Abstract

This thesis examines the relationship between governance and economic performance from different perspectives. It is also related to private sector and countries' economic development.

In the first chapter I focus on bureaucratic corruption and examine how it affects firm performance in Central and Eastern European countries. While previous research relies on the data from the BEEPS (Business Environment and Enterprise Performance Survey) solely, which suffers from excessive non-reporting of firm performance, I combine the data on bribery practices from the BEEPS with reliable and large firm performance data from the Amadeus database. Focusing on within-firm variation, I find that a higher bribery level negatively affects both the sales and labor productivity growth of firms. Nevertheless, conditional on a given level of bureaucratic corruption in a narrowly defined local market, a higher unevenness of firms' bribing behavior within such a market appears to facilitate firm performance. The chance of receiving benefits from bribery may be one reason why corruption does not vanish in spite of its overall damaging effect.

In the second chapter, coauthored with Vahagn Jerbashian, we concentrate on the diffusion of telecommunication technologies as an instrument of reduction the costs of entry. Utilizing the difference-in-difference strategy due to Rajan and Zingales (1998), we empirically show that the more intensive use and wider adoption of telecommunication technologies significantly increase the level of product market competition in services and goods markets. This result is consistent with the view that the use of telecommunication technologies can lower the costs of entry. The finding is robust to various measures of competition and a range of specification checks.

In the third chapter, coauthored with Carlos Caceres, we consider governance and institutions quality of countries in a broad sense and analyze their relationship to countries' incidence to fiscal and political stress events. We introduce two innovative indicators to measure these stress events. The results suggest that weaker governance quality, approximated by the Worldwide Governance Indicators, is associated with a higher incidence of both fiscal and political stress events. In particular, internal accountability, which measures the responsiveness of governments to improving the quality of the public service provision, and corruption, is associated with fiscal stress events. All aspects of governance, and especially external accountability capturing government accountability before the public through elections and the democratic process, seems to be more important for political stress events.
Preface

This thesis examines the relationship between governance and economic performance from different perspectives. In particular, it is related to areas of the private sector development and countries' economic development.

In the developing world corruption, presumably, is the most traumatic weakness of governance. It is considered a heavy constraint to countries' economic functioning, growth and development. Leaving apart grand and legislative forms of corruption (Jain, 2001), in the first chapter of this thesis I focus on bureaucratic corruption as a hindrance of the private sector development. I empirically examine how it affects firm performance in Central and Eastern European countries. I, thereby, contribute to the ongoing debate about two opposing consequences of corruption on economic performance. Previous research on this topic relies on data from the BEEPS (Business Environment and Enterprise Performance Survey), which suffers from excessive non-reporting of firm performance characteristics. To mitigate this problem, I combine the data on bribery practices from the BEEPS with reliable and large firm performance data from the Amadeus database. Focusing on within-firm variation, I find that a higher bribery level negatively affects both the sales and labor productivity growth of firms. Nevertheless, conditional on a given level of bureaucratic corruption in a narrowly defined local market, a higher unevenness of firms' bribing behavior within such a market appears to facilitate firm performance. This result implies that in more uneven local markets negative externalities from bureaucratic corruption are negligible. Bribery helps overcome operational and growth constraints for favored firms and/or for those with stronger willingness to pay. Non-bribing firms in such environments seem to be more efficient in production and growth, so that both types of firms generate increasing growth rates on average. The chance of receiving benefits from bribery may be one reason why corruption does not vanish in spite of its overall damaging effect. The task for policymakers, therefore, could be to increase the transparency of interactions between firms and policy officials to ensure the evenness of public services provision.

Another important aspect of private sector development is barriers to entry and entry costs. In countries with complex bureaucracy systems, inefficient public services provision, high state controls, political connections leading to monopolistic market structure, high entry costs impede competition and job creation, undermine productivity and overall development. In the second chapter, coauthored with Vahagn Jerbashian, we explore one of the mechanisms of reducing the costs of entry and, consequently, increasing the competition -- higher use and wider adoption of telecommunication technologies. The relationship between the diffusion of telecommunication technologies and competition is not straightforward. On the one hand they can be positively related since telecommunication technologies lower information acquisition and consumer search costs. On the other hand, telecommunication technologies can help increase product market differentiation and therefore gain market power. Utilizing the difference-in-difference strategy due to Rajan and Zingales (1998) to alleviate the endogeneity problem, we empirically show that the more intensive use and wider adoption of telecommunication technologies significantly
increase the level of product market competition in services and goods markets. Thus, policies aiming to motivate higher diffusion of telecommunication technologies can complement competition and antitrust policies. Our inference is based on 21 countries from European Union, however, it can be fairly extrapolated to developing countries, where the barriers to entry is a bigger concern.

In the third chapter, coauthored with Carlos Caceres, we concentrate on countries' fiscal and political stress events. These events certainly are painful for countries, since they provoke sharp drop of growth rates, economic stagnation and various sacrifices that are usually born hard by the poorest population. We analyze the linkages between countries' quality of governance, institutions, and business environments, approximated by the Worldwide Governance Indicators, and propensity to have fiscal or political stress events. For this purpose, we introduce two innovative indicators to measure stress events, which are less restrictive than those used in the previous literature (Kaminsky and Reinhart, 1996; Manasse, Roubini, and Schimmelpfennig, 2003; Alesina, Ozler, Roubini, and Swagel, 1996; Dutt and Mitra, 2008). Applying a simple methodology to compare governance quality of countries that have undergone and have not stress events, and estimating logistic regression, we confirm that weaker governance quality is associated with a higher incidence of both fiscal and political stress events. In particular, only internal accountability, which measures the responsiveness of governments to improving the quality of the public service provision, and corruption, is associated with fiscal stress events. All aspects of governance, and especially external accountability capturing government accountability before the public through elections and the democratic process, seems to be more important for political stress events.