
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 report.

1. WDI Partners with WRI for conference *Eradicating Poverty Through Profit: Making Business Work for the Poor*

WDI is a partner for The World Resources Institute's (WRI) December 12-14 conference *Eradicating Poverty through Profit – Making Business Work for the Poor*. The conference, to be held in San Francisco, will bring together business leaders, entrepreneurs and senior policymakers to share hands-on experience of proven, profitable, and innovative approaches for a more active and beneficial presence at the bottom of the pyramid. The conference will discuss the importance of engaging the poor – the world's largest untapped market for business innovation, partnership, and profits - and how this engagement will change how companies do business worldwide. For more information on this initiative please see

<http://www.wdi.bus.umich.edu/events/default.htm>

2. Requests for Research Proposals on CEE and Eurasia

The Davidson Institute is pleased to announce that we will again support research by U.S. scholars on business development and public policies which positively affect the development of free markets in Eurasia and the Balkans, thanks to generous support from the U.S. Department of State's Program for the study of Eastern Europe and the

Independent States of the Former Soviet Union (Title VIII). Collaborative projects are also encouraged, but only if the non-U.S. collaborator is funded from other sources. Up to 15 grants not exceeding \$50,000 will be awarded. The full request for proposals and application form and guidelines are available at <http://www.wdi.bus.umich.edu/research/call/CEE&Eurasia.1.htm>

3. WDI NGO Network

The William Davidson Institute has launched the NGO Alliance initiative, a network of public interest groups based in Central Europe, Eastern Europe and the NIS that works on issues central to creating a foundation for a successful transition from a controlled to a market-based economy. The Alliance will be comprised of NGOs doing work in: 1) Innovation and commercially sustainable approaches to alleviate poverty, 2) corporate governance and business ethics, 3) institution-building, 4) economic development, and 5) trade and open markets. The NGO Alliance aims to promote information sharing and dissemination of best practices, with the goal of promoting the development of effective and efficient markets that work for all people. More information is available at <http://www.wdi.bus.umich.edu/research/ngo/>. The first Alliance networking conference is scheduled for spring 2005 and a call for policy papers will be included in the next research update. If your organization is interested in joining the Alliance or if you know of an organization that would benefit from membership please submit an institute profile and statement of interest to:

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Manager of Research Programs
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734-913-5954

4. DDCN Update

We invite you to visit and/or archive your data in the Davidson Data Center Network (DDCN). The DDCN offers one of the most comprehensive “one stop shops” for data on emerging market and transition economies. The DDCN has five interesting new additions including a survey dataset on corruption patterns in the various Russian regions and a cross-sectional dataset on income and living standard changes in Romania. We encourage you to join the 460 other active registered users. The DDCN also offers more than 400 data links in its data resource portal to aid researchers to locate resources and information quickly. For more details, please visit our website at <http://ddcn.prowebis.com> or contact us at DDCN@bus.umich.edu.

5. Newest Additions to WDI Policy Brief Series

Policy Brief no. 4: *Operationalizing the Concept of Policy Space in the WTO*

Bernard Hoekman, World Bank. This paper examines various models for providing a more effective framework for “special and differential treatment” status within the WTO. The full text is available at

http://www.wdi.bus.umich.edu/publications/policy_brief/brief_04.pdf

Policy Brief no. 5: *The Road to Greater Economic Gain*

Dave Dougherty, CEO, Convergys Corporation. This paper argues that offshore outsourcing, rather than being a threat to the U.S. economy, is actually an opportunity to increase American earnings, productivity and prosperity.

The full text is available at

http://www.wdi.bus.umich.edu/publications/policy_brief/brief_05.pdf

Policy Brief no. 6: *Globalization Threatens Michigan’s Manufacturing and Services*

Donald Jakeway, CEO and President, Michigan Economic Development Corporation. This paper examines recent and future trends in job loss in Michigan and the state’s strategy to compete for new jobs. The full text is available at

http://www.wdi.bus.umich.edu/publications/policy_brief/brief_06.pdf

More information about the series is available at

http://www.wdi.bus.umich.edu/publications/policy_papers_briefs.htm

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 this summary listing, or click on the http address to go directly to the paper on our web site.

No. 716: The Evolution of Cross-Region Price Distribution in Russia

Konstantin Gluschenko

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp716.pdf>

No. 715: Languages in the European Union: The Quest for Equality and its Cost

Jan Fidrmuc and Victor Ginsburgh

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp715.pdf>

No. 714: Voice of the Diaspora: An Analysis of Migrant Voting Behavior

Jan Fidrmuc and Orla Doyle

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp714.pdf>

No. 713: International Coercion, Emulation and Policy Diffusion: Market-Oriented Infrastructure Reforms, 1977-1999

Witold J. Henisz and Bennet A. Zelner and Mauro F. Guillen

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp713.pdf>

No. 712: Votes and Vetoes: The Political Determinants of Commercial Openness

Witold J. Henisz and Edward D. Mansfield

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp712.pdf>

No. 711: Interest Groups, Veto Points and Electricity Infrastructure Deployment

Witold J. Henisz and Bennet A. Zelner

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp711.pdf>

No. 710: Firms' Price Markups and Returns to Scale in Imperfect Markets: Bulgaria and Hungary

Rumen Dobrinsky, Gábor Korösi, Nikolay Markov, and László Halpern

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp710.pdf>

No. 709: The Stability and Growth Pact from the Perspective Of the New Member States

Gábor Orbán and György Szapáry

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp709.pdf>

No. 708: Contract Violations, Neighborhood Effects, And Wage Arrears in Russia

John S. Earle and Klara Sabirianova Peter

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp708.pdf>

No. 707: Determinants of Employment Growth at MNEs: Evidence from Egypt, India, South Africa and Vietnam

Sumon Kumar Bhaumik, Saul Estrin and Klaus Meyer

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp707.pdf>

No. 706: Economic Reform in Tanzania and Vietnam: A Comparative Commentary

Brian Van Arkadie and Do Duc Dinh

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp706.pdf>

No. 705: Beliefs about Exchange-Rate Stability: Survey Evidence From the Currency Board in Bulgaria

Neven T. Valev and John A. Carlson

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp705.pdf>

No. 704: Returns to Schooling in China Under Planning and Reform

Belton M. Fleisher and Xiaojun Wang

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp704.pdf>

No. 703: Returns to Skills and the Speed of Reforms: Evidence from Central and Eastern Europe, China, and Russia

Belton M. Fleisher, Klara Sabirianova and Xiaojun Wang

<http://www.bus.umich.edu/KresgeLibrary/Collections/Workingpapers/wdi/wp703.pdf>

Abstracts of Recent Working Papers

No. 716: The Evolution of Cross-Region Price Distribution in Russia

Konstantin Gluschenko

The behavior of the entire cross-section distribution of prices in Russian regions is analyzed from 1992 through 2000, using non-parametric techniques. The cost of a staples basket is used as a price representative. Price dispersion measured as the standard deviation of prices is found to be diminishing since about 1994; and the shape of the cross-region distribution of prices tends to be more regular over time. To characterize intra-distribution mobility, a transition probability function (stochastic kernel) is estimated. It is also used to derive a long-run limit of the price distribution. Overall, the results suggest that, excluding a few years following the price liberalization, price convergence has been happening among Russian regions.

No. 715: Languages in the European Union: The Quest for Equality and its Cost

Jan Fidrmuc and Victor Ginsburgh

The European Union has recently expanded from 15 to 25 countries. In line with this enlargement, the list of official EU languages has grown from 11 to 20. Currently, the EU extends equal treatment to all member countries' official languages by providing translations for documents and interpreting services for meetings and sessions of the European Parliament. This, however, is costly, especially when recognizing that many Europeans speak one of the procedural languages of the EU, English, French or German, either as their native language or as a foreign language. We compute disenfranchisement rates that would result from using only the three procedural languages for all EU business, and marginal costs per disenfranchised person associated with providing translations and interpreting into the remaining 17 languages. The marginal costs are shown to vary substantially across the different languages, raising important questions about the economic efficiency of equal treatment for all languages. We argue that an efficient solution would be to decentralize the provision of translations.

No. 714: Voice of the Diaspora: An Analysis of Migrant Voting Behavior

Jan Fidrmuc and Orla Doyle

This paper utilizes a unique dataset on votes cast by Czech and Polish migrants in their recent national elections to investigate the impact of institutional, political and economic characteristics on migrants' voting behavior. The political preferences of migrants are strikingly different from those of their domestic counterparts. In addition, there are also important differences among migrants living in different countries. This paper examines three alternative hypotheses to explain migrant voting behavior: adaptive learning; economic self-selection and political selfselection. The results of the analysis suggest that migrant voting behavior is affected by the institutional environment of the host countries,

in particular the tradition of democracy and the extent of economic freedom. In contrast, there is little evidence that differences in migrants' political attitudes are caused by self-selection based either on economic motives or political attitudes prior to migrating. These results are interpreted as indicating that migrants' political preferences change in the wake of migration as they adapt to the norms and values prevailing in their surroundings.

No. 713: International Coercion, Emulation and Policy Diffusion: Market-Oriented Infrastructure Reforms, 1977-1999

Witold J. Henisz and Bennet A. Zelner and Mauro F. Guillen

Why do some countries adopt market-oriented reforms such as deregulation, privatization and liberalization of competition in their infrastructure industries while others do not? Why did the pace of adoption accelerate in the 1990s? Building on neo-institutional theory in sociology, we argue that the domestic adoption of market-oriented reforms is strongly influenced by international pressures of coercion and emulation. We find robust support for these arguments with an event-history analysis of the determinants of reform in the telecommunications and electricity sectors of as many as 205 countries and territories between 1977 and 1999. Our results also suggest that the coercive effect of multilateral lending from the IMF, the World Bank or Regional Development Banks is increasing over time, a finding that is consistent with anecdotal evidence that multilateral organizations have broadened the scope of the "conditionality" terms specifying market-oriented reforms imposed on borrowing countries. We discuss the possibility that, by pressuring countries into policy reform, cross-national coercion and emulation may not produce ideal outcomes.

No. 712: Votes and Vetoes: The Political Determinants of Commercial Openness

Witold J. Henisz and Edward D. Mansfield

Societal theories of trade policy stress the importance of domestic interest groups, whereas statist theories focus on the effects of domestic institutions. Debates over the relative merits of these approaches have been fierce, but little systematic empirical research has been brought to bear on the relative merits of these theories. In this paper, we argue that, while societal and statist factors are generally regarded as having independent and competing effects, it is more fruitful to view the influence of each type of factor as conditional on the other. As societal explanations contend, deteriorating macroeconomic conditions are a potent source of protectionist pressures. The extent to which such conditions reduce commercial openness, however, depends centrally on the domestic institutions through which societal pressures must filter to influence policy.

Two institutional features stand out. First, in states marked by greater fragmentation and more "veto points," it is harder to change existing policies because any number of actors can block such change. Consequently, we expect the effects of macroeconomic conditions on trade policy to be weaker in fragmented states than in those characterized by a highly centralized national government. Second, we expect both fragmentation and the societal pressures stemming from the economy to have a more potent impact on trade policy in democracies than in other regimes, since the electoral constraints facing democratic leaders force them to respond to demands made by key segments of society.

The results of our statistical tests covering more than one hundred countries during the period from 1980 to 2000 strongly support these arguments.

No. 711: Interest Groups, Veto Points and Electricity Infrastructure Deployment

Witold J. Henisz and Bennet A. Zelner

In this paper we examine the effects of interest group pressure and the structure of political institutions on infrastructure deployment by state-owned electric utilities in a panel of 78 countries during the period 1970 – 1994. We consider two factors that jointly influence the rate of infrastructure deployment: (1) the extent to which the consumer base consists of industrial consumers, which are capable of exerting discipline on political actors whose competing incentives are to construct economically inefficient “white elephants” to satisfy the demands of concentrated geographic interests, labor unions and construction firms; and (2) veto points in formal policymaking structures that constrain political actors, thereby reducing these actors’ sensitivity to interest group demands. A higher fraction of industrial customers provides political actors with stronger incentives for discipline, reducing the deployment of white elephants and thus the infrastructure growth rate, *ceteris paribus*. Veto points reduce political actors’ sensitivity to interest group demands in general and thus moderate the relationship between industrial interest group pressure and the rate of infrastructure deployment..

No. 710: Firms’ Price Markups and Returns to Scale in Imperfect Markets: Bulgaria and Hungary

Rumen Dobrinsky, Gábor Korösi, Nikolay Markov, and László Halpern

Under perfect competition and constant returns to scale, firms producing homogeneous products set their prices at their marginal costs which also equal their average costs. However, the departure from these standard assumptions has important implications with respects to the derived theoretical results and the validity of the related empirical analysis. In particular, monopolistic firms will charge a markup over their marginal costs. We show that firms’ markups tend to be directly associated with the employed production technology, more specifically with their returns to scale. Accordingly, we analyze the implications for the markup ratios from the incidence of non-constant returns to scale. We present quantitative results illustrating the effect of the returns to scale index on the firms’ price markups, as well as the relationship between the two indicators, on the basis of firm-level data for Bulgarian and Hungarian manufacturing firms.

No. 709: The Stability and Growth Pact from the Perspective Of the New Member States

Gábor Orbán and György Szapáry

The purpose of this paper is to examine the fiscal characteristics of the new members in the light of the requirements of the SGP and the criticisms levelled against the Pact and to see in what ways their initial conditions differ from those faced by the current euro zone countries in the run-up to the adoption of the euro. Overall, because of the lower debt levels and greater yield convergence already achieved, the new members will be able to rely less on gains from yield convergence than the current euro zone members were able to do. EU accession will also have a negative net impact on the budgets of the new members in the early years of membership. We also look at the cyclical sensitivities of

the budgets and find that in the new members the smoothing capacity of the automatic stabilizers might be weaker than in the current euro zone members. Beyond these general characteristics, we also emphasize that there are large differences in the starting fiscal positions of the new members. Some of the policy implications of our findings are discussed.

No. 708: Contract Violations, Neighborhood Effects, And Wage Arrears in Russia

John S. Earle and Klara Sabirianova Peter

We present a model of neighborhood effects in wage payment delays. Positive feedback arises because each employer's arrears affect the late payment costs faced by other firms in the same local labor market, resulting in a strategic complementarity in the practice. The model is estimated on panel data for workers and firms in Russia, facilitating identification through the use of a rich set of covariates and fixed effects for employees, employers, and local labor markets. We also exploit a policy intervention affecting public sector workers that provides an instrumental variable to estimate the endogenous reaction in the non-public sector. Consistently across specifications, the estimated reaction function displays strongly positive neighborhood effects, and the estimates of four feedback loops – operating through worker quits, effort, strikes, and legal penalties – imply that costs of delays are attenuated by neighborhood arrears. We also study a nonlinear case exhibiting two stable equilibria: a “punctual payment equilibrium” and a “late payment equilibrium.” The estimates imply that the theoretical conditions for multiple equilibria under symmetric local labor market competition are satisfied in our data.

No. 707: Determinants of Employment Growth at MNEs: Evidence from Egypt, India, South Africa and Vietnam

Sumon Kumar Bhaumik, Saul Estrin and Klaus Meyer

Foreign investors are expected to contribute to economic development through a variety of channels. However, many foreign investment operations are small, and almost insignificant in their impact on the local environment. An important indication of the potential contribution of foreign investors is thus their employment growth. Employees working for, and trained by, a multinational enterprise may become carriers of new technology and business practices. The more employees receive access to new knowledge, the more they in turn may spread the knowledge across the economy, for instance by setting up their own businesses. In this paper, we make a first step in investigating the determinants of this important mediating variable, employment growth. For a dataset covering four diverse emerging economies, we find that wholly-owned FDI operations have higher employment growth, while local industry characteristics moderate the growth effect.

No. 706: Economic Reform in Tanzania and Vietnam: A Comparative Commentary

Brian Van Arkadie and Do Duc Dinh

The economic reforms in Tanzania and Vietnam represent the two typical cases of transition economies in Asia and Africa, particularly the transformation of the two developing economies from the planned to the market mechanism. In this paper, the two authors, Brian - a British economist and Dinh - a Vietnamese economist, have, basing on

a comparative approach, enquired into various economic and social aspects of the economic reforms in the two countries, including the demographic transition, the change in population growth, the investment in human capital, the growth of GDP, the structural transformation, the linkage between agricultural growth, rural development, food production and poverty alleviation, the reform in the industrial sector and the state enterprises, the change of ownership, the role of the State, the capital formation, the role of the domestic savings, foreign aid, investment and trade, the gains and losses from globalisation, with an aim to find the answer to the question why in the two cases, Tanzania seemed to follow the donors' guidance better than Vietnam, but achieved smaller successes?

No. 705: Beliefs about Exchange-Rate Stability: Survey Evidence From the Currency Board in Bulgaria

Neven T. Valev and John A. Carlson

We use unique survey data from Bulgaria's currency board to examine the reasons for persistent incomplete credibility of a financial stabilization regime. Although it produced remarkably positive effects in terms of sustained low inflation since 1997, the currency board has not achieved full credibility. This is not uncommon in other less-developed countries with fixed exchange rate regimes. Our results reveal that incomplete credibility is explained primarily by concerns about external economic shocks and the persistent high unemployment in the country. Past experiences with high inflation do not rank among the top reasons to expect financial instability in the future.

No. 704: Returns to Schooling in China Under Planning and Reform

Belton M. Fleisher and Xiaojun Wang

We estimate returns to schooling using a retrospective work history survey covering more than 4,000 workers over the period 1950 to 1994, with particular emphasis to the returns to schooling for workers who attended institutes of higher education and who graduated from college. We find evidence that schooling returns declined throughout the period leading up to the Cultural Revolution (CR), with returns for workers who did not attend college becoming negligible. Returns to those with some college education remained positive, but low compared to other countries. Consistent with other studies, we find that returns to schooling did not recover from their CR low until the 1990s. Increases in the return to schooling during the transition following the CR were not associated directly with workers changing jobs or with taking "new-economy" jobs but appear to have occurred for most workers across all ownership categories. Workers most likely to leave jobs in the traditional ownership sector for jobs in the private or joint venture categories were those who entered the labor force prior to 1967. We do not find evidence supporting other studies' finding that schooling returns for college graduates increased more than for workers with lower levels of schooling attainment.

No. 703: Returns to Skills and the Speed of Reforms: Evidence from Central and Eastern Europe, China, and Russia

Belton M. Fleisher, Klara Sabirianova and Xiaojun Wang

We explore the pace of increase in returns to schooling during the transition from planning to market over time across a number of Central and Eastern European countries,

Russia, and China. We use metadata from 33 studies of 10 transition economies covering a period from 1975 through 2002. Our empirical model is an attempt to account for cross-section and over-time variation in rates of return as a function of the timing, speed, and volatility of reform processes as well as estimation methods used and sample characteristics. Our principal aim is to investigate the relative strength of two hypotheses: (1) the speed of economic transformation from planning to market represent the relaxation of legal, regulatory, and institutional constraints on wage-setting behavior, leading directly to adjustment returns to schooling to market rates; 2) the rapid increase in returns to schooling during the early reform period reflects the ability of highly-educated individuals to respond to changing opportunities in a disequilibrium situation. We find that both the speed of reforms and the degree of economic disequilibrium as reflected in macroeconomic volatility help to explain cross-country differences in the time paths of the returns to schooling. We report the systematic effects of sample characteristics, estimation methods, and model specifications on estimated returns to schooling.