Persistent economic divergence and institutional dysfunction in post-communist economies: an alternative synthesis

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ABSTRACT

This paper seeks to explain the continuing lack of economic convergence and the persistence of market dysfunctionality, or wild capitalism, in post Communist transformation. An overview of key statistics on economic convergence and market failure are presented. The paper then analyses the causes of malaise through the lens of institutionalist and radical perspectives. In doing so key data is assembled and presented from documents of the international financial institutions and other agencies monitoring crime and corruption. The paper concludes that rather than encourage convergence and tame dysfunctionality, neoliberalism and its offspring of labour market reform has created the conditions for continuing economic divergence and for wild capitalism to survive and thrive.

KEYWORDS

Post Communist transformation, wild capitalism, market failure, institutional dysfunction, international financial institutions.

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Introduction

When we examine the experience of post-communist transformation two key aspects of market failure are evident. First, predictions from orthodox economists of early economic convergence with the west have failed to materialise. While growth rates of GDP have often outstripped the old market economies, levels of industrial production have hardly exceeded 1989 levels, and are in some cases still behind. Income inequality between east and west has failed to narrow, and employment growth has been absent. The 2008 financial crash also appears to have had a worse effect on the post-communist economies than their western counterparts. Second, the 'dysfunctional' aspects of the market have become more prominent in both absolute and relative measurement. Dysfunctionality can be characterised by inefficient forms of market regulation, informal and/or illegal work, lack of regard for the rule of law, together with continuing problems of crime, corruption and state capture models of governance. In this article it is suggested that problems of both the lack of convergence and persistence of dysfunction are a consequence of a particular model of labour exploitation based on labour cost reduction as a source of competitive advantage. Neoliberal restructuring has acted to engender this model and labour market 'reforms' designed to unblock dysfunctionality, rather than solve the problem, have acted to exacerbate it. Poor business ethics and weak standards of corporate governance are a consequence of the combination of market liberalisation, dependence on labour exploitation for comparative advantage, and the abandonment of one party authority over control of industrial production. This chemistry of events allowed rapacious rent-seeking by individuals well placed to benefit from the newly de-regulated regime (Filatov, 1994). In turn, this has created political and economic space for the informal economy to grow and mafia crime and corruption to flourish.

This article examines these two key dimensions of failure in post-communist economies; namely the failure of these economies to converge with western market economies and persistent dysfunction in their economic systems, and the presence of high levels of corruption in particular. A brief statistical overview of related measures of convergence and 'dysfunctionality' are given. The market failure, institutionalist and radical perspectives are

presented and critically assessed. The article concludes with an alternative synthesis which draws on notions of uneven and combined development and the embeddedness of dysfunctional practices.

The False Mantra of Economic Convergence?

We need first to consider the orthodox economic 'model' of transformation. This dominant economic model, revealed in neoliberal prescriptions applied by Governments, international financial institutions (IFIs) and their advisors, was that of the establishment of comparative advantage through trade integration, capital shift and equalisation of marginal profit rates. The Heckscher-Ohlin-Samuelson international free trade model would anticipate the development of comparative advantage in national production regimes, initially re-enforced by capital transfers and foreign direct investment in the cheaper labour economies of the east, complemented by labour migration in the opposite direction (Dunford and Smith, 2004). The technology gap between east and west would be bridged by the process of investment and this would in turn lead to a closure of the productivity gap. This would then act to equalise marginal profit rates as labour costs and rates of return on capital investment converged. Shock therapy was designed to act as an enabling vehicle of this process, by clearing the post-communist market of labour 'rigidities', and allowing investment opportunities in both privatised formerly state owned industries and greenfield industry. The opening of markets, aided in some states by accession to the EU, would also act as a spur for convergence. After twenty years and more of post-communist transformation we find while there is clear evidence of trade integration, the evidence on convergence is less strong. On trade integration the World Bank finds:

> Trade integration in the transition (formerly centrally planned) ECA countries—measured by the sum of merchandise exports and imports as a share of GDP in purchasing power parity—rose from 20 percent in 1994 to around 50 percent in 2008, about 10–15 percentage points higher than in developing East Asia and Latin America. Turkey saw an increase from 10 percent to 30 percent over the same period. The averages mask substantial variation across subregions—the ratio ranged from a median value of around 35 percent in the South Caucasus, Central Asia and Moldova, where exports are generally intensive in natural resources and unskilled labor, to

> nearly 85 percent in the new member states of the European Union and Croatia, where exports are intensive in capital and skilled labor (World Bank, 2010).

Indeed, the process of integration into the world economy was associated and led by export led development in transformation countries, alongside credit expansion designed to help build domestic capital formation and consumer demand (EBRD, 2010: v). However, this growth did not automatically lead to convergence. Recent growth rates of GDP in the new member states of the EU have been notable for exceeding that of the old member states. Between 2005 and 2010, for example, while the EU as a whole grew in total GDP by 6.2 per cent, Poland's economy grew by 30 per cent, and both the Czech Republic and Bulgaria grew by more than 21 per cent. The weakest economy was Hungary, which only grew by 2.5 per cent[i]. Evidence of lack of convergence, however, has been evident on other measurements of growth and has been monitored by international financial institutions (IFIs) such as the European Bank for Reconstruction and Development (EBRD), the International Monetary Fund and World Bank. The World Bank, for example, has produced two reports, ten years and twenty years on from 1989 (World Bank, 2002, 2010). Three key areas are identified by the IFIs for measurement where lack of convergence can be observed. These are indices of total production; income per capita; and totals of employment. On total production, Poland was the first country to recover to 1989 levels of production, which it achieved in 1995, followed by Slovenia (1998), and Hungary (2000). But for many other transformation states production levels have still not reached their 1989 levels. Serbia and Ukraine, for example, are still at about 70 per cent of 1989 levels of production, while Latvia languished with production levels in 2010 only 56 per cent of 1989 levels[ii].

The difficult return to 1989 production levels also has a geo-economic dimension. Those states geographically closest to the European Union generally have returned to post-1989 production levels more readily, and have higher income per capita. Those former Communist states who have become full members of the EU have also fared better than later members, or non-members. As the World Bank reports:

> At the beginning of the new millennium, a profound divide lies between Central and Southeastern Europe (SEE) and the Baltics (CSB) and the Commonwealth of Independent States (CIS). In the CSB, officially measured gross domestic product

> (GDP) bounced back from a transition recession, recovered to its 1990 level by 1998, and exceeded that level by 6 percent in 2000. However, in the CIS GDP in 2000 stood at only 63 percent of its 1990 level. While GDP in Poland, the most populous country in the CSB, increased by more than 40 percent between 1990 and 1999, it shrank by 40 percent during the same period in the Russian Federation, the most populous country in the CIS (World Bank, 2002).

Data on income levels show a similar pattern of overall tardiness in growth intensified by east-west geographical disparity. Both Slovenia and the Czech Republic, for example, record income levels per capita closest to the EU 15 median at approximately 75 per cent in 2008 (measured in purchasing power parity - PPP). However, most CIS states are between 5 and 10 per cent of the EU 15 median, while the majority of EU Accession States are at about 50 per cent (World Bank 2010, p 26). There is evidence of convergence of incomes since 1998, but this is often from a very low starting point measured in purchasing power parity (PPP). *Nominal* wage levels remain much smaller than in the west. The convergence that has taken place is largely explained by a growth of real wages from 2003 to the financial crash of 2008. This growth followed a major fall in real wage growth in the immediate period after 1989, and in some countries, such as Bulgaria and Lithuania the recent growth is still not enough to bring real wages back to the levels of 1989 (Onaran, 2010).

In terms of employment the phenomena of 'jobless growth' is apparent across the region, at a scale larger than evident in the countries of the EU 15 (Boeri and Garibaldi, 2006). Employment levels are depressed and decreasing in total while unemployment levels increase. Furthermore the evidence would suggest that the 2008 financial crisis has had generally more severe effects in the post-communist states than in most of western Europe. Hungary, Latvia and Romania have resorted to IMF credit, but the associated level of austerity introduced as part of the package is more intense than west European comparisons, including that of the 'peripheral' states of Portugal, Ireland, Greece and Spain (Onaran, 2010). In Latvia, for example, public sector wages have been cut by 35 per cent and pensions by 10 per cent, while VAT has been increased from 18 to 21 per cent. In other countries, such as Estonia and Lithuania, deep cuts of 20 per cent have also been enforced as part of austerity measures (Gligorov *et al*., 2009). But although the net result of the persistence of the above features has been a miserable one for the mass of working people, it has been a lucrative one for the elite. Inequality has increased markedly. Pre-transition Gini co-efficients were around

the 0.25 mark across the region, but had increased to levels approaching 0.36 by 2005. The average co-efficient for the EU 15 in 2005 was 0.31[iii], so only in the area of inequality has convergence taken place.

Corruption as a continuing signs of dysfunction

A second, and undoubtedly associated problem of transformation, has been the persistence of non-regulated or poorly regulated forms of economic behaviour. The existence of large informal, black or grey economies, for example, appears inextricably linked to crony capitalism and crime and the wider problems of what may be termed 'wild capitalism'. Data on informal working is difficult to assemble both because of lack of data officially assembled at government level and because of the difficulties of definition, and as a consequence is generally measured by independent surveys. Schneider (2003, p. 26) estimates, with figures from a variety of sources, 'that the average size (measured as proportion of GDP) of the shadow economy in the nine CEE Transition Countries has increased from 23.4 percent for the years 1990-1993 to 29.2 percent in 2000-2001.' Within the countries of the former Soviet Union the average size of the informal economy reached 44.8 per cent in 2001, an increase from an estimated 35.7 per cent estimated for 1990-93 by Johnson *et al* (1997). While informal working has also been growing in the states of the European Union 15, it has grown at a lower overall level and not by as fast a rate as in the post-communist states. A geographical dispersion of informal working is also apparent. According to results from a study of 30 European countries by Hazans (2011) '..dependent work without contract is more prevalent in Eastern Europe than in the West, except for Ireland, the UK and Austria.'

Corruption and bribery remain endemic in ex- Soviet, Central East and South East Europe (SEE) states. A recent survey in these regions indicates that 31 per cent of survey respondents claim to have failed to win a contract because of a competitor's bribes to the purchaser *(*Gosztonyi and Bray, 2009). The 2010 Transition Report from the European Bank for Reconstruction and Development finds that corruption 'is the top concern for businesses in eight of the transition countries, and among the top three in another third of them' (EBRD 2010, p.83). Transformation states score at the more 'corrupt' end of the Transparency International's Corruption Perceptions Index[iv]. Such problems are recognised by international agencies as they attempt to encourage transformation states to tackle corruption and economic crime. Most especially the United Nations Development Programme (UNDP) has developed an Anti-Corruption Practitioners Network. There is special focus on the CIS and

post conflict transformation countries such as Serbia and Bosnia and Herzogovina (BiH). However, prospects for reform do not look favourable. For example in the Serbian case, the government has created a range of anti-corruption measures and institutions including an internal anti-Corruption Task Force, and measures to de-politicise the civil service. But action on the ground appears slow and constrained by lack of resources. An independent report on progress commissioned by the UNDP in 2007 concluded that 'Although there have been major improvements in a range of development areas in recent years, progress in respect to mitigating corruption has been partial and slow' (UNDP 2007, p. 5). In addition the resources, both technical and in terms of manpower, available to the police force to investigate corruption were found by the report to be 'not sufficient' (ibid:, p.23). Indeed, Serbia was still ranked 85th out of 180 countries in the Transparency International Corruption Perception Index (lower scores equal greater perception of corruption) with a score of 3.4 in 2008. While Serbia in the former Yugoslavia scored particularly badly even worse scores were recorded further eastwards for the CIS, with Azerbaijan, for example, scoring 1.9 (158th), and Uzbekistan and Turkmenistan 1.8 (166th), compared to an average score for the CEE of around 5.0. A similar pattern can be discerned from the World Bank's indicators of the 'rule of law' (defined as 'the extent to which agents have confidence in and abide by the rules of society, and in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence'). The measure is from a point range of – 2.5 to + 2.5 with positive scores indicating greater regard and enforcement of the law. Again, in 2008, Serbia appeared towards the bottom of the scale and received a score of – 0.46 which was a lower score than major comparators such as Slovenia (+ 0.91), Hungary (+ 0.82), and Croatia (+ 0.08) and was the lowest score in the former Yugoslavia. As before the scores worsen from west to east, with Ukraine, for example, scoring -0.62, Russia -0.91 and Kyrgyzstan -1.26. The CEE states all rated positive scores, with Estonia scoring highest at +1.05. For comparative purposes, the US score in the same year was + 1.65 and New Zealand + 1.85 (all data from Kaufman *et al*, 2009).

The downgrading of the protective labour codes has also enabled the process of informalisation whereby regulations on dismissals and redundancies as well as pension provision have been loosened in an effort to clear labour market 'rigidities'. Indeed, such downgrading of labour protection has been a major focus of IFI conditionality in the granting of loans and grants (Forteza and Rama, 2001; Upchurch, 2009). The concomitant absence of

rules and regulations, or sometimes deliberate ignoring of regulations governing the behaviour of corporations and corporate elites is partly engendered by states wishing to create favourable conditions for foreign direct investment, partly by the collapse of party authority and command planning, and partly by delayed societal adjustment to new regimes of practice.

There is also a preponderance of weak and under-developed agencies within 'civil society' (Howard 2003), which might otherwise have been able to keep corporate and individual interests in check. This 'weak' civil society in most cases sits side-by-side with a strong state, containing many authoritarian features of the past. However, such a 'strong' state may contain dominant traits of administrative corruption based on asymmetry of information between politicians and civil servants whereby 'benevolent politicians (if any) are just not informed about misdemeanour of their subordinates' (Begović, 2005, p. 3). Notable by absence may be, as Lane Bruner (2002, p. 180) suggests in the case of Russia, 'Public education, strong and independent judiciaries, a free press, federal oversight through security exchange commissions, the rule of law, enforceable private contracts, and numerous other institutions and the values that support them must be in place'.

Political, economic and social space is thus created whereby norms of expected behaviour within society are formed which emphasise personal rent-seeking at the expense of 'ethical' business behaviour. The 'informal rules of the game' are juxtaposed with efforts to regulate behaviour in terms of western 'best practice'. Most crucially, wild capitalism, and its crony variant, is recognisable by the continuance of the control of regime 'insiders, who have often bought up privatised concerns to maintain and enhance their wealth and privilege. Woods (2006, p. 121), for example, reports on the process in Russia whereby Yeltsin's loans-for-shares programme of privatisation 'left controlling stakes in the newly privatised companies firmly in the hands of newly established financial institutions' and in so doing 'conferred enormous power on the oligarchs or financial-industrial groups'. The process of insider acquisition of economic power also expands into the political arena. In Serbia, for example, many privatised concerns passed directly into the hands of key members of political parties. As Pesic (2007, p. 16) records, 'The 17 biggest companies founded by the government of Serbia are managed by the parties that comprise the ruling coalition at the national level – the managing boards, presidents and directors – are compiled and by a quota-system are divided up among each of the parties of the ruling coalition which appoint the management positions as if the companies were their own property. All other public companies – about 500 – are in

the hands of the ruling coalitions at the local levels'. In such a scenario the door is opened for 'state capture' models of political process, whereby competing elites jostle for privilege and position while having a collective vested interest in preserving oligarchical and clientelist systems of governance. In these 'capture economies' oligarchs and captor firms do not pressure states to regulate through institutions, rather they seek to enhance their property rights by directly purchasing advantages from the state (Hellman *et al*., 2000). Indeed, Hellman and Kaufmann (2001: 1), for the IMF, construct a direct linkage between state capture and corruption *vis*:

> In transition economies, corruption has taken on a new image—that of so-called oligarchs manipulating policy formation and even shaping the emerging rules of the game to their own, very substantial advantage. We refer to this behavior as state capture. Though this form of grand corruption is increasingly being recognized as the most pernicious and intractable problem in the political economy of reform, few systematic efforts have been made to distinguish its causes and consequences from those of other forms of corruption. Moreover, there have not been any attempts to measure this specific type of corruption and to compare it across countries.
>
> We define state capture as the efforts of firms to shape the laws, policies, and regulations of the state to their own advantage by providing illicit private gains to public officials.

Wild capitalism clearly produces inefficiencies within the economic and political system. The high income inequality generated by wild capitalism militates against the creation of efficient distribution of disposable income necessary for effective consumer demand. It creates low aggregate propensity for tax collection which in turn reduces aggregate state revenue and subsequent infrastructure development. Capital and financial markets remain under-developed or starved of sufficient funds, further exacerbating problems for potential new entrants into the business arena. The weak or non-existent business ethics, gangsterism, and corruption are a barrier to outsider and institutional investors seeking a safe home for their investment. Money made in the country leaves the country. Assets of the elite have been 'tunnelled' into offshore accounts, and dynasties are created as a result. Cronyism and corruption are breeding grounds for the (legal) process of 'tunnelling' whereby private

individuals are ‘paid’ in shares in the company which are then cashed in overseas bank accounts.

> They were also unable to contain tunnelling, the expropriation of assets and income belonging to minority shareholders, and theft through either rule of law or administrative control. Though many of these countries did encourage new entry early in the transition, the capture of the state by a narrow set of vested enterprises—old enterprises and well-connected early entrants—discouraged further entry and created a poor investment climate, resulting in a pattern of protection and selective encouragement. (World Bank 2002, p. xvii)

The process of tunnelling and private acquisition of funds and assets was clearly exacerbated and encouraged by the credit boom within many post-communist countries. Latvia provides an example *in extremis* whereby ‘destructive rent seeking’ fed by external credit led to a boom in real estate prices at the expense of productive investment (Sommers and Bērziņš 2011, p. 137).

So how are the problems of lack of convergence and continuing and worsening dysfunction to be explained? We look first at orthodox explanations and then at heterodox.

Market failure explanations for persistent divergence and corruption

Orthodox economic explanations for the lack of convergence focus on a number of explanations. These explanations include claims *inter alia* that in terms of production statistics, the pre- transformation states had falsely calculated totals (Åslund, 2001) and that the ‘fall’ in production post transformation is exaggerated as a result. However, even given the likelihood of such false calculation the falls in output have been excessive, and over a twenty year period consistency in statistical production has been achieved. Other commentators point to the impact of external trade shocks, a mismatch in aggregate demand and supply of goods and services, or simply policy mistakes as the cause of falls in output (see Turley and Luke, 2011, pp. 242-243, for a review of these arguments). Some also point to a ‘theory of disorganisation’ as an explanatory factor whereby existing supply chains under the command economy have been broken by the turn to the market, and new supply chains have not yet developed in response (Blanchard and Kremer, 1997; Roland and Verdier, 1999). More salient are the possible hypotheses presented by Lucas (1990) in addressing the

problem of why capital generally does not flow from rich to poor countries. He suggests, in respect to under-developed economies, that human capital effects, political risk and barriers to entry in profitable sectors are better explanatory factors for the lack of convergence than theories which depend on capital mobility. But most transformation states had high levels of human capital, skills, literacy and education. This would make their potential experience different from the under-developed countries alluded to within Lucas' argument. The above explanations, which all may have some validity in the short term, begin to appear unsatisfactory given the extended period of more than twenty years of transition, in which output levels, while sometimes growing have struggled in both relative and absolute terms. Neither do they necessarily explain lack of convergence in other indicators, such as labour market participation, or give reasons to explain the relative increase in informal working.

The persistence of wild and crony capitalism is explained in orthodox accounts primarily by agency factors linked to blockages to reforms. Such 'blockage', it is suggested, is engendered by corrupt insiders with vested interests (Lane Bruner, 2002; Harper, 2006; Gustafson, 1999; Peev, 2002). For proponents of neoliberal restructuring the key question is then how such features of *blocked reform* can be overcome (Havrylyshyn and Odling-Smee, 2000). The World Bank also adopts the position in its working articles that many of the features of wild capitalism, including cronyism, crime and corruption, are *temporary* features that can be overcome by further institutional reform. In its 2002 Report on Transition, for example, the Bank focuses attention on removing obstacles to 'new entrants' into the business system who may rise and challenge 'oligarchs and insiders' (World Bank, 2002: xxii). The Report (2002: 106) also attempts to contextualise the problem of lack of reform by reference to the competitiveness (or not) of the individual political systems within each state. 'Concentrated' political regimes (for example, Croatia, Bulgaria, Russia), it is argued, are more open to 'state capture' and reform blockage than 'competitive' regimes (for example, Poland, Slovenia, Hungary). The necessity of tackling the 'vested interests' within post-communist states is also a recurring theme within IMF documents. Such vested interests, it is argued, might be overcome 'through the emergence of a strong leader willing to take on the vested interests, or from the political clout of a growing middle class, or pressure from foreign competitors and international financial institutions' (IMF, 2000).

Other commentators offer cultural/historical explanations for the persistence of bribery and corruption. In particular, the (relative) lack of corruption in western countries is explained by

religious tradition, whereby countries which have a background of British colonial rule, with protestant origins and a long exposure to 'democracy' are less likely to experience corruption than poorer, non-English speaking, non-Protestant countries (see, for example La Porta *et al*, 1999; Treisman, 2000). One culturalist argument put forward to explain continuing corruption comes from the 'Slavic' tradition depicted in Serbia. That is to say that within Serbian popular tradition it is considered perfectly acceptable to bribe someone in order to 'oil' the process of business. Commercial bribery becomes acceptable when local or national public authorities remain impassive to the problem, or engage in corruption on a widespread basis themselves. Thus, 'Popular tradition tacitly approves and has great understanding for an individual who by bribery expedites or receives certain decisions or settlement, because it knows that the state administration or authorities, or state employees who are representatives of the authorities, can always find an excuse for not issuing a ruling'(Antonić *et al.*, undated: 26).

However, it would be wrong, as in the above examples, to explain the high incidence of corruption, cronyism and 'wild' capitalism purely by ethno-pathology. Structural factors must also be considered. For example, 'Anglo-Saxon'/Protestant countries have long held a dominant position in the world economy, and would have accessed and controlled markets through the exercise of power relations which reflected their dominance. The need to corrupt through bribes was less necessary as a result. Far from being pure of corruption, many British ex-colonies also now score badly on indices of corruption. Most importantly, however, corruption may also be more nuanced and subtle in advanced western democracies, manifesting itself in informal networks and given as contractual favours rather than as hard bribes. Tunnelling of share options, corporate raiding and management buy-ins are common features of 'western' capitalism, and are perfectly legal practices which embed excess and personal gain. Reward systems of shares and bonus payments also operate on a mimetic basis, re-enforcing excess by benchmarking 'median' rates determined by uncontested remuneration committees. In reality, there is interplay between structural and agency factors which offers a more reliable explanation of corruption. In transformation states this interplay is spurred by opportunities created by privatisation of state assets and deregulation of labour markets. Of course, channelling of corporate profits into personal accounts of shareholders is also not unique to post-communist states, it is a practice (often legal) common among western elites as well. Bribery associated with crime and corruption is also an international phenomenon, and as Transparency International reports 'just four of 36 countries party to the

OECD Anti-Bribery Convention are active enforcers. There is moderate enforcement in 11 and little to no enforcement in the 21 remaining countries. Such performance throws into question governments' commitments and threatens to destabilise the definitive legal instrument to fight international bribery' (Transparency International, 2009: 6). Corruption may be endemic in all market based systems, the phrase 'there ain't no such thing as a free lunch' (TANSTAAFL), for example, has its origins in 1930s America, in a country also associated with 'pork barrel' politics. We are mindful of Habermas's (1987) theoretical construct of the 'lifeworld'. This allows us to imagine the possibility of self-deceptive norms of behaviour continuing, despite the tendency of external norms to 'colonise' under the power and authority of external agencies such as the international financial institutions or the EU.

The institutionalist critique

The failure of the transformation economies to converge as well as the continuance of market dysfunctional behaviour has led to some soul searching within international financial policy discourse and practice. For example, Joseph Stiglitz and other liberal critics of the IFIs have adopted an institutionalist perspective on reform and have argued against the 'shock therapy' position. Stiglitz does not reject the privatisation and reform process but argues for 'gradualisation', recognising institutional differences between countries, and supporting the need for institutional pre-conditions which include building up of social and political capital to enable the necessary reforms (Stiglitz 1999). The International Monetary Fund has recognised the problem alluded to by Stiglitz in its 'Second Generation Reforms' in terms of the lack of *social capital* which might act as a check to the power and authority of dominant and sometimes corrupt elites. In addressing the IMF on the necessity of social capital development in post-communist regimes Fukuyama argues that '…the economic function of social capital is to reduce the transaction costs associated with formal coordination mechanisms like contracts, hierarchies, bureaucratic rules, and the like' (Fukuyama 1999). Indeed, the IMF, in its *Operational Guidelines* (2006, para.7), has included trade unions in its description of civil society organisations which may be included in its rubric of 'social capital'. The guidelines state that 'Staff should encourage the authorities to engage in a transparent participatory process….and be prepared to assist the authorities…by meeting with various interest or political groups (that is) parliamentary committees, trade unions, business groups etc.'. Such an approach is also endorsed by the World Bank in a Report published in 2008 by its Social Development Department (World Bank, 2008). It advocates policy based on 'political economy' because :

> Development practitioners engaged in policy dialogue often have in-depth knowledge about the political economy of the contexts where they work, but their expertise tends to remain 'hidden' due to the sensitivity of such issues in an ostensibly technical relationship with the client government. (World Bank 2008, p. i).

In developing the approach of practitioner engagement, 'political economy' and participation the World Bank has even highlighted the positive role of trade unions and collective bargaining in reducing relative poverty. The Bank collected evidence to show that:

> …union density … appears to have little or no impact on comparative labour market performance …there is, however, one significant exception … high union density is associated with compression of wage distribution and a reduction of earnings inequality (World Bank 2003).

However, the reliance on contextual framework, participatory approaches and 'political economy' remains problematic for the IFIs if fundamental divisions within societies under scrutiny are denied, obscured or obfuscated. Trade unions, to take a key example, are always likely to prove an obstacle to IFI conditionality and policy prescription because so much of the agenda of the IFIs adversely affect workers' collective interest. Trade unions inevitably address issues of class-based division within society which may prove uncomfortable to IFI policy based on establishing national business competiveness. Trade union interest representation, in contrast to many other agents within civil society, directly challenges existing power relationships between capital and labour, and is likely to be more disruptive of 'consensus' than may otherwise be the case with many civil society organisations. Discussion articles commissioned by the World Bank do in fact begin to address this problem (Mosse 2004), by differentiating participation as a vehicle for empowerment by which poorer groups can have the *power to do* things, against those for which empowerment allows them to have *power over* things or people within the context of a struggle for resources (Nelson and Wright, 1994). This conundrum between power over and power to do poses problems for policy which relies on the development of social capital for its theoretical and practical base. Policy solutions will remain elusive so long as social capital is considered a class 'neutral' transformative vehicle (Das, 2006). Such tensions within a framework of social capital posed by the role of trade unions are, however, apparent in the discourse of the IFIs in offering

explanations of dysfunction. Most often the 'problem' is presented as one of the ambiguity and complexity of 'political economy' rather than one of class differentiated interests (World Bank, 2008, p. i). In respect of this conundrum of 'complexity' and 'ambiguity', Upchurch and Weltman (2008) have argued through the method of textual analysis that the IFI approach is little more than a form of 'utopian liberalism....(whereby) a false *harmony of interests* is presumed between capital and labour that in reality cannot be bridged '. Given this obfuscation of reality it may not be so surprising that the World Bank and other agencies continue to struggle to explain dysfunction by simply addressing the problem through the lens of further market tampering. To take the analysis further we may need to view market 'dysfunction' not as a temporary deflection from normative market efficiency but rather as a permanent or embedded feature of transformation. Alternative, and critical explanations are necessary which avoid the utopianism of liberal economic normative thought.

A radical perspective

The dominance of neoliberal practice has also been explained by the trajectory of economic restructuring within the region. Indeed, a focus on exploitative relationships can be discerned in both regulationist and critical Marxist interpretations of transformation. In this scenario the entry of the post-communist economies into the world market was predicated on a state strategy of encouraging and promoting production regimes based on labour rather than capital intensity (Bohle, 2006; Bohle and Greskovits, 2007). For some, this was an elite-driven process whereby state restructuring in post-communist states was linked to the interests of western-based transnational capital (van der Pijl, 1993; Shields, 2008). Gowan (1995) similarly argued that West European capital sought eastward expansion precisely to exploit cheaper labour and expand markets. As such extensive labour exploitation, achieved through poor working conditions and relatively low pay, was necessary both for capital accumulation in the east and profit maximisation of western-based capital expanding to the east. Neoliberal marketisation may then have fulfilled the objectives of western capital by opening up new production opportunities in geographical spaces unfettered by restraints on profit maximisation. Indeed, models of exploitation might explain the denial of the 'factor-price equalisation' model to operate and go some way to explaining non-convergence. Neoliberalism, in such accounts, is thus subject to its own contradictory forces and produces a paradox of low consumption demand in the east which holds back pressure for higher rates of wage growth, productivity increase and factor equalisation. Data collected by Onaran (2008) suggests that wage growth has generally not kept pace with productivity growth

(GDP/employee) in the region, especially in manufacturing. Unit labour costs would therefore have fallen in relative terms, confirming the exploitation 'model'. However, while 'under-consumption' may be a *consequence* of neoliberal prescription it is not necessarily the cause of crises, which lay more acutely in crises of *profitability and debt* (Kliman, 2011).

But how might the persistence of market dysfunction be explained in these models of exploitation? David Harvey (2003, pp. 145-147) offers a potential explanation by suggesting that capitalism post 'Golden Age' has developed specific dominant features, most notably a tendency for 'accumulation by dispossession' similar to the 'primitive' stage of accumulation as defined by Marx (1867). Harvey's model postulates the reduction of whole populations to 'debt peonage' as the power of CEO's is increased and the finance sector dispossesses assets by credit and stock manipulation. This model of contemporary capitalism assumes the development of rapacious activity under a new neoliberal *version* of capitalism driven by a *distinct class* of capitalists who seek to expand their own profits at the expense of other capitalists. This 'dispossession' thesis would assume that the dispossessors are agents of western capital conducting a raid on the assets of the post-communist states. The process would be mediated through the agency of financiers. However, while there is credibility in Harvey's conclusions the central proposition of finance-driven dispossession does not help explain why 'indigenous' asset stripping and personal enrichment has taken place within these states by an 'insider' elite. Indeed Harman (2007) argued that such dispossession is not valid as it cannot enable the capitalist class *as a whole* to accumulate. Furthermore, Harvey may be wrong in claiming that the officious process of 'primitive' accumulation which he associates with contemporary 'dispossession' had ever gone away in the 'golden age' and beyond. Primitive accumulation certainly existed in the post Second World War colonies, and has arguably been a feature of the period of rapid industrialisation in both the Soviet states and post 1978 China. Thus corruption may be integral to the dynamic of capitalism in general, rather than specific to a certain variant.

Towards a synthesis?

To summarise the analysis so far, we have seen that levels of production, income and employment still lag behind twenty plus years after 1989. There is unevenness in the record, with those states geographically closer to the west and the EU faring better than those further away. Convergence has not occurred, and there is a persistence of features of wild capitalism

such as cronyism, corruption, crime, and informal and illegal working. Neoliberal prescriptions, aided and abetted by the financial institutions, tells us insiders who profit from such malfeasance are barriers to reform, and therefore new entrants must be encouraged by more of the same reforms to break the mould. Wild capitalism, and the resultant lack of convergence, is then presented as a temporary dysfunction on way to the nirvana of the invisible hand. A harmony of interests is assumed whereby social capital and institution building is presented as a necessary pre-condition to barrier erosion. It is suggested in this article that such a harmony of interests is an illusion, founded on obscuration of class division and interests and manifested as a form of utopian liberalism. We can, however, offer explanations for the lack of convergence and the continued lag of growth and production. This may be rooted in a model of exploitation whereby the driving force of development is grounded in the search for low unit labour costs and profit maximisation, rather than factor-price equalisation and convergence. As such, the neoliberal model is hoist on a petard of its own contradictions. What is more difficult to explain is the continuation of wild capitalism as a distinct and common feature across transformation states. In this respect, rather than adopt a purely path dependent, institutionalist approach to the analysis it is more appropriate to adopt an approach that marries the dialectic of both path dependency and path shaping in helping out understanding (see, for example, Nielsen *et al.,* 1995).

As an aid to developing such an approach we might see that the process of transformation, and its outcomes, is governed by both uneven and combined development of the social forces of production. Such theories of uneven and combined development have a long history, and were applied most trenchantly to analyses of the form and content of the 1917 Russian Revolution, most notably in Trotsky's *History of the Russian Revolution* (1977) and more recently by Novack (1980). Uneven and combined development has become a sub-study in disciplines as diverse as evolutionary biology, archaeology, anthropology and international relations theory with research centres devoted to its study. An ongoing debate has developed about whether or not the theoretical framework can be applied transhistorically (Rosenberg, 2006) or can be only limited to study of capitalist regimes of production (Ashman, 2009). Given the globalising period of capital expansion which embraced the 1989 revolutions, such theories are trenchant as the post-communist economies enter the world market order on an 'unfettered' basis (see Dale (ed) 2011, for a more detailed exposition of this theoretical position). As these economies entered the world market they were subsumed into a generalising tendency to equalise the rate of profit under the weight of the law of value, in

that product competition became governed by the necessity to produce with the minimum amount of labour time (see also Hardy 2009). However, as Barker (2006) suggests it is this very process of creating evenness in the rate of profit that exposes *un-evenness* in the productive capacity of enterprises within transformation states.

> The interaction of capitals, through the circuit of production and circulation, involves unevenly advantaged capitals which differentially invest in new means of production, thus tending to cheapen commodities at the point of sale. They act in this way because of competition between them, and because, in any case, technical change does not occur evenly. (Barker 2006, p. 81).

Where unevenness exists it is exposed in the final price of goods and services with the consequence of enterprise collapse and industrial restructuring. Evenness, in the case of neoliberal prescriptive methods under transformation, may only be achieved on an exploitative labour-price model and (combined) 'western' forms of work organisation and technological input. In such a model the extraction of value is either achieved through extensive forms of exploitation (lower pay, longer working hours etc.) or intensive exploitation (technological inputs). However, the reliance on an exploitative model further highlights unevenness, not only between east and west, but also within and between post-communist states themselves. Unevenness is thus a combination of both backwardness in technique, productivity and innovation as well as forwardness by which the backward nations skip whole phases of development by adopting the most advanced techniques of production and industrial organisation. Unevenness between the post-communist states as described here therefore reflects different combinations of (relative) backwardness and processes of 'skipping over' to more advanced stages within states own unique place in the world economy. The combined aspect of development follows on from the unevenness, in that the most modern and technologically efficient modes of production sit side-by-side with 'pre-existing modes' of organisation (Burawoy, 1985, p. 99). As such, work organisation expressed as extensive exploitation of cheap labour and low cost may be found alongside 'cathedrals in the desert' where advanced technical processes are applied to extract value through intensive means (Hardy 2009).

As Davidson (2010) suggests uneven and combined development affects not just the economy but society in general, its norms of behaviour, and patterns of authority and control. So there emerges a direct linkage between the material base of the production process and the

continuation and adaptation of behavioural practice. For our purpose we can thus discern in post-communist states a continuation of many of the ways and means of the 'old order' combined with the new. This is especially important when we consider two important aspects of the organisation of working life, that of informal and illegal working. Unevenness produced by the predatory nature of neoliberalism provides explanation for the persistence not only of lagged production growth but also increasing informalisation of the economy (Woolfson, 2007). In terms of informal working, Williams and Round (2007) provide sound evidence that informal working had *always* been a feature of the economy under the command economy and is now carried over in post transformation as custom and practice. Informal working may under the old order have supplemented formal employment; have been utilised as 'off the books' payment in 'brown envelope' bonuses; or simply paid as favours akin to forms of mutual aid between individuals and households.

We must also consider, as Clarke (2002) reminds us, under the command economy a large range of services (e.g. painting and decorating, TV and radio repair, care of elderly etc.) were not provided by state-owned enterprise. 'Informal' working, when depicted by such tasks, was integral to the system. Informal working, as Williams and Round (2007, p. 2326) suggest may thus be considered as a 'core means of livelihood for a significant proportion of households' that has since been carried over into the new order. Rather than being discouraged by a state's entry into the world economy, the legacies of past practices of informal working are encouraged to expand. Round *et al* (2008), in their study of employment practices for Ukrainian graduates, for example, find that informal methods of recruitment and selection predominate alongside the growth of informal working. Most notably bribery and corruption is *de rigeur* within this sub-set of employment practices. Furthermore, while the Ukrainian Government have taken steps to counter bribery and corruption, it has little effect other than driving up the price of bribes in reflection of the higher risks (see Jain, 2001). A related feature is that under Communism the black market economy created and sustained a market for shortfall products within the system. The black economy was, by definition 'off the books' and more often than not involved in trading goods and services illegally.

As has been argued in this article there has emerged a distinct interplay between informal working and illegal working, between the grey economy of informal working and the black economy of illegal working. The operators of the black market under transformation conditions were well placed to take the economic and political opportunity to expand their

trading relationships with the clientelist groups associated with the new ruling elites. The old *nomenklatura* and the *penumbra* mafia operators of the black market thus have a vested interest in blocking any 'reform' of the economy constructed in regulatory form. The two social forces combined to preserve their position within the new market-based economy. Their complicity with, and sometimes integration into the state machinery regularises irregularity, and ensures the continuation of old habits alongside attempts to introduce new regulatory regimes based on the western ideal. In conclusion, we can begin to appreciate that rather than being a temporary dysfunction, 'wild' capitalism emerges as the normal *modus operandi* of post-communist transformation. Orthodox prescriptions merely exacerbate the problems of wild capitalism by opening further the doors of irregular market behaviour and blocking the possibility of economic convergence. Most importantly, in terms of structure, the process of transformation remains inextricably linked to a particular model of labour exploitation that feeds more general economic asymmetries between east and west.

Conclusion

What has been argued in this article is that the lack of economic convergence and persistence of dysfunctionality in post Communist transformation is a direct product of the dominant prescribed political economy. Rather than encourage convergence and tame dysfunctionality, neoliberalism and its offspring of labour market reform has created the conditions for continuing economic divergence and for wild capitalism to survive and thrive. Debt dependence and labour exploitation has not proved a sustainable option for post Communist economies and consequently the financial crash of 2008 has further exacerbated and exposed the underlying social and economic problems.

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Notes

[i] Eurostat, Table tsieb2020

[ii] www.databasece.com/en/industrial-output-during-transition

[iii] www.eurofound.europa.eu/areas/qualityoflife/eurlife/index.php?template=3&radioindic=158&idDomain=3 accessed 5th April 2011. The Gini co-efficient actually varies considerably within the EU 15, with the lowest ratio recorded by Sweden (0.23) and the highest by Portugal (0.41).

[iv] See www.transparency.org/policy_research/surveys_indices/cpi/2010 for results

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