PROTECTION OR REPRESSION: THE IMPACT OF JUDICIARY BEHAVIOR ON SME DEVELOPMENT IN RUSSIA

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ABSTRACT

The paper investigates the role of judiciary behavior in the development of SMEs in Russian regions. Specifically, it looks at how repressive Russian courts are in punishing economic crime. Repressiveness of courts can be both an obstacle of business development (if it serves the predatory behavior of bureaucrats) and a factor improving the environment for business (if it reduces risks of illicit behavior on the side of SMEs' counterparts). Utilizing the differences in court repressiveness and SME development across Russian regions, we show that court behavior indeed affects the development of SMEs, at least as captured by the official statistics. For small business in the area of trade, higher repressiveness of courts in the matters of fraud seems to encourage business development, while repressiveness in corruption and illicit entrepreneurship has a negative effect.

KEYWORDS

small business, judicial behavior, Russian regions

JEL CLASSIFICATION

L26; K14

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1. INTRODUCTION

Russia is notorious for having a particularly low level of SME activity, compared to both developed and developing countries. It can indeed be seen while considering almost all statistical indicators of SME activity. For example, as of 2009 (this is the year used for empirical investigation in this paper), 92.5% of the employed population of Russia were working for hire; those employing others made out 1.3% and self-employed 5.6%. Thus, the share of entrepreneurs and self-employed (6.9%) was substantially lower than in most European countries, regarding of the level of their development (29.2% in Greece, 26.8% in Moldova, 23.0% in Portugal, 20.7% in Romania, 18.8% in Poland, 17.7% in Ukraine, 16.5% in Ireland, 16.3% in Spain, 11.6% in Italy and 11.4% in Bulgaria). The share of entrepreneurial income in the total income of the population decreased in 2011 as compared to 2000 from 15.4% to 8.6%. The share of small enterprises and micro-entrepreneurs in the total employment in Russia, as of 2010, accounted for 21.5%; even if one adds the employment in the medium-sized enterprises (accounting for roughly one quarter of the total employment), one still obtains an indicator lower than that of European countries and substantially lower than in South-East Asia and in some of the African countries (Chu et al. 2008). We have to acknowledge that these comparisons are based on official statistics, which may be particularly misleading for SMEs in the developing countries with large shadow economy. Still, the fact that the SME sector is underdeveloped has been acknowledged already in early 2000s by numerous studies (Liedholm and Mead 1999; Safavian et al. 2001). Over time, the situation is claimed to have deteriorated: for example, Berkowiz and DeJong (2011) pointed out that the contribution of SMEs to the overall economic growth, substantial in the 1990s, decreased throughout the 2000s.

The reasons for low performance of the SME sector are numerous, but the low quality of economic institutions stands out as a particularly important challenge. The Doing Business rating, which captures the quality of formal institutions, in its latest edition (2014) shows that Russia, in spite of a number of recent positive changes, still ranks 92 of all countries (as of 2013, Russia ranked 111). One of the reasons of this low performance, in addition to excessive red tape and bureaucratic burden in many areas (e.g. extremely sophisticated mechanism of obtaining construction permits), is low protection of property rights through the judiciary. The protection of foreign investors score in Doing Business data, which could be seen as partly reflecting the quality of judiciary, is very low: Russia ranked 115 in 2014, even somewhat worse than in 2013. Russian courts are notorious for lacking impartiality and having inefficient judicial procedure. While the low quality of judiciary has only an indirect impact on the SMEs operating in the shadow economy (by possibly affecting the initial choice of the entrepreneur as to whether to legalize one's business or move in the informal sector), for enterprises at least partially operating in the formal sector (i.e. those, which are captured by the statistical data) judiciary is essential. A result of the interplay of low quality of supply of judiciary, specifics of law enforcement (Taylor 2006) and demand for inefficient institutions on the side of entrepreneurs (Puffer et al. 1998; Kuznetsov and Kuznetsova 2003) is that business conditions for SMEs in Russia deteriorate.

The aim of this paper is to investigate how the judiciary behavior and, in particular, the repressiveness of the judiciary while considering economic crimes, affects the development of SMEs in Russian regions. We use the fact that in Russia bureaucratic performance and in particular behavior of courts, varies substantially across individual regions of Russia (Gimpelson et al. 2010; Yakovlev and Zhuravskaya 2013; Bruno et al. 2013). While the federal government for the last twelve years invested substantial effort into centralizing the country, it only partially succeeded – the large formal differences between Russian regions, which existed in the 1990s, disappeared, but there are still substantial informal differences in how Russian bureaucrats act. These differences are partly unavoidable due to inevitable principal-agent problems in the bureaucratic hierarchy. We will specifically focus on the performance of the general purpose courts (sud obshchey yurisdiktsii); Russian judiciary also includes another branch of commercial courts (arbitrazhnyi sud). The

performance of commercial courts is generally believed to be much better than that of general purpose courts: for example, in terms of contract enforcement (which is the main task of commercial courts) Russia ranks 10 in the Doing Business rating.

Our focus is, however, on how the behavior of courts in the area of criminal law (and, in particular, crimes potentially associated with business activity) influences the SMEs; criminal jurisprudence falls in the domain of general purpose courts. In Russia and in other post-Soviet countries it is not unusual to apply criminal law mechanisms to pressure entrepreneurs. The severity of punishments associated with criminal law (e.g. imprisonment) is obviously an effective threat against private business. But also the very way how criminal prosecution is organized can be used for harassment of private enterprises. While the most prominent examples of how criminal law was used are associated with large corporations (in Russia, the infamous Yukos case of 2004 is probably the best known one), small business is even more likely to be subject to criminal pressure, since its resources for legal representation are very small. However, severe criminal prosecution does not necessarily imply pressure on SMEs: it can also be used as a tool to restrict the predatory behavior of regional bureaucrats and possible violations of law on the side of the business partners and thus, essentially, improve business environment. Essentially, the trade-off is between repressive jurisprudence as a tool constraining private predation (which is good for business, especially SMEs with limited own capacity to protect themselves) vs. repressive jurisprudence as an instrument of governmental predation (which is bad for SMEs) (Djankov et al. 2003). In this paper we intend to test whether Russian jurisprudence focuses on protection or repression against SMEs.

The paper is organized as follows. The next section presents the key variables and the econometric model we use. The third section summarizes the main results. The last section concludes.

2. KEY VARIABLES AND ECONOMETRIC STRATEGY

Dependent variable: In order to understand how judiciary behavior affects the development of the SMEs, we use official statistical data published by Rosstat, the Russian statistical agency. Again, we have to point out that the Rosstat data should not be treated as entirely accurate while describing the SME activity; a reduction in the number of SMEs could very well be associated with their shift into informal economy (Dreher et al. 2014). Still, the Rosstat data could serve as at least a crude proxy for the SME activity in the formal sector. We use two main dependent variables. First, we look at the total number of small enterprises in the region. Second, we investigate the average number of workers per company; basically, it captures how large individual SMEs in the region are. It is possible to argue that these two indicators are better capable of measuring the SME activity than, say, turnover or profit – the last two variables may be subject to major manipulations as a tool of tax evasion or avoidance. Still, the employment data may be manipulated to a greater extent than the simple number of SMEs (to avoid responsibilities associated with social security contributions employer has to pay according to the Russian law). We investigate specifically SMEs of three sectors: trade, industry and construction. Since the requirements for the business environment and the risks are very different, it is also possible that the judicial behavior affects the SMEs in these groups in a different way.

We have to acknowledge that there are also other indicators of sub-national SME activity in Russia. For example, in 2005-2006 VTsIOM (one of the largest Russian public opinion agencies) implemented (on behalf of Opora Rossii, a large business association focusing on SMEs) a large-scale study of the entrepreneurial activity in Russian regions. It measured a number of indicators of business activity (e.g. financial status, transaction costs, motivation for business activity, security, assets, legal environment and governmental support). However, this dataset (VTsIOM 2006) seems

to rather capture the subjective perception of the entrepreneurial activity (and, to a large extent of its environment), based on a survey of owners and managers of small companies. The inability to distinguish the perception of environment from that of actual business activity could be a limitation from the point of view of our paper. The 2012 Doing Business study (Doing Business 2012) also compiled data on SME environment in Russia at the sub-national level, but it covered only 26 regions (i.e. less than a third of all Russian provinces we study), and focused on cities and not on the entire regions. RIA Rating Agency (RIA 2012) also published an indicator of 'entrepreneurial initiative' in Russian regions, which is an aggregate of multiple indicators of Rosstat (SME turnover, SME investments etc.), but the interpretation of this aggregated index is extremely hard.

Explanatory variable: In order to capture the judicial performance, we use the approach suggested by Libman et al. (2012), Schultz et al. (2014) and Libman and Kozlov (2012) and focus on *repressiveness of courts in criminal matters.* More specifically, repressiveness is measured as a share of prison sentences in the total number of prison sentences and conditional releases determined by the courts in the region. The Russian law (as many other legal systems) allows the prison sentence for most cases (and, in particular, for almost all economic crimes, which are in the focus of this study) to be substituted by a conditional release (suspended sentence). In this case the accused is considered to be legally sentenced to a term in prison, but does not actually serve the term – instead, (s)he is monitored by the police and (often) restricted in the right to travel and in the kind of activities permitted. The decision as to whether use the actual sentence or the conditional release depends not on the type of crime committed, but on the personality of the accused (the court has to judge how 'dangerous' it is for the society to leave the accused outside of prison). Thus, there is no difference in the substance of crimes, which were punished by a prison sentence or a conditional release (with some minor exceptions, again, almost irrelevant for economic crimes); the severity of punishment is, of course, very different, especially in Russia with harsh prison conditions (Oleinik 2003). Therefore, the variable actually captures how likely the courts are to use more severe punishment for comparable crimes. In Russia, looking at this variable is important for another reason – the organization of Russian legal system almost precludes judges from acquitting the accused (there are strong bureaucratic incentives to prevent the acquittal). Therefore, conditional release is often the most 'merciful' decision a court is capable of making (Schultz et al. 2014).

We look, specifically, at the repressiveness of courts in four types of crimes, which are relevant for economic activity: (1) fraud (moshennichestvo); (2) tax crimes; (3) corruption (paying bribe and accepting bribe) and (4) illicit entrepreneurship (lzhepredprinimatel'stvo).

- Fraud (Article 159 of the Russian Criminal Code) is probably one of the articles of the Russian Criminal Code most frequently used for harassment of entrepreneurs. The content of the legal norm is vague and provides the prosecution with ample opportunities to adjust it to cases involving entrepreneurs (see Schultz et al. 2014 for a more detailed description of this type of crimes in the Russian legal system). Even if other articles of the Russian Criminal Code (e.g. Articles 169-199.2) are more applicable, the prosecution often prefers using the fraud article, since it involves harsher penalties. At the same time, however, fraud is not only a convenient accusation to be made against private business, but also a serious risk for SMEs, which are much more sensitive to possible abuse by business partners – e.g. cases when fraud actually does occur in real life and is not merely a pretext used by governmental authorities. Increasing repressiveness is likely to increase the expected costs of committing a crime (Becker 1974); thus, in cases of possible crimes against SMEs, where expected gains are rather small, high repressiveness could deter criminal activity (as a caveat, the outcome also depends on the likelihood of uncovering a crime, which we cannot observe with our data).
- Tax crimes are another very often used tool of pressure against private business (in fact, this was the tool used in the already mentioned Yukos case) and in particular against SMEs. Darden (2008) describes what he calls a 'blackmail state': a system, where legal system and taxation are

intransparent and highly complex, such that behavior according to the law is impossible; the government consciously creates such a system, allowing it to attack any business actor, if it wants to do so. Darden's focus is on political implications of the blackmail state (which deters private business from supporting opposition); however, blackmail state for the SMEs implies that the intransparent and contradictory law and, more importantly, law enforcement practices make predatory behavior of governments much easier, forcing business into accepting an informal contract with the government based on graft (see e.g.. Radaev 1998; Paneyakh 2001, 2008). In Russia, where the tax law as such is relatively simple (after the major reforms of the early 2000s), it is the inconsistent application of tax law, which creates main risks for business actors (Libman et al. 2014). More repressive application of tax law is therefore likely to represent higher pressure of the government against business.

- Convictions for corruption, on the contrary, are more likely to be used as protection of private business. The overall level of corruption in Russia is very high; while the federal government has repeatedly claimed its willingness to fight against corruption (Obydenkova and Libman 2014), the effectiveness of this campaign has been extremely low. One could, therefore, expect that in the regions where corruption crimes are punished more severely, demand for corruption by public officials is lower. It is likely to improve the environment for entrepreneurs (though, as our discussion will show, more complex reaction is also possible; furthermore, accusations in giving bribes, although not so often, are used as a tool of pressure against private business as well).

- Finally, illicit entrepreneurship is typically used as a tool of pressure against business – these crimes involve, for example, business activity without necessary licenses in areas where such licensing by the federal government is required. While illicit entrepreneurship charges could also be used to protect the consumers, still, it would make the business environment for SMEs harsher, especially since in Russia allocation of licenses is, again, associated with graft and corruption. On April 9, 2010, the illicit entrepreneurship was excluded from the Russian Criminal Code (currently these crimes are classified as fraud or tax evasion), but it still is present in other former Soviet Union countries (e.g. in Belarus; Kazakhstan abolished an analogous article in its criminal code only in early 2014).

Summing up, illicit entrepreneurship and tax crimes repressiveness are likely to serve as proxies of pressure against private business and thus should reduce the scope of SME activity in the region or at least shift it into informal sector. Fraud is a more ambiguous case; on the one hand, high repressiveness in the cases of fraud could be used in attacks against entrepreneurs conducted by governmental agencies and bureaucrats, but on the other hand, regions with repressive law enforcement could protect entrepreneurs from abuse by their business partners and thus improve the business environment. Corruption, evidently, is a crime directed against business, and thus more repressive regions could be associated with better business environment (again, notice that our measure of repressiveness looks at how identical crimes are treated – thus, we avoid a typical problem present, e.g. in corruption research, where high number of convictions could be an indicator of both high level of corruption and intensive anti-corruption governmental activity). We acknowledge that other articles of the Criminal Code can also be used to pressure business (or matter for protecting SMEs – e.g. simple theft can be a serious risk for small companies or individual businessmen); however, economic crimes are the most evident ones, and thus constitute a good starting point for our analysis. Furthermore, criminal cases resulting in actual conviction or conditional release in these economic crimes often attract substantial public attention and can have a major impact on the behavior of entrepreneurs.

Model and control variables: In a nutshell, we regress the indicators of development of SMEs on the level of repressiveness in the region, as well as a set of control variables. The sample we use covers almost all regions of Russia: it excludes Chechnya (due to the lack of reliable data); the City of Moscow (the economic development of the Russian capital is often substantially

different from that of other regions); and the so-called autonomous okrugs (Russian regions with lower-level status, for which data availability is also limited). All variables we use are for 2009 or 2010, depending on data availability. We estimate cross-sectional regressions using OLS.

The set of controls includes the following variables. First, SME development obviously depends on the economic development of the region; thus, we control for the income per capita, as well as urbanization (share of urban population in the total population of the region), as well as total population. SMEs gain from qualified labor force; improved education also may stimulate demand for goods and (in particular) services offered by SMEs; therefore, we also control for the educational level in the region (since in Russia secondary schooling covers almost the entire population, we look at the share of regional population with a university degree, which we extracted from the census data of 2002). Finally, we also control for the distance between the regional capital and the city of Moscow, since the former could serve as a good proxy for the specificity of regional economic and political development, as well as could capture the extent of access to markets in other regions (Russian transportation system is highly centralized, with almost all regions accessing markets in other regions only through Moscow). For each of the dependent variables we estimate five regressions: four, where repressiveness indicators for four types of crimes are included one by one (to avoid multicollinearity), and the fifth one, where all four indicators are included simultaneously.

Table 1 reports the descriptive statistics for the main variables used in our investigation. As expected, trade SMEs are substantially more frequent than SMEs in industrial production and in construction (there are on average almost four times more trade SMEs than SMEs in other sectors). However, employment of a trade SME is on average smaller than of a construction SME and in particular of an industrial SME (which has the average employment twice as high as the trade SME). Fraud seems to be characterized by the highest overall level of repressiveness (consistent with the argument presented above), followed by corruption. It is interesting to notice that illicit entrepreneurship is associated with substantially lower repressiveness levels than fraud (the repressiveness indicator is almost three times lower). Tax evasion is associated with very low repressiveness levels – it is likely that in this case real convictions follow only high-profile cases, attracting public attention and serving as a signal to the entrepreneurial community in the region.

Table 1 **Descriptive statistics**

	Mean	St. Dev.
Dependent variables		
Number of SMEs, '000 (trade)	6.9475	9.7133
Average employment per SME, people (trade)	4.8954	1.4029
Number of SMEs, '000 (industry)	1.8438	2.2714
Average employment per SME, people industry)	10.0890	3.1034
Number of SMEs, '000 (construction)	2.1038	2.5285
Average employment per SME, people (construction)	8.2805	3.9022
Control variables		
Monthly income per capita, RUR	16482.1400	6085.4020
Education, share of population with university degree	0.1703	0.0292
Distance from Moscow, '000 km	2.4028	2.7179
Population, '000 people	1626.0370	1281.7510
Urbanization, %	69.5725	12.6124
Repressiveness indicators		

Illicit entrepreneurship	0.0775	0.2168
Corruption	0.1855	0.1902
Fraud	0.2500	0.4357
Tax evasion	0.0458	0.1504

3. FINDINGS

Tables 2 and 3 report the results of our estimations for SMEs in the area of trade. We find that repressiveness has a contradictory effect on the SME development. Repressiveness in the matters of fraud is associated with a growing number of SMEs. However, regions with more repressive tax evasion, corruption and illicit entrepreneurship litigation were characterized by lower employment per SME and (in some specifications) lower number of SMEs. In terms of fraud, the results indicate that high repressiveness, although occasionally used as a tool of bureaucratic predation directed against private business, rather matters for SMEs because it limits the business risks they encounter in dealing with their business partners (trade firms are likely to have a particularly broad set of business partners and thus be very sensitive to fraud). Repressive behavior encourages entrepreneurs and constraints possible criminal behavior. For taxation and illicit entrepreneurship – i.e. crimes associated with violations of governmental regulation rather than directed against business partners – SMEs are more interested in less repressive jurisprudence; repressive behavior of courts does not reduce business risk and merely serves as a tool of predation.

Table 2 **Impact of repressiveness on the number of trade SMEs**

	(1)	(2)	(3)	(4)	(5)
Income per capita	0.000	0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Education	134.726**	123.786**	125.498**	125.182**	136.929**
	(65.093)	(69.025)	(69.776)	(69.352)	(60.857)
Distance from Moscow	0.103	0.026	0.027	0.027	0.096
	(0.154)	(0.189)	(0.183)	(0.185)	(0.160)
Population	0.004***	0.004***	0.004***	0.004***	0.004***
	(0.001)	(0.001)	(0.001)	(0.001)	(0.001)
Urbanization	0.173***	0.161**	0.156**	0.159**	0.166***
	(0.065)	(0.069)	(0.067)	(0.070)	(0.061)
Repressiveness: fraud	4.256*				6.075**
	(2.181)				(2.971)
Repressiveness: tax evasion		-3.247			-4.295*
		(2.331)			(2.348)
Repressiveness: corruption			-0.736		-6.846
			(2.437)		(4.150)
Repressiveness: illicit entrepreneurship				-0.952	-1.752
				(1.686)	(2.036)
Constant	-33.002**	-30.139**	-29.743**	-29.977**	-32.253***
	(13.174)	(13.691)	(13.404)	(13.649)	(11.790)
No. obs.	80	80	80	80	80
R^2	0.748	0.715	0.713	0.714	0.769

Note: robust Huber-White standard errors in parentheses. *** significant at 1% level, ** 5% level, * 10% level

Table 3 **Impact of repressiveness on the average employment per a trade SME**

	(1)	(2)	(3)	(4)	(5)
Income per capita	0.000	0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Education	-20.999***	-21.384***	-20.445***	-20.852***	-20.968***
	(4.350)	(4.232)	(4.572)	(3.994)	(4.319)
Distance from Moscow	-0.01	-0.009	-0.011	-0.01	-0.012
	(0.065)	(0.065)	(0.064)	(0.066)	(0.066)
Population	0.000***	0.000***	0.000***	0.000***	0.000***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Urbanization	-0.011	-0.009	-0.013	-0.009	-0.01
	(0.017)	(0.017)	(0.017)	(0.017)	(0.017)
Repressiveness: fraud	-0.192				0.176
	(0.285)				(0.289)
Repressiveness: tax evasion		-1.609***			-1.363**
		(0.544)			(0.662)
Repressiveness: corruption			-1.140*		-1.051
			(0.670)		(0.820)
Repressiveness: illicit entrepreneurship				-1.130***	-0.889**
				(0.425)	(0.413)
Constant	8.271***	8.058***	8.507***	8.142***	8.293***
	(1.099)	(1.033)	(1.131)	(1.038)	(1.095)
No. obs.	80	80	80	80	80
R^2	0.208	0.231	0.228	0.234	0.269

Note: see Table 2

Probably, the most unusual finding is that corruption has a negative effect on busness development.[3] As we have hypothesized, repressive jurisprudence in the area of corruption was expected to encourage business activity, making business environment more attractive. Our findings indicate the opposite: the less likely the courts are to severely punish corruption crimes, the better it is for business. It could be explained by the fact that we, as mentioned, look at crimes associated with both bribe-paying and bribe-taking: SMEs frequently are forced to pay bribes as a simple condition of survival of their businesses, and thus repressive jurisprudence in this area increases risks for business. Furthermore, it is also possible that punishments of bureaucrats are risky for businessmen as well – they distort the informal corruption networks, which have been established in the region (Pleines 2001), require a (possibly costly) adjustment to new bureaucrats, increase other legal risks (which were previously covered by the informal corruption contract between the bureaucrat protecting the firm and the firm paying bribes to the bureaucrat). Somewhat simplified, the existing corruption networks create better environment for business activity than high level of uncertainty in the bureaucracy associated with repressive jurisprudence for corruption cases.

If that is the case, the result we observe fits into the established discussion on the so-called institutional traps (Polterovich 1999). An institutional trap is typically defined as an equilibrium institutional norm, which is inefficient (i.e. there exists another norm, which could be a Pareto-improvement, but is not an equilibrium). For corruption, institutional traps work as follows: if business is heavily involved in corruption networks, it is getting used to the particular business

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[3] We have to point out that the coefficient for this variable is significant only at 10% level, and the findings are not robust to specification – hence, caution is required in interpreting the results.

practices (involving corruption) and reduces demand for anti-corruption activities. In particular, it happens because in Russia, if a corrupt official is punished, (s)he is often replaced by a new corrupt bureaucrat, merely increasing the activity associated with rent-seeking. In Russia established corruption ties to bureaucrats actually serve as a competitive advantage; as Bardhan (1997, 2006) shows, in countries with high level of corruption companies more actively involved in corruption networks perform better than companies refraining from using corruption tools. Our findings may fit results reported by other studies: Yakovlev (2013) shows that Russian business does not perceive corruption as a priority obstacle (though the level of corruption in Russia is very high); numerous studies (Paneyakh 2001; Olimpieva 2009) look at the 'demand for bad institutions', including corruption practices, in Russian business.

There is an alternative explanation for the finding we reported: we may merely observe what is typically referred to as 'grease the wheel corruption' (Leff 1964). Economics literature has speculated that under certain conditions corruption has a positive effect on economic performance of a country and may even attract FDI (Bardhan 2006; Meon and Weill 2010): economic growth under military dictatorship in South Korea is sometimes believed to be an example of this mechanism. Specifically, if a country or a region is characterized by extremely inefficient bureaucracy the business finds very hard to deal with, corruption may be, although suboptimal, a preferred alternative allowing overcoming the barriers created by the bureaucratic red tape. If bureaucrats behave according to the law, and the law is contradictory and, generally, designed in a way not suited for demands of the business, honest bureaucracy following the legal acts up to the letter may be less attractive for the business than a dishonest bureaucracy willing to take bribes and thus allowing to 'overcome' the existing barriers. It could explain the results of our regressions. Furthermore, our findings are more consistent with the picture of a centralized corruption, where corruption networks are organized in a hierarchical way. An alternative to this outcome would be the decentralized corruption case (e.g. observed in Indonesia after the fall of Suharto regime or in the post-Soviet countries in the 1990s), associated with multiple competing bureaucrats attempting to extract bribes from the business activity. It is typically associated with much higher level of predation and low reliability of transactions based on corruption.[4] The fact that in Russia only high-profile cases of tax crimes typically result in 'real' prison punishments also may serve as indirect evidence of centralized corruption model (at least at the regional level).

Tables 4 and 5 report the results of our regressions for industrial SMEs, which are substantially weaker. As in case of trade SMEs, number of businesses increases if repressiveness in the matters of fraud is higher; in some specifications, number of SMEs goes down if repressiveness in tax evasion is higher. There is no effect of repressiveness on the employment indicators; it may be because for industrial companies requirements of technology do not allow changing employment as freely as for trade companies (fixed costs are higher). For construction (Tables 6 and 7) we also find less clear results. Again, repressiveness in the matters of fraud increases the number of SMEs. Repressiveness in the matters of illicit entrepreneurship decreases the employment indicator (it is possible that for construction licensing is particularly important, as it is for trade). In one of specifications we find that repressiveness in the matters of fraud is associated with lower employment, but the result is not robust to specifications and significant only at 10% level.

Table 4 **Impact of repressiveness on the number of industrial SMEs**

	(1)	(2)	(3)	(4)	(5)
Income per capita	0.000	0.000	0.000	0.000	0.000

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[4] Note that in this case we refer to a setting where multiple bureaucrats hold veto-player positions and, basically, extract rents from the same group of entrepreneurs. In a setting where, for example, there is a competition between corrupt bureaucracies of different regions for the inflow of capital, the outcomes are very different and could be associated with decreasing pressure of corruption (see e.g. Allen et al. 2012).

	(1)	(2)	(3)	(4)	(5)
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Education	28.792**	26.624**	26.985**	26.999**	29.055***
	(11.410)	(12.220)	(12.407)	(12.353)	(10.731)
Distance from Moscow	-0.035	-0.05	-0.049	-0.049	-0.036
	(0.037)	(0.046)	(0.044)	(0.044)	(0.038)
Population	0.001***	0.001***	0.001***	0.001***	0.001***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Urbanization	0.030**	0.028**	0.027**	0.027*	0.029**
	(0.013)	(0.014)	(0.014)	(0.014)	(0.012)
Repressiveness: fraud	0.825**				1.119**
	(0.384)				(0.521)
Repressiveness: tax evasion		-0.726			-0.980**
		(0.604)			(0.491)
Repressiveness: corruption			0.023		-1.141
			(0.487)		(0.751)
Repressiveness: illicit entrepreneurship				0.049	-0.102
				(0.311)	(0.329)
Constant	-6.592***	-6.042**	-6.014**	-6.007**	-6.475***
	(2.323)	(2.442)	(2.407)	(2.452)	(2.102)
No. obs.	80	80	80	80	80
R^2	0.839	0.817	0.815	0.815	0.851

Note: see Table 2

Table 5 **Impact of repressiveness on the average employment per an industrial SME**

	(1)	(2)	(3)	(4)	(5)
Income per capita	-0.000**	-0.000**	-0.000**	-0.000**	-0.000*
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Education	-37.937***	-36.225**	-36.311**	-36.021**	-37.040**
	(14.053)	(14.357)	(13.767)	(13.996)	(14.074)
Distance from Moscow	0.024	0.037	0.03	0.04	0.026
	(0.162)	(0.153)	(0.151)	(0.153)	(0.162)
Population	0.000	0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Urbanization	0.037	0.041	0.034	0.04	0.031
	(0.032)	(0.033)	(0.031)	(0.032)	(0.031)
Repressiveness: fraud	-0.740				-0.575
	(0.664)				(0.859)
Repressiveness: tax evasion		0.192			0.128
		(1.638)			(1.799)
Repressiveness: corruption			-1.844		-1.598
			(1.300)		(1.797)
Repressiveness: illicit entrepreneurship				1.266	1.744
				(1.926)	(1.982)
Constant	15.993***	15.438***	16.072***	15.414***	16.403***
	(2.524)	(2.495)	(2.538)	(2.462)	(2.526)
No. obs.	78	78	78	78	78
R^2	0.186	0.175	0.188	0.183	0.205

Note: see Table 2

Table 6 **Impact of repressiveness on the number of construction SMEs**

	(1)	(2)	(3)	(4)	(5)
Income per capita	0.000	0.000	0.000	0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Education	31.921**	29.404*	29.595*	29.728*	32.444**
	(15.282)	(16.301)	(16.522)	(16.527)	(14.803)
Distance from Moscow	-0.028	-0.047	-0.046	-0.045	-0.029
	(0.039)	(0.048)	(0.047)	(0.046)	(0.038)
Population	0.001***	0.001***	0.001***	0.001***	0.001***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Urbanization	0.032**	0.029	0.029*	0.028	0.030*
	(0.016)	(0.018)	(0.017)	(0.017)	(0.016)
Repressiveness: fraud	1.058**				1.371*
	(0.513)				(0.721)
Repressiveness: tax evasion		-0.406			-0.801
		(0.856)			(0.633)
Repressiveness: corruption			0.102		-1.440
			(0.595)		(1.040)
Repressiveness: illicit entrepreneurship				0.500	0.286
				(0.448)	(0.526)
Constant	-7.614**	-6.883**	-6.897**	-6.867**	-7.407**
	(3.112)	(3.265)	(3.199)	(3.280)	(2.891)
No. obs.	80	80	80	80	80
R^2	0.798	0.766	0.766	0.767	0.808

Note: see Table 2

Table 7 **Impact of repressiveness on average employment per a construction SME**

	(1)	(2)	(3)	(4)	(5)
Income per capita	0.000*	0.000*	0.000*	0.000*	0.000*
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Education	-35.198***	-32.188***	-31.689***	-32.772***	-34.740***
	(11.336)	(10.409)	(10.082)	(10.102)	(10.793)
Distance from Moscow	-0.234*	-0.210*	-0.218*	-0.218*	-0.237*
	(0.133)	(0.125)	(0.124)	(0.121)	(0.130)
Population	0.001	0.000	0.000	0.001	0.001
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Urbanization	-0.073	-0.068	-0.074	-0.065	-0.071
	(0.059)	(0.060)	(0.060)	(0.057)	(0.060)
Repressiveness: fraud	-1.480*				-1.119
	(0.841)				(0.933)
Repressiveness: tax evasion		-0.455			0.626
		(1.985)			(1.846)
Repressiveness: corruption			-2.321		-0.466
			(1.433)		(1.719)
Repressiveness: illicit entrepreneurship				-3.352***	-2.893**
				(1.266)	(1.321)
Constant	17.274***	16.203***	16.982***	16.245***	17.218***
	(3.672)	(3.348)	(3.517)	(3.232)	(3.734)
No. obs.	80	80	80	80	80

R^2		0.127	0.101	0.113	0.135	0.152

Note: see Table 2

4. CONCLUSION

It remains to summarize the main findings of the paper. Repressive behavior of judiciary (i.e. its likelihood to impose harsher penalties in comparable cases) has an ambiguous effect on SME development in Russian regions, which depends on particular area of law. If government is more likely to punish fraud severely, it seems to be perceived by entrepreneurs as a positive feature of the business environment. However, severe punishments in the area of corruption and illicit entrepreneurship have a negative impact on the SME development. The effect is stronger for trade SMEs than for SMEs in the areas of construction and industry. We have to acknowledge that the fat that we mostly used 2009 data may have affected the results – 2009 was the year when the global economic crisis had a particularly pronounced impact on the Russian economy; it is possible therefore that the number of SMEs observed was relatively low and also that some of the SMEs were in fact shell firms used for tax optimization. However, it is unlikely that the crisis affected the judicial behavior we observe; most of the crimes considered by courts in 2009 actually happened in 2008, or even earlier.

While our paper demonstrated that judicial variation at the sub-national level does affect the behavior of SMEs, we did not explore the specific reasons for the existence of this variation. A recent literature has looked at the determinants of behavior of Russian courts, focusing on the low independence of judges (Pozdnyakov 2014), dominance of the prosecutor, specifics of organization of litigation and reporting of court activities, as well as informal ties between judicial actors (Schultz et al. 2014). Bureaucratic incentives created by these formal and informal relations in the judiciary, combined with own interests of judicial actors (prosecutors and judges) may have an important influence on the judiciary behavior (Titaev 2011; Volkov 2012) and, in particular, affect the variations in the level of repressiveness we observed in Russian regions. It is plausible to hypothesize that these informal rules of the game in the judiciary are known to the entrepreneurs, who therefore react not on observed repressiveness, but rather base their decision on their knowledge of how regional judiciary functions. This topic constitutes an interesting avenue for further investigation.

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