
The William Davidson Institute (WDI) Research Update

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You can subscribe to the WDI Research Newsletter at <http://listserver.itd.umich.edu/cgi-bin/lyris.pl?enter=wdi-friends> Please also feel free to contact Kelly Janiga at janigak@umich.edu with comments or submissions for future updates. Instructions to unsubscribe are located at the bottom of the newsletter.

1. The Davidson Institute Emerging Markets Forecast (DIEMF)

The most recent update of the DIEMF, released July 17, projects growth in the former Soviet Union will surpass most economists' expectations by about one-third. In addition, the forecast, which is designed to keep more current with changing economic conditions than other projections, show that one price of Central Europe's coziness with the West is that it is the latest region to enter the deflation danger zone. The full forecast along with an in-depth analysis can be found at <http://www.wdi.bus.umich.edu/research/forecast/forecast.htm>

2. Post War Iraq Conference Summary

On May 22, the Davidson Institute's Distinguished Scholar, former Secretary of State Madeleine Albright, hosted a policy discussion of action plans to address the urgent need for a clear economic development strategy and speedy socio-economic stability for Iraq. The session was co-hosted by U.S. Representatives Henry Hyde and Tom Lantos, and included key members of Congress, high-level Bush Administration officials, the international community, business leaders, and researchers.

Some key conclusions include: 1) security is a prerequisite for economic change; 2) establishing clear governing arrangements is a crucial second step; 3) an economic strategy overly reliant on oil is counterproductive and would subject Iraq to corrosive

problems; 4) macroeconomic stabilization, including stabilizing Iraq's currency, is crucial for political and social stability; 5) small and medium enterprises are crucial to job growth and sustainable economic development; strong institutions (legal, education and financial) must be put in place as quickly as possible to support business, job creation and economic activity; and 6) economic reform should be coordinated with political reform rather than being delayed.

The full conference summary can be found at

http://www.wdi.bus.umich.edu/dc_report2003/reports.htm

3. Sabbatical Visitors

WDI is pleased to welcome Mathilde Maurel as a WDI Visiting Professor during the 2003-2004 academic year. Professor Maurel received her PhD in Economics from the Ecole des Hautes Etudes en Sciences Sociales in Paris, France. Since then she has been a Researcher at the Centre National de la Recherche Scientifique (ROSES, Paris). Dr. Maurel's research focuses on the economics of transition with specialization in international trade and labor markets in Eastern Europe and Russia. Her expertise is frequently called on by the European Commission and the French and European development agencies.

Janos Kollo will spend the fall 2003 semester at WDI. We are looking forward to his stay. Professor Kollo received his PhD from the Budapest University of Economics. He is a researcher at the Institute of Economics of the Hungarian Academy of Sciences. His research focuses on labor issues in transition economies.

If you are interested to spend some or part of your future sabbatical at the Davidson Institute, please send a statement of interest and your curriculum vitae to Kelly Janiga at janigak@umich.edu.

4. Upcoming Conferences

Political Economy of Transition: Job Creation and Job Destruction: August 14-17, Bonn, Germany. The conference, jointly organized by WDI and the Center for European Integration Studies (ZEI), will bring together approximately 15 established experts and promising young researchers to further the understanding of job destruction and job creation processes and their implications for political developments and institutional change in post-communist countries. A tentative program for the conference is available at http://www.wdi.bus.umich.edu/events/PoliticalEcon_03.htm.

Research Conference on Microeconomic Analyses of Labor Reallocation: August 21-23, Kalamazoo, Michigan. The conference is sponsored jointly by WDI, the Upjohn Institute for Employment Research, and the Institute for the Study of Labor (IZA) to

promote applied research that uses micro-level data from a variety of economies, including the U.S. and other industrialized countries, as well as developing and transition economies. Conference information can be found at

http://www.wdi.bus.umich.edu/events/Labor_Kalamazoo_03.htm

5. Call for Papers

Financial Market Development in Emerging and Transition Economies: December 15–16, 2003, Hyderabad, India. This will be the Fifth Annual Conference, hosted by WDI, The Indian School of Business, Amsterdam Center for International Finance Research (CIFRA) at the University of Amsterdam, and the International Review of Finance. This annual conference is a small gathering of researchers focusing on the evolution of financial markets and corporate finance practices in emerging and transition economies. The call for papers **deadline is August 30, 2003**. The complete call for papers is at http://www.wdi.bus.umich.edu/events/CallForPapers_India_03.pdf.

6. New Additions to WDI Working Paper Series

The following are fourteen recent additions to the WDI **Working Paper Series** dealing with a variety of transition issues. The abstracts can be found below the titles, or click on the http address to go directly to the paper on our web site.

No. 594: The Political-Economy of Argentina's Debacle

Marcos A. Buscaglia

<http://eres.bus.umich.edu/docs/workpap-dav/wp594.pdf>

No. 593: While Labour Hoarding May Be Over, Insiders' Control Is Not. Determinants of Employment Growth in Polish Large Firms, 1996-2001

Kate Bishop and Tomasz Mickiewicz

<http://eres.bus.umich.edu/docs/workpap-dav/wp593.pdf>

No. 592: Globalization and Trust: Theory and Evidence from Cooperatives

Ramon Casadesus-Masanell and Tarun Khanna

Soon to be posted - <http://eres.bus.umich.edu/docs/workpap-dav/wp592.pdf>

No. 591: Restructuring or Disintegration of the German Corporate Network: Globalization as a Fifth Column

Bruce Kogut and Gordon Walker

<http://eres.bus.umich.edu/docs/workpap-dav/wp591.pdf>

No. 590: Institutional Change and Firm Creation in East-Central Europe: An Embedded Politics Approach

Gerald A. McDermott

<http://eres.bus.umich.edu/docs/workpap-dav/wp590.pdf>

No. 589: Legitimacy, Interest Group Pressure and Institutional Change: The Case of Foreign Investment and Host Country Governments

Witold J. Henisz and Bennet A. Zelner

<http://eres.bus.umich.edu/docs/workpap-dav/wp589.pdf>

No. 588: Institutions and the Vicious Circle of Distrust in the Russian Household Deposit Market, 1992-1999

Andrew Spicer and William Pyle

<http://eres.bus.umich.edu/docs/workpap-dav/wp588.pdf>

No. 587: Foreign Direct Investment and the Business Environment in Developing Countries: the Impact of Bilateral Investment Treaties

Jennifer Tobin and Susan Rose-Ackerman

Soon to be posted - <http://eres.bus.umich.edu/docs/workpap-dav/wp587.pdf>

No. 586: Trust in China: A Cross-Regional Analysis

Rongzhu Ke and Weiyang Zhang

<http://eres.bus.umich.edu/docs/workpap-dav/wp586.pdf>

No. 585: Family Control and the Rent-Seeking Society

Randall Morck and Bernard Yeung

<http://eres.bus.umich.edu/docs/workpap-dav/wp585.pdf>

No. 584: Wage Determination: Privatised, New Private and State Owned Companies, Empirical Evidence from Panel Data

Tomasz Mickiewicz and Kate Bishop

<http://eres.bus.umich.edu/docs/workpap-dav/wp584.pdf>

No. 583: An Investigation of Firm-Level R&D Capabilities in East Asia

Gary H. Jefferson and Zhong Kaifeng

<http://eres.bus.umich.edu/docs/workpap-dav/wp583.pdf>

No. 582: R&D and Technology Transfer: Firm Level Evidence From Chinese Industry

Albert G.Z. Hu, Gary H. Jefferson, Guan Xiaojing and Qian Jinchang

<http://eres.bus.umich.edu/docs/workpap-dav/wp582.pdf>

No. 581: Credit Market Disequilibrium in Poland: Can We Find What We Expect? Non-Stationarity and the “Min” Condition

Christophe Hurlin and Rafal Kierzenkowski

<http://eres.bus.umich.edu/docs/workpap-dav/wp581.pdf>

Abstracts of Recent Working Papers

No. 594: The Political-Economy of Argentina's Debacle

Marcos A. Buscaglia

In this paper I argue that political-economy considerations –and in particular the identity of the reformers- are central to understanding the Argentine crisis. During the 90's the main political parties remained attached to populism, and no strong party emerged at the center of the political spectrum. This had two effects in the reform process. First, it severely deteriorated it (efficiency, corruption), reducing the support of the population. Second, when a series of shocks hit the economy the anti-reform camp tried to undo most reforms, and thus convey a message to the population about the “right” model of the world.

No. 593: While Labour Hoarding May Be Over, Insiders' Control Is Not. Determinants of Employment Growth in Polish Large Firms, 1996-2001

Kate Bishop and Tomasz Mickiewicz

This paper examines the determinants of employment changes using a panel of Polish large firms during the period 1996-2001. We investigate the impact of wages, output growth, investment, firm size and sectors upon employment, focusing on the asymmetry hypothesis. We find that investment plays an important role in enhancing employment growth. We also notice that employment dynamics is not affected by alternative wages and therefore appears consistent with the ‘right to manage’ model. Furthermore, unlike the early transition period, we can confirm that employment adjusts to positive sales growth, not just to decline as found in studies on earlier periods (Köllö, 1998). This reflects that labour hoarding can no longer be a factor, which decreased employment elasticity in times of positive demand shocks. Interestingly, large state companies appear to cut employment in response to output growth, when one controls for investment. A result, which may be consistent with the insiders (employee) control model.

No. 592: Globalization and Trust: Theory and Evidence from Cooperatives

Ramon Casadesus-Masanell and Tarun Khanna

No. 591: Restructuring or Disintegration of the German Corporate Network: Globalization as a Fifth Column

Bruce Kogut and Gordon Walker

No. 590: Institutional Change and Firm Creation in East-Central Europe: An Embedded Politics Approach

Gerald A. McDermott

A central debate about the transformation of post-communists countries is how the process of institution building impacts firm restructuring and creation. This debate has largely been dominated by approaches that emphasize either the depoliticization of

institutional designs or the determining impact of pre-existing social structures. These views, however, have serious problems explaining one of the key comparative developments in East-Central Europe – the strong economic growth in Poland and the demise of the Czech Republic in the 1990s. This paper explains these differences by offering an alternative, embedded politics approach that views firm and institutional creation as intertwined experiments. Czech attempts to implant a depoliticized model of reform impeded the necessary reorganization of socio-political networks, in which firms are embedded. Poland facilitated institutional experiments not only in the ways it promoted negotiated solutions to restructuring, but also in the ways it empowered sub-national governments. The study utilizes data on manufacturing networks, privatization, bankruptcy, and regional government reforms collected over the past six years.

No. 589: Legitimacy, Interest Group Pressure and Institutional Change: The Case of Foreign Investment and Host Country Governments

Witold J. Henisz and Bennet A. Zelner

We offer a simple model of policymaking emphasizing socialization and limits on human cognition to explicate mechanisms of change in emergent (as opposed to established) institutions. Emergent institutions are more susceptible to change, and their opponents may use frames or existing reference points to illustrate inconsistency with prevailing notions of legitimacy. Broader institutional structures and specific organizational characteristics moderate pressure for change. This perspective has novel implications for strategy and policy design.

No. 588: Institutions and the Vicious Circle of Distrust in the Russian Household Deposit Market, 1992-1999

Andrew Spicer and William Pyle

In our analysis of the Russian household deposit market during the 1990s, we show how the initial conditions of market emergence contributed to a vicious circle in which private commercial banks progressively lost the trust of potential depositors. The roots of this destructive dynamic lay in the initial conditions of market emergence. Initial experiences of fraud and financial loss led Russian households to distrust that commercial banks would honor their contractual obligations. As distrust grew and became more ingrained, the competitive conditions in the deposit market changed in a way that further increased the gains to opportunism and decreased the returns to trust production. In a self-reinforcing process, fraud beget more fraud.

No. 587: Foreign Direct Investment and the Business Environment in Developing Countries: the Impact of Bilateral Investment Treaties

Jennifer Tobin and Susan Rose-Ackerman

No. 586: Trust in China: A Cross-Regional Analysis

Rongzhu Ke and Weiyang Zhang

Using the cross-regional data, this paper shows that trust has a strong effect on uneven development of economy in China. As is discovered in many studies, it is found that trust affects the growth of economy, size distribution of enterprise, and FDI inflow and so on. We also find that cross-regional differences of trust in China are reflections of the regional diversities of education, marketization of economies, urbanization, population density and transportation facilities. Although not statistically significant, “too many officials” may damage social trust. The paper demonstrates that trust cannot simply be taken as a cultural heritage. The paper also argues that sustainability of further economic development of China much depends on how fast China can build trust-facilitating institution, and that the most fundamental institution for trust is the property right.

No. 585: Family Control and the Rent-Seeking Society

Randall Morck and Bernard Yeung

The small number of very large family-controlled corporate groups in many countries combined with their long continuity of control and ability to act discretely give these organizations a comparative advantage in political rent-seeking. This advantage is a key part of a self-reinforcing system whereby oligarchic family corporate control, political rent seeking, and low general levels of trust combine to stymie growth.

No. 584: Wage Determination: Privatised, New Private and State Owned Companies, Empirical Evidence from Panel Data

Tomasz Mickiewicz and Kate Bishop

This paper examines the determinants of wage pressure in large companies, including ownership characteristics and the impact of regional labour markets. By using a panel of 329 Polish largest firms during the period 1997- 2001, we find evidence of rent sharing activities, however there is also asymmetry in quasi rent elasticity of wages. The wage setting mechanism seems to differ between new private companies, privatised companies, state firms and mixed ownership. In particular, wages in state firms are highly responsive to regional labour market conditions, while firms in other sectors are not. Rent sharing is visible in both the state sector and new private companies, yet several specific characteristics differ. On the other hand, quasi rent elasticity appears to be suppressed in privatised companies.

No. 583: An Investigation of Firm-Level R&D Capabilities in East Asia

Gary H. Jefferson and Zhong Kaifeng

This paper uses a survey of 1,826 firms distributed over ten East Asian metropolitan areas – Jakarta, Kuala Lumpur, Manila, Seoul, and five Chinese cities – to investigate the sources of firm-level R&D capabilities. The analysis identifies the impact of 23 survey variables, classified by openness, human capital, R&D network, and institutional quality, on the efficiency of firm R&D operations and on overall firm performance. These firmlevel results are used to construct composite measures R&D capabilities for each of the 10 metropolitan economies. Using the firm samples, returns to R&D are also estimated for each of the metropolitan areas. Where cross economy comparisons are

possible, as they are for Seoul and the five Chinese cities, we find a strong association between overall R&D productivity in these city economies and the composite measures of citywide R&D capabilities. In particular, high composite measures in Seoul and Shanghai are associated with high returns to R&D in those cities. The large productivity wage gaps in the Chinese cities appear to be attracting large and visible investment in R&D operations. Whether R&D wages rise to narrow this gap or investment and technology flows continue to sustain the gap will substantially affect the pattern of R&D operations within the Asian region.

No. 582: R&D and Technology Transfer: Firm Level Evidence From Chinese Industry

Albert G.Z. Hu, Gary H. Jefferson, Guan Xiaojing and Qian Jinchang

The capacity of developing economies to narrow the gap in living standards with the OECD nations depends critically on their ability to imitate and innovate new technologies. Toward this end, developing economies have access to three avenues of technological advance: technology transfer, domestic R&D, and foreign direct investment. This paper examines the contributions of each of these avenues, as well as their interactions, to productivity and knowledge production within Chinese industry. Based on a large data set for China's large and medium-size enterprises, the estimation results show that technology transfer – whether domestic or foreign – affects productivity only through its interactions with in-house R&D. Foreign direct investment does not appear to facilitate the adoption of market-mediated foreign technology transfer. Firms wishing to produce patentable knowledge do not benefit from technology transfer; patentable knowledge is created exclusively through in-house R&D operations.

No. 581: Credit Market Disequilibrium in Poland: Can We Find What We Expect? Non-Stationarity and the “Min” Condition

Christophe Hurlin and Rafal Kierzenkowski

This paper presents an empirical investigation of the disequilibrium hypothesis on the Polish loan market in the 1990s. Using data over this period of deep transition, we estimate a disequilibrium model with a standard maximum likelihood method. However, the estimates are highly counter-intuitive as regards the timing of the identified regimes. We show that the gap between the econometric evidence and the expected results may stem from the issue of stochastic non-stationarity in a disequilibrium setting based on the “min” condition. We find that the omission of one non-stationary variable of the cointegrating space or the absence of a “structural” cointegrating relationship in one or both regimes lead to a spurious configuration. In such a case, using, wrongly, the standard likelihood function, derived under the hypothesis of stationarity, may lead to non-convergent estimates of structural parameters and, as a consequence, to a fallacious regimes identification. Therefore, as the first approach to this issue, we estimate a disequilibrium model with stationary data. The empirical results are then robust and economically founded and correspond to the set and the timing of anticipated regimes.