Introduction

In 1990 Aleksander Gudzowaty chartered a plane, filled it with cheap consumer goods and Polish fashion models, and flew to Siberia for a meeting with an old acquaintance, the chairman of the Russian natural gas supplier Gazprom. When Gudzowaty returned ten days later, he approached the heavily indebted Polish government as the sole mediator with which Gazprom would negotiate gas supplies to Poland. Poland depended on the Russian natural gas supplied by Gazprom and earned a substantial income from transit fees on gas headed west through the Yamal pipeline, but it found itself in constant negotiations over its gas debts. With winter approaching and Poland's gas supply threatened, the Polish president had to accept the businessman's terms: a percentage fee on all natural gas arriving in and transiting through Poland to western Europe. By taking a remarkable gamble and banking on his connections, Gudzowaty became Poland's first overnight dollar billionaire.

Gudzowaty began to invite a coterie of powerful new friends to visit his walled and heavily guarded home—complete with a private zoo and glass meditation pyramid—in a forest outside Warsaw. Although his first move toward wealth had depended on the protection of foreign patrons, he quickly understood that political allies at home were a key element of any future success in the highly uncertain market environment. As Poland began to practice democracy in fits and starts, Gudzowaty started to finance acquaintances from before 1989 who had entered the new left political party, the Democratic Left Alliance (SLD); to hire former bureaucrats as executives of his holding company;[1] and to purchase shares of other firms. He did not hide his support of the left and openly admitted to good relations with the SLD. He routinely used these contacts to influence regulatory policy and the legislative agenda.

[1] His company, Bartimpex, reportedly employed seventeen former ministers.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

The party system was sharply divided between the post-communist SLD and the anti-communist Solidarity coalition. Thus, at each change of government, Gudzowaty had to re-evaluate his position and work to maintain the material and legislative goods he had obtained. He became known as a close ally and supporter of the SLD and was received as an almost holy figure at the annual party congress – a strange relationship between a gas magnate and a supposedly social democratic party. Party finances were opaque but it was alleged that he contributed millions of dollars to each campaign.[2] When the SLD was in opposition, his business fared less well, and his ability to participate in privatizations and government contracts suffered because right-wing politicians spoke against his plans and favored other businesspeople. When asked in an interview in 2000 about his ties to political parties, he said: "With the last [left] government we had good contacts. This current [right] government, of Mr. Buzek, is simply aggressive toward us and we have constant conflicts with it. We try to use state institutions – courts, the prosecutor's office – and nothing works out."

The ties of businesspeople to parties remained stable over the first decade and a half of reform. In 2006, when changes in the party system seriously weakened the left, Gudzowaty tried to shift alliances, but with only limited success. In an attempt to distance himself from his old allies, he leaked tapes of a private conversation with the former SLD prime minister, Josef Oleksy, about dealings between politicians and businesspeople. In that discussion, Oleksy told Gudzowaty that the Polish president, Aleksander Kwasniewski, had established "political capitalism" in Poland and cultivated a group of insider businesspeople who supported the left.

By "political capitalism," Oleksy meant that there existed a cohort of businesspeople who were closely allied with political parties and depended on their support for business success. In fact, Gudzowaty operated among a group of such businesspeople. They did not form a strong, united front to speak with one voice, but they were recognized as businesspeople who had benefited from ties to left politicians and were, consequently, eager financial supporters. Similarly, they had all created relationships of reciprocal benefit and commitment with politicians. Their wealth depended on these ties, which allowed them to participate in privatizations, win government contracts and licenses, and influence laws and regulations when the left was in power. And they all actively sought to employ former bureaucrats, ministers, and elected officials to strengthen their ties to government. In other words, "political capitalism"

[2] Until recently there was only anecdotal evidence of Gudzowaty's contributions to the left, because party budgets provided no detail of such contributions in Poland. In March 2009 documents surfaced detailing the transfer of 3 million złoty from Gudzowaty's companies to the SLD (*Rzeczpospolita* 2013). Gudzowaty himself confirmed these donations (*Newsweek Polska* 2009). And Marek Belka, long-time SLD member and future prime minister, sat on the supervisory board of one of the donating companies (*Newsweek Polska* 2009).

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

was a headline-grabbing label for the embeddedness of the polity in the economy. What Oleksy failed to observe was that Poland exhibited only one of the varieties of embeddedness emerging across the region.

In this book, I examine the emergence of different varieties of links between the polity and the economy: the network relationships between businesspeople and political actors that have emerged across the post-socialist world. In Poland, networks between economic and political elites have been a key component of robust economic development and the emergence of broadly distributive, as opposed to selective advantage, institutions.

I define institutions as "the rules of the game in a society or, more formally, . . .the humanly devised constraints that shape human interaction" (North 1990: 3). More specifically, "[i]nstitutions are relatively stable sets of widely shared and generally realized expectations about how people will behave in particular social, economic and political circumstances. Expectations structure behavior by informing individuals about the likely consequences of alternative courses of actions" (Weimer 1997: 2). I focus on formal institutions, which set out these expectations in rules enforced by the state. "Broadly distributive" institutions are those that distribute benefits to broad segments of the affected population, such as whole classes or types of actors. Such institutions are the result of policy making that does not deliver selective advantages and rewards supporters only indirectly (Kitschelt 2000: 849–50). These institutions may provide club or collective goods but they do not bestow private benefits. Further, the redistributive consequences of these institutions are applied regardless of whether an actor supported the party initiating a particular institutional reform. By contrast, "selective advantage" institutions distribute benefits to targeted recipients, and only those who engage in the quid pro quo with political actors receive the benefit. The purpose of this book is to explain the effect of network ties between the political and economic sphere, as well as the effect of uncertainty, on the emergence of broadly distributive institutions.

The negotiated nature of the Polish transition – accompanied by the widespread belief that no single party would dominate post-socialist Polish politics – set Poland on a particular trajectory of political capitalism. As in the case of the SLD, the parties that emerged on the right from the Solidarity movement also sought economic allies. Beginning with Lech Wałęsa's first presidential campaign, parties sought a-legal donations to increase their chances of winning. They found allies in the likes of Jan Kulczyk,[3] partial owner of the privatized telecommunications company TPSA, who had strong ties to the parties on the right.

[3] Kulczyk was selected as the buyer of the important Lech and Tyskie Breweries by the privatization minister, Janusz Lewandowski, in the center-right government of Hanna Suchocka. He was also selected in partnership with France Telecom for exclusive negotiations in the privatization of the Polish telephone company TPSA under the Solidarity government of Jerzy Buzek.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

Politicians also frequently sought out ties with businesspeople, particularly when their parties depended on business as a source of political finance. The linkage of politics and business was initially very direct. Quite quickly, however, the opportunities for the direct political creation of firms disappeared; they constituted too great a liability for Polish politicians. Instead of politically creating firms, politicians from all parties sought to acquire political control of privatized firms by staffing corporate boards with the party faithful. This became another source of revenue for political parties in addition to the financial support of individual business owners. One by-product of this broad enmeshing of politics and business was that political responsiveness to business interests and effective business regulation came to be in the interest of political elites.

Across post-communist Europe businesspeople and politicians eyed each other as possible allies or resources to different extents. The central place of ties between politicians and businesspeople in the Polish economic transformation is surprising, however, given the emphasis placed on rapid reform in explaining Poland's early emergence as one of the best-performing post-communist countries. The prominence of networks thus challenges the traditional explanation for Poland's success: relatively rapid progress on privatization and economic reform that established functioning markets (Lipton and Sachs 1990b; Sachs 1994; Åslund 1995) and allowed firms to operate with little regulation (Shleifer and Vishny 1998; Frye 2010) while disrupting pre-1989 social networks.

In this book, I re-examine both paradigmatic success stories and frequently cited laggards of political and economic reform in post-communist Europe between 1989 and 2005, by focusing on the neglected role of networks between firms and political parties. My goal is to explain the role of networks and uncertainty in the emergence of broadly distributive institutions in the region. The combination of business and politics was by no means peculiar to Poland or members of the former Communist Party. In the Polish case, however, the purpose of bringing together the two spheres – economy and polity – was quite different from what it was in many other countries, due to the intensity of Polish political competition in the early 1990s. Polish businesspeople sought to secure their place in the economy and approached politicians to offset some of the uncertainty that the early period of transformation to capitalism entailed. Their political counterparts, faced with sharp electoral competition, sought to increase their chances of victory at the polls. Both groups recognized that the changes that began in 1989 would completely change their understanding of politics and the economy, but no one knew exactly how. Because so many different actors were involved, no one could hope to control the process or its outcome.[4]

[4] Ostrom refers to such contexts as "unstructured problems" in which individuals are at best engaged in a "trial and error effort to learn more about the results of their actions so that they can evaluate costs and benefits more effectively over time" (Ostrom 1990).

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

In an attempt to offset the uncertainty inherent in periods of massive social change, politicians and businesspeople forged networks of social ties, political financing, and favors. In addition, party members moved between political organizations, jobs in the state bureaucracy, and positions in the private sector. The networks linking the polity and the economy grew deeper over time, and with each passing year the links between a particular political party and their business allies grew more intense. As on K Street in Washington, and in many other capitals of established democracies, these businesspeople provided jobs to former party officials and politicians in exchange for access.

There is no question that the first two decades of transformation in Poland were marred by corruption between businesspeople and politicians, as they were in all post-communist countries.[5] Blame was placed on everyone from the socialist *nomenklatura* after 1989 to the new "nomenklatura," composed of elite members of the former opposition, the secret services, lobbying and pressure groups, and "networks" (Żakowski 2009).

Instead, however, in the context of strong networks between the state and business, broadly distributive institutions emerged in Poland. This outcome was not a given, as the trajectories taken by the two other case studies in this book, Bulgaria and Romania, clearly demonstrate. Hence, I seek to understand how the configuration of networks determined the institutional trajectories of post-socialist states. The three basic questions of this study are as follows. Why do networks among firms and between politicians and firms emerge? Why did variation emerge in the types of networks and in relationships between the state and the economy? And what is the relationship between networks and institutional development?

I develop the argument in greater detail in the next chapter. Briefly, I argue that the structure of networks and the level of uncertainty within which these networks operate shape the incentives of elites to act collectively. Networks emerge to fill the space left by incomplete institutions. Broad networks link cross-sectoral coalitions and thus facilitate collective action. The effect of uncertainty on collective action depends on the type of network present. Under high levels of uncertainty, cooperation emerges if networks are broad, because information flows and the threat of damage to reputation undermine defection from agreements between politicians and businesspeople. Under high levels of uncertainty and narrow networks, parties are weakened by high levels of competition and are unable to credibly commit to agreements with business because the narrow network makes their defections hard to detect, and uncertainty lowers the value of their promises. The result is that cooperation between firms and parties is unlikely, and, consequently, business can prey directly on the state. Under low levels of uncertainty and narrow networks, dominant political elites, safe from the threat of political competition, exploit atomized

[5] Corruption here means illegal or a-legal exchanges between these groups.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

firms. Under low levels of uncertainty and broad networks, dominant political elites enter into collusive relations with firms.

These findings challenge the traditional view by suggesting that broad networks are not anathema to the emergence of broadly distributive institutions. To the contrary, in conditions of widespread uncertainty, networks are necessary for the development of broadly distributive institutions. Chapter 2 develops a theory of how networks function dynamically in times of widespread institution building, how network variation shapes institutional development, and why network variation emerges.

The starting point for this analysis is identifying the distinctive features of Poland in comparison to other post-communist countries. As will be explored in more detail in the pages below, Poland stands out because the networks widely blamed for post-communist corruption were broad at all levels of society. These networks made possible the gradual institution building that took place.

Two types of network are examined in this book. First, Polish ownership networks were much broader than those in other countries, meaning that firms in many different sectors were joined in a horizontal web linking state firms and private firms. Ownership cross-holdings are a common way for firms to enable credible commitments when institutions are still incomplete or when the complexities of market activity are such that contracting cannot cover all contingencies in a practical fashion (Williamson 1985; Gerlach 1992).

Second, Polish personnel networks – those created among the individuals who hold high-level positions within the same organization – included many more individuals than those in other post-communist countries. This came about because appointments were highly politicized in Poland, with the result that high-level employment experienced significant turnover after every election that brought about a shift in the ruling party. These personnel networks spanned the state and the private sector. They had a sharp partisan logic, as bureaucrats and private individuals often depended on party support to obtain elite positions. Although changing jobs frequently imposed regular start-up costs on individuals, it also limited the length of time any one person spent in a particular position of power, increased the level of connection among the elite, and thereby produced another key form of state–economy embeddedness.

As a result of Poland's broad networks, political and economic elites looked to the long run: they all knew their fortunes did not lie in maximizing short-run benefits but, rather, in working within lasting political structures. Alternation in power of the two largest coalitions – center-left and center-right – held for the first four fully democratic elections, in 1991, 1993, 1997, and 2001. Business elites realized that short-run benefits might be fleeting and defecting from a party could lead to future punishment. In contrast, lasting alliances were likely to deliver long-run benefits, even if those benefits were unavailable when the allied party was out of government. They also had invested into developing relationships with political allies that were not so easily shifted to the opposing

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

political side. The alternation of parties in power alone was not sufficient to realize coordination, however. Only because networks connected a large group of firms and politicians, providing many points of contact and creating a web of mutual obligation and commitment, were political and economic actors able to focus on the long term. No one group of businesspeople could coordinate to steer the process of institution building in its own direction, because networks included too many different firms with too many disparate interests.

Thus, instead of pushing for narrow, selective benefits, firms and parties eventually sought to turn over power to broadly devised institutions and to empower the state with decision-making authority through a series of compromises. This state functioned both by command and by adjudication, mediating between various competing interest groups that would otherwise face a stalemate. In the process, stakeholders developed a functioning competition policy, built financial institutions and regulation, reformed banking policies, and developed a comprehensive corporate governance system before neighboring countries managed these feats. Polish financial law was more effective in 2000 than financial law in almost all the other countries in the region (Sanders and Bernstein 2002). Corporate governance law more closely approached international standards for the protection of shareholder rights than that of any country in the region. Poland was even comparatively successful in developing a framework to regulate lobbying relations between business and politicians.

Evidence that networks drove this process appears in the surprising persistence of network-based economic activity in an otherwise rapidly developing liberal institutional context. According to a 2005 survey, of all the Balkan, Baltic, and east European countries, Polish firms were most likely to turn to collective associations to resolve disputes with other firms (EBRD 2005b). According to Williamson (1985: 166), recourse to dispute resolution mechanisms other than courts is a key signal that credible commitments are a cornerstone of inter-firm relations and play a larger role in market relations than is customarily recognized. Polish firms also used network-based sources of capital as a primary form of credit (EBRD 2005b). In the first two decades after 1989 Poland underwent a great deal of institutional change in the context of broad networks that played a central role in the day-to-day ability of firms to navigate an uncertain environment. Broad network ties enabled firms to make credible commitments and forge broad coalitions with political actors. The cooperative relationship that developed between business and politics determined the trajectory of Poland's institutional development.

Not all countries fared so well; most much more closely resembled the stereotypical "wild East" that we have come to associate with the post-communism era. For the sake of illustration, the next pages briefly contrast the case studies discussed at greater length later in this book.

In sharp contrast to his Polish colleagues, the Bulgarian businessman Ilya Pavlov, who ranked among the ten richest men in eastern Europe until 2003,

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

had a different impact on institutional development. Pavlov was a well-known wrestler (Bulgaria was an international leader in the sport) who married the daughter of the last communist secret police chief. He was well acquainted with high-ranking party officials and members of the military and security services. As the communist regime was unraveling, Pavlov and others like him – many of them emerging from professional sports circles, the military, and the secret police – began to take part in foreign trade. Pavlov founded a company called Multigroup that, formally, dealt in the import and export of art, although it quickly expanded to trade in other products. Multigroup established a bewildering array of shell companies in offshore tax havens, making it impossible to trace the company's structure. It used these shells and the vast resources the company quickly acquired to avoid the control of the state – even flying products directly out of Bulgaria without submitting to customs procedures (Ganev 2001: 15).

The methods employed by Pavlov and a group of other businesspeople blurred the lines between (semi-)legitimate business activities and mafia methods. They formed companies with names such as Alpha and Beta and business groups such as VIS-2[6] that traded small arms to developing countries, captured the privatizations of large resorts, offered insurance and private security services, and fought among themselves over the division of Bulgaria's valuable tourist infrastructure and industry. As they came to control banks, hotels, and heavy industry, Bulgaria was rocked by car bombings and contract killings of businesspeople in broad daylight. In 2000 the capital, Sofia, averaged three per week. The interior minister even publicly stated that the police were powerless to do anything, but that normal people should not be concerned because the killers were conscientious and rarely involved innocent bystanders. As violence became part of the standard toolkit of business, it ultimately consumed even Pavlov – several times named "Bulgarian businessman of the year" and ranked the eighth wealthiest man in central and eastern Europe – with a single bullet to the heart outside Multigroup's headquarters in 2003.

The business groups behind this violence were in a position of asymmetrical force and influence. Rumors that they had infiltrated the police, the military, and the state bureaucracy were plausible, given the lack of energy with which contract killings, bombings, and illegitimate business deals were investigated.

Pavlov and his cohort show how, despite internal conflicts among business leaders, a small group was able to use its strength to influence the political scene. Bulgarian parties, in effect, became clients of a narrow field of businesspeople. In this context, businesspeople had no interest in creating pacts with politicians and found it difficult to sustain alliances among themselves. Networks among firms and members of the state bureaucracy, as well as those between businesspeople

[6] VIS-2 was a successor company to VIS-1, which was blacklisted by the government for selling insurance to owners of expensive Western cars in what was alleged to be a protection racket.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

and politicians, were much less broad than in Poland and offered fewer points of contact. As a result, businesspeople did not have the same network assets to negotiate broad institutions with a view to the long term. Competition policy remains poorly developed in Bulgaria, and low enforcement capacity means that even the weak existing institutions of market regulation function poorly. Moreover, secured transaction law that regulates the risk of giving credit does little to protect creditors, because influential interests have managed to block institutional development. Despite intense pressure in the process of EU accession, business elites and politicians operate in a highly uncertain environment based on domination, without the network ties that create webs of joint obligation or mutual reassurance, and large areas of the state remain under the influence of narrow, mafialike groups (Andreev 2009).

Romania's transition set in motion yet a third dynamic. One dominant party emerged out of the jarring revolution of 1989 as a national unity government: the National Salvation Front (NSF). The central actors of the NSF subsequently dominated Romanian politics through a new umbrella party, the Party of Social Democracy of Romania (PDSR),[7] which lost its first election, in 1996, to an ineffectual opposition party that spent most of its mandate on internal squabbles. The PDSR, renamed as the PSD in 2001, returned in 2000 to further dominate Romanian politics until 2004. Romanian business elites grew out of this milieu dependent on political support. In turn, they provided financial support to the NSF and PSD. To limit financial extraction, however, some business elites attempted to develop a margin of autonomy by forming their own satellite political parties with strange names and obscure platforms, such as the vaguely liberal Humanist Party and the nationalist New Generation. These personal parties brought their business sponsors some attention and limited autonomy from PSD politicians. In turn, personal parties served the PSD by taking voters from opposition parties by offering similar platforms. For example, the Humanist Party, founded by one of Romania's wealthiest men, Dan Voiculescu, brought votes and the support of Voiculescu's television station to the PSD from 2000 to 2006.

Although this strategy was available only to a few, it contributed to fragmenting the business community and prevented the development of organizations. Networks of cross-ownership were weak and firms rarely shared directors. As a result, institutions were poorly developed until the intense pressure of the EU accession process generated a significant degree of business regulation. At that time, progress was made in the reform of banking law, and the state of secured transaction law improved. Overall, the level of institutional change lay somewhere between Poland and Bulgaria, but networks between firms tended to be weak.

[7] I refer to this party throughout the text as the PSD – its current name – to indicate also the period when it governed as the PDSR.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

Thus, three sharply different forms of the business–politics relationship emerged in Poland, Bulgaria, and Romania. In Poland, collaborative exchanges between two politically allied sets of business elites and their political sponsors defined the first two decades of struggles over reform, with the effect of a gradual consolidation of state power. In Bulgaria, the dominance of a narrow group of business actors over politicians undermined the development of broadly distributive institutions. In Romania, the dominance of political actors similarly failed to support the development of institutions.

The divergence between these cases points to the role that networks play in reducing uncertainty and complementing the development of institutions. The absence of such networks limits the extent of collective action by promoting the interests of narrow coalitions. By contrast, broad networks allow cross-sectoral coalitions to emerge. Thus, broad networks are crucial for the development of collective action and a necessary but not sufficient condition for the emergence of broadly distributive institutions (which additionally require the condition of widespread uncertainty).

The next chapter reviews relevant contributions in the literature and then moves to develop a theory of how networks affect the emergence of broadly distributive institutions. Before moving to that task, the next section reviews alternative explanations of post-socialist state development.

Traditional explanations of variation in institutional development are largely the product of a long-standing debate between two camps: those who feared widespread popular opposition to painful reforms and those who believed that powerful insiders would impede restructuring or even seek to stall reform. Concern about the political sustainability of reform was one of the motivations behind a lively literature about the appropriate speed of economic reform (Fischer and Gelb 1991: 104). Those who worried about a popular backlash and the sustainability of reform and saw benefits to a piecemeal approach viewed a gradual set of policy reforms as the best way to transform the state socialist economies into dynamic market economies (Portes 1990; Roland 1991; McMillan and Naughton 1992: 141; Dewatripont and Roland 1992a: 292; Aghion and Blanchard 1994; Dewatripont and Roland 1995). Those who feared bureaucrats and insider interests would try to block reform viewed rapid reform or "shock therapy" as a way to kick-start market economies (Lipton and Sachs 1990a; Frydman and Rapaczynski 1994; Sachs 1994; Åslund 1995; Hellman 1998).[8]

Even the brief comparison of Bulgaria, Romania, and Poland brings into question the standard explanations for differences in developmental trajectory

[8] As Dewatripoint and Roland point out, some authors took a mixed position, seeing the need for a shock approach on some dimensions and a gradual approach in others. For example, most economists agreed that measures to bring about macroeconomic stabilization should be adopted rapidly but diverged on liberalization, privatization, and the pace of firm restructuring (Dewatripont and Roland 1995).

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

in the post-socialist region. To better understand the institutional development of these countries, this book focuses on the role of elite agency as shaped by network structure and uncertainty. I argue that the differences between these countries are better explained by a combination of social network structures and political factors, specifically levels of political uncertainty. Therefore, this book takes a different approach from the broader literature, and instead builds on the work of some scholars who have explored how networks in post-socialism served as resources during the transformation, and those who have also explored how political competition has promoted institutional development.[9] This book brings these elements together, however, to identify the conditions under which networks running between political and economic actors can, in the context of high levels of competition, support the development of broadly distributive institutions.

The approach presented in this book developed as a response to scholarship that has focused on the speed of reform. The following section explores this existing scholarship on post-socialist reform to situate and substantiate the alternative proposed here.

I also discuss two other alternative explanations. First, scholars have argued that some countries had a better chance in the reform process on the basis of various legacy effects and a history of contact with cultural or physical proximity to the West (Jowitt 1992; Hanson 1995; Jowitt 1996; Ekiert 1999; Kopstein and Reilly 2000). Second, as countries in post-socialist Europe began to negotiate the possibility of joining the European Union, scholars began to study the impact of such external actors and the conditions they imposed on the speed of reform in candidate countries (Moravcsik and Vachudova 2003; Vachudova 2005; Ekiert, Kubik, and Vachudova 2007). This "conditionality," as it became known, is a potentially important alternative factor that may have pushed countries along, and it thus merits discussion as an alternative explanation.

SHOCK THERAPY VERSUS GRADUALISM

Even before the political transition to democracy began in 1989 scholars had begun to consider how experiments with reformed socialism that introduced elements of markets would impact the institutions of state socialism and shift the sources of power and privilege (Kornai 1986; Stark 1986; Szelenyi 1988; Nee 1989). After 1989, as policy makers and academics began to consider how to create market economies in the region, a heated debate about the reform process developed in the literature. A central question of this debate focused on

[9] For examples of the network approach, see McDermott (2002) and Stark and Bruszt (1998). Grzymała-Busse (2007), O'Dwyer (2006), van Biezen and Kopecky (2007), and Woodruff (2009) are examples of scholarship on the role of political competition.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

the appropriate speed of economic reform. Opposing sides embraced so-called "shock therapy" and "gradualism." The speed of the transformation was central, because each side attached negative consequences to the other's recommended pacing of reform.

Advocates of shock therapy contrasted it with a "muddling along" approach to reform and argued that the only way to create prospering and successful market economies was to carry out reforms quickly (Sachs and Lipton 1989; Lipton and Sachs 1990a). The advantages of the "shock program," as it was initially called, were both economic and political. Supporters argued that, from an economic standpoint, shock therapy would bring a return to growth sooner, generating a sustained rise in standards of living (Sachs and Lipton 1989: 1). It developed out of Sachs' experience in Latin America, and he and Lipton advocated this approach as advisors to Solidarity in 1989. The program began with price liberalization, which had the advantage of bringing macroeconomic stability by controlling inflation, reducing dangerous shortages in retail goods, and creating stable exchange rates. Price liberalization would also eliminate the distortions in investment that plagued command economies. In addition, it was supposed to reduce the costs of foreign debt and inspire confidence, which would make foreign loans and investment available. Price liberalization was to be accompanied by rapid reforms to remove obstacles to private sector activity, and privatization. Altogether, these moves would rapidly increase the allocative efficiency and raise productivity, albeit at the cost of massive layoffs and labor reallocation (Dewatripont and Roland 1992b).

Although there were several parts to the program, privatization was at its core. Describing the consensus approach to reform of post-communist societies in the early 1990s, Zinnes, Eilat, and Sachs (2001: 148) state,

> [T]he linchpin of transition was to transfer ownership of the firms in the economic sectors to private hands – and to do so as fast as possible. Once in private hands, a series of self-reinforcing, virtuous, though self-interested, forces would emerge to demand the creation of all the institutions required for private ownership, thereby locking in the market economy.

This "stakeholder lobby" theory was the political argument for shock therapy. It claimed that the privatization of public assets was a policy that would move the reforms in the desired direction because these new owners of private property would then become the lobby that pushed for the development of market-supporting institutions (Fischer and Gelb 1991: 95; Shleifer and Vishny 1998: 10–11). Underpinning shock therapy was the idea that the ownership of private property would promote the articulation of demands for market-governing institutions.

Sachs and Lipton anticipated that privatization would begin with small enterprises, which could be privatized quickly, and move on to the more

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

complicated large privatizations as soon as practicable. They also advanced a strategy for rapid large-scale privatization, however (Lipton and Sachs 1990a). As the privatization of large enterprises could take some years, Fischer advocated removing enterprises from the control of ministries and establishing them as independent entities with their own management in the interim (Fischer and Gelb 1991: 98). Fischer's addition highlights the importance attached to creating independent stakeholders in these new market economies. Separating the state from the economy, it was hoped, would also reduce government budgets by removing state-owned enterprises from them, and perhaps create new avenues to power and prestige (Nee 1989: 679). The shock therapists answered the criticism that these measures were too dangerous and would lead to a backlash against reform by saying that there was no other option (Sachs and Lipton 1989: 3).

The stakeholder lobby argument was based on the perceived harmful role that insiders and state actors can play in the reform process. Managers of firms had been recruited on the basis of loyalty to the Communist Party and lacked the technical skills to manage firms properly while operating in an environment lacking an adequate system of corporate governance (Lipton and Sachs 1990b: 314). These insiders might organize to extract concessions from the state, derail the reform process, and engage in a lengthy battle over the terms of privatization. Given their economic power, they might also attempt to influence state actors directly. When shock therapy was pursued a rapidly created large private sector would marginalize insiders and bureaucrats, creating larger sets of stakeholders using the "honeymoon period" after 1989 to quickly push through irreversible reforms (Svejnar 1989; Lipton and Sachs 1990a: 87–9; Sachs 1994; Åslund 1995; Boycko, Shleifer, and Vishny 1995; Johnson and Loveman 1995).

Privatization, preferably using a method that quickly distributed as many shares as possible to outsiders, was seen as a necessary step because it would limit state interference, impose hard budget constraints and private market signals on firms, and thus root out insider interests (Lipton and Sachs 1990b; Sachs 1994; Aghion and Blanchard 1998). Partial reform, by contrast, would produce "early winners" who could stall further privatization and reform to reap the economic benefits of the initial stages of transformation (Hellman 1998). This position was strengthened as the planning structure collapsed, leaving behind a large and directionless state-owned economy and firms that were often no longer under state control but in the hands of insiders with inadequate resources and abilities to carry out restructuring (Lipton and Sachs 1990b: 314; Aghion and Blanchard 1994: 287; Aghion and Blanchard 1998: 89). One of the reasons that rapid privatization would lead to both economic growth and political development, according to the shock therapists, was that it would free the state of actors linked to it by distorted incentive structures and create a large set of "outsider" stakeholders committed to going forward and developing institutions that supported the market (Shleifer and Vishny 1998: 10–11).

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

Gradualists, on the other hand, argued that shock therapy ignored the political realities and potential economic effects of the reform process. Prominent advocates of this view did not disagree on the destination of reform but envisioned a different "road" (Kornai 1986: 1715–24, 1728–30; Kornai 1990). Again, there were both political and economic arguments. Politically, gradualists argued that the extreme individual and aggregate uncertainty about what the future held could lead to popular opposition to rapid reform precisely because of the high reversal costs that shock therapists viewed as an advantage (Dewatripont and Roland 1995: 1208). A slower pace would instead allow policy makers to rack up some initial reform successes, building support for further reform among those who would need to approve the process. As reforms took place, the status quo ante would increasingly look less attractive than the outcome of a reformist policy (Roland 2002). Partial reforms would thus build support along the way for further reform. Partial reforms are also more acceptable since they are perceived as reversible and may be less costly in terms of compensation payments to losers in the process (Dewatripont and Roland 1995; Roland 2002: 33). And gradual reforms permit a "divide and rule" approach to reform in which governments can build coalitions with different groups affected by reforms instead of facing widespread opposition to rapid reforms that are opposed by a majority (Dewatripont and Roland 1992b: 721).

Gradualists also argued that shock therapists underestimated the budgetary costs of the compensation that would make restructuring acceptable to workers (Dewatripont and Roland 1992a: 292). As such, it had the potential to undermine the return to growth (Portes 1990; Roland 1991; Dewatripont and Roland 1992a: 292; McMillan and Naughton 1992: 141; Aghion and Blanchard 1994; Roland 1994; Dewatripont and Roland 1995; Roland 2002). Kornai argued that reform programs should focus on transferring firms to better owners and developing good corporate governance instead of emphasizing a quick transfer out of state hands (Kornai 1990).

The post-communist state was viewed quite differently by each approach. Shleifer and Vishny drew attention to the potential for states to disrupt the reform process by engaging in pathological behavior (Shleifer and Vishny 1998). Their "grabbing hand" approach attempted to identify ways to prevent government officials from turning to predatory behavior, which they identified as the cause of poor growth. Consequently, they argued that depoliticizing the economy was one of the priorities of the reform process and privatization one of the key tools to achieve it. This view was based on the perception that post-communist states had the ability to meddle with the economy. Political scientists, however, pointed out that post-socialist states were often weak and in need of rebuilding. In other words, the problem was not an excess of predatory or other kinds of state intervention but a lack of state capacity (Grzymała-Busse and Jones-Luong 2002). In the worst cases, this lack of capacity allowed private actors to overrun the state (Ganev 2001; Hellman,

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

Jones, and Kaufmann 2003; Ganev 2007). By contrast, some scholars found that, when bureaucracies were more developed, states could play a crucial role in helping firms adjust to the post-reform economic conditions. For example, in a comparison of Russian regions, Brown, Earle, and Gehlbach (2009) found that, when bureaucracies were larger, privatization was more successful and firms more productive.

This discussion cannot cover all the intricacies of the debate, and my goal in discussing this literature is not to resolve the shock therapy versus gradualism debate. Others have already suggested that the emphasis on speed was misplaced (Kolodko and Nuti 1997; Kolodko 1999; Kornai 2000; Popov 2000; Zinnes, Eilat, and Sachs 2001; Popov 2007). Consequently, the central issue of relevance to my argument is the contention that fast reform, particularly rapid privatization and the marginalization of insiders, would yield better outcomes by undermining attachments to the status quo, distancing the state from the economy, and scrambling old networks. The main claim of interest here – that of the stakeholder lobby theory – proposes that the emergence of private owners would promote the development of institutions.

Numerous scholars have raised questions about this argument since it was proposed. They point out that private owners may, in fact, oppose the emergence of market institutions. For example, Hoff and Stiglitz (2002: 38) argue that uncertainty about the impact of the future legal regime may lead insiders to postpone its development or avoid making demands for it altogether. This applies both when privatization puts ownership in the hands of insider oligarchs and when property is distributed widely (Hoff and Stiglitz 2002). Black, Kraakman, and Tarassova (2000: 1753) have similarly shown that privatization did not generate demand for institutional reform because company owners and "kleptocrats" instead opposed efforts to strengthen market rules and push forward with reform after an initial, partial, market opening.

Data on the size of the private economy from the 1990s support the view that the "stakeholder lobby" theory does not account for differences between countries. The size of the private sector, shown in Table I.1, captures the emergence of new firms and privatized firms alike. Examining this data set shows that the supposedly detrimental economic effects of slow privatization are hardly borne out by evidence about the growth of the private sector. The quintessential success story of both growth and the development of institutions – Poland – generated the same percentage of GDP in the private sector as Albania, Hungary, and the Slovak Republic in 1995 and similar levels to Bulgaria and Romania,[10] which were extreme laggards in institutional reform, in 1996. Lithuania, Estonia, Hungary, and the Slovak and Czech Republics overtook Poland after 1995,

[10] In the Albanian case, this may be due more to the collapse of the state sector than the productivity of the private sector. In the other cases, however, the private sector grew as quickly as it did in the regional leader of growth and institutional reform.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

TABLE 1.1 *Percentages of private sector's share in GDP*

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Albania	5	5	5	10	40	50	60	75	75	75	75	75	75	75	75	75	75
Bulgaria	10	10	20	25	35	40	50	55	60	65	70	70	70	70	75	75	75
Czech Republic	5	10	15	30	45	65	70	75	75	75	80	80	80	80	80	80	80
Estonia	10	10	10	25	40	55	65	70	70	70	75	75	75	80	80	80	80
Hungary	5	25	30	40	50	55	60	70	75	80	80	80	80	80	80	80	80
Latvia	10	10	10	25	30	40	55	60	60	65	65	65	65	70	70	70	70
Lithuania	10	10	10	20	35	60	65	70	70	70	70	70	70	75	75	75	75
Poland	30	30	40	45	50	55	60	60	65	65	65	70	75	75	75	75	75
Romania	15	15	25	25	35	40	45	55	60	60	60	60	65	65	65	70	70
Slovak Republic	5	10	15	30	45	55	60	70	75	75	75	80	80	80	80	80	80
Slovenia	10	15	20	30	40	45	50	55	60	60	60	65	65	65	65	65	65

Source: European Bank for Reconstruction and Development (EBRD) "Structural change indicators."

and Poland's performance subsequently trailed many countries in the Baltics, central Europe, and the Balkans.

Traditional explanations thus made much more than was warranted of the impact of privatization while ignoring other factors. The trajectories of countries shown above suggest that privatization is likely part of a more complex dynamic governing the emergence of well-functioning institutions.

In arguing against the shock therapy approach, I do not wish to throw the proverbial baby out with the bathwater. By emphasizing the importance of steady progress with reform, the shock therapists identified the key issue of how emergent economic elites would act in an economic system caught between the opposing logics of state socialism and market capitalism. In other words, their emphasis on the articulation of demands for the development of market-governing institutions as a result of privatization was based on a conception of the reform process as a coordination problem. They worried about the effect elites would have on the future course of reform in the absence of privatization. The shock therapists also believed that, once established as private owners, they would be driven to cooperate in their demand for institutions.

While I have raised questions about the linkage between privatization and institutional reform, underlying this literature is an interest in how economic and state elites interact to push forward the development of formal institutions of government. The literature has yet to provide an account, however, that examines the effect of different forms of this interaction – various network structures linking officials and business leaders – on the development of post-socialist institutions. I propose that to provide such an account requires the incorporation of other factors, such as the context in which firms were being privatized, the role that the state and parties played as the ownership of firms was being transformed, and the availability of networks to help firms coordinate.

LEGACIES AND GEOGRAPHY

A second strand of literature focuses on the radically different historical legacies and the role of geography that, scholars argue, continues to influence decision-making processes and the functioning of institutions (Jowitt 1992; Janos 1993; Hanson 1995; Jowitt 1996; Panther 1997; Ekiert 1999; Kopstein and Reilly 2000; Winiecki 2004; Dimitrova Grajzl 2007). The argument is that certain legacies or proximity to the West lead to better outcomes than other legacies or geographic distance. It often hinges on one of the following factors: the perceived negative influence of Ottoman and Russian rule and the beneficial impact of Habsburg and Prussian institutions (Panther 1997; Winiecki 2004; Dimitrova Grajzl 2007); the continued salience of pre-communist differences (Janos 1993); the negative impact of Soviet influence (Jowitt 1992); the spread of norms via geographic proximity to the West (Kopstein and Reilly 2000); the positive influence of economic contacts

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

(Hanson 1995); or expectations of EU and NATO membership (Kopstein and Reilly 2000).

Essentially, the argument explains why east central European countries have developed the best-functioning states, whereas southern European countries perform progressively worse by appealing to one or more of these factors. Hence, the farther north one travels toward the Russian imperial borders, the better bureaucratically endowed and culturally advanced countries are, and hence the better they fared under communism (Panther 1997; Winiecki 2004; Dimitrova Grajzl 2007). Similarly, according to this argument, associational patterns – the extent to which political and bureaucratic actors are embedded in webs of obligation with societal interests – increase in southern countries, because such ties became part of the general social fabric and culture under the Ottomans and were much less prominent under the Hapsburgs and Prussians.

Two critiques undermine the legacies argument. First, the empirical validity of such arguments is questionable, as I show below. Second, that specific legacies can be identified as explanations for the characteristics of some later time period, in this case the institutional development of countries a century or more later, is far from clear.

The coming chapters show that the legacy argument does not predict where networks are important. In fact, the opposite of what we would expect is true: networks have developed much more broadly in Poland than in the southern European cases examined here. As such, the mechanism implied by the legacy explanations – that lasting cultural maps are transmitted across generations – is unable to account for the level of network development or the extent to which networks are used.

According to Mendelski (2008), such legacies do not explain well institutional development or any other related variable. In fact, the data in Table I.2 show that geographical features fail to account for variation in measurable outcomes such as progress in the development of institutions. The interactions between interest groups that have brought about these changes are counterintuitive. Table I.2 shows the complex patterns between imperial legacy, geography, and institutional development. The indicator shows the level of the EBRD reform index for six key areas of reform averaged over the first decade of reform and over the first fifteen years. To compare the longer-term trajectories of these countries, the yearly scores were averaged for the periods 1990 to 2000 and 1990 to 2005. Averages flatten sharp differences between countries that occur in any given year.[11]

[11] For example, in 1994 the Czech Republic scored significantly better for the development of securities market institutions than Hungary. The two countries changed places in the following year, however. Looking at the average score over time gives a general sense of both the speed and the extent of progress for the first decade and a half of reform.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

TABLE 1.2 *Imperial legacy and progress on reform*

Country	Principal imperial legacy	Average reform index 1990–2000[12]	Average reform index 1990–2005[13]
Albania	Ottoman	2.1	2.31
Bulgaria	Ottoman	2.43	2.67
Czech Republic	Austro-Hungarian	2.95	3.17
Estonia	Russian	2.73	3.03
Hungary	Austro-Hungarian	3.25	3.43
Latvia	Russian	2.56	2.83
Lithuania	Russian	2.49	2.79
Poland	Russian, Prussian, Austro-Hungarian	3.09	3.28
Romania	Austro-Hungarian, Ottoman	2.28	2.51
Slovak Republic	Austro-Hungarian	2.85	3.06
Slovenia	Austro-Hungarian	2.76	2.94

Source: EBRD.

The data confirm that imperial legacy fails to explain fully the different trajectories. There is significant variation among countries with the same imperial legacy. Neighboring countries such as Slovenia and Hungary, both former Austro-Hungarian territories, have taken significantly different paths. Bulgaria, which the Ottomans ruled with a particularly brutal hand, performs better than Romania and Albania. The Baltic states also progress at rates similar to those of the Czech Republic and Slovenia despite Russian imperial domination.

Some countries that today are unified were formerly split among imperial powers. Romania, which was split between Austro-Hungarian and Ottoman influence until independence in 1878, seems to lend support to the negative influence of Ottoman rule, although we might expect partial Austrian rule to lift it onto a better path than those countries that were subjects only of the Turks. As noted already, this is not the case. Poland, which ceased to exist after 1795 as the result of partition among three empires, performs second only to Hungary on the reform index, despite the negative influence of Russian rule,

[12] Average of EBRD country reform scores on enterprise restructuring, price liberalization, trade and foreign exchange, competition policy, banking reform and interest rate liberalization, and securities market and non-bank financial institution regulation.

[13] Average of EBRD country reform scores on enterprise restructuring, price liberalization, trade and foreign exchange, competition policy, banking reform and interest rate liberalization, and securities market and non-bank financial institution regulation.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

tripartite partition, and its difficult re-emergence from that experience, to become a unified state that was quite radically recomposed after both the First and Second World Wars.

The failure of legacy arguments to account well for subsequent institutional development holds also if we extend the analysis to include the communist legacy. Despite the hypothesized negative effect of Ottoman legacy, Bulgaria had a similar level of institutional quality to Habsburg successors Hungary and the Czech Republic in the mid-1980s. Poland's low level of institutional quality in the mid-1980s was close to that of Romania. Poland was also considered one of the economic basket cases of socialist Europe in the 1980s (Frye 2010). Poland and Romania both achieved rapid institutional change until 1994, however, when the two countries began to diverge (Mendelski 2008).

The inconsistencies above raise bigger questions about the legacy approach. Not only is it difficult to identify when but also how and which legacies matter. In other words, why focus on imperial legacy, when we could go further back in time, or forward to consider the legacy of Nazi occupation or some other period (Gross 1989)?

Geographic proximity to the West similarly raises many questions. Although the capital of the Slovak Republic is only thirty-five kilometers from Vienna, it was ruled by the increasingly undemocratic regime of Valdimir Meciar from 1994 to 1998. Kopstein and Reilly (2000: 30) argue that this was only an episode, and ultimately the Slovak Republic ended up on a better path than could be expected on the basis of policy alone. Nevertheless, the episode raises questions about the stability of the path. This is even more the case in Hungary. That country, by contrast, had been on a good trajectory since the beginning of the transformation. Since the publication of their paper, however, Hungary has seen a series of eyebrow-raising institutional reforms by the Fidesz government that took power in 2010. These have included the drafting of a new constitution and the passage of laws that concentrate power in the hands of the government. The far right party Jobbik, often described as anti-Semitic, anti-Roma, racist, and homophobic, has emerged as the third largest party in the National Assembly. While it is plausible that geographic factors have some influence, the effects seem to be weak, and these "trajectories" often change quite dramatically.

While legacies do not offer a compelling account of the trajectories of countries after 1989, Crawford and Lijphardt (1995) point to important lessons generated by the approach. First, considering central features of socialist society, they argue that, because these were dominated by elites that had few societal linkages and the political transitions themselves were largely the result of splits within the ruling elite and challenges from small groupings of counter-elites, an analytic focus on elites in the post-communist region is justified. Second, successes and failures in the transition process were often overdetermined by immediate factors, even where legacies would seem to be relevant (Crawford and Lijphart 1995: 175).

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

In this book, I prefer to treat legacies as a background condition with some impact, but to bear in mind that there are complex and inconsistent mechanisms by which legacy affects actors and institutions. My belief is that the agency of actors is of greater interest in understanding contemporary outcomes, and I make that argument in this book.

I can thus better account for variation in developmental paths than the arguments above. This is not to say that legacy plays no role in facilitating or complicating progress on institutional development. The variety of paths followed by countries emerging from the same imperial legacy show that agency, particularly elite agency, can overcome the effects of legacy. As Kitschelt has argued, legacies matter, but we must not dismiss the impact of elite decision on country trajectories (Kitschelt 1999; Kitschelt 2003).

EU CONDITIONALITY

Although I focus on domestic factors in this book, it is worth considering the possibility that external factors may have influenced the development of these same institutions. The most significant of these external factors is the European Union, which could have positively affected the reform process by imposing conditionality on countries throughout the region as part of the accession process. A significant literature has attempted to identify how and to what extent EU pressure on candidate countries might have affected the process being discussed here. Some scholars have argued that the accession process tipped the scales in favor of reform and the adoption of democratic and market institutions (Moravcsik and Vachudova 2003; Vachudova 2005; Ekiert, Kubik, and Vachudova 2007). These accounts do not see the European Union simply as an external actor affecting domestic policy choices, however. The EU's influence is filtered through domestic actors. For example, Ekiert, Kubik, and Vachudova (2007: 11) state that "the benefits and constraints offered by the European Union shaped the character of domestic political competition, informed the agendas of many political and economic actors, and expanded opportunities for reformers."

In keeping with this approach, Jacoby argues that conceptualizing external actors as a "freestanding" influence on domestic policy events holds little promise. In other words, we should view external actors as an additional component of an explanation more than an alternative explanation. In this view, external actors influence the choices of domestic actors in a kind of "informal coalition" (Jacoby 2006: 626). In a review of several studies examining the effects of EU influence, however, Jacoby finds evidence that the success of external actors in influencing domestic policy is rare, even when linkages with domestic actors are present (Jacoby 2006: 643–4).

Other scholars echo the limits of this effect in new member states. Frye and Grzymała Busse argue outright that the pressure of the European Union came too late to explain the paths of institutional change taken by different

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

countries (Grzymała-Busse 2007: 89, quoted by Frye 2010: 16). Jacoby notes that bureaucrats were also able to avoid revealing areas of institutional dysfunction. Although such revelations were a prerequisite to receiving assistance, ministerial elites also perceived them as a potential weapon in the hands of opponents of enlargement and preferred to avoid such disclosures (Jacoby 1999: 62).

Others note the ability of interest groups to resist external pressure (Höpner and Schäfer 2010). These scholars use comparative case studies to show that active interest groups and domestic resistance are a key factor impeding the effects of EU expansion and shaping national variation in policy adoption. For example, Höpner and Schäfer (2010) find strong resistance to pressure to adopt economic institutions that undermine domestic models of capitalism. The latter finding is particularly relevant, because this book explores the formation of these domestic models of capitalism. The policy areas examined here are keenly guarded and influenced by domestic groups. Undoubtedly the European Union at times impacted debates and the progress of reform in post-communist Europe. The literature reviewed here, however, suggests that this impact was often insufficient to affect the course of domestic actor's choices and, when relevant, was layered over existing interest group struggles.

Consequently, I argue that the two dominant explanations for post-socialist development – speed of reform, and legacy or geography arguments – fail to explain well the trajectories that countries in post-socialist Europe have followed on the path to developing economic institutions. In this book I also take the position that the impact of the European Union does not undermine an analysis that focuses primarily on the interaction of domestic interests.

In the coming chapter, I argue for an approach that focuses on two key variables in the process by which state power develops in contemporary societies: networks, which sustain coalitions; and uncertainty, which limits how networks are used.

As I will show, neither variable alone is sufficient to explain the different developmental outcomes. A more parsimonious explanation, that political competition creates a watchdog effect driving countries toward better institutional outcomes, is shown to be false in the comparison of Romania and Bulgaria. Frequent alternation of the party in power alone failed to put Bulgaria on a much better path than Romania. I explain below why competition in the absence of networks is insufficient to allow elites to coordinate toward mutually beneficial equilibria.

CASE SELECTION

In studies of the varieties of capitalism, the focus has been on countries in which institutions are already formed and not on places where the development of market institutions is stalled or in the early stages of development. Hence,

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

the post-socialist countries offer a unique opportunity to pursue a much broader question: how do the institutions that regulate markets and the institutions to govern them develop? The post-socialist countries allow us to observe this process in a relatively compressed and well-documented period of elite struggles over the contours of basic societal institutions that determine the breadth and depth of participation in the market, such as the protection of competition, access to credit via both banks and securities markets, the role of networks in economic activity, and the extent to which government reinforces insider ties.

In broader comparative terms, this study is concerned with a mid-category of cases among capitalist countries. There exist countries in which institutions of economic management have long since stabilized – the advanced industrialized states – and countries that have developed highly effective institutions to steer industrialization before developing democratic institutions – the so-called developmental states (Wade 1990; Evans 1995). The former type of state developed a variety of state forms as a result of class conflict (Moore 1967) and the pressure to raise capital or finance the nation state (Tilly 2001), while the latter type developed capacity in an attempt to catch up with the industrial world.

By contrast, the post-communist countries considered in this study offer an opportunity to investigate states that are neither developmental, in that they have lacked both the capacity and the capital to engage in any substantial industrial policy, nor simply predatory (Bates 1981; Shleifer and Vishny 1998). In the period under consideration they all had governments subject to recall by elections, were open to the flow of transnational capital, and faced considerable external pressure to reform. At the same time, the breakdown of state socialism had severely undermined the power of their bureaucratic institutions. Thus, the transition to capitalism and democracy meant developing institutions by leaps and bounds in a process defined by internal political pressure and external advice. Most countries had inherited and resurrected regulation and law from the 1930s, which had large gaps when it came to regulating much more complicated contemporary economies. Areas of law as basic as the handling of bankruptcy and relations between creditors and debtors were fundamentally lacking. Hence, they have recently undergone a process of often lurching institutional development.

This setup allows for a number of insights. First, it puts in a national context some of the global patterns affecting countries more broadly. By selecting countries experiencing similar shifts over time, this book sheds light on the national-level factors through which international effects – such as the European Union, openness, liberalization, and capital flows – act on these countries. Second, it permits an explanation of divergence between countries that were similar, in that they are all transformed socialist societies, but are now very different on account of internal phenomena, such as the restructuring of social ties and informal organizations.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

PLAN OF THE BOOK

This book examines why some post-socialist countries have developed broadly distributive institutions while others have not. My explanation focuses on how different social network structures and levels of uncertainty have affected the types of market institutions – broadly distributive or selective advantage – that political and economic elites can develop collectively.

The book is divided into parts and proceeds as follows. Part I provides an introduction, a review of relevant literatures, and argument. Chapter 1 discusses the contributions of two literatures in political economy that shed light on the institutional impact of state–business ties. The literature on the developmental state offers a point of departure for thinking about how the relationship between economic and state-level actors affects institutional development. A second literature on the varieties of capitalism provides a way of thinking about how firms and political actors develop institutions in the advanced industrialized world. I draw on both lines of scholarship to construct a theory that also incorporates the untreated variable of networks and partisan political competition. Bringing networks and political competition over economic resources to the fore, I develop and extend both literatures to contexts that are democratic but not part of the advanced industrialized world. The result is a theory that prospectively conceptualizes the bargaining moves between political and economic elites as a way of understanding elite collective action. The rest of the chapter develops the argument about networks, uncertainty, and the trajectories of institutional development.

Part II discusses the role of networks in shaping firm behavior and interaction with political actors. Networks facilitate monitoring and the spread of information. In order to demonstrate that networks shape institutional outcomes and not the reverse, Chapter 2 sets out in more detail an argument about how corporate governance – that is, who controls firms – and ownership influence collective action. I show that, when networks are broad, firm collective action increases.

Chapter 3 examines the first type of network treated in this study: the development of the actual ownership and director networks in three post-socialist countries and the trajectories that each case represents. It shows that very different actors have emerged as key owners in each of the societies under study between 1990 and 2005. I focus on the dominance of financial versus industrial firms and find that the former maintain far more ties. As a result, when financial firms dominate, much broader networks emerge. Chapter 3 shows that "who owns whom" – whether key owners are banks, families, or industrial firms – affects the shape of the ownership network and thus structures the incentives that firms have when organizing for collective action.

Part III shows how uncertainty interacts with networks. Chapter 4 investigates how uncertainty affects the incentives of firms and politicians to create alliances. It shows that party financing networks vary significantly across the three case studies, representing three distinct forms of party–firm alliance.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

Chapter 5 explores the second type of network by mapping the system of influence constructed out of the individual career paths of elite state bureaucrats developed between 1990 and 2003 across the three countries. Political parties manage the promotion and advancement of their cadres into non-state positions as part of a broad informal organization that aims to garner power and control financial resources. How frequently personnel moved, whether their state and non-state positions were stable after elections, and where in society they went from their state positions had a key impact on the distribution of influence in each society.

Chapter 6 carries out a quantitative cluster analysis and comparison of eleven countries in the region to identify the role of networks and the extent of uncertainty in each country. These results are used to individuate different forms of state–society relation that have emerged across the region. The argument of this book is that the social structure of economic interests and their embeddedness with political actors, in combination with the level of uncertainty, determines the trajectory of institutional development. I find three clusters. The first, *concertation states*, in which elites and firms form broad networks under high levels of uncertainty, have made the most progress on institutional development. This comes about because uncertainty constrains political actors, and networks facilitate monitoring, information flows, and credible commitments. Thus, economic and business elites have been able to forge broad distributive bargains. The second, *patronage states*, in which elites form narrow networks under low levels of uncertainty, have made moderate progress because political elites are not constrained and are not able to make commitments, and narrow networks also undermine monitoring. *Captured states*, in which elites form narrow networks under high levels of uncertainty, are extreme laggards on institutional development because monitoring is poor and extreme uncertainty discounts the value of the promises of political actors.

Finally, I present the conclusions of the book in order to offer a comprehensive understanding of how different paths – those based on broad versus narrow networks and high versus low levels of uncertainty – influenced the development and consolidation of institutions. The book ends with a discussion of the implications of this argument for our understanding of the development of market institutions in emerging market economies.

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press

https://doi.org/10.1017/CBO9781139381628.001 Published online by Cambridge University Press