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What Does Ukraine's Orange Revolution Tell Us About the Impact of Political Turnover on Economic Performance?

Political turnover is a normal, even desirable, feature of competitive politics, yet turnover in a context of weak institutions can create policy uncertainty, disrupt political connections, and threaten the security of property rights. What is the impact of political turnover on economic performance in such an environment? We examine the behavior of over 7,000 enterprises before and after Ukraine's Orange Revolution—a moment of largely unanticipated political turnover in a country with profoundly weak institutions. We find that the productivity of firms in regions that supported Viktor Yushchenko increased after the Orange Revolution, relative to that of firms in regions that supported Viktor Yanukovych. Our results illustrate that the efficiency consequences of turnover can be large when institutions are weak.

Introduction

Politics in much of the world is a winner-take-all contest. When Viktor Yanukovych fled Kyiv in February 2014, for example, he was joined by a close group of associates overwhelmingly drawn from the country's Russian-speaking East, including Yanukovych's home region of Donetsk. The governors who ran Ukraine's regions under Yanukovych fared no better. Oleksandr Turchynov, who served as acting president from February to June of that year, did what all Ukrainian presidents do: he fired the existing governors and replaced them with figures friendly to the new regime.

What is the impact of such political turnover on economic performance? In principle, replacement of political elites can have profound consequences for enterprise owners and managers, who rely on the support of patrons in government for government contracts, direct and indirect subsidies, the security of property rights, and permits to do business. In a system without effective checks and balances, economic policy can also swing widely as power passes from one group to another. Yet little is known about the impact of such changes on firm productivity, a major driver of economic welfare.

We examine the impact of political turnover on productivity and other aspects of firm performance in "The Productivity Consequences of Political Turnover: Firm-Level Evidence from Ukraine's Orange Revolution" (Earle and Gehlbach, 2015). Our main finding is that the productivity of firms in regions that supported Yushchenko, the eventual winner of the 2004 presidential election, increased after the Orange Revolution, relative to that of firms in regions that supported Yanukovych, the chosen successor of incumbent President Leonid Kuchma. These results demonstrate that political turnover in a context of weak institutions can have major efficiency consequences as measured by differences in firm productivity.

Ukraine in 2004

Three factors make Ukraine in 2004 an appropriate setting for identifying the effect of political turnover on economic performance. First, Ukraine under Kuchma was a paradigmatic case of "patronal presidentialism," in which the president "wields not only the powers formally invested in the office but also the ability to selectively direct vast sources of material wealth and power outside of formal institutional channels" (Hale 2005, p. 138). Who won the presidential contest had enormous implications for economic activity.

Second, economic and political power was regionally concentrated in Ukraine's Russian-speaking East—Yanukovych himself was closely affiliated with oligarchs in Donetsk—while the political opposition represented by Yushchenko had its base in the ethnically Ukrainian and less industrialized West. Voting in Ukraine's 2004 presidential election reflected this regional divide.

Third, few gave Yushchenko much chance of winning the presidency until the presidential campaign was well underway. In the end, it took not only a highly contested election, but also sustained street protests to wrest power from the existing elite.

Together, these considerations imply not only that political turnover in Ukraine could have an impact on firm performance, but also that any such effect could be observed by comparing the performance of enterprises in regions supportive of the two candidates before and after Yushchenko's unexpected election victory.

The Orange Revolution and Firm Performance

To analyze the impact of political turnover, we use data on over 7,000 manufacturing enterprises that we track over many years, both before and after the Orange Revolution. We compare the evolution of productivity across firms in regions by vote in the 2004 election that was won by

Yushchenko, while controlling for any shocks to particular industries in any year, for constant differences across firms in the level or trend of their productivity, and for regional differences in industrial structure. This design avoids many of the other influences on firm-level productivity that might have coincided with the Orange Revolution.

Our primary finding is that the productivity of firms in regions that supported Yushchenko in 2004 increased after Yushchenko took power, relative to the productivity of firms in regions that supported Yanukovych (and, implicitly, his patron Kuchma, whom Yushchenko succeeded as president). This effect is most pronounced among firms that had the most to gain or lose from presidential turnover: firms in sectors that rely on government contracts; private enterprises, given Ukraine's weak property rights; and large enterprises. Other measures of economic performance suggest that these results are driven by favorable treatment of particular firms, either before or after the Orange Revolution, rather than by broad changes in economic policy.

Conclusion

Political turnover is often desirable. Nonetheless, our results suggest that the distributional consequences can be profound when institutions are weak, that is, when access to those in power is the primary guarantee of market access, contract enforcement, and property-rights protection. Oscillation of privilege from one region or sector to another is inefficient, as firms initiate or postpone restructuring based on who is in power. The optimal solution, of course, is not to restrict turnover, but to make turnover safe for economic activity. This requires that institutions be reformed to guarantee equal treatment for all economic actors—a difficult process that has proceeded with fits and starts in post-Yanukovych Ukraine.

References

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