacies of welfare provision often inherited by enterprises, and so on: these factors can hardly be controlled by individual firms. To deter PR threats, it is *not* necessary for an alliance to have been created for that purpose: intentionality influences emulation prospects, not deterrence.

[53] Markus 2008.

[54] Author interview, Kiev, Ukraine, February 13, 2007.

unable to negotiate on an equal footing with local and regional governments. The . . . adoption of . . . social responsibility will make it possible [for these businesses] to solve a large number of conflicts . . . [with] the government."[55] Overall, the islands of accountability established by firm-based alliances are not incommunicado; in striving to survive, they are both learning and expanding.

Second, learning is also likely to occur among the *state actors*, raising the question of what would be observed in the resulting equilibrium. There is some evidence that mutually beneficial state-business arrangements featuring higher provision of public goods are replacing hostility and particularistic rent seeking. Based on large-N surveys of Russian firms, Frye et al. show that between 2000 and 2007 "a tangible change has taken place in business-state relations at the regional level," as firms planning to invest locally have increasingly experienced the "helping hand" of the state.[56] Ledeneva and Shekshnia, based on a survey and interviews in Russian regions, "demonstrate that long-term informal relationships between government officials and business executives replace the transactional approach" with business leaders being "interested in shaping the development [of their business] . . . for the next 10–20 years."[57] Both studies point toward a new state-business *consensus* beyond short-term tactics. While the causal mechanism behind this consensus remains underspecified in the quoted studies, the alliance-based argument advanced here may fill this gap. The larger theoretical point is that the locus of contestation between owners and potential predators is shifting from "buying" select bureaucrats to "buying" *encompassing nonstate groups* (communities, labor, investors, and so on). In addition to being more durable, due to the incorporation of previously sidelined stakeholders, such arrangements also approximate Olson's "by-product" theory of public goods' provision.

Could the firm-based alliances translate into the rule of law proper, that is, into universally applicable rules enforced by the state? Conventional emphasis on elite struggles at the sovereign level, often based on the British case, renders such a scenario implausible. Yet precedents from the developing world suggest otherwise. In China the incremental constitutional adjustments stipulating the protection of private property occurred as a result of a bottom-up informal process, as Tsai shows: "[i]n the course of their daily interactions . . . with local staff of the party-state, business owners have had a structural impact on

[55] Yurgens 2008.
[56] Frye, Yakovlev, and Yasin 2009, 48.
[57] Ledeneva and Shekshnia 2011, 15.

the direction of formal institutional reforms."[58] In countries as diverse as Peru, Egypt, and post-WWII Japan, legally effective allocation of property rights, triggering growth and investment by allowing assets to be used as collateral, emerged only to the extent *local informal consensus regarding property rights' protection* preexisted (and was later acknowledged by) formal national institutions.[59] Importantly, even the canonical English case has undergone a revision that is consistent with this article. According to Stasavage, it was not so much the institutional checks and balances that restrained the Crown from expropriating its creditors (who, in fact, were poorly represented in the Parliament) as it was the extent to which "government creditors . . . [were] able to form durable coalitions with other social groups."[60] Rajan and Zingales extend this reinterpretation: British property, the authors argue, was secured through the *informal power of the gentry*, manifested through its *alliances with recruited militias* and rooted in its ability to manage property efficiently, rather than through the deals between the king and the great lords.[61] Both monographs note that effective formal institutions in England *gradually came to reflect* (and, no doubt, cement) the informal power of owners and lenders.

The details of this process can be expected to differ across countries. For Russia, existing research suggests that while firms increasingly use legal instruments, such as courts, to settle disputes, the effectiveness of such instruments is limited to conflicts with private (rather than state) actors.[62] My work uncovers some more subtle dynamics: in particular, companies with nonstate alliances display higher readiness to *publicly expose predation*. My survey data show, for example, that Russian companies with either local or foreign alliances receive significantly more frequent coverage in the local press and on television; moreover, companies with alliances are 43 percent more likely than firms without alliances to agree with the statement that they "can count on the media in the case of a serious and groundless interference with the management of the enterprise by state agencies or private actors." This trend extends to Ukraine, where the battle over the marketplace in Vinnitsa illustrates the point. After thirteen hundred stands had been leased out to market sellers by the old municipal administration, the new mayor personally annulled the lease and put pressure on the sellers to relocate to the "official marketplace" run by a private company connected to the mayor. In

[58] Tsai 2007, 140.
[59] De Soto 2003.
[60] Stasavage 2003, 3.
[61] Rajan and Zingales 2004, 146.
[62] Frye 2004; Hendley 2004.

the process, several containers with sellers' goods were confiscated. After the businesspeople refused to give in, one seller was beaten by thugs. As I was interviewing the leader of the Vinnitsa Union of Private Entrepreneurs, police were waiting for her outside ("for her protection," they said). The businesswoman stressed that while small entrepreneurs usually have zero chance in such conflicts, their cause was helped by "high cooperation and connections with business associations in other regions who face similar problems. . . .When people get together, confidence rises."[63] Two days later, the entrepreneurs' union was able to gather an array of journalists, a parliament deputy from Kiev (responsible for small business policy), the mayor in question, and a dozen of local business representatives. Over the course of three hours, the pale-faced mayor, visibly unaccustomed to being disagreed with, endured a cross-examination by the parliament deputy and business representatives on the fees and ownership structure of the "official marketplace," as well as on the details of the ongoing conflict. Such outcomes involve painstaking work; the network building by Vinnitsa entrepreneurs involved years of attending business roundtables in Kiev, where a working relationship with the parliament deputy was established and supportive relations with other associations across the country were nurtured.

While the Vinnitsa case may not involve "legal instruments," it is symptomatic of private actors' rising confidence vis-à-vis the state, a confidence often rooted in alliances and channeled through the local media. Informal, de facto accountability, as previously discussed, has historically facilitated the institutionalization of the rule of law. However, one must beware teleological expectations: alliance-based accountability may stabilize as a partial-reform equilibrium. Nonetheless, auspiciously, alliances do *not* seem to decrease the "demand for law" by firms. In fact, when asked about the importance for business activity of independent and noncorrupt courts or of democratic control over the government, companies with alliances in both Russia and Ukraine rate these aspects as being *more* important than do firms without alliances.

Apart from its potential for the rule of law, private nonmafia enforcement of property rights *as such* must not be theoretically neglected. On the one hand, research on "second best institutions" suggests that local, context-specific institutions per se may be more appropriate for the developing world than the imported "best practice" reforms.[64] (See Allina-Pisano's work for a recent critique of the latter reforms in the agricultural PR regimes of Russia and Ukraine.)[65] On the other hand,

[63] Author interview, Vinnitsa, Ukraine, February 26, 2007.
[64] E.g., Rodrik 2007.
[65] Allina-Pisano 2008.

the literature on *contractual* rights lionizes private enforcement: the private Law Merchant system, for example, has been credited with the rise of medieval Europe as a trading power.[66] So why cannot private institutions supplement, if not supplant, the state in the case of *property* rights, if they do so in enforcing contracts? The literature responds by drawing a stark line between horizontal interbusiness relations and vertical state-business interaction.[67] Yet if this dichotomy is based on the wrong understanding of expropriation problems faced by business, as argued here, then the key implication is that orthodox enthusiasm about business-based institutions ensuring contract enforcement should extend to business-based institutions securing PR.

Modern capitalism, like the rule of law, is unthinkable without secure property. The state and big business invariably feature as the two founding fathers of capitalism in the economic histories of prosperous nations: while capitalists like John Rockefeller and the earlier financiers of the Industrial Revolution are often credited with the rise of the Anglo-Saxon economies, the state has played a major role in the "catch-up nations" of continental Europe and East Asia. The role of the remaining multitude of firms appears secondary at best. Governmental benevolence and competence, however, are in short supply in modern developing countries, as are the pools of capital to be invested. My study hints at the role of "small" capitalists in the evolution of capitalism. This role is political: by forging alliances with stakeholders around their firms, owners force the state and rival businesses to respect their rights. The Roman emperor Tiberius, seeking to curb rampant predation by local governors, said he wanted his "sheep shorn, not flayed." The current literature on PR enforcement tends to treat businesses as sheep, too. Yet in weak states, the strategies of sheep may matter along with the words of the emperor.

Appendix

Table A1[a]

Variable	*mean*	*SD*	*min*	*max*
Threat_State: average of 7 threats from state actors	2.38	0.56	1	4
Threat_Private: average of 4 threats from private actors	2.32	0.85	1	4
Community: very significant support of community and labor	0.06	0.25	0	1
Foreigners: foreign creditor or foreign investor	0.03	0.17	0	1
MerchantGroup: participation in federal business association	0.28	0.45	0	1

[66] E.g., Milgrom, North, and Weingast 1990.
[67] Acemoglu and Johnson 2005.

TABLE A1, *cont.*

Variable	*mean*	*SD*	*min*	*max*
TaxShare: firm's share of local tax revenue	2.26	0.69	1	3
Loyalty: attitude toward "loyalty"strategies	1.88	0.55	1	3
Legitimacy: public attitude toward private wealth in the region	0.67	0.47	0	1
ForcedFunding: state pressure for community support	0.31	0.46	0	1
Financial: current financial performance (Russia only)	2.89	0.57	1	4

[a] Regarding semistructured interviews: most interviewees agreed to being recorded but, due to the sensitivity of the subject, requested anonymity. All interviews were conducted by the author in Russian and Ukrainian between June 2005 and September 2009.

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