Reputation and Property Rights in Russia:

Four Survey-Based Experiments

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Abstract

Do private or public institutions provide stronger incentives to trade? What is the relative importance of each? Are private and public institutions that support trade complements or substitutes? Is “word of mouth” a more reliable source of information about reputation than the local press? These questions have implications for economic development, but also inform debates on state/society relations. Some argue that trust-based social networks that rely on reputation sap the ability of state agents to provide public goods, while others argue that strong social network are the keys to improving state governance. Survey-based experiments of 500 businesspeople conducted in Russia in 2008 find that a good reputation provides a more potent stimulus to trade than does a 15 percent discount in price; that reputation and state-run courts each promote trade; and that reputation and courts are complements rather than substitutes. By using a survey-based experiment to manipulate reputation and the quality of courts, this essays mitigates endogeneity and selections problems that plague many studies of institutions.
The capacity of state institutions to promote trade is central to economic development. But states are far from the only organizations that perform this task. Societies typically boast a rich array of private means to support exchange that rely on reputation and other forms of social sanctions. The interplay of private and public institutions that support trade raises a host of questions for political scientists and economists.\(^1\) What role do private institutions, such as reputation, and public institutions, such as courts, play in promoting exchange?\(^2\) Does a concern for reputation or confidence in the courts provide stronger incentives to trade? Do private institutions that promote trade undermine or underpin state institutions?

Answers to these questions have important implications for transition and developing countries where many have cited weak institutions - both private and public - as a primary obstacle to economic development and political stability. They also inform a central debate on state/society relations. Some argue that trust-based social networks that rely on reputation sap the ability of state agents to collect taxes, deliver justice, and provide public goods, while others claim that strong networks based on social trust are the key to improving the quality of governance by state officials (Migdal 1988; Putnam 1994). Finally, they have policy relevance

\(^1\) Less benignly, private protection organizations that use threats of violence to enforce trade contracts also a staple of life in many countries. I deal with these issues only tangentially here. See Hendley et al. (2000); Frye and Zhuravskaya (2000) Varese (2002); Volkov (2002); and Frye (2002).

\(^2\) I borrow (North’s 1990: 3) commonly used definition of institutions here as the “humanly devised constraints that shape human interaction.” More colloquially, institutions are akin to the rules of the game and organizations are the players of the game. See also Knight (1992).
by giving advisors some insight into the relative importance of public and private institutions for supporting trade.

In answering these questions, scholars face several challenges. First, studies of institutions often face an endogeneity problem. To identify the independent effect of an institution, the institution should be uncorrelated with other factors that may influence the outcome (Acemoglu, Johnson, and Robinson 2001). For example, the strength of private institutions, like reputation, should be uncorrelated with public institutions, like courts. However, in practice the two factors may be strongly related which makes it difficult to identify the independent impact of each of these factors.³

Second, as many have noted, analyzing the impact of courts on behavior by using data about the use of courts is often helpful, but can be problematic because only a small number of cases with specific features end up in court (Macauley 1963; Hendley et al. 2001). Drawing inferences from a sample of court cases can produce insightful analyses of cases that end up in court, but are less useful for making generalizations about the impact of courts on behavior in other cases because we miss exchanges in which both sides hold up their end of the contract. This selection problem also leads us to miss cases in which contracts are violated, but the aggrieved party does not turn to the courts.

Third, few studies capture the size of the deterrent effect of public and private institutions on behavior.⁴ Courts and social networks that work relatively may deter violations in the first place and thereby encourage trade. If we only examine disputes, violations of contracts, or cases

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³ Multivariate regression is one potential solution, but measurement issues and model specification invariably provoke debate. Instrumental variable regression is another potential answer, but finding valid instruments is typically very difficult (Greene and Gerber 2002: 809).

⁴ The analyses only focuses on the ability of the courts and reputation to promote trade prior to a dispute and say nothing about whether courts and reputation are substitutes or complements after a dispute occurs.
that actually end up in the court, we fail to identify the important role of courts in promoting trade by deterring violations in the first place. This is important because businesses are often reluctant to use courts (for the US, Macauley 1963; for Japan, Haley 1978; for Europe, see Arrighetti, Bachman, and Deakin 1997).

This essay addresses these shortcomings by using a survey-based experiment that manipulates reputation and the quality of courts and a multivariate analysis of survey responses to explore how public and private institutions influence incentives to trade. The survey-based experiment helps to mitigate the endogeneity problem by varying the quality of courts and reputation and then measuring behavior.

The paper presents four main results. First, reputation provides a powerful stimulus to trade. For example, a good reputation provides a greater boost to trade than does a 15 percent discount in price. Second, “word of mouth” and the “local press” are equally powerful in conveying information about a firm’s reputation. This is surprising given that most observers emphasize the importance of personal networks rather than the free press in Russia as a source of credible information about business practices (Ledeneva 2006). Third, state-run courts promote trade. While Russia’s courts are often depicted as weak and corrupt, this analysis suggests that firms that can use courts are much more likely to engage in trade than those who have less confidence in courts. Fourth, courts and reputation are better seen as complements than substitutes.

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5 The postcommunist world offers an excellent opportunity to study these issues. Developed economies are typically marked by strong public institutions and robust private institutions. This makes it difficult to identify how public and private institutions influenced each other in their formative stages. By analyzing efforts to construct public and private institutions to support trade in the postcommunist world, we can study the interaction of these institutions before they reach a steady state.
The Problem of Trade

The exchange of goods and money invariably creates a problem. Unless goods are exchanged simultaneously and quality can be determined on the spot, the party who gives up control of their assets first becomes vulnerable to breach. Sellers who receive payment may abscond with the funds without delivering the good, while buyers who receive the good before payment, may decline to send the money. As each party can anticipate the other’s behavior, both sides are likely to decline to trade and miss an opportunity for potential gains. To capture these gains societies have developed a rich variety of private and public institutions that sharpen incentives to trade. Countries that create institutions to prevent disputes and promote trade most efficiently have typically been at the frontier of economic development (North 1990; Knack and Keefer 1995; Acemoglu, Johnson, and Robinson 2001).

All societies rely on a mix of private and public institutions to promote these types of exchange and scholars debate the relative importance of each. Public institutions have the advantage of economies of scope and scale in organizing the coercion necessary to sanction violators of property rights. Few dispute that the development of capable public institutions such as the state is central to economic development (North 1981).

In recent years, however, scholars have paid increasing attention to the role that private institutions play in governing a wide range of trading relationships. Williamson (1985) argues that private firms have considerable scope in designing bilateral private institutions to support trade without recourse to state institutions. Geertz (1978) identifies information relayed through

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6 These problems are hardly unique to the economy. Congressional representatives exchanging support for bills introduced sequentially or parents organizing car pools for their children face similar incentives.

7 The famous debate over the timing of the payment and receipt of the chair in Ilf and Petrov’s classic Twelve Chairs highlights this problem. “Den’gi utrom i stulya vecherom?”
gossip and social sanctions as critical to promoting trade in the bazaars of Morocco. Others point to social networks, business organizations, professional associations, and ethnic networks that provide means to sanction non-compliance and thereby promote cooperation without relying on the state for enforcement (Granovetter 1985; Milgrom, North and Weingast 1990; Ellickson, 1991; Ostrom 1992; Bernstein 1992; McMillan and Woodruff 1999).8 Because even the best-governed state lacks the resources to resolve every potential dispute, private solutions to problems of intertemporal trade are widespread (c.f. Macauley 1963).

Such private mechanisms may have advantages over public institutions, particularly where the latter function poorly. Market participants may have more expertise than judges and they can take advantage of information that cannot be used in court (Charny 1990; Johnson, McMillan and Woodruff 2002b: 229). Over the long run the state offers economies of scope and scale that private institutions cannot match, but which is a more potent stimulus to trade in a given setting is not immediately clear.

Observers of Russia have begun to contribute to this debate by studying private and public institutions that shape trading relations. Some have identified trading networks based on long-standing social ties and a concern for reputation as key factors in maintaining production and trade (Gerber and Kharkhodin 1994; Sedaitis 1994; Raiser 1999; Ledeneva 1998, 2006; Hendley et al. 2000; 2001; Frye 2000; Gaddy and Ickes 2003; Pyle 2005). Others have found that state courts in Russia are used more frequently and are more effective than is commonly appreciated (Hendley et al. 2000; 2001; Shvets 2003; 2005; Simachev 2003; Hendley 2004; Frye 2004, but see Hellman et al. 2003; and Berger 2004). As in other settings, however, there is considerable debate about which is more important in protecting rights to trade.

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Institutions as Substitutes

Another important debate examines the interrelationship between private and public mechanisms for preventing disputes and promoting trade. One view argues that private and public institutions serve as substitutes. Reliance on private institutions “crowds out” demand for state institutions and thereby limits the resources available to state agents (Frey 1997). When businesspeople in the private sector can overcome the problems that plague trade using private means, like reputation or trust, they express less demand for capable state institutions. Rather than devoting resources to develop the state, businesspeople will invest in the creation of powerful private organizations to support trade. Bernstein (1992) finds that the traders in the tight-knit community of Orthodox Jewish diamond traders in New York City opposed state regulation even when offered and instead preferred to rely on informal means to resolve disputes. Ellickson (1991) argues that ranchers and farmers in Shasta County California used informal understandings of the law rather than formal institutions to resolve disputes. On this view, powerful social networks reduce demand for state institutions that resolve disputes.

On a macro-level, countries with strong social institutions that provide many forms of public goods often have difficulty developing capable states. Most prominently, Migdal (1988) characterizes these polities as having “strong societies and weak states.” States and social organizations consistently compete for the authority to make rules for society and where social organizations are imbued with dense networks of trust they may have advantages over the state. Thus, the micro-level decision studied here may have implications for larger processes at the

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9 This is a common assumption in formal models that require economic agents to invest in either the formal or informal economy. Investing in the formal economy generates a good equilibrium where firms pay taxes and use courts, while investing in the informal economy leads firms to avoid taxes and use private protection rackets. See for example, Johnson, Kaufmann and Shleifer (1997).
level of the state and society. The substitution argument suggests that strong private institutions that support trade should be associated with weak state institutions and vice-versa.

**Institutions as Complements**

A competing argument suggests that private and public institutions are complements. That is, strengthening one increases demand for the other. Strong private institutions and strong formal institutions go hand in hand in promoting trade. North (1990: 46) argues that “formal rules can complement and increase the effectiveness of informal constraints.” More broadly, capable state institutions may make reputation and social trust more effective by sharing information about other social actors (Levi 1998; Frye 2000). Moreover, strong social institutions that rely on reputation may help private agents overcome collective action problems and hold public officials accountable and thereby increase the effectiveness of state institutions (Putnam 1994). Finally, capable private institutions that support trade may ease the burden on state officials by reducing the number of disputes than actually end up in court. This view, which lies at the core of Putnam’s *Making Democracy Work*, suggests that the development of private and public institutions should be mutually reinforcing (Putnam 1994).

The relationship between private and public institutions has important ramifications for understanding the development of state capacity. If the use of reputation to promote social cooperation underpins state capacity, then it may be worthwhile to use scarce foreign aid to develop social organizations that promote trust and transmit information about the reputation of social actors. If, however, a reliance on networks of reputation to support trade undermines state
capacity, then such strategies require difficult decision about the tradeoffs between public and private institutions.\textsuperscript{10}

Given the importance of the issue and the advantages of studying it in a transition setting, it is not surprising that scholars have begun to explore this topic. Hendley, Murrell and Ryterman (2000) conducted an innovative study of 328 business managers in six cities in Russia in 1997 which explored their strategies for resolving disputes. Respondents were asked to rate the “importance of each of the following methods for your firm” for resolving disputes on a scale of 1-10 where the rating should “reflect both the frequency of use and effectiveness” of the different mechanisms. Respondents rated negotiations as a 7.39 and arbitration courts as a 5.40 on this ten-point scale. The authors found that three-quarters (76.4\%) of firms facing disputes with suppliers used negotiations to help resolve the dispute, and about one-quarter (25.5\%) turned to state arbitration courts. In addition, they found little evidence of complementarities among negotiations, informal meetings between firm representatives, and the use of courts.\textsuperscript{11}

Johnson, McMillan and Woodruff (2002) in a 1997 study of 1500 medium-size manufacturing firms in five postcommunist countries find that private institutions, such as personal relationships are a predominant form of contracting, but that courts play a critical role in promoting trade as well. In a related work based on the same survey, McMillan and Woodruff (2000) found that social networks and gossip substitute for formal legal institutions, but that business networks and trade associations complement formal legal institutions. Pyle (2005) uses data from the Johnson, McMillan and Woodruff survey to find that business organizations help resolve contracting

\textsuperscript{10} There is a growing literature on laboratory experiments that assess the impact of public and private institutions on the propensity to trade. For a good example, see Lazzarini et al. (2004).

\textsuperscript{11} Hendley and Murrell (2003) repeated this question in a study of 254 companies in Romania in 2001, and again, found little evidence of complementarities among formal and informal institutions.
problems, particularly when trading partners are located in other regions. In a study of five markets in Moscow in the 1990s, Frye (2000) finds that when state policy lowered the costs of sharing information sufficiently, brokers created organizations that relied on reputation to support exchange and served as substitutes for state courts.

**A Methodological Concern**

Institutional analyses have made important advances in recent years, but often confront endogeneity problems. If private and public institutions that support trade are jointly determined, then it is often difficult to draw clear inferences about the extent to which each factor is shaping behavior. A researcher may witness that social trust is high, that courts work well, and that individuals comply with contracts. The covariance of public and private institutions makes it difficult to identify the relative effects of each factor in supporting trade. This may be problematic in cross-sectional survey analyses. In addition, cross-section analyses can identify correlations between variables controlling for other factors, but are less useful for making causal claims (Kramer 1983).

This work differs from much existing literature by using a survey-based experiment to identify relationships among reputation, courts, and the propensity to trade. Survey-based experiments randomly assign respondents to slightly different versions of a question, and when the number of respondents who receive each version of the question is sufficiently large, the differences in the responses should only be attributable to the small changes in the question wording. Random assignment should ensure that variables that may influence the responses are distributed roughly equally across each version of the question and thus should not be able to account for differences in responses between versions of the question. Survey based experiments

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12 See Acemoglu, Johnson, and Robinson (2001) for more on this point.
can alleviate the endogeneity problem by ensuring that public and private institutions do not co-vary. Moreover, survey-based experiments can also provide greater confidence in making causal claims, in part because they require less stringent assumptions about the data than do standard multivariate analyses.\textsuperscript{13}

2. Survey Description

I commissioned a survey of 500 company managers in 8 of Russia’s 86 regions to address these and other questions.\textsuperscript{14} At least one region from each of Russia’s 7 “super-regions” was included in the sample with most firms coming from the more heavily populated European part of Russia. The survey included firms from 23 different economic sectors as categorized by the State Statistical Agency and ranged from industrial giants in metals and energy to retail trading firms and light industry. The sample excluded firms in agriculture, communal services, and health and social services. Firms were chosen using a stratified random sampling technique. Researchers from the Levada Center stratified the sample by size and sector to mirror the population of firms in each region and firms were selected at random from within each of the strata. Each firm within each stratum had an equal probability of being included in the sample.

\textsuperscript{13} Survey-based experiments raise issues of internal and external validity. Concerns about internal validity arise “when the treatment does not exactly correspond to the construct that is envisioned as the independent variable” (Green and Gerber 2002: 811). Internally valid experiments capture the true causal process claimed by the researcher. External validity generates concerns about whether the results produced in an experiment travel outside the setting in which the experiment is conducted.

\textsuperscript{14} The overall response was rate 55 percent for firms contacted by the interviewer. More than one-half of all refusals came from the capital city. Absent Moscow the response rate increases to 65 percent. The analyses are unchanged if responses from Moscow are dropped from the sample. Twenty percent of respondents were called back to ensure quality control. Respondents were asked a range of questions about the legal and business environment. Cites in the sample include Moscow, Nizhni Nivgorod, Volgograd, Smolensk, Novgorod, Ekaterinburg, Voronezh, Rostov, Ufa, Khabarovsk, Tula, and Omsk.
Interviewers from the Levada Center spoke face to face with managers in the summer of 2008. Chief executive officers, chief financial officers, and chief legal officers were included as potential respondents and interviewers spoke with only one person per firm. The distribution of firms in the sample roughly mirrors the national population. Most managers (70 percent) were male and more than 90 percent had college-level degrees. The age of the average respondent was 47. The average (mean) firm included 436 workers and ranged from a minimum of 3 to a maximum of 22,000. Half the respondents headed firms with fewer than 130 workers and one-quarter headed firms with fewer than 50 workers. Twelve percent of the firms were majority state-owned and 62 percent had undergone some form of privatization. Levels of ownership concentration were fairly high. In 49 percent of the firms more than half of the shares were owned by a single stakeholder. Only five percent of firms had foreign ownership.

Focusing on reputation and courts in Russia is important as business people rely heavily on both bilateral negotiations and courts to help resolve disputes. Sixty-nine percent of respondents who had at least one dispute with a business partner in the last two years turned to a court to help resolve it.\textsuperscript{15} Contrary to popular wisdom, courts are commonly used in Russia (see also Hendley et al. 2000; 2001). In addition, negotiations are common. Eighty-two percent of respondents who had at least one dispute engaged in negotiations with the other side. As reputation is an important element of negotiations there is much to be gained in studying the role of the former in the latter. Courts and negotiations are by far the most common means of resolving disputes in Russia and merit further examination.

\textsuperscript{15} Here courts refers to state arbitration courts which are the main public fora for resolving economic disputes between private actors and between private and state actors. State arbitration courts are located in the capital city in almost each of Russia’s regions.
Experiment 1. The Value of Reputation

To begin, I explored the value of a good reputation relative to a deep discount in sale price. In this experiment, half the managers whether they would accept an offer to buy a good at a price 5 percent below the market price, and half were offered the same good at a 20 percent discount relative to the market price. In addition, half the managers were told that the seller had a good reputation and half were given no additional information about the reputation of the seller. This set-up allows us to compare the relative impact of a good reputation relative to not having any information about the reputation of a trading partner. In addition, it allows us to compare the importance of reputation relative to a steep discount in price. More specifically we asked:

Let’s say that a firm with which you had not worked before offered to sell you a high quality product at a price $\frac{5}{20}$ percent lower than the market price and asked for 50 percent prepayment.[**In addition this firm has a good reputation in the region in that it almost always fulfills its contractual obligations.**] Would your firm be willing to accept this offer?

1) Yes 2) Probably Yes 3) Probably no 4) No

Table 1 reports the percentage of respondents willing to accept the offer under the four experimental conditions. Here responses of yes and “probably yes” are reported.
Heaving a good reputation is a quite valuable commodity. A seller can with a good reputation can increase the percentage of buyers accepting her offer of a five percent discount to the market price by 14 percentage points compared to a similar offer made by a seller about whose reputation little is known (63% versus 77%). In addition, with a price 20 percent lower than the market, a seller with a good reputation can increase the number of buyers accepting the offer by 23 percentage points (60 percent versus 83 percent).

It is interesting to note that when information about the reputation of the seller is not provided reducing the price from 5 to 20 percent below the market does not lead to more acceptances. It seems that a discount of 20 percent to the market, if anything, produces skepticism about the credibility of the offer and reduces the likelihood that a buyer will accept. However, when the seller has a good reputation, a similar discount is associated with a 6 percentage point increase in the likelihood that the offer will be accepted. Thus, having a good reputation is a more potent stimulus to trade than is a discount of 15 percent of the market price.
Experiment Two: The Sources of Information about Reputation

There has been a great deal of research on the impact of reputation on a variety of economic and political outcomes, but less is known about how different sources of information about a reputation influence outcomes. To explore this issue, I conducted an experiment that manipulates whether the source of information about a firm’s reputation is “the local press” or an “old business partner.” I also manipulated whether the information conveyed led the respondent to believe that the seller had either a good or a bad reputation for abiding by its contractual obligations. More directly, we asked:

Let’s say that a company from another region with whom you had not worked before offered to sell you a product that you need for 10 percent less than the market price. Recently you learned [in the local press/ from an old business acquaintance] that the company had [always/not always] fulfilled its obligations to other firms in your region. Would your firm accept this offer?

1) Yes  2) Probably Yes  3) Probably No  4) No

The results from Table Two indicate somewhat surprisingly that the local press and old business acquaintances are equally powerful sources of information about a firms’ reputation. When the seller has a bad reputation and the source of information about the reputation is the local press, only 16 percent of respondents accepted the offer, but this figure was only 15 percent when the source of information is an old business acquaintance. Similarly, there are only minor differences in the acceptance rate when the seller has a good reputation (67 percent for the local press versus 69 percent for an old business acquaintance).
Table 2. The Sources of Reputation

<table>
<thead>
<tr>
<th></th>
<th>Bad Reputation</th>
<th>Good Reputation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Local Press</td>
<td>16</td>
<td>67 (n = 124)</td>
</tr>
<tr>
<td></td>
<td>(n = 124)</td>
<td>(n = 120)</td>
</tr>
<tr>
<td>Old Business Acquaintance</td>
<td>15</td>
<td>69 (n = 131)</td>
</tr>
<tr>
<td></td>
<td>(n = 131)</td>
<td>(n = 128)</td>
</tr>
</tbody>
</table>

Figures represent percent responses “yes” or “probably yes.” N = number of observations. Don’t knows are counted as “no” responses when calculating the percentages.

In both experimental settings, sellers with a good reputation were far more likely to have their offer accepted than sellers with a bad reputation (67 percent versus 16 percent if the source is the local press and 69 percent versus 15 percent if the source is an old business acquaintance). The impact of reputation here is much larger than in the preceding experiment. This may be a reflection of the comparison group. In this experiment, the impact of a seller with a good reputation is relative to a seller with a bad reputation, but in the preceding experiment the impact of a seller with good reputation is relative to a seller having no reputation.

Experiment Three: A Business Association as a Source of Reputation

In this section, I explore the extent to which membership in a prominent business association can increase confidence in the security of contracts. The focus here is slightly different than in preceding examples. If previous experimental manipulations concerned features specific to firm, here reputation attaches to all members of the business association. In this manipulation the respondent is told that the buyer is a member of the Russian Union of
Industrialists and Entrepreneurs, the most prominent business association in Russia. In addition, the respondent is told that the potential buyer is either from the respondent’s region or from another region. Pyle (2006) argues that business associations are especially valuable in promoting trade across regions. To assess these arguments, we asked:

Let’s say that a firm from [your/another] region is planning to place a larger order (about 20% of your annual sales) at your firm at the market price and offers to pay 50 percent up front and pay the rest two months after it receives the product. [XXX/The company is a member of the RUIE (the Russian Union of Entrepreneurs and Industrialists)]. Would your firm be willing to accept this offer?

1) Yes  2) Probably Yes  3) Probably No  4) No

Table Three indicates that being a member of the RUIE significantly increases the likelihood that the respondent will accept the offer. If the buyer-firm is from another region, being a member of the RUIE increases the likelihood that the respondent will accept the offer by 16 percentage points (74 percent versus 58 percent). If the buyer-firm is from the respondent’s region this increase is 20 percentage points (71 versus 51 percentage points). This indicates that business associations can play an important role in promoting trade.
Table 3. The Benefits of Membership

<table>
<thead>
<tr>
<th></th>
<th>No information about membership</th>
<th>Member of RUIE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Another Region</td>
<td>58 (n = 131)</td>
<td>74 (n = 120)</td>
</tr>
<tr>
<td>Your Region</td>
<td>51 (n = 126)</td>
<td>71 (n = 126)</td>
</tr>
</tbody>
</table>

Figures represent percent responses “yes” or “probably yes.” N = number of observations. Don’t knows are counted as “no” responses when calculating the percentages.

It is somewhat surprising that respondents appear to prefer to trade with buyers from other regions rather than from their own region. One would expect that trading with a partner from a region rather than your own would involve higher transaction costs and thereby depress incentives to engage in exchange, but that does not appear to be the case as in this experiment respondents, on average, preferred trading with buyers when given no information about the buyer’s membership status. This anomalous result merits further exploration.

Experiment IV. The Impact of Reputation Relative to Courts

Finally, the last experiment compels respondents to make tradeoffs between using courts and reputation as a means of buttressing trade. This allows us to examine the relative impact of courts and reputation in boosting trade. Respondents were asked to evaluate the likely behavior of a manufacturing firm who has and has not been able to use courts in the past who is considering an offer from a new firm. In one condition, the manufacturing firm is told that the seller has a good reputation in the region, but in the other condition, the manufacturing firm receives no information about the seller’s reputation. We asked:
Let’s say that a firm in retail trade plans to make a large order at a large manufacturing plant in your region at a market price. This retail trading firm recently opened [XXX./, but in the region it is considered to be a reliable partner.]

What do you think, will the manufacturing firm accept this trade given than it has [rarely/often] been able to defend its interests in the state courts of arbitration?

1) It will refuse the offer
2) It will accept the offer, but only the condition of a prepayment of ____ percent of the order. Please indicate the amount of prepayment
3) It will accept the offer without any prepayment

Table IV reports the results for each of the four scenarios. For example, when the respondent is given no information about the reputation of the buyer and the seller is not expected to be able to use the courts 22 percent of the respondents said that the manufacturer would refuse the offer outright, 24 percent said that the manufacturer would request at least 50 percent prepayment and 53 percent said that the manufacturer would accept the trade without preconditions.

**Table IV. Reputation and Courts**

<table>
<thead>
<tr>
<th></th>
<th>Refuse</th>
<th>Conditional Accept</th>
<th>Accept</th>
</tr>
</thead>
<tbody>
<tr>
<td>No reputation Cannot use courts</td>
<td>22</td>
<td>24</td>
<td>53</td>
</tr>
<tr>
<td>No reputation Can use courts</td>
<td>11</td>
<td>19</td>
<td>70</td>
</tr>
<tr>
<td>Good reputation Cannot use courts</td>
<td>18</td>
<td>23</td>
<td>55</td>
</tr>
<tr>
<td>Good reputation Can use courts</td>
<td>13</td>
<td>15</td>
<td>72</td>
</tr>
</tbody>
</table>

Percentage responses in each category. Demands for prepayment greater than 50 percent are treated as
To make the results reported above, somewhat more intuitive I report the responses subtracting the refusals reported in Column 1 from the acceptances reported in Column 3 in Table IV. In Table V, we see that buyers who are thought to be able to use courts are significantly more likely to accept the offer in both conditions. Indeed, courts provide a powerful stimulus to trade. When the seller has no reputation, moving from a condition in which the buyer cannot use courts to one in which he can use courts increase the likelihood of accepting the offer from 31 percent to 59 percent. Similarly, when the seller has a good reputation, such a move increases the acceptance rate from 41 percent to 61 percent.

**Balance of those Accepting**

(Accept Offer-Refuse Offer)

<table>
<thead>
<tr>
<th></th>
<th>Buyer Cannot Use Courts</th>
<th>Buyer Can Use Courts</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Seller has no reputation</strong></td>
<td>31 (n = 98)</td>
<td>59 (n = 103)</td>
</tr>
<tr>
<td><strong>Seller has good reputation</strong></td>
<td>41 (n = 94)</td>
<td>61 (n = 109)</td>
</tr>
</tbody>
</table>

n = number of observations.

In addition, reputation is an important motor of trade especially when the buyer is thought to be unable to use courts. When the buyer cannot use courts, moving from a condition in which the seller has no reputation to having a good reputation increases the likelihood of acceptance by 10 percentage points (31 versus 41 percent.) This increase is smaller when the buyer can use courts (59 percent versus 61 percent). On balance, one can argue that courts and
reputation are complements. Having a good reputation is far more valuable when courts are also available to protect property rights.

Conclusion

Scholars have developed a rich literature on the significance of public institutions, such as courts and bureaucracies for the creation of markets and states. They have also created an impressive body of scholarship on the role that private institutions, such as reputation and trust, play in these processes. However, we know less about the relative importance of public and private institutions or about how these institutions interact in different settings (but see c.f., Kohli and Shue eds. 1994). In addition, we know little about the relative importance of different sources of information about reputation and the magnitude of the value of having a good reputation. These drawbacks are unfortunate as the quality of institutions -- both public and private -- is a critical issue for transition and developing countries in general and Russia in particular. Evidence from a 2008 survey of businesspeople in Russia contributes to these debates. Experimental analyses of survey responses indicate that private institutions, such as reputation, and public institutions, such as courts, both provide a potent stimulus to trade. In addition, both the local press and word of mouth are valuable sources of information about reputation. There is also evidence that good reputations and capable courts are complements rather than substitutes. That reputation and courts are mutually supporting is broadly consistent with Putnam (1994), but not Migdal (1988).

Given the importance of reputation for promoting trade, future research would do well to analyze precisely how reputations travel. How do business elites gain information about contract violations if the disputes do not end up in court? Why are some business elites better informed about the reputations of potential trading partners than others? How do managers verify
information about a particular dispute absent an impartial third-party arbiter? These are questions that merit greater attention.

Finally, this study makes a case for the use of survey-based experiments to help unravel the difficult endogeneity problems that are inherent in institutional analysis. The experimental design employed here provides a particularly potent way of identifying the impact of institutions on behavior by manipulating the quality of reputations and courts to ensure that they do not co-vary. This design provides an especially clean test of the impact of institutions on the propensity to trade.
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