

**ECONOMIC STRUCTURE AND SOCIAL ORDER DEVELOPMENT IN POST-
SOCIALIST EUROPE**

by

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CHAPTER 1

Introduction

1.1 Aims of the thesis

This study aims to offer a fresh perspective on why, nearly twenty years after the collapse of socialism, the countries of post-socialist Europe have experienced such divergent trajectories of political development.¹ The study is based on the assumption that societies, or social orders, can be distinguished by the extent to which competitive tendencies contained within them – economic, political, social and cultural – are resolved according to open, rule-based processes. Social orders are also assumed to exhibit a ‘double balance’ between political and economic systems in which political systems will tend to reflect the prevailing economic system within a society, and that changes in one are necessary for changes in the other. In turn, this has implications for the wider form of social order; if a social order is to be characterized as open-access then the economic system must provide the conditions that facilitate greater political competition. In short, the two arenas are assumed to be mutually constitutive. The focus of this dissertation will therefore be on tracing which economic conditions facilitate increased levels of political competition. Principally, it will test the hypothesis that the nature of a country’s ties with the international economy, and the level of competition within a country’s economic system, will shape the nature of political competition within that society. After several decades of relative ‘bloc autarky’, the ongoing process of reintegration across the post-socialist region has resulted in varying patterns of interaction with the international economy. This study will focus primarily on the links with the international economy that are formed through export sectors.

¹ Where appropriate, the term ‘socialism’ is employed throughout this study in place of ‘communism’. This is based on the manner in which Marxism-Leninism, the official ideology of the ruling Communist parties of the region, used the expression ‘communist’ to describe the unattained utopian society of the future. Indeed, according to Kornai (1992, p.10), the ruling parties of the region never referred to themselves as communist, instead preferring to employ the term socialist to indicate that their rule was merely a point on the journey towards the attainment of communism. There are a range of other synonyms that might also be used to describe the socialist systems, including ‘Soviet-type system’, ‘centrally administered economy’, ‘command economy’ and ‘centrally planned economy’.

So far, a wide body of literature has sought to identify the determinants of variation in political development across the post-socialist region. Explanations for this variation that have been offered so far, include, but are not limited to: the role of ethnicity and nationalism (e.g., Horowitz, 1993; Karatnycky, 2002); the success or otherwise in building capacious state structures (e.g., Holmes, 1996; Ganev, 2005, 2007; Colton and Holmes, 2006); the choice of institutional arrangements after the collapse of socialism (e.g., Frye, 1997; Elster, Offe and Preuss, 1998; Ostrow, 2000; Fish, 2006); the extent of political party development (e.g., Kitschlet *et al*, 1999; Lewis, 2002; Kopecky, 1995, 2008); the strength of civil society (e.g., Linz and Stepan, 1996; Ekiert and Kubik, 1999; Morje-Howard, 2003; Uhlin, 2005); geographical location (Kopstein and Reilly, 2008); the choices made by elite political actors (e.g., Przeworski, 1991; Eyal, Szelenyi and Townsley, 1999; Haughton, 2005); initial conditions and the legacies inherited from the socialist-era (e.g., Stark, 1994; Crawford and Lijphart, 1995; Bruszt and Stark, 1998; McFaul, 1999; Hedlund, 1999); and the role of external forces, such as the European Union (e.g., Jacoby, 2004; Vachudova, 2005; Hanson, 2007a). These explanations all have their merits and constitute valuable contributions to the debate surrounding the determinants of the divergent trajectories of political development across the region.

Few studies, however, have examined the role of structural economic variables in explaining political outcomes. Where economic variables are considered, it is very often as the dependent variable, with political factors being used to explain why, for example, some countries have been more successful than others in undertaking economic reform (e.g., Fish, 1998, 2005; Hellman, 1998), why some countries adopted the privatization strategies that they did (e.g., Hare, Batt and Estrin, 1999; Gould, 2003; Appel, 2004), and how institutional structures have shaped the emergence of different ‘varieties of capitalism’ across the region (e.g., Hall and Soskice, 2001; Amable, 2003; Lane and Myant, 2007). Where economic phenomena are considered as explanatory variables, trends in economic output have been considered to be an important factor in shaping political development. For instance, sustained economic growth has been posited as a necessary condition for the development of democratic tendencies (e.g., Lipset, 1959;

Rostow, 1961; Bunce, 2000; Janos, 2000). However, cases where countries that have experienced periods of high rates of economic growth have become more, not less, authoritarian indicate that perhaps economic growth is not a satisfactory explanation on its own (see, e.g. Karl, 1997; Ross, 2001; Fish, 2005). Rather, it suggests that what a country produces, and how its economy is organized, might offer a more plausible explanation of patterns of political development.

The structural characteristics of an economy, the relationship between its constituent organizations, and the implications that these have for the development of competitive political tendencies, are the subjects of this study. The crucial importance of political variables in explaining political outcomes across the post-socialist space is not disputed. However, the conception of politics that underpins this study is much broader than studies that focus primarily on political explanations of political outcomes. For example, where comparative studies focus on, for example, institutional design – i.e., on the constitutional arrangements of a country, the distribution of legislative and executive functions, and electoral rules – it is often assumed that political outcomes are contingent on choices made at the onset of the reform process (Hellman, 1998; Fish, 1998). This neglects the importance of political and, more frequently, economic legacies from the socialist-era, broader political factors beyond the scope of how central governments are organized, and on structural economic factors that shape the incentives for certain types of political behavior. It is this imbalance that this study seeks to redress.

Broadly speaking, the focus throughout this study is on the relationship between the structure of a country's economic system and the types of social order that have developed across the post-socialist region. Specifically, attention is focused on how different patterns of integration with the international economy, primarily through the role of export sectors, have shaped the development of different types of social order. Social order type – defined in greater detail in Chapter Two – broadly refers to the extent to which competition within societies is resolved according to impersonal, universally applied rules. Thus, unlike many existing studies in comparative political economy, the explanatory framework emphasizes not the role of the state in shaping the economy (e.g.,

Amsden, 1989; Evans, 1995, Wade, 2004), but instead on how structural economic variables shape politics (e.g., Shafer, 1994; Karl, 1997; Robinson, 2004; Greskovits, 2005).

Although progress or otherwise in developing democratic institutions across the post-socialist region is the subject of a large body of existing research, the focus here is not on explaining variation in the formal, procedural indicators of democracy. Instead, the dependent variable – the type of social order – is more narrowly defined to encompass the extent to which competition within societies (in both the economic and political arenas) is resolved according to impersonal, universally applied rules. In this sense, issues of accountability, the rule of law, and the prevalence of corruption are emphasized more directly than the procedural aspects of democracy (e.g. elections, constitutions, formal institutional configurations, etc). These variables do, however, act as a measure of the quality of democracy in societies, particularly where many of the formal institutions of democracy may have already been adopted but only in a manner that is inconsistent with the substantive meaning of democracy (Wilson, 2005; Berg-Schlosser, 2007). Thus, while the focus is not on democracy *per se*, it is on those very factors that determine whether or not the informal practices of a society are consistent with the formal, procedural institutions. As such, any conclusions drawn on the relationship between economic structure and the dependent variable, as defined in this dissertation, are likely to have implications for the wider study of democratic development, both across the post-socialist region and elsewhere.

The conceptual framework presented in this study is, however, also broader than much of the existing research on, for instance, the processes of state formation across the post-socialist region (see, for example, Gryzmala-Busse, 2006; O'Dwyer, 2006; Ganey, 2007). Although these studies also explore the impact of competition on political outcomes, their attention is directed towards the narrower task of explaining patterns of state exploitation by political parties through the development of patronage networks. In this sense, the subject of this dissertation is broader because any variation in type of social order has much wider implications than simply for patterns of state exploitation, or relations between political parties and the state. While the type of social order prevalent

in any given society will surely help explain why some states are subjected to more predation by particular organizations than others, it also has implications for myriad other spheres of political and economic life. Furthermore, where these studies identify political competition as the key to restraining ‘rent-seeking’ across the post-socialist region, the sources of this political competition remain ambiguous (Hellman, 1998; Grzymala-Busse and Jones-Luong, 2002).² In short, this study proposes an analytical framework that might lead to a greater understanding of why some societies exhibit greater levels of economic and political competition than others.

Given that the object of this study – variation in social order type – is broadly related to a range of other areas of research, this dissertation is expected to make a contribution to two main existing areas of research. First, it is hoped that the study will make a contribution to research on institutional explanations of political behaviour. As will become clear in the next chapter, the dependent variable is defined in a relatively new manner, with the concept of social orders still very much in its infancy in terms of the volume of academic attention that has been paid to it. So far, discussion of social orders – as defined by North, Wallis and Weingast (2006, 2007, 2009) - and their determinants has been limited to the mature democracies of Western Europe and North America. In examining social order variation in less economically and politically advanced countries, this study represents an application of an original conceptual framework in a new setting. The use of a structural economic explanatory variable offers an additional, original explanation of social order variation to those posited by North, Wallis and Weingast. Indeed, while structural economic explanations of political outcomes are not entirely new – they have, for example, been used in both transition (e.g., Robinson, 2004; Fish, 2005) and non-transition (e.g., Paige, 1991; Karl, 1997) contexts - the precise causal relationship as specified in this dissertation is new. In particular, the emphasis on how economic competition and political competition is mediated through organizations located in the civic, political and economic sphere (see

² Rents can be defined as ‘profits in excess of the competitive level’(see Brealy and Myers, 2000). Rents, like competition, are ubiquitous. They accrue to the individuals or organizations that own or control an economic asset, when the benefit received by that asset for performing any action exceeds the opportunity cost of performing the action. Because of the similarity between profit and rent the choice of using the latter over the former is, in effect, down to the discretion of the user.

Chapter Two) offers a simple yet compelling explanation of how changes in the production structure of an economy can lead to increased competition at the political level. In this sense, this study builds on existing concepts and develops them further, offering a more precise specification of the causal mechanisms that link economic and political competition than currently exists.

Second, this study is intended to make a contribution to the existing research on the different patterns of political behaviour that have been observed across the post-socialist bloc since the collapse of the socialist regimes between 1989-1991. Unlike many of the existing accounts of political behaviour in the post-socialist area, the dependent variable is defined not in procedural terms, but instead in a way that focuses attention on those substantive factors that offer a more meaningful measure of institutional development across the region. Again, while existing studies have also examined institutional development across the region, the specification of the variables, and the causal mechanisms linking them, has not been examined in the post-socialist context. Moreover, if the use of a structural economic explanatory variable is relatively rare in the wider literature on institutional political economy, it is a similarly underresearched determinant of institutional development in the post-socialist region.

What follows is an exercise in testing a small number of conceptually simple, but original, hypotheses. These hypotheses are derived from a broad range of sources and disciplines, including political science, political economy, institutional economics and politics, and industrial organization. While this seemingly diverse array of theoretical influences makes classification of the subject area of this dissertation somewhat difficult, it is probably best viewed as an economic explanation of political behaviour. It is not an explanation of economic outcomes *per se* (e.g., variation in levels of output, employment levels, etc); although it is certainly true that the nature of a given social order has important implications for the organization of economic activity that takes place within that society. The fact that this dissertation represents an attempt at providing an original explanation of a relatively originally defined dependent variable also means that the conceptual framework, and any conclusions derived from this study, should be viewed

not as definitive, but instead as merely the preliminary stages of the construction of a more robust explanation of political behaviour.

1.2 How the study is approached

This is primarily a study in comparative political economy, making use of data – both qualitative and quantitative - for nineteen countries over a period of nearly twenty years. As outlined above, some chapters compare more countries than others, with Chapter Four providing a very broad overview of the relationship between the two main variables across the nineteen countries under examination in this study, while the case study chapters examine only one or two examples at a time. Broadly speaking, the comparative method centres on three main objectives (Landman, 2000, pp.4-12). The first objective of comparison is *contextual description*; the process of describing the political phenomena and events of a particular country, or group of countries. Quite simply, this enables political scientists to describe the main features of different countries. Good description serves the purpose of providing the raw data that can permit higher levels of explanation. The data contained in Chapters Three and Four, along with the observations made in the case study chapters perform this role in this study. The second objective of comparison is *hypothesis-testing*, the *raison-d'être* of newer fields of comparative politics (Mayer, 1989). Comparisons of countries enable rival explanations to be ruled out and hypotheses derived from certain theoretical perspectives to be tested. This study performs this role by first generating a series of simple hypotheses in Chapter Two, identifying a method of measurement in Chapter Three, and then marshalling the evidence furnished from both the broad cross-country data and the case studies to test these hypotheses. The third objective of comparison is *prediction* based on the generalizations and conclusions that emerge from rigorously testing hypotheses. This study does not focus on making predictions about other countries, but the conclusions drawn throughout the study can form the basis for making predictions in future research.

While these constitute the objectives of the comparative method, there are both advantages and limitations associated with it that ought to be considered. In order to illustrate these differences, it should be noted that the central distinction between

different comparative methods depends on the trade-off between the level of abstraction and the scope of countries under examination (Mair, 1996). In general, the greater the level of conceptual abstraction, the more potential there is for the inclusion of a large number of countries, allowing conceptual frameworks to ‘travel’ across different contexts (Sartori, 1974, 1994). Alternatively, focus on one country or a few countries permits researchers to use less abstract concepts that are more tailored to the specific contexts under scrutiny. Representing all three types of analysis (large-*n*, small-*n*, and single case studies) as comparative differs from some other typologies contained in the literature on comparative politics (e.g., Lijphart, 1971; Collier, 1991).³ For example, single case studies are not always considered comparative even if they have comparative merit. However, if research – even in a single case study – strives to make larger inferences about political behaviour through some form of comparison and uses concepts that are applicable to more than one country, it should be considered comparative (Lichbach and Zuckerman, 1994, p.4).

The advantage of large-*n* studies lies in the extensive coverage of countries that facilitates stronger inferences and theory-building, since a hypothesized relationship can be demonstrated to exist with a greater degree of certainty. A second advantage lies in the ability to identify ‘deviant’ cases or ‘outliers’. These are cases where values on the dependent variable are different to than those that would be expected given the values on the independent variable. There are, however, several disadvantages to the large-*n* study. First, because most large-*n* studies tend to be of a quantitative nature, researchers can often be constrained by the availability of good quality data.⁴ Secondly, measurement of variables can also be problematic. Finally, the high level of conceptual abstraction can sometimes lead to a misspecification of the causal relationship between the two variables (i.e., a Type I error).

³ It should also be noted that this nomenclature tends to confuse the terminology (Eckstein, 1975). It is possible to have a single-country study with a large number of observations, such as in a single-case study that examines multiple elections over different periods of time, or separate instances of high employment within the same country. Here, *n* is used to denote the number of observations.

⁴ Finer’s (1997) qualitative comparison of regime types over 5000 years and across space is a notable exception.

Single-case studies exhibit the opposite tendencies. As noted above, a single-country study can be considered comparative if it employs or develops concepts that are applicable to other countries (i.e., as opposed to ‘atheoretical’ or ‘configurative-ideographic’ studies). Such studies are useful for generating hypotheses for theories that are yet to be fully specified, or as ‘plausibility probes’ (Eckstein, 1975, p.108), where the study represents the first test case for a fully specified theory. Single-country studies can also be used to confirm or infirm existing theories, or to identify deviant countries in the hope of testing existing hypothesized relationships more rigorously. While enhanced detail and attention to country-specific phenomena are obvious advantages of single-country studies, the main disadvantage lies in the temptation to treat each case as ‘unique’, effectively disregarding the comparative method.

Finally, the ‘focused comparison’ (Hague *et al.* 1992) of only a few cases achieves control through the careful selection of countries that are analyzed using a level of conceptual abstraction that falls somewhere between the single-country study and the large-*n* study. This enables the researcher to test more variables in greater depth. This type of study is often referred to as ‘case-oriented’ (Ragin, 1994), due to the country being the usual unit of analysis. Such methods of analysis permit the more rigorous testing of hypothesized relationships than is possible in a large-*n* study, while allowing more room for explicit comparison than is possible in single-case studies. As such, a range of analytical tools – both quantitative and qualitative - are available to the researcher, depending on the object of analysis.

This dissertation attempts to combine elements of all three approaches. Chapter Four utilizes a range of data and statistical techniques to provide a preliminary test of the hypothesized relationship between economic structure and social order type across the nineteen countries from the post-socialist region. This is then followed by a number of case studies that are used to investigate the link between the two variables in greater depth using a range of quantitative and qualitative methods, including the use of statistics, elite-level and expert interviews (for Belarus, Estonia and Russia), and extensive use of secondary sources. Given that the theoretical framework employed throughout this study is original, it is hoped that this mixture of methods will help test the framework more

rigorously than would be possible through an exclusive use of either the large-*n* or single-case study approach.

1.3 Thesis structure

This thesis explores the relationship between economic structure and social order development across post-socialist Europe, adopting a broadly comparative approach. The chapters analyse developments in both economic structure and social order up to the end of 2007. The time frame selected is due in part to data availability, but also because the events surrounding the global economic crisis that began in the summer of 2007 constitute an exogenous shock to the region that is likely to have significant implications for the economic and political development of the region in the future. As such, this provides a natural ‘cut-off’ point for the chronological scope of the study. Some basic observations on the global economic crisis that began at the point at which this study ends, and its implications for the issues that are discussed here, are made in the concluding section. The chapters are ordered as follows.

Chapter Two outlines the conceptual framework. It opens with a discussion of the methodological foundations on which the remainder of this study is based, and then outlines the conceptual framework that will be tested throughout the study. The first section provides an overview of institutional approaches to economic and political behaviour, locating this study in the historical institutionalist tradition. This is followed by a discussion of the dependent variable: social orders, or more precisely, the institutional order of a society. Social orders are shown to differ in the degree to which competition is prevalent, and also in the extent to which competition is resolved according to impersonal, universally enforced rules. A third section then outlines an explanation for the variation in how competition is channeled across the post-socialist region. It is suggested that different patterns of integration with the international economy, as manifested in the structure of a country’s export profile, offer a parsimonious explanation of the sources of social order variation across the region. In essence it is argued that different patterns of integration with the international economy result in distinct patterns of economic and political competition across the region.

Chapter Three provides an overview of the data that are used to measure the relationship between the dependent variable (social order) and the independent variable (economic structure) since the collapse of the socialist regimes across the region between 1989 and 1991. Subsequent sections that refer to economic structure or type of social order before the collapse of socialism utilize a range of different sources and subjective assessments due to the unavailability of comparable data. However, the focus of much of this study is on developments since the collapse of socialism and it is for this period that data are available. The first section describes the World Bank data sources that are used to measure types of social order. The second section outlines the measures used to identify different types of economic structure across the region. This is done by comparing export profiles. The final section provides the rationale behind the case selection for subsequent chapters, identifying three clusters of cases among the countries of the region. The subsequent case studies examine exemplar cases from each of these clusters.

Chapter Four provides a comparison across space and time of the main features of the region's place within the wider international economy. The overall objective of this chapter is to provide a historical overview of the development of both economic structure and social-order development across the socialist and post-socialist region. Specifically, it examines the variation in export structures across the region between the 1980s, before the collapse of socialism, and in 2006, assessing not only whether they have changed over time, but, perhaps more importantly, how they have changed. The overall objective of this chapter is to provide an historical overview of the development of both economic structure and social-order development across the socialist and post-socialist region. The first section traces the main patterns of interaction between the countries of the region and the international economy up until 1980. The second section considers the structure of the region's exports at the collapse of socialism and also the different regime-types that were in existence at this point. The third section outlines the broad patterns of continuity and change in economic structure across the region. The final section explores the relationship between economic structure and social order type by comparing the explanatory variable with other possible explanations of variation in social order across

the region. It is argued that the hypothesized relationship between the two variables does appear to be evident across the region. The subsequent case studies are used to examine this relationship in greater detail.

Chapter Five differs from the other case-studies contained within this study in so far as it examines a case from the socialist period. However, the application of the conceptual framework is just as pertinent. The Soviet Union was a classic limited-access order. It also had a very specific economic structure with a distinct pattern of integration with the international economy. These two features – a limited-access order and an economic structure that left it dependent on natural resource exports from the 1970s onwards – existed in a symbiotic relationship that prevented the Soviet Union from adapting to the changing conditions of the international economy. Quite simply, natural resource rents reduced the incentive for the Soviet leadership to engage in the sort of systemic change that was required for it maintain its position as a geopolitical superpower. However, once these rents dried up, the fragilities of the prevailing limited-access order, which prevented it from modernizing the technological base of the economy, left the leadership in a position where it was forced to engage in a reform process that grew rapidly more radical. The ultimate consequence – the collapse of the Soviet Union – was almost certainly unintended. In this respect, the reforms undertaken in the face of declining natural resource rents were a classic case of agents attempting to alter the institutional framework around with them with unintended consequences.

Chapter Six picks up from the previous chapter and examines the role of the natural resource sector on the political development of the Soviet Union's largest successor state, the Russian Federation. Russia is selected as an exemplar case from the first group of countries identified according to their position on the independent variable. This chapter is the longest of the case studies, essentially because it contains two distinct periods – the Yeltsin period (1991-1999) and the Putin period (1999-2007) - that require separate attention because of the contrasting trajectories of political economy in Russia during these two periods. Here it is argued that Russia has failed to develop an open-access order and has instead been constrained by a transnational economic structure that is concentrated in only a few natural resource sectors that tend to be characterized by

monopolistic or oligopolistic market structures. This has reduced economic competition in Russia, preventing the emergence of the sort of broad array of social and political forces that, independent of the state, are crucial in providing the foundations for open-access order development.

Chapter Seven compares two cases from the middle cluster of countries that are identified in Chapter Three, Belarus and Romania. These two countries have both exhibited contrasting trajectories of economic restructuring and social order development. As such, they represent excellent cases against which the conceptual framework can be tested; if the divergent patterns of economic restructuring appear to explain the variation in social order development, then the conceptual framework employed throughout this study will be given greater support. The evidence presented in this chapter appears to confirm the hypotheses outlined in Chapter Two. Belarus has experienced very limited economic restructuring, with relatively low levels of investment – both domestic and foreign – and a low level of private sector activity. This has resulted in continued state dominance of the Belarusian economy with very little evidence of significant levels of economic competition, in turn reducing political competition to an almost non-existent level. In such conditions, Belarus has experienced a persistent decline on all indicators of social-order development. By contrast, the Romanian case illustrates the decisive effect of economic restructuring on social-order development. After experiencing very limited economic and political change during the 1990s, the burst of investment, particularly foreign, that accompanied the beginning of substantive negotiations for EU accession in 1999, helped stimulate the diversification and technological upgrading of Romania's transnational economy. This boosted economic competition in Romania, leading to a slow but steady improvement in Romanian social-order indicators.

In **Chapter Eight**, Estonia represents the third group of countries identified in Chapter Three. It is the smallest economy in the sample and has the best state statistical service of the case studies. This permits greater detail being paid to the structure of particular sectors. It is argued that Estonia is an example of a country that has developed a diverse, and in some areas, technologically sophisticated, economy. Because of favourable initial economic and political conditions, and as a result of judicious and

autonomously formulated policy choices made early after independence from Soviet rule, economic pluralism and competition have been the defining characteristics of Estonian development. Estonia's integration within the wider international economy has been deep (i.e. it displays a high degree of openness to trade) and based on a diverse range of activities, meaning that no single sector dominates Estonia's export profile. This has been complemented by vibrant competition within sectors, thus facilitating the development of an open-access political system that has so far proven to be one of the success stories of post-socialist Europe. Rapid economic restructuring based on deep integration with the international economy, a diversification of the production profile, and market structures characterised by high levels of competition, have all helped cultivate a competitive political system, resulting in a broadly positive trajectory of social order development.

The **Conclusion** considers the main findings of the thesis, assesses theoretical considerations, and identifies areas for future research. It is argued that while the conceptual framework developed in this study does appear to have some analytical utility, further research would be required to provide greater evidence to support the hypothesized links between the independent and dependent variables, and that the model employed here is not mis-specified. Finally, the findings of this thesis are placed in the context of the current economic crisis that is, at the time of writing, ongoing, and likely to exert a considerable influence over both economic restructuring and social order development in the region. Economic restructuring and institutional development – along with demographic pressures and the effects of the ongoing financial and economic crisis – are identified as the most important challenges that are likely to face the region in the future. It is argued that the countries of the region will only be able to cope with the challenges of its demographic structure and the effects of the economic crisis if further economic restructuring and institutional development take place.

CHAPTER TWO

Conceptual framework: economic structure, the international economy, and social-order development

2. Introduction

This chapter presents the theoretical apparatus that is used to explain political developments across the post-socialist region from a fresh perspective. Broadly speaking, the focus throughout this study is on the relationship between the structure of a country's economic system and the types of social order that have developed across the post-socialist region. Specifically, attention is focused on how different patterns of reintegration with the international economy, primarily through export sectors, have shaped the development of different types of social order. This chapter presents a discussion of the methodological foundations on which the remainder of this study is based, and then outlines the conceptual framework that is employed throughout. The first section provides an overview of institutional approaches to economic and political behaviour, locating this study in the historical institutionalist tradition. The second section defines the object of explanation: social orders, or more precisely, the institutional order of a society. Social orders are shown to differ in the degree to which competition is prevalent, and also in the extent to which competition is resolved according to impersonal, universally enforced rules. The third section proposes an explanation for the variation in how competition is channeled across the post-socialist region. It is suggested that different patterns of integration with the international economy, as manifested in the structure of a country's export profile, help explain the variation of social order across the region.

2.1 Institutional explanations of political and economic behaviour

2.1.1 Institutions and organizations

Institutional accounts of both politics and economics do not share a common conception of what exactly constitutes an institution. As a result, a certain level of ambiguity

surrounds the precise definition, with institutions meaning many things to different people. In general, however, most working definitions tend to emphasize the importance of formal structures and the informal rules and norms that structure human conduct. Douglass North's (1990, p.3) widely used definition of institutions suggests that institutions are "the rules of the game in a society or, more formally, are the humanly devised constraints that shape human interaction" and that they "structure incentives in human exchange, whether political, social or economic". Elsewhere, March and Olsen (1989, p.22) define institutions more broadly to include "beliefs, paradigms, codes, cultures" so that human behaviour is guided by a logic of appropriateness. All institutions, at the formal, social, or personal level, contain a degree of abstraction; they are frameworks for analyzing the world in which humans live. This implies that institutions are sometimes difficult to identify observationally. While some components of institutions are readily observable, such as formal rules (e.g. constitutions, legal frameworks), other components are almost impossible to observe or measure precisely, such as shared beliefs or conventions.

If institutions that are at times abstract frame human behaviour, it is through organizations that humans undertake myriad forms of social interaction (North, 1981, p.33).⁵ Organizations are somewhat more concrete than institutions as they are composed of groups of individuals, more or less directed toward a common goal through more or less coordinated behaviour (North, Wallis and Weingast, 2006). It is organizations that make political and economic choices within a society. Most human activities involve a degree of cooperation among individuals and the organizational forms of cooperation and coordination that exist within a society directly affect a country's political and economic performance. Therefore, any institutional explanation of political economy must show an appreciation of the manner in which the institutional structure of a society shapes the kind of organizations that can be created and sustained within it, with certain institutional structures being more or less supportive to the existence of certain organizations.

⁵ There is some ambiguity within institutionalist literature as to where institutions end and organizations begin. For example, some argue that the state is an institution, while others view it as an organization, albeit the primary organization within a society. Others use the terms interchangeably, seeing the state as both institution and organization.

This distinction between institutions and organizations is somewhat confused by the fact that almost all organizations have an institutional structure. As noted previously, institutions are essentially frameworks for interpreting the behaviour of other people and a significant benefit of belonging to an organization is the ability to coordinate the actions of actors with the actions of other actors within an organization. Effective coordination requires that individuals share a set of models about how people behave. Coordination within an organization requires that actors share a set of models about how they each will behave. Because the rules, norms, and conventions structure the relationships of an organization's members, they constitute its institutional structure. In some organizations these structures are formal; in others, they are informal. These rules can be labeled 'organizational forms' (North, Wallis and Weingast, 2006, p.22).

2.1.2 Analytical approaches to studying institutions

Institutionalism and the study of institutions have become increasingly prevalent in explaining political and economic behaviour.⁶ Its origins lie in the attempt to contextualize both politics and economics in institutional terms and to view the conditions of human opportunity as being, to varying degrees, framed institutionally.⁷ In economics, institutions were, at least until the 1970s, largely taken for granted. The dominant neo-classical paradigm assumed a frictionless world in which the effects of government and institutions were ignored, thereby assuming transaction costs to be zero (see, for example, Arrow and Debreu, 1954). Once it was accepted that different institutional structures might raise or lower transaction costs for economic actors, it became apparent that the elegance of rational choice based attempts at explaining economic behaviour might be matched only by their limited utility in explaining economic reality. In political science, institutions - particularly those associated with the state - had been perceived as neutral arenas upon which certain political actors imposed

⁶ This is evident in studies that focus on the post-socialist region. See, for example: Crawford and Lijphart (1995); Hausner, Jessop, and Nielsen (1995); Elster, Offe, and Preuss (1998); Robinson (2000).

⁷ Early examples from the new institutional economics include: Coase (1937, 1960, 1988); Olson (1965); Demsetz (1967); North and Thomas (1973). In political science, notable examples include: Skocpol (1979); Evans, Rueschemeyer, and Skocpol, eds. (1985); Krasner (1988); Rueschemeyer, Stephens, and Stephens (1992).

their own preferences (e.g. rational choice theories and pluralist accounts), or as reflections of social structures (interest-group theories and Marxist accounts).

The rise of institutionalism in both economics and political science can be seen as a reaction to the prior ascendancy of rational choice based, deductive methods in the social sciences and as a move towards incorporating a more inductive and contextually sensitive approach to explaining both politics and economics. In economics, the new institutional economics (NIE) literature emphasized the context in which economic behaviour is located, with institutions shaping the incentives and constraints imposed upon economic actors, and thereby raising or reducing transaction costs and increasing or decreasing the economic efficiency of a given social system. Indeed, institutions have been seen by some as offering the best explanation of variation in patterns of economic growth and prosperity throughout history.⁸ Furthermore, such theorists argue that not only are economic institutions thought to determine the aggregate economic growth potential of an economy, but also as shaping the potential economic outcomes in the future, such as the future distribution of resources amongst groups within a society.

Broadly speaking, both strands of literature share the view that institutions – both economic and political - are not entirely derivative of either social structures or the preferences of individuals, and that institutions have an independent effect on economic and political behaviour, the influence of which fluctuates depending on the historically specific conditions of each case. However, the diverse array of methods employed to analyse the effects of institutions on political and economic behaviour render the field a conceptual *mélange*, with different approaches taking varying positions on the role of structure and agency, rationality and rule following, and the extent to which institutions evolve or are the product of purposeful design.

2.1.3 From the 'old' institutionalisms to the 'new'

No account of institutional thought, however brief, would be complete without first mentioning the old institutionalisms used to analyse economic and political

⁸ See, for example, Acemoglu, Johnson and Robinson (2001, 2002, 2005).

behaviour. In political science, the old institutionalism focused on the formal institutions of government and conceived the state in terms of its political, administrative and legal arrangements (Schmidt, 2006, p.99). It employed an essentially descriptive methodology to explain the different relationships within a given polity among the various levels and branches of government. In so far as it was comparative, it described various state configurations and examined the similarities and differences in the manner in which each worked and, consequently, its approach was considered to be largely atheoretical with very little predictive utility. Later, more 'holistic' approaches (e.g. structural-functionalist and Marxian accounts) became dominant, with the formal institutions of the state being replaced as the object of analysis by an emphasis on the wider political system, explaining political behaviour in terms of the equilibrium-seeking functioning of its component parts through interest articulation and aggregation (e.g. Almond and Powell, 1966). Systems were viewed in static terms and revolutionary change was considered an anomaly, with political changes absorbed by the system as an instance of 'homeostatic equilibrium'. Where structural-functionalist approaches were linked to theories of the state, it was assumed that the state's role was that of arbiter among competing interest groups (Dahl, 1961).

These approaches were later challenged by Marxian analyses which, although similar in their systemic focus, viewed the state (the pre-eminent political institution) as a superstructure operating in the service of the bourgeoisie. Here the system was considered as functioning via class conflict rather than as competition among interest groups, with the predicted outcome being systemic self-destruction through revolutionary change (e.g. Dahrendorf, 1959). Over the course of the 1960s and 1970s, the 'methodological holism' of structural-functionalist accounts gradually gave way to the 'methodological individualism' of behaviouralist explanations which explained political behaviour in terms of general laws and propositions that were established by observation (Downs, 1957; Riker, 1981; Przeworski, 1991 and 2000). This involved attempts at quantifying political behaviour and, where this was not possible, importing rational choice approaches based on mathematical models employed in economics (e.g. Downs, 1957). The behaviouralist approach treated institutions as arenas in which utility

maximizing politicians and groups sought to advance their own interests. It was against this background that a renewed emphasis on the role of institutions in framing human behaviour emerged towards the end of the 1970s.

The old economic institutionalism was also based on a rejection of the assumption that human behaviour could be reduced to its methodological individualist parts. However, it emerged at the beginning of the twentieth century and so predated the turn against methodological individualism in political science by around 70 years. The most prominent strand of old institutional economics (OIE) is associated with the work of Thorstein Veblen (see, for example, 1904, 1915, 1919) and, later, Clarence Ayres (e.g., 1952, 958), who built upon Veblen's previous work.⁹ According to Veblen, economic behaviour is socially rather than individually determined with economic organization being a process of ongoing evolutionary change in which there exists a dichotomy between the instrumental (or ceremonial) and technological (instrumental) forms of behaviour. He addressed the effects of the introduction of new technology on existing institutional structures, and the manner in which established social conventions and vested interests resisted or welcomed these changes. Consequently, Veblen appreciated that existing institutions might not 'fit' the prevailing instrumentalities (technology) if powerful political and economic interests saw the newly available technology as inimical to their interests.

⁹ Rutherford (1993, pp. 1-3) also identifies a second strand. The second school within the OIE has its foundations in the work of John Commons (e.g., 1924 and 1931) and was later developed by the likes of Warren Samuels and Allan Schmid (1981). Whereas the work of the first school fails to address the judicial and political processes of conflict resolution that shape economic behaviour, the second school emphasizes legal structures, property rights and organizations, in particular how organizations evolve and affect the distribution of legal, political and economic power within a society. Institutions are viewed as outcomes of formal and informal processes of bargaining and conflict resolution between organizations, with the success of an institution being measured by the extent to which it generates satisfactory outcomes to the organizations that created it. This emphasis on institutional outcomes led opponents of the OIE, particularly those from the new institutional economics school (NIE), to complain that the OIE is not grounded in any rigorous, testifiable theory and is too descriptive; that there is a tendency to argue in holistic rather than in individualistic terms; that a rule-following, norms based decision-making framework is used instead of a rational choice framework; that there is a failure to appreciate the importance of economizing in decision-making processes; and that they suffer from an inability to give sufficient emphasis to unintended processes in institutional development, as opposed to processes of collective decision-making and institutional design (Rutherford, 1993, p.4). It was not until the 1960s that attempts were made by NIE scholars to incorporate some of insights of the OIE into more mainstream economic theory.

2.1.4 The 'new institutionalisms': a conceptual mélange

The 'new' institutional explanations of human behavior that emerged later differ over a wide range of methodological issues. Four broad schools of institutionalism can be identified that straddle both economic and political institutionalism: rational choice oriented approaches; structural institutionalism; historical institutionalism; and constructivist institutionalism. Each school varies according to the extent to which they emphasize: (i) methodological individualism or holism as the epistemological foundation on which their accounts are based; (ii) whether mathematically formal or non-formal methods of analysis are employed; (iii) the degree to which individuals are conceived as rational or rule-following actors; and (iv) the intentional and deliberative, or spontaneous, evolutionary nature of institutional design. This classification broadly captures some of the key similarities and differences between different strands of thought across both political science and economics; it is therefore an approximate categorization that does not capture many of the more subtle similarities, differences and crossovers between the four approaches.

2.1.5 Rational choice institutionalism

While accepting the importance of institutions in framing human behaviour, rational choice institutionalism places greater emphasis at the individual level of analysis. Individuals are seen as rational actors possessing fixed, stable and endogenously determined preferences who make strategic calculations in order to maximize those preferences. Consequently, institutions – both political and economic - are viewed in more instrumental terms.¹⁰ This instrument – the institutional framework of a society - structures the incentives within which rational actors advance and attempt to maximize their preferences. With the emphasis placed firmly on individual agency, many of the rational choice institutionalist approaches share the characteristics of traditional, neo-classically rooted (economics) methods of analysing social behaviour. In this respect,

¹⁰ Here the term “supervenience” has been proposed to indicate the priority of the individual over the social, while allowing for the social conditioning of individuals, stating that “whatever complex and reciprocal relations there are between social entities and individuals, it is the totality of individual facts which determines the totality of social facts” (Currie, 1984, p.345).

many examples of this approach are more reliant on mathematically formal methods of analysis, with a preference towards assuming actors' behaviour as being rational rather than rule (or norm) following, and, by extension, viewing the emergence of institutions as a function of deliberate human design (e.g. Coase, 1937, 1960, 1988; North and Thomas, 1973; Becker, 1995).¹¹ Despite this apparent emphasis on individual agency in rational choice approaches to institutional analysis, some studies adopt a stronger version of functionalism and presume that every organizational device has a function and that the function explains its presence. For example, studies that focus on the cost-reducing properties of certain organizational forms and organizational innovations – such as works that analyse the performance of the firm – show a tendency towards explaining individual motivations in terms of their functions, e.g. a reduction in a firm's transaction costs (Coase, 1937, 1988; Williamson, 1975, 1985).¹²

Rational choice approaches to institutional analysis have been criticized for a number of reasons. Firstly, they are weak in explaining anything other than interest-motivated action and offer only a 'thin' definition of rationality, thereby raising the level of abstraction but missing the more subtle, and often more important, sources of human behaviour (Mansbridge, 1990). Second, rational choice analyses are weak in their approach to change. Because of their emphasis on fixed preferences and equilibrium conditions, it is difficult to account for change in anything other than functionalist terms, i.e. the origins of institutions are explained by their outcomes and are, more often than not, seen to be socially efficient. Finally, rational choice explanations are weak in their treatment of power (Olson, 2000). The creation of institutions is seen as a quasi-

¹¹ Rational choice institutionalist analyses are also common in principal-agent theories of how 'principals' – e.g. senior state and government officials, or enterprise managers – maintain control or gain compliance from 'agents' to which they delegate power – e.g. bureaucracies, regulatory agencies, or lower level employees within a firm. The degree to which principals can ensure compliance from agents is viewed as a function of the prevailing incentive structure, and the extent to which asymmetries of information between principal and agent exist. In terms of institutional analysis, the behaviour of an institution can be reduced to the aggregate behaviour of individuals at all levels within that institution, each of whom bases their decisions on the perceived costs and benefits to each of their alternative courses of action (Ostrom, 1991, p.243). The reliance on methodological individualism is evident in the assumption that utility maximizing principals and agents often exhibit opportunism as well as self interest, or as Oliver Williamson suggests, they exhibit "self interest seeking with guile" (Williamson, 1985, p.30).

¹² All of these works share in common a focus on institutional frameworks serving the purpose of solving the problems of agency by reducing the transaction costs faced by individuals and organizations.

contractual process rather than being governed by asymmetries of power (Hall and Taylor, 1996). By neglecting the interests of the powerful, i.e. the practical context in which choices are formulated and made, this approach fails to appreciate that power and its distribution is the essence of both politics and economics, and that power and its application can explain socially inefficient outcomes.¹³

2.1.6 Structural and constructivist institutionalism

Structural institutionalist accounts describe the range of analytical frameworks that assert culture, values and norms as the primary explanatory factor in analysing institutions. Institutions are viewed as socially constituted and culturally framed, with actors operating according to each distinct ‘logic of appropriateness’ that exists within a society and is itself a function of culturally-specific rules and norms. In contrast to rational-choice theorists who see human behaviour in terms of an endogenous ‘self-interest’ that exists prior to institutions, structural institutionalist accounts see actors’ preferences as exogenous, i.e. as being framed by cultural institutions and historically specific values and norms (e.g. Fligstein, 1990; March and Olsen, 1989). These accounts do not lend themselves to formal methods of analysis and the tilt towards methodological holism sees individuals behaving not in the manner assumed by rational choice theorists, but instead in terms of rule or norm following behaviour. The main flaw in structural accounts lies in its implicit relativism that is a result of its emphasis on culturally unique structures and norms, i.e. on the system level of analysis, rendering cross-country analyses difficult as outcomes in individual cases are largely viewed as being the result of culturally specific conditions.¹⁴

It is also important to briefly consider the importance of the role of ideas and discourse in institutional analysis as it can introduce a dynamic element to approaches that may otherwise appear to be quite static. Although this can be considered as a

¹³ Instead, for rational choice theorists institutions are seen as largely neutral phenomena, existing to create a more stable environment in which rational actors can maximize their utility.

¹⁴ Because of its neglect of human agency and its emphasis on cultural norms rather than individual action, structural institutionalism can appear ‘culturally deterministic’. Consequently, this invites criticism that it is an analytical framework that is inherently static with too much attention paid to equilibrium conditions.

separate category in itself, it is possible to view the role of ideas within the context of each of the three constructs described here as each approach has its own view of the role of ideas within their original frameworks of analysis. Perhaps the central issue in terms of the role of ideas within the constructs outlined above is whether ideas are constitutive of institutions (or interests, in the case of rational choice approaches) or vice versa. Thus, while discursive institutional approaches do not incorporate formal mathematical models of analysis, the extent to which they perceive human behaviour as being essentially rational or rule-following varies depending on each case. For example, while Peter Hall sees ideas as constitutive of both interests and institutions in the introduction of monetarist ideas under the Thatcher government, he asserts the primacy of institutional structures in framing the environment in which Keynesian economic ideas were adopted across the world (Hall, 1989 and 1993). In the post-socialist context, Hilary Appel (2004) places the ideology of market liberalism at the centre of her analysis of the privatization process in the Czech Republic and Russia in the 1990s.¹⁵

2.1.7 Historical institutionalism

Historical institutionalism emphasizes the importance of the origins and development of institutions, which are explained as the outcomes of purposeful choices (although the outcomes may be unintended) and historically unique initial conditions. In this context, the central premise of rational choice institutionalism: that actors' preferences are fixed, stable and exogenously given, are rejected in favour of a more nuanced and realistic view that preferences are neither fixed nor entirely exogenously determined. As a result, such approaches tend not to utilize formal methods of analysis as the degree of abstraction associated with these methods would not capture the context-specific detail that is central to historical institutionalist analysis. Although lacking a common position on the role of structure or agency explaining human behaviour, most

¹⁵ Appel highlights the power of market ideology in driving the privatization process in spite of the array of structural forces that opposed such ideas. She does, however, argue that ideology can only go so far in explaining the adoption of certain privatization policies, and that agency level variables – such as the fact that opponents of liberal economic reform diluted many of the reforms that were implemented, particularly in Russia, and that the personal characteristics of key actors (especially Vaclav Klaus in the Czech Republic) in the privatization process were of significant importance – were also key factors in shaping the privatization process across the two cases.

proponents of historical institutionalism view actors as both shaping and being shaped by institutions (Hay and Wincott, 1998). Institutions, while shaping actors' preferences and effecting an uneven distribution of resources and power, are also created, reformed and altered by actors. This relationship is dynamic and mutually constitutive with institutions shifting in their role as both the independent and dependent variable at different points in the analysis.

Consequently, historical institutionalism incorporates both structure *and* agency with each empirical case determining which is more prominent in the explanation. Unlike rational choice analyses, historical institutionalist approaches tend not to neglect power. Instead, for example, in politics, the state is seen "no longer as a neutral broker among competing interests but as a complex of institutions capable of structuring the character and outcomes of group conflict" (Hall and Taylor, 1996). However, by focusing on the effects of positive feedback, timing, sequencing, and phases of change, the emphasis can often be placed not only on asymmetries of power and how they influence the development of institutions, but also on path-dependencies and unintended consequences (e.g. Thelen, 1999; Pierson, 2000, 2004). Interests, therefore, are contingent on context rather than being universally defined and change is viewed as an evolutionary process, often as the result of conflicts between competing groups. This emphasis on context can be perceived as being the primary weakness of historical institutionalism in the sense that it limits the extent to which generalizable hypotheses can be made and rigorously tested, rendering it a more descriptive method of explaining human behaviour with less predictive utility. These charges are discussed in more depth below.

2.1.8 Continuity and change in historical institutionalism

As the discussion above implies, many institutional approaches display an inherent tendency towards viewing institutional development in static terms. Because of the emphasis on fixed preferences in rational choice institutionalism, institutional continuity is often assumed as institutions are simply viewed as an extension of individual preferences. Structural institutionalist accounts also tend to emphasise the continuity of institutions, although this is a function of the preference for explaining

human behaviour in terms of cultural norms and social structures. Both sets of approaches also display an inherent functionalism that sees institutions as socially efficient. By contrast, historical institutionalist accounts – with the incorporation of both structure and agency – facilitate more realistic accounts of both institutional continuity and change that are not weighed down by accusations of functionalism. Integral to the historical institutionalist approach is the appreciation of the importance of the shifting distribution of power within a society in shaping the prospects for future change or stasis. This is particularly important in the post-socialist context where institutional structures – both formal and informal – have tended to be more fluid than in many other parts of the world, often creating the conditions for certain organizations to be able to impose their preferences on institutional development (Horak, 2007).

2.1.9 Institutional continuity: path dependence

The concepts of path dependence and historical contingency are central to the historical institutionalist explanation of human behaviour, with path dependency being cited as the defining characteristic of the institutionalist analytical framework (Krasner, 1998, p.67).¹⁶ The combination of historically specific circumstances framing the choices of self-interested actors can offer a path dependent explanation of institutional change in which prior institutional choices constrain the options available to actors and organizations for future development. Previous choices made by actors shape the choice set available to future actors and increase or reduce the probability for the occurrence of certain eventualities. Consequently, much attention is paid to moments of institutional formation, which are viewed as being crucial because of the possibilities for ‘locking in’

¹⁶ The concept of path dependency employed in economics is similar to that described here. Like historical institutionalist accounts, the historical past and cumulative processes are viewed as largely determining the choices available to decision-makers and the context in which these decisions are made. In a strictly economic context path dependence implies that the components of an economy – productive technologies, economic institutions, and the geographic distribution of economic activity – are the consequence of many minor and random developments. Where neo-classical economics tends to see the magnitude of an effect as derivative of the magnitude of the cause (i.e., that there is a linear relationship between the two), path dependence implies that small, and sometimes apparently minor causes, can have disproportionately large effects, often due to the importance of ‘increasing returns’ to specific courses of action. Prominent examples include Veblen (1915), Krugman (1991), Arthur (1994) and David (2000).

certain historical paths for future development.¹⁷ Nothing in path dependent accounts presupposes that institutional development will move towards teleologically defined, socially efficient outcomes, as in some rational choice and structural institutionalist explanations, because the outcomes of actors' decisions are not considered predictable, with unintended outcomes considered as much a possibility as intended outcomes. With this in mind, historical contingency – the notion that accidents or coincidences of history may leave lasting legacies – and the inevitability of multiple equilibria, are also integral elements of institutional development.

There are three main causal mechanisms by which the past can be viewed as shaping the present: first, by influencing the values, beliefs and habits of actors; second, that the existing institutional structure has created organizations with a vested interest in the maintenance of the existing structure; and third, past institutional frameworks may serve as a model for the creation of new institutional frameworks.¹⁸ Consequently, path dependence has a more precise meaning than simply asserting that 'history matters'. Instead, it is the direct and indirect effects of past choices and beliefs of political and economic organizations that shape the options available to decision-makers in the present. In this respect, inefficient outcomes, i.e. poor institutional performance, may persist because of the power of vested interests and because of potential imbalances in power between political and economic actors. This also incorporates the notion of 'sequencing' in which the order of events can also be of critical importance to explaining how certain future choices are made possible or impossible as the 'feedback' from previous choices shapes decisions in the present.

It has been argued that historical institutionalist approaches, with their focus on path-dependencies, can be "too contingent and too deterministic" leading them to over emphasise structures and processes over specific events and individuals (Thelen, 1999, p.385). This then leads to a weakness in explaining change as the focus is on continuities

¹⁷ It is also true that too much attention can be paid to the moment of institutional formation, and sometimes too little paid to the reasons behind the original choices that produced this particular path. The problem of locating the sources of institutional formation in the post-communist context are highlighted in Fish (1998).

¹⁸ Prominent accounts of path dependence include: Elster, Offe, and Preuss et al. (1998); North (1990, 2005) and North, Wallis and Weingast (2006, 2006 and 2009) .

and path-dependence. However, this implied hyper contingency is an oversimplification of the position. For example, the ‘critical junctures’ literature that considers ‘configurative’ moments and ‘punctuated equilibrium’ focus on specific moments or choices that open up certain possibilities for later developments but preclude others (Gourevitch, 1986; Krasner, 1988; Karl, 1997; Collier and Collier, 1999). Indeed, “nothing in path-dependent analyses implies that a particular alternative is ‘locked in’ after a critical juncture has passed, merely that certain outcomes are more probable than others (Pierson, 2004, p.52). Instead, change continues, but is seen as ‘bounded change’, with structures facilitating or inhibiting certain courses of action (Simon, 1982). This point is perhaps best summarized by Bob Jessop (1990, p.260) who, when discussing the state – but could equally be referring to any other organization or institution - argues that it is a dynamic and constantly unfolding system with its specific form at any given moment representing a crystallization of past strategies with the institutional structure “more open to some types of political strategy than others”. As will be discussed below, an openness to the possibility of path dependence in social science is not incompatible with moments of dynamic institutional change; merely, that the probability of either is contingent on the specific circumstances of each case.

2.1.10. Institutional change: path contingency

Change as much as continuity is part of the historical institutionalist approach to analyzing politics and economics, despite the fact that it is often criticized as being under-theorized with too much emphasis placed upon institutional stasis, stability and path dependence constraining action. Because of its incorporation of the assumption that actors’ preferences can be both endogenously and exogenously formed at different points over time, the relationship between institutions and behaviour is viewed as being mutually constitutive, thus facilitating a more dynamic conception of institutions within a framework that also facilitates continuity and path dependence. Change is usually incremental, as political and economic entrepreneurs perceive new opportunities or react to new threats to their well-being (North, 2005, p.6). However, sudden, sharp, non-linear periods of change are also possible, depending on the nature of the political-economic structure that is under examination, as some structures may be more ‘brittle’, and appear

stable on the surface, but are only capable of sudden change.¹⁹ Four sources of institutional change can be identified within the existing historical institutionalist literature: the ‘incidental institutions’ view; the ‘social conflict’ view; the ‘endogenous change’ view; and the ‘exogenous change’ view. These sources of change are often complementary and should not be viewed as mutually exclusive. Moreover, each source of institutional change demonstrates that institutional development need not always be *path dependent*, but instead that it can be *path contingent*.

The first approach to institutional change can be termed the ‘incidental institutions’ view.²⁰ This approach sees institutional change emerging as an unintended product of decisions taken at any given time, i.e. as an historical accident in which causes, intentions and outcomes do not fit tidily together. For example, Barrington Moore argues that class coalitions, and the way agriculture was organized, helped shape the political development of a number of democratic and non-democratic countries (Moore, 1966). However, the organization of agriculture is not chosen with an eye to its effects on political institutions, so these institutions are seen as an unintended consequence and, *ex post*, as historical accidents. In other words, historical accidents at critical junctures might shape institutional development, and these institutions may persist for a long time, with significant consequences. Such approaches can be weakened by placing too much emphasis on unintended consequences; clearly, history demonstrates that institutional development can be a function of both intended and unintended consequences.

The ‘social conflict’ approach asserts the importance of conflict between social groups as explaining institutional change within and across countries (e.g., Acemoglu, 2003; Acemoglu and Robinson, 2006, 2008). According to this view, economic and

¹⁹ The example of the Soviet Union is instructive in this respect. While it was often considered a very stable system, it was the inherent conservatism within the system that prevented it from changing and adapting to the changing demands imposed upon it by technological progress and political and economic competition with the West. When change did occur, it occurred at an extremely fast pace. This is discussed in greater detail in Chapter 5.

²⁰ The field of New Comparative Economics also emphasizes the differences in historical institutional choices across capitalist countries to explain later outcomes. In a similar way, La Porta, Lopez-de-Silanes, Shliefer et al. (1998, 1999) argue that the efficiency of institutions is largely explained by the choice of legal systems within a country. This choice then determines the potential for future efficiency. A summary of the literature and the basic foundations of this field is contained in Djankov, Glaeser, La Porta et al. (2003).

political institutions are not always chosen by the whole society (and not for the benefit of the whole society), but by the groups that control political power at the time (perhaps as a result of conflict with other groups). These groups will choose the institutions that maximize their own rents, and the institutions that result may not coincide with those that maximize total surplus, wealth or income. For example, institutions that enforce property rights by restricting state predation may not be in the interest of a ruler or organization that wants to appropriate assets in the future. By establishing property rights, this ruler or organization would be reducing its own future rents, and so may prefer institutions other than enforced private property. Consequently, “equilibrium...institutions will not be those that maximize the size of the overall pie, but the slice of the pie taken by the powerful groups” (Acemoglu, Johnson and Robinson, 2005, p.36). Thus, changes in the distribution of resources among competing actors and organizations and their perceptions of whether they are able to effect a corresponding increase in their size of the social ‘pie’ are central to any explanation of change. Opportunities for change can also emerge from endogenous competition if the socio-economic structure of a society is amenable to competitive tendencies among organizations.

The ‘endogenous change’ approach identifies variation across countries in terms of the differences in beliefs and ideological structures as a source of institutional change across and within countries. According to this view, societies may choose different institutional structures, with very different implications, because they – or their leaders – disagree about what would be good for the society. According to this approach, there is sufficient uncertainty about what constitutes the ‘correct’ institutional framework that even well-intentioned actors disagree about what might be good for their own people. When actors or organizations with a different conception of how to organize society find themselves in a position to effect institutional change – such as after a major social upheaval, or after an electoral victory – the probability of change increases, at least at a formal level. However, the extent to which the changes in belief structures are accepted by wider society at a more conventional and informal level often diverges with the changes that may have taken place at the formal level. This has been particularly apparent

in the post-socialist context, where changes within leaderships concerning formal institutional structures have often been lagged by changes in informal practices.

Finally, the ‘exogenous change’ approach to explaining institutional change focuses on the effects of external factors in precipitating institutional change by altering the goals, strategies or resources available to actors or organizations within a country. Examples of such exogenous shocks include periods of crisis, changes in relative price levels for goods or services, and changes in the technology used within an economy; or, conceivably, all three may occur simultaneously (Krasner, 1984; Gourevitch, 1986). The effects of such exogenous changes may be mediated by the factors described above. For example, a new technological development in a specific economic sector may raise the relative distribution of resources available to organizations within this sector, thus increasing the perception of what goals are achievable to these organizations. This may result in conflict between these organizations and those that have been made relatively worse off by the price change, but who have a stake in preserving the *status quo* institutional framework that benefited them (Acemoglu, 2008).

This brief overview of approaches to institutional continuity and change within the historical institutionalist framework illustrates that the charges of under-theorization in relation to change, and an overemphasis on continuities, are clearly exaggerated. It is the complexity and historical contingency of these types of accounts of change that often leads to accusations of under-theorization. However, the ingredients for constructing a useful analytical framework are clearly present. What is required is a conceptual framework that incorporates the different insights presented above, but that is still capable of indicating when certain outcomes (change or stasis) are more or less probable, while accepting that historically specific conditions may explain why hypothesized outcomes may not always occur. This need not be a weakness, however. Cases in which the predicted outcome does not occur can be used to sharpen the analytical framework by using them to identify circumstances that are or are not compatible with the framework being employed. After all, different conceptual frameworks can only explain so much, with anomalous cases illustrating those instances when a particular model may or not be of much utility.

2.1.11 Institutional analysis: conclusion

Although the approaches to institutional analysis outlined above are each unique and appear to be very different from one another, the four constructs are not as mutually exclusive as they might initially appear, and there are in fact many shared assumptions between the approaches that leave room for a more synthetic approach that bridges some of gaps that exist between them (Rutherford, 1993; Kato, 1996).²¹ A recent study by Douglass North (2005), for instance, offers a framework for analysing institutional change that integrates elements of all of the constructs discussed above. North emphasises the importance of non-ergodicity in shaping rationality assumptions, the role of cultural beliefs and norms, and the varied effects of human intentionality to offer a more comprehensive framework of institutional evolution, arguing that individuals and their perceptions, preferences and intentions (fulfilled or otherwise) are central to explaining institutional development. However, the importance of structural factors, such

²¹ For example, it is possible to adopt an agency centred approach to institutional analysis that explains the emergence of cultural norms and beliefs by viewing these norms as outcomes of a series of aggregated principal-agent relationships. Those studies that focused on the emergence of informal networks between state officials and enterprise managers within the Soviet Union often do this by first emphasising the self-interest and opportunism of agents (in the context of information asymmetries) responding to the demands imposed by a restrictive formal institutional environment, which then resulted in the emergence of informal practices that over time became embedded within the institutional framework of Soviet society (e.g. Urban, 1985; Solnick, 1998; Harrison, 2002). Such approaches might be termed as ‘individual institutionalism’ which indicates a methodological viewpoint that gives slightly extra weight to the preferences and rationality of the individual actor, while acknowledging the importance of institutions and other social structures (such as ideology or belief systems) in shaping those preferences and in constraining rationality (Agassi, 1975). It is, however, difficult to be precise when employing such terms. Quantifying just how much structure or how much agency is being emphasised in any given account is fraught with difficulty. However, if the strengths of all approaches are appreciated it ought to be possible to give extra weight to one stance, if only to identify those cases where other approaches may have been more useful. For example, Steven Solnick’s (1998) account of institutional collapse in the Soviet Union provides a vivid example of an agency centred explanation of how self-interested individuals behaving opportunistically responded to the signals of weakening formal state structures (the central Soviet authorities) and, by choosing to ‘exit’ the formal structures of the USSR, inadvertently caused the collapse of the Soviet state. This approach is parsimonious, elegant, and captures some of the dynamics that were active during the later years of the Soviet system, but the model is more useful in some contexts than in others. For example, the ‘exit’ of the Baltic states from the Soviet state was characterized more by the emergence of nationalist forces that came to dominate the political agenda than by the activities of self-interested and opportunistic middle-level state officials (e.g. Lieven, 1993; Linz and Stepan, 1996; Laar, 1998; Raun, 2001). Thus, rather than suggest that Solnick’s agency centred approach is fundamentally weakened because of its failure to explain *all* aspects of the Soviet Union’s collapse, it should be praised for its capacity to identify those situations that were amenable to analysis using this particular framework and those that were less amenable. Consequently, Solnick’s framework is an extremely useful heuristic device, even when not directly applicable, as its failure to explain certain cases might help point the analyst in the direction of a set of analytical tools that will be more useful.

as norms, conventions, belief systems and the potentially dynamic effects of ideology are all incorporated into his analysis, with individual rationality ‘bounded’ by the institutional framework in which it exists. For North, none of the constructs described above – in their less extreme forms - are viewed as being necessarily incompatible with the other, and the emphasis placed on structure or agency is contingent on each case.²²

In light of this, the conceptual building blocks for the framework that is employed in this study will emphasize: (i) the self-interest and choices of powerful actors and organizations within society, and thus the distribution of power between these groups and the potential for conflict between them; (ii) the incentive structures that these self-interested actors operate within (both political and economic), therefore appreciating the ‘bounded’ nature of self-interest and the constraints and opportunities that these structures present; (iii) the fact that the choices of self-interested actors and the structures within which they exist can lead to specific norms, values or ideologies becoming embedded within societies, leading, in certain circumstances, either to structural behavioural barriers to change or incentives to change; (iv) the recursive nature of human behaviour, i.e. the mutually constitutive nature of the interaction between agents and institutions, and the complicating effect that this has on actors’ intentions in shaping institutions; and, finally, (v) an appreciation that institutional change (path contingency), as much as continuity (path dependency), is possible depending on the combination of endogenous and exogenous variables that shape institutional development within different contexts.

²² Thus, when discussing the rise and fall of the Soviet Union, North emphasises the importance of the belief structure (Marxism-Leninism) of the Soviet leadership in his account of the rise of the Soviet Union (North, 2005, pp.146-154). The practical exigencies imposed by the ongoing crises of revolution, civil war, starvation and international events all had the effect of shaping the manner in which the initial ideological framework was imposed upon Soviet society, so that the eventual outcome of the revolution (the Stalinist model of political economy) was a function of both the intentions of actors grounded in the dominant ideological framework, and also of the unintended consequences of the compromises that were made as the revolutionary leadership grappled with the desperate challenges imposed by their domestic and international situation. Conversely, when discussing the fall of the Soviet Union, greater emphasis is placed upon the individual responses of actors to changes in the incentive structure caused by Gorbachev’s reforms, although the nature of the reforms themselves were shaped by ideological considerations. North’s framework can therefore be viewed as benefiting from the scope of its methodological assumptions.

To be clear, the methodological position adopted in this study will proceed on the assumption that self-interested agents and organizations operate within the constraints of formal and informal institutional environments. In this sense, the approach tends more to the rational-choice oriented variant of historical institutionalism. While this facilitates the formulation of a small number of testable hypotheses that can be tested across time and space, the approach adopted here will not be too rigid in its application of these methodological assumptions. Instead, where the hypotheses generated in this chapter appear to be contravened by the evidence, or where perhaps the influence of economic structure on social order development is mediated by other variables, an appreciation of other methodologies will be shown. This enables an analysis that is both parsimonious in its model of explanation, but equally open to the influence of other explanations. Consequently, the approach here is both deductive (in the formulation of hypotheses) and inductive (in the openness to other explanatory variables). By qualifying any explanation of social order development that is made using the conceptual framework in this study, this methodological openness should help develop a better theoretical framework for future research. Indeed, in effect, an openness to alternative methodological approaches and other explanatory variables introduces an implicit appreciation of the margin of error of the explanatory power of the conceptual framework.

2.2 The object of explanation: social orders across the post-socialist region

So far the conceptual discussion has dealt with the different approaches to analyzing economic and political institutions simultaneously, arguing that both share common methodological traits rendering them amenable to categorization along similar lines. However, in reality political and economic institutions and organizations are analytically distinct, in as much as they perform different functions and roles within a society, while at the same time they are intimately intertwined due to the fact that different political and economic institutional structures support specific forms of political and economic organizations, which in turn has implications for the type of state-society relations that will characterize a given society. The symbiotic relationship between economy and polity is captured by the concept of limited-access (LAO) and open-access (OAO) social orders (North, Wallis and Weingast, 2006, 2007, 2009). These constitute two broadly defined

poles of a social order dichotomy that emphasize the ‘double-balance’ between political and economic systems, highlighting the complex interplay between organizations and institutions in both the political and economic sphere.

Social orders encompass the wide array of political, economic, cultural, religious, military, and educational systems that might be present within a society. The form of social order shapes the organizational pattern of its constituent systems. The types of organizational patterns that can exist within a social order can vary widely. However, the key manner in which social orders differ is in their ability to create and maintain contractual organizations, and can therefore be distinguished by the nature of competition between organizations and the manner in which rents are created.²³ In open-access systems, open competition ensures that an impersonal form of contractual organization is prevalent, while in limited access systems contractual organizations are more informal and arbitrary. The ‘double-balance’ described above refers to the manner in which the distribution of economic rents and political power are related; LAOs see the distribution of rents intertwined with political power, while OAOs exhibit a more even distribution of economic rents and political power.²⁴

Although all societies contain competitive tendencies, it is the manner in which societies channel competition that distinguishes a social order, with LAOs resolving competitive tendencies among organizations in a more arbitrary and sometimes violent manner than in OAOs. Similarly, rents are created in different ways within the two social orders. Whereas in perfectly competitive open access markets, competition for rents among organizations leads infra-marginal rents to accrue to many producers and

²³ Organizations can be broken down into two main types of organization: ‘adherent organizations’ and ‘contractual organizations’ (North, Wallis and Weingast, 2006, pp.21-33). Adherent organizations are characterized by self enforcing, incentive-compatible agreements among their members and are not reliant on third parties to enforce agreements among members. Cooperation requires that it must be in the interests of all of the members to remain in the organization, or ultimately those individuals will cease to cooperate. Contractual organizations, on the other hand, utilize third party enforcement of contracts among their members. Contractual organizations may also rely on incentive-compatible agreements among members in contractual organizations, but they employ third party enforcement for some arrangements so that members can pre-commit to a subset of arrangements among themselves that may not, at all times, otherwise be incentive-compatible.

²⁴ Other theoretical and empirical discussions of the relationship between political and economic competition include: Schumpeter (1948); Rose-Ackerman (1999); Rustow (1970); Migdal (1988); Demsetz (1982); Stigler (1972).

consumers, in LAOs organizations limit market entry and competition to ensure that individuals or organizations (whether it be the state or firms) with market power can accrue rents. Rents can also be created by differential access to organizational forms or resources if, for example, a firm in an industry is able to ensure the special enforcement of its contracts, then even in a competitive market that firm earns infra-marginal rents because of lower costs. On a wider scale, the purposeful creation of rents by states in LAOs is a consequence of the purposeful creation of differential access for individuals or organizations to the goods and services that the state can provide, such as enforcement of property rights and contracts, legal systems, etc. Consequently, it is the extent to which social orders are governed by rules and legal frameworks that distinguishes whether it is a limited or open access order and it is this that constitutes the object of explanation throughout this dissertation.

2.2.1 Limited-access orders (LAOs)

In limited-access orders – as in open-access orders - politics and economics are mutually constitutive. Actors within the state limit economic entry to other actors within society to generate economic rents which are used to create credible commitments among competing elites to support the current regime and provide some sense of order within society (North, Wallis and Weingast, 2006, 2007, 2009; Acemoglu and Robinson, 2006, 2008).²⁵ Because the political system is used to manipulate the economic system to produce and maintain order, it is possible to conceive of economic and political systems as existing separately, but not as independent entities. Thus, the political system is not exogenous to the economic system due to the political system being the primary actor in the economy. Similarly, the economic system is not exogenous to the political system, since the existence of economic rents structure political relationships.²⁶

LAOs are relatively conservative orders in which only limited economic and political change occurs. This is because although LAOs possess some inherent incentives

²⁵ Such elites can be labeled ‘distributional coalitions’ (Olson, 1982).

²⁶ The forms of state autonomy in LAOs can be either absolute, in which case rents accrue directly to a predatory state rather to private organizations, or compromised, in which case the state is itself the subject of predation by private organizations. The distinction between predatory and predated states is made in Evans (1995).

to promote specialization and division of labour – through the provision of rents to powerful elites – they only extend to the point where elites will be required to increase the degree of entry, openness and access to the economic system. This would then reduce the rents that had previously accrued to the elite in question and increase the threat to the prevailing status-quo (Acemoglu and Robinson, 2008). The potential development of an LAO therefore involves a tradeoff in which “the gains from specialization must be balanced against the threat of disorder” (North, Wallis and Weingast, 2006, p.16).²⁷ Although there are differences in the internal structure of LAOs, they all share in common a propensity among their ruling elites to limit economic, political, and social access to generate economic rents and then use the rents to create credible commitments between elites to the existing social order.

In comparison with the OAOs, typical LAOs today have state-controlled industries, problematic business licensing regimes (for new entrants), and patron-client networks characterized by high levels of corruption. “All are manifestations of rent-creation” (North, Wallis and Weingast, 2006, p.11). LAOs often share many formal institutional structures with OAOs – including, elections, legal frameworks, corporations, etc. - but the extent to which the informal beliefs, conventions and patterns of behaviour ‘fit’ with the formal rules is very different to that observed in OAOs. More sophisticated LAOs possess robust institutional structures for the state and can enable a wide array of elite organizations to exist separate from the state. In practice, this means that the institutions of the state must be readily identifiable by members of the dominant coalition. A sophisticated LAO, therefore, “has a well articulated body of public law that specifies the offices and functions of the state, the relationship between the offices and functions, and provides for methods of resolving conflicts within the state, and by extension, within the dominant coalition” (North, Wallis and Weingast, 2006, p.14).²⁸

²⁷ See also, Acemoglu (2008).

²⁸ It should be noted that in order to facilitate the emergence of more sophisticated LAOs, increasingly independent and sophisticated elite organizations are not only a source of socio-economic development, but their existence stimulates the emergence of more sophisticated institutions and organizations within the state. This is due to the manner in which non-state organizations fight to protect the differentiation and autonomy of public institutions, such as courts and the central bank. This process is more visible in OAOs, where sophisticated private organizations in a market economy serve as a counterbalance to political

2.2.2 Open access orders (OAOs)

In contrast to LAOs, open-access orders are sustained by competition rather than rent creation. Specifically, political competition is necessary to maintain open access in the economy, and economic competition is necessary to maintain open access in the polity. Open-access orders are sustainable when a society is able to produce three outcomes: (i) entry into economic, political, religious, and educational activities is open to all citizens without restraint; (ii) support for organizational forms in each of those activities that are open to all citizens; and (iii) the rule of law enforced impartially for all citizens. Schumpeterian creative destruction ensues when entry into economic activities is open to all citizens and organizations. With open access market entry, economic actors create rents through innovation. Competition then gradually erodes those rents as new firms and individuals enter either new markets or by transforming existing markets. Although economic organizations might prefer to shape the political process to restrict entry and maintain access to rents and, although political actors might prefer to use the political process to restrict entry, create rents, and bind economic actors to support a developing political coalition, what prevents elites from transforming open access orders into LAOs is the fact that the persistent competition that is a consequence of open entry frustrates the wishes of economic and political actors to create *permanent* rents through limiting access to markets.²⁹ This reduction of rents through open competition is the defining characteristic of open-access orders.

The creation of privileges for one person or organization that is the defining characteristic of LAOs necessarily involves the denial of opportunities and access to other individuals or organizations. However, because all actors within an open-access order wield the ability to form organizations, the selective distribution of rents by the state is likely to stimulate opposition by other well organized groups. If access to organizational forms is open, the state cannot prevent groups forming to oppose the

organizations. In sophisticated LAOs, the government can credibly commit to a wider range of policies and institutions because elite private organizations can effectively punish the government if it deviates from its commitments. In this way, a double balance between the sophistication of public and private organizations emerges in mature LAOs that can sustain a considerable level of political and economic development.

²⁹ Studies that examine the role of competition in reducing rent-seeking behaviour include: Demsetz (1982) and Stigler (1972).

state's action. Indeed, in open-access orders one organization cannot prevent the formation of another organization with conflicting goals. This is the essence of relative state autonomy: no organization, whether it be the state itself or a private organization is able to prevent the entry of other organizations in order to maintain access to rents. This is because competition between organizations limits the exploitation of the state by raising the costs for ruling elites and lowering the benefits. In contrast, LAOs support the selective creation of elite organizations with similar interests to those of the dominant coalition. An LAO exercises greater influence over the distribution of interests within both the elite and wider society through the systematic manipulation of rents. This is because state autonomy is either absolute or compromised in LAOs whereas the autonomy of the state is relative, or 'embedded', within OAOs (Evans, 1995).³⁰

Any attempt to create rents by the political actors may stimulate other economic organizations that are adversely affected by rent creation to organize politically. Because organizations mobilize and coordinate their members when their interests are threatened, open access to organizations of all types, especially economic, helps sustain political competition. Indeed, political competition in the context of open access to organizations also provides opposition political parties with both the formal incentive and legal right to monitor the state and oppose developments that may potentially compromise competition and the integrity of an open-access system in general. Open access to organizational forms is therefore critical to both political and economic activities. While competition and its beneficial effects upon the development of a social order are clearly of immense importance, it is not clear what causes some societies to become more competitive – both within the economy and at the political level - than others.

³⁰ Relative state autonomy, or 'embedded' autonomy, refers to a situation where the state is immersed in a dense network of ties that binds it to groups or classes that can become allies in the pursuit of socially negotiated goals. Thus, they are neither fully insulated from social groups, as is the case of absolute autonomy, nor are they subject to predation by a few powerful groups. This is because the density of the state's links to different segments of society ensures that no group enjoys disproportionate access to the state. This concept is outlined in more detail in Evans (1995).

2.2.3 The 'double balance' between politics and economics

The concept of the 'double-balance' suggests that open access political and economic systems cannot sustain themselves independently of the other system.³¹ A competitive political system cannot be sustained by its own internal structure and institutions if it is located within a limited access economy. For example, open access for economic organizations sustains a wide range of organizations that could potentially mobilize against a ruling coalition that seeks to limit access to the economy and create rents for its favoured organizations. Indeed, if political competition is to be maintained over a longer period of time, the shifting distribution of economic resources that exists in an open access economy should discipline political actors. Conversely, the distribution of economic resources does not shift as frequently or with the same degree of freedom in an LAO, because of the manner in which the leaderships of LAOs control the pattern of access to economic resources, which is then reflected in a less frequent shift in the distribution of resources among political organizations. Thus, the nature of the principal sources of economic power within a society is likely to have important implications for the types of political institutions that are likely to emerge (Karl 1997, p.44-5). Existing research on patterns of state formation supports this by asserting the importance of the nature of economic resources in shaping the extraction strategies (i.e. taxation) that elites pursue to impose different patterns of governance (Tilly, 1992; Herbst, 2000).³²

In contrast to LAOs, all open-access orders have sophisticated public *and* private organizations as open entry in both economy and polity stimulates the creation of more sophisticated groups and generates forces that provide balance in both systems. As with the limited-access order, the logic of open-access describes a self-sustaining social order where all of the constituent parts are involved in a complex interrelationship that

³¹ This is where the exogeneity assumptions of many orthodox approaches to economics and political science suffer severe weaknesses. Any approach that seeks to explain either needs to take into account the other. Consequently, traditional political economy approaches like those employed by Adam Smith and David Ricardo, in which politics and economics are seen as mutually constitutive, are more comprehensive in their coverage and, arguably, substantively more realistic.

³² The sociological literature on the emergence of state institutions sees leaders demanding greater resources from their subjects in order to increase their war fighting capacity. In return for greater resources, primarily taxes, leaders are forced into making concessions, such as political representation for taxed elites, as a quid pro quo. Which sections of society provide tax receipts and are granted political representation then shapes the types of state structures that are formed.

maintains the prevailing social order. Indeed, political competition in an open-access order demands the existence of many sophisticated, well organized organizations that can compete effectively with one another through the prevailing political institutions. To sustain open entry, the state in an open-access order must have significant specialized institutions that both provide these services and that make the necessary credible commitments to maintain them without expropriating the value they create. It is imperative that the state possess the capacity to create incentive compatible institutions so that both those in power and their constituents have an incentive to abide by the rules of the game, whether they be formal or informal rules.

Central to the limited-open access order dichotomy is the emphasis on the importance of both formal (*de jure*) and informal (*de facto*) rules (see, for example, Acemoglu and Robinson, 2006). The adoption of, for example, formally open-access institutions in a society – such as a legal framework that guarantees private property rights, or a constitution that guarantees citizenship rights – requires a corresponding adoption of informal practices and conventions that mirror these formal rules. Without this, the formal rules will remain hollow with an increased probability of them being rejected at a later point in favour of formal rules that reflect prevailing dissonant informal rules and conventions. Indeed, it is the mutually constitutive relationship between institutions and organizations within that gives substance to formal rules. Without open access to all organizational forms in both polity and economy, the maintenance of open access in the political arena is not possible in the long run. Thus, in both limited- and open-access social orders there are a range of economic, political, religious, military, and educational organizations that reinforce one another, with the mutually supporting logic of each respective order ensuring that any formal institutions will, over time, broadly reflect the interests and beliefs of the constituent parts of a given society.

As noted in the preceding discussion of institutional change, change and continuity are both possible within institutional structures. In limited-access orders, elites are impelled to balance the distribution of elite interests within the dominant coalition. A shift in the incentives facing a major actor to defect from the coalition and use violence or other means to forward his interests will produce instability, if not open conflict. Because

many shocks – including technological advances, changes in relative prices, international pressures – may affect the relative distribution of elite resources and organizational capacity the internal structure of the dominant coalition and its distribution of rents are not immune to change. Any shock that changes the distribution of resources across the elite can force the renegotiation of the distribution of rents; and a violent resolution to conflict may be a constant possibility, because members of the dominant coalition may fail to reach a negotiated redistribution. Consequently, it is possible to argue that although LAOs are relatively stable as a social order, they are certainly not static. Although frequent changes in the composition of the dominant coalition and the distribution of rents may occur, they remain limited-access orders.

2.2.4 Conclusion: social orders in the post-socialist context

The overview of limited-access and open-access orders given above should focus attention on the types of challenges that have confronted and continue to face societies across the post-socialist region. Socialist societies were, without exception, limited-access orders, although there was some significant variation in the internal organization of the different states.³³ Unlike most contemporary examples of limited-access orders across the world, the economy was to all intents and purposes dominated by the party-state with almost all independent private economic organizations suppressed.³⁴ In this respect, the autonomy of socialist states was, in most cases, close to absolute with the state performing a predatory role within the economy as rents accrued to the party-state, which itself acted as a sort of ‘ruling class’ (see, for example, Cliff, 1974). The absence of any significant independent economic organizations was mirrored by the political domination of each ruling communist party and meant that competition on all levels was extremely limited and, when present, was largely confined to internal competition within the ruling party.

³³ See the typologies contained within Kitschelt et al (1999) and Linz and Stepan (1996).

³⁴ Some significant private economic activity was tolerated to varying degrees in Yugoslavia, Hungary and Poland, but still the general tendency was towards state ownership. However, within the Soviet Union the only private economic activity that was officially sanctioned was, until the mid-1980s, largely confined to small-scale (i.e. allotment level) agricultural production.

With the collapse of the ruling communist parties that started in 1989 in Eastern Europe, and culminated in 1991 with the disintegration of the Soviet Union, most ruling elites across the region expressed – at least at a formal level - a desire to transform their respective countries from limited-access orders to more open-access orders, usually citing the formation of democratic political systems and free market economies as the desired outcome. Indeed, most countries across the region initially did just that and adopted many of the formal features of open-access systems, including measures to liberalize their economies and to democratize their political systems. However, as time has passed, it has become apparent that there remains a great deal of variation across the region in the degree to which these formal institutions have been given more substantive meaning by a change in informal practices. Furthermore, the ‘double balance’ described above has often thwarted attempts to install democratic practices in countries that have not managed to create open-access economies, thus inhibiting the development of open-access political systems. The framework explicated above suggests that the sources of this variation lie in the degree of competition present within a society, with higher levels of competition providing the demand for greater emphasis on rule-based institutional practices.

This relationship between political competition and institutional outcomes across the post-socialist region has been the subject of increasing attention (Grzymala-Busse and Jones-Luong, 2002; Grzymala-Busse, 2002, 2006; O’Dwyer, 2004, 2006; Ganev, 2005, 2007; Sikk, 2006; Haughton, 2008). Although much of the research so far has focused on patterns of state-building or ‘state-stealing’, central to all of these explanations is an appreciation of the importance of robust political competition in reducing the opportunities for rent-seeking among post-socialist elites. Where competition is less intense there appears to be a tendency towards greater exploitation of the state for private benefits. The focus in this study is somewhat broader than on the patterns of state exploitation or patronage politics that are the object of explanation elsewhere. Here, the emphasis is on whether social orders within post-socialist societies are defined by more or less regard for formal rules and encompasses not just relations between political parties and the state, but also among business, trade unions, civil society and any other sections of society whose behaviour might be regulated by state-sanctioned legal frameworks.

Indeed, while the focus on patterns of patronage in political parties is relevant in parliamentary democracies, it can be of less importance in presidential systems where the relationship between business and the presidential administration might be of more importance. Furthermore, defining state exploitation in terms of the changes in the size of state administrations can be problematic as these may not necessarily be a function of party patronage, but instead of broader public sector reform or reorganization (Meyer-Sahling, 2006; Haughton, 2008).

The conclusions derived from the studies cited above suggest that the sources of lower levels of state exploitation are to be found in the levels of wider political competition. This is consistent with the hypothesis that higher levels of competition lead to societies resolving the competitive tendencies present within them through open, rule-based frameworks. If robust political competition is integral to ensuring lower levels of rent-seeking among elites and to compelling elites to play by the rules, perhaps the most obvious challenge would therefore be to locate the sources of robust political competition. The remainder of this chapter proposes one factor that might be of explanatory significance: namely, that the sources of political competition are to be found in the structure of a society's economy, and, in turn, that economy's place in the wider global economy. This is consistent with the concept of the 'double balance' outlined above and offers a parsimonious explanation of how the structural features of a society's political economy can explain the variation in forms of social order across the post-socialist region.

2.3 The explanatory variable: economic structure and the international economy

The 'double balance' between economy and polity outlined above suggests that political systems will tend to reflect the prevailing economic system within a society, and that changes in one are necessary for changes in the other. In turn, this has implications for the wider form of social order; if a social order is to be characterized as open-access then the economic system must provide the conditions that facilitate greater political competition. In short, the two arenas are mutually constitutive. The focus of this dissertation will therefore be on tracing which economic conditions facilitate increased

levels of political competition. Principally, it will test the hypothesis that the nature of a country's ties with the international economy, and the level of competition within a country's economic system, will shape the nature of political competition within that society. After several decades of relative 'bloc autarky', this ongoing process of reintegration within the post-socialist region has resulted in varying patterns of interaction with the international economy. This study will focus primarily on the links with the international economy that are formed through export sectors. Import flows and capital flows are only addressed in so far as they directly affect export capacity (e.g., through foreign direct investment). This is not to dismiss the importance of other aspects of integration with the international economy; however, the parsimony of the model outlined here is contingent on a narrow focus.

As will be explained in the following chapter, export structures are measured in three ways. First, the degree of inter-sectoral concentration or diversity will be measured. Second, the technology intensity of these sectors will be measured. Finally, the market structure of leading export sectors will also be considered, i.e. whether a leading sector exhibits monopolistic, oligopolistic or competitive tendencies. Export structures that are characterized by inter-sectoral diversity, medium to high levels of technology intensity within the leading export sectors, and higher levels of intra-sectoral competition will be expected to facilitate more robust political competition.

In order to outline the approach that will be employed throughout this dissertation, the next section describes the mechanisms through which increasing participation in the world economy can shape domestic economic and political organizations. It will be shown that changes in the levels of trade and in relative prices between factors of production and economic sectors can affect the relative distribution of resources among organizations within a society. This is followed by an overview of how specific sectors might be expected to interact with the state. It is argued that a country's export structure (the inter- and intra-sectoral distribution of production, as well as the technology intensity of these sectors) is an important factor in moulding the behaviour of economic organizations vis-à-vis the state. These factors will be shown to affect the distribution of resources among domestic organizations with particular implications for the autonomy of

the state. In turn, it will be argued that certain patterns of state autonomy will result in specific types of social order.

This explanation of institutional development places issues of institutional continuity and change at the centre of analysis. For example, an awareness of the influence of the international economy and of the role of technological change introduces exogenous variables that can be crucial in explaining institutional change. Similarly, an emphasis on the effects of economic sectors and their constituent organizations on state autonomy can also shed light on why some societies are more resistant to change – both economic and political - than others. For instance, the presence of powerful economic organizations with an interest in resisting change may explain the prevalence of continuity rather than change in certain cases.

2.3.1 The international economy and domestic economic organizations

There are a number of ways in which increasing integration with the international economy can affect the preferences and resources of actors and organizations within countries. Firstly, increased integration can expand the tradables sector within an economy, thus exposing an increasing amount of economic activity within a country to the fluctuations of world markets. Therefore, *ceteris paribus*, increased interaction with the world economy should increase the sensitivity of national economies to developments in world markets. As will be discussed later, this can affect the strategies that some organizations employ against the state in order to insulate themselves from fluctuations in international markets. Furthermore, increased interaction with the world economy affects the relative prices of goods or assets owned by organizations within the economy, compared to both each other and also to foreign goods and organizations. These changes in relative prices have important implications for growth, and more importantly in the context of this study, for the distribution of income and resources across the economy. Consequently, organizations that benefit from these changes may pressure the state to maintain or increase levels of interaction with the world economy, or organizations that are disadvantaged may resist integration by pressuring the state for protection or

restrictions to trade. Either way, changes within the international economy result in fluctuations in the relative power of domestic economic and political organizations.

The likelihood of organizations achieving their aims is contingent on both the resources at their disposal and on their relationships with the state. This is because increased integration with the world economy affects organizations and their capacity to organize in different ways, depending on the institutional context and the relative power of organizations prevailing in each case. For instance, limited-access orders will already be characterized by compromised state autonomy with some selected organizations enjoying the benefits of rent creation. In these instances, the likelihood of increased integration with the world economy affecting the relative distribution of domestic resources will be somewhat reduced due to the expectation that the institutional structures mediating the effects of increased integration will insulate elite organizations from at least some of the effects of relative price changes. Thus, the mediating role of domestic institutions is central to explaining how the effects of increased interaction with the world economy can be absorbed, blocked or refracted, depending on the institutional context that conditions the incentives facing organizations within a country.

There are main four arguments within the existing body of literature that identify the likely effects of increasing interaction with the world economy on domestic politics and economics (Milner and Keohane, 1996). The first, associated with Ronald Rogowski's (1989) *Commerce and Coalitions*, argues that changes in international trade flows affects domestic political alignments by altering the returns to factors of production. Rooting his analysis in the Heckscher-Ohlin approach to international trade, Rogowski argues that organizations characterized by factors that gain or lose from changes in international markets form distinct political coalitions that tend to mark the major political cleavages within countries, with winners pressuring the state for the

maintenance of links with the international economy and losers pressuring the state to slow or reverse patterns of integration.³⁵

This argument can be developed by suggesting that coalitions formed along factors is too broad an approach, and that the factors of production used are in fact tied to specific sectors within the economy, thus suggesting that coalitions will form along cleavages defined by economic sector rather than factors of production *per se*. Consequently, political conflicts will not crystallize along labour versus capital lines, or landowners versus industrialists, but instead between tradable or non-tradable sectors or between primary product exporters and domestic producers or consumer goods. This view is exemplified by Peter Gourevitch (1986) who argues that countries' production profiles, defined by "the preferences of societal actors as shaped by the actors' situation in the international and domestic economy", can help explain why countries adopt certain trade policies. Indeed, the implications are broader for changes in trade flows and volumes and the competitiveness of sectors mould the preferences of sectorally defined organizations as well as the relative distribution of resources among sectors.

The third argument that stresses the effects of increasing integration with the global economy focuses attention at an even more specific level than sectors. In *Resisting Protectionism*, Helen Milner (1988) argues that the sheer complexity of modern economies means that the gains or losses from trade are felt among even more specific groups of organizations than broadly defined factors of production or sectors. Instead, the gains and losses from trade accrue to particular firms with domestic political and economic coalitions formed between firms that share the same interests. Milner illustrates this point by pointing to the manner in which the differing extent of export dependence or multinationalization of production by firms shape the preferences of organizations towards the regulation of trade.

Finally, the manner in which different levels of integration into the world economy may shape the character of institutional structures themselves is considered,

³⁵ In short, the Heckscher-Ohlin model suggests that countries will export products that utilize their abundant and cheap factor(s) of production and import products that utilize the countries' scarce factor (Ohlin, 1967).

rather than on organizations as in the studies described above. This can be seen as a natural extension of the conflict between organizations over the gains and losses from trade and the effect that this has on the relative distribution of resources. As groups negotiate the terms on which trade may be permissible, compromises may be forged between winners and losers to ensure that a 'zero-sum' outcome does not ensue. For instance, David Cameron (1978) demonstrates how the increasing exposure to the international economy among developed countries in the 1960s and 1970s led to an increase in the size of public sectors as winners from trade sought to reduce the impact on losers from trade. Elsewhere, Peter Katzenstein (1985) in *Small States in World Markets* argues that the corporatist structures of some small European states were purposefully designed to provide an institutional mechanism that might mobilize support among the populations to cope with the costs of rapidly increasing levels of interaction with the world economy.

All of the studies cited above illustrate the importance of the role of increasing levels of interaction between domestic economies and the international economy, thereby highlighting the Janus-faced nature of states' positions in the world economy, and the implications that this has for domestic politics (Skocpol, 1979). Following Gourevitch, this study will focus on the role of economic sectors, specifically export sectors, in shaping institutional development across the post-socialist region. The impact of changes in the world economy on sectors' distribution of resources and the strategies employed by sectors to achieve their aims are considered to be of central importance. The sectoral attributes of economic organizations and the market structures of prominent sectors are seen as integral to explaining what levels of competition or rent-seeking are present within an economic system which, it is argued, has important implications for the development of robust political competition within a society and the type of social order that is likely to emerge.

2.3.2 *How sectors shape politics*

The importance of a country's ties with the international economy suggests that the structure of a country's export profile, and the distribution of power and resources among domestic organizations that is a function of this structure, is a significant factor in shaping the developing of different types of social order. Principally, it is will be argued that the development of patterns of social orders within societies is, to some degree, a product of the characteristics of the dominant export sectors within an economy. Particular sectoral attributes result in distinct market structures (both domestically and internationally) that endow organizations with varying levels of power and shape their preferences, each of which reward different kinds of organizations and demand particular strategies. By shaping the degree of competition or rent creation within an economy, these sectoral attributes influence the nature of competition within a society and result in distinct patterns of institutional development, and of interest groups with sectorally determined interests and collective action capabilities. These sectorally framed organizations and interests interact to produce different patterns of social order. In short, a sectoral approach to institutional analysis explains how different sectoral profiles affect the nature of economic and political competition within a society. As illustrated in Table 2.1 below, the exposure of the post-socialist economies to trade has tended to increase since 1991, and is high relative to many other economies in the world.³⁶

³⁶ It should be noted that the figures given in this table are not directly comparable across cases. This is for the simple reason that smaller economies tend to be more open to trade as a proportion of gross domestic product (GDP) than larger economies. Thus, small economies like the Baltic states will always display higher figures than, for example, the United States.

Table 2.1 Trade openness in the post-socialist region and other selected countries, 1991-2006 (imports plus exports as a proportion of GDP)³⁷

	1991	1995	2000	2006
Armenia	100.9	86.1	73.9	58.5
Azerbaijan	86.9	69.4	77.4	105.3
Belarus	70.3	103.7	141.6	124.1
Bulgaria	82.7	91.0	116.8	146.2
Czech Republic	98.5	105.8	129.8	148.3
Estonia	-	144.5	174.4	167.3
Georgia	58.9	67.8	62.7	89.9
Hungary	66.5	89.3	147.8	155.1
Kazakhstan	-	82.5	105.7	91.6
Kyrgyzstan	72.0	71.8	89.4	115.7
Latvia	60.7	87.5	90.3	109.5
Lithuania	50.7	109.3	95.9	129.8
Moldova	66.4	107.3	125.2	137.0
Poland	49.0	44.2	60.6	81.2
Romania	39.1	60.8	71.4	78.5
Russia	26.3	55.2	68.1	54.9
Slovakia	95.6	112.6	143.1	172.6
Slovenia	157.8	103.0	113.0	135.7
Ukraine	50.1	97.2	119.9	96.1
<i>Memorandum items</i>				
China	38.3	43.9	44.2	72.0
France	44.2	44.4	56.2	55.1
Germany	51.9	47.4	66.4	84.7
Thailand	78.5	90.4	124.9	143.3
United Kingdom	47.4	57.2	58.2	61.6
United States	20.5	23.4	26.3	27.2
Unweighted regional average (excluding memorandum items)	72.5	88.9	105.6	115.6

Source: World Bank (2009).

The relationship between economic structure and politics has been investigated elsewhere. Earlier analyses (Wittfogel, 1957) link different agrarian modes of production to the development of specific social formations, and argue that class coalitions and the way agriculture was organized determined which political institutions emerged in the early modern period and afterwards (Moore, 1966). This line of argument was extended to more recent examples in Latin America, where economic structure is identified as the

³⁷ Data for former Soviet states in 1991 includes intra-USSR/inter-republican trade.

primary source of variation in behaviour across agrarian social movements (Paige, 1975), with it being argued that the interests and capacity for collective action of agrarian economic organizations are determined by the sectoral organization of the export crop that they are producing. In a later study, Paige (1991) developed this theory from one that dealt only with agrarian societies to one that examines the role of a wider array of economic organizations, suggesting that the policy variation among Latin American countries to similar external challenges were a result of “choices made by social groups [whose] economic interests...are central to their political choices”, and that economic interests are the primary factor in affecting the evolution of national politics (Paige, 1991, pp.7-8). For Paige, the level of pressure exerted by economic interest groups would be in direct proportion to the amount that such groups had to gain or lose from policy and to the amount of resources that could be mobilized to advance their cause.

In more recent studies, Terry Lynn Karl's (1997) analysis of 'petro-states' also illustrates how the dominance of certain economic sectors can result in particular political and economic outcomes. Karl argues that oil resources shape the structure of state and non-state organizations and interests which lead to political regimes defined by deeply entrenched patterns of rent-seeking. This has since been supported by further research exploring the link high natural resource endowments and dysfunctional political development (see, for example, Auty, 1990; Chaudhry, 1997; Ross, 2001; Jones-Luong and Weinthal, 2004; Tompson, 2005). Elsewhere, Michael Shafer (1994) identifies the ways in which the dominant export sectors tie a country to the international economy and how the characteristics of these leading sectors then affect the development of domestic state autonomy and capacity. He argues that when a state's production and export profile is highly concentrated in one sector, the characteristics of the leading sector play a crucial role in moulding political institutions. If the leading sector is dominated by a small number of organizations, with high barriers to entry and exit, and a high degree of asset specificity, it is likely to be exceptionally politically influential. In such a context, state autonomy is eroded as the dominant sector imposes its preferences upon the state (Shafer, 1994, pp.17-24). Such states then become dependent on the leading sector and develop

specialized institutional capabilities that deal with the dominant sector to the detriment of the requirements of other economic sectors.

2.3.3 Sectoral attributes and the implications for economic and political competition

In order to gauge the attributes of a particular sector, a sectoral approach begins by measuring four variables: (i) capital intensity; (ii) the extent of economies of scale; (iii) production flexibility; and (iv) asset/factor flexibility/specificity (Shafer, 1994, pp.22-25). As will be discussed below, these variables are broadly related to the level of technological development within a sector. On the surface, capital intensity simply refers to the amount of capital available per unit of labour. However, the term indirectly refers to a lot more, including start-up costs, production costs, and research and development costs. These serve as a proxy for other characteristics of a particular sector, such as technical complexity, management professionalism and the skill level of the work force. Similarly, whilst economies of scale describes the extent to which the production costs of a good decline with the number of goods produced, it also acts as a proxy for the geographical concentration of production, the size and composition of the workforce, and the extent to which specific infrastructure is required. Production flexibility is the ability to meet short-term market shifts by varying output levels or product mix. Finally, asset/factor flexibility/specificity refers to the sector-specificity of facilities, supporting infrastructure, and workforce skills. The first two variables tend to be inversely related to the last two variables.

These variables are interrelated and consequently it is possible to group them together in order to describe particular sectoral ‘syndromes’ that broadly result in distinctive institutional structures and capabilities, external and internal distributions of power, and sets of societal actors. It is possible to imagine a single continuum between two ideal types: ‘concentrated’ sectors characterized by high levels of capital intensity, high economies of scale, low production flexibility and low factor flexibility; and ‘dispersed’ sectors marked by low levels of capital intensity, low economies of scale, high production flexibility and high factor flexibility. This dichotomy is a simplification of reality made for heuristic purposes; it does not describe all types of sectors that might

be observed. For instance, some sectors may display high levels of capital intensity and high economies of scale alongside high production flexibility and asset flexibility. The presence of high asset and production flexibility along high capital intensity might be a function of high levels of technological development within a firm or sector. In which case, the flexibility afforded by high technology capital may make a firm or sector less resistant to change. In short, however, different mixes of concentrated and dispersed sectors will be expected to influence the development of distinct patterns of competition within a society.

Concentrated and dispersed sectors exhibit different market structures and impose different behavioural opportunities and constraints upon organizations located within them.³⁸ Concentrated sectors are typified by monopolistic or oligopolistic market structures with high barriers to entry and exit. Conversely, dispersed sectors are characterised by larger numbers of relatively small, competitive firms. Barriers to entry and exit are lower due to the absence of high levels of economies of scale and low levels of capital intensity. These different conditions give rise to different political strategies that are employed by firms in their respective sectors. Firms within concentrated sectors tend to be fewer in number and larger in size, and employ stabilizing strategies to manage the risks to their large investments. Of these strategies, collusion - either with fellow oligopolists and with or through the state – is seen as a rational means to providing stability to their respective markets. This makes change in concentrated sectors more difficult because large firms responsible for export earnings and for the provision of employment are able to mobilize resources (lobbying, strikes, etc) to insulate them from the pressures of competition, thus making firms from concentrated sectors potent political actors that might be more likely to be resistant to change. Conversely, dispersed forms of productive organization lower barriers to entry and exit, thus creating larger numbers of firms; this in turn encourages competition, making it more difficult to coordinate collective responses to changes in the market. Thus, the level of competition or rent-

³⁸ The following section is informed by the ‘collective action’ literature, especially the work of Mancur Olson. See: *The Logic of Collective Action* (Harvard University Press, 1965); *The Rise and Decline of Nations* (Yale University Press, 1982); and *Power and Prosperity* (Basic Books, 2003).

seeking within an economy can be seen as a direct consequence of a country's sectoral profile.³⁹

2.3.4 The technology intensity of production and the implications for economic and political competition

The level of technological development within and across different sectors is broadly related to the factors described above.⁴⁰ Specifically, it affects the flexibility and organizational complexity of a sector which in turn has important consequences for the level of competition within a given sector and also for the manner in which the incentive to pressure the state is shaped by its flexibility. Higher technological levels of development tend to increase the organizational complexity and production flexibility of sectors with three main effects: (i) sectors are less likely to be affected by the sort of sudden fluctuations in prices associated with primary products; (ii) they are more likely to possess more flexible production systems, enabling quicker changes in product mix in response to market changes, and reducing the incentive to attempt to alter state policy; and (iii) higher technology sectors are more likely to be information intensive, rather than simply just capital intensive, and more likely to be organised 'horizontally' than is the case in 'vertically' organised sectors that rely on economies of scale.

Conversely, countries that possess export profiles that are concentrated in exporting primary products or other goods requiring a relatively low level of technological development will, in general, be likely to: (i) be prone to crises imposed by

³⁹ The international dimension also explains some of the pressures that are imposed on domestic firms and the broad range of strategies employed to cope with these pressures. Domestically, firms' interests are also shaped by the international sector that they are located within. For example, concentrated sectors will oppose attempts at economic restructuring within their respective state, if they perceive that their sector will become less important. This is because such sectors (and to a certain extent, the state) have a range of 'sunk costs' in their given industry (capital – fixed and human, investment in infrastructure, etc.) that restrict their flexibility to adapt to a changing environment. Collectively, these international pressures and domestic pressures form collective action opportunity structures that "provide incentives for people to undertake collective action by affecting their expectations for success or failure" (Tarrow, 1994, p.85).

⁴⁰ The technological level of development across an economy is a function of both exogenous and endogenous factors. It is exogenous when interaction with the world economy transmits technology across state boundaries as firms adopt technology and practices from other firms. Endogenous development occurs when domestic organizations increase their level of technological development in response to competitive pressures, relative price changes, improvements in property rights provision or through the allocation of increased resources to technological development.

fluctuations in world prices for commodities; (ii) be characterised by high levels of asset specificity, i.e. possessing dedicated plant and equipment producing stable product mixes, thereby increasing the incentive for firms to pressure the state into protecting their sectors from world market conditions; and (iii) possess sectors characterised by high levels of capital intensity and economies of scale, thus reducing the number of firms, but increasing their size. In these instances, collective action problems for firms within concentrated sectors are reduced and the incentive to influence state policy is higher.

High levels of market concentration within and across sectors increase the likelihood of a concentration of economic resources, thereby reducing the probability of the development of any robust political competition that sustains the development of open-access orders. Consequently, economies dominated by a small number of sectors that are themselves monopolies or oligopolies, are more likely to experience high levels of rent-seeking behaviour and also closer links between state and economy. Such close links between state and economy cause the lines between public and private property to be blurred, resulting in: (i) higher levels of corruption; and (ii) a tendency towards either state predation over dominant export sectors; or predation of dominant export sectors over the state. In both instances, the end result is largely the same; a fusion of public and private resources and the control of economic resources by a relatively small number of actors, the hall mark of a limited-access order.

The differences between ‘older’ techno-economic production structures and newer ones are summarised in Table 2.2. This general tendency towards diffusion of information and economic power in higher technology sectors reduces the concentration of market share in companies and facilitates competition, thereby reducing the incentive and capacity for exerting pressure over the state. A state’s role in such sectors is one of information coordination and selective regulation, with a very low incentive for state ownership and interference due to the myriad problems associated with centralised, bureaucratic control of information and allocation of resources that increases with technological complexity (von Hayek, 1945). Consequently, close direct links between state and economy should be lower, given the limited opportunities presented by the

diffusion of production and information, and the opportunities for predation, by either state or industry, are severely curtailed by competition.

Table 2.2 Two techno-economic paradigms

<i>Fordist production techniques (old)</i>	<i>IT led production techniques (new)</i>
Energy intensive	Information intensive
Standardized	Customized
Rather stable product mix	Rapid changes in product mix
Dedicated plant and equipment	Flexible production systems
Automation	Systemization
Single firm	Networks
Hierarchical structures	Flat horizontal structures
Departmental	Integrated
Product with service	Service with products
Centralization	Distributed intelligence
Specialized skills	Multiskilling
Government ownership, control, and planning	Government information coordination and regulation; vision

Source: Adapted from Freeman (1992).

2.3.5 The mechanisms linking economic structure and political competition

In the context of a sectoral approach to institutional analysis, the incentives for organizations to undertake collective action are framed by their sectoral interests, which in turn are shaped by the market structure and market signals at both the international and domestic level, with sectors' expectations for success or failure largely determined by the size and resources at the disposal of economic organizations. However, the mechanisms linking export sectors to political competition should be expected to vary across cases, depending on the level of competition prevalent within each economy, and varying also according to the institutional environment. For example, mechanisms might be expected to include the representation of business interests directly in parliamentary parties (where

parliaments have power), or indirectly through dialogue between political parties or the government and non-party economic organizations such as business associations, trade unions, etc. Alternatively, in formally presidential systems, the expectation that sectorally defined organizations might concentrate on influencing political parties would probably be lower. Instead, such organizations might be expected to channel their energies into exerting influence over presidential institutions. In general, greater competition within the economic arena would manifest itself in more or less open, transparent and rule-based competition within business associations, political parties, wider civic associations, and in relations between the state and sectorally organized organizations.

More limited economic competition, however, is likely to manifest itself in lower levels of competition within those mechanisms that might be targeted by economic organizations. In such circumstances, political parties, business associations, and civic associations, might be dominated by a single or a very few economic interests. Alternatively, the concentration of economic activity might have resulted in a high degree of state domination of the economy. In cases where the state is dominant in the economy, it might be expected that, in the absence of strong, well-funded sources of opposition, the state would also dominate political parties, business associations and civil society. This might result in informal mechanisms, such as personal links between economic organizations and political organizations, becoming the primary mechanism of interest articulation. In short, while the mechanisms through which economic and political competition are channeled may vary, it is the degree of competition within the economy that will be expected to be of most importance in shaping whether that competition is channeled onto the political level in an open and rule-based manner or not.

The broadly uncausal relationship between economic structure and social order development outlined here might, however, conceal a more complicated underlying process of political and economic change. The argument presented throughout this study is essentially that changes in economic structure, and the effects that this has upon wider economic competition, exert a decisive effect over the degree to which political competition is present, thereby shaping the prospects for positive or negative social order development. However, the relationship between economic structure and social order

development is no doubt far more circular or mutually constitutive than would be implied by the explanation outlined above, with social-order type itself likely to be a key factor in explaining the degree of economic restructuring. This issue of specifying the precise direction of causality between economic and political variables is important. However, the hypotheses that underpin this study assume, for heuristic purposes, that it is economic variables that explain political change.

2.3.6 Testable hypotheses

The outline of the independent variable and the dependent variable provided above provides the framework to generate a series of hypotheses that will be tested throughout the remainder of this study. Chapter Four will provide a stylized analysis of the relationship between economic structure and social order development. It will contain a rudimentary statistical analysis of the explanatory power of the independent variable in accounting for the variation on the dependent variable in the post-socialist period. Because this will focus on broad cross-country tendencies, only first order hypotheses will be tested. They are:

(H1) Developments in the wider international economy will affect the distribution of power between organizations within a society, and thus shape the prospects for economic competition within a society.

(H2) A higher level of economic competition, manifesting itself in the form of a diverse and technologically sophisticated inter-sectoral export profile, and dispersed intra-sectoral market structures, will help facilitate the development of an open-access social order.

The subsequent case studies will provide a higher degree of detail. While the first case study, the Soviet Union, will test the first order hypotheses outlined above as an example of a limited-access order from the socialist era, the subsequent case studies will test a series of second order hypotheses that are intended to lend greater credence to the results of the first order hypothesis tests. These focus on the hypothesized mechanisms linking the two variables. Specifically, they examine intervening variables that include political

parties, civil society, business associations, and direct relations between business and the state. These variables are qualitative in nature and so can only be tested through the more detailed case study analyses. The second order hypotheses are:

(H3) Greater economic competition will provide the basis for the development of a broader array of political parties. Possessing support bases independent of the state, competition among these parties is expected to exert a positive influence over social order development.

(H4) Increased levels of economic competition will also provide the basis for the emergence of a broader array of groups independent of the state and the more overtly political sphere in general. Consequently, increased activity by civic groups should also be expected to inject greater competition into the wider social sphere, thereby facilitating the development of an open-access social order.

(H5) A higher degree of economic competition will ensure greater competition within and between business associations, reducing the capacity for such organizations to impose their preferences on state policy.

(H6) Greater economic competition between and across sectors should reduce the scope for close state-business relations.

This constitutes the theoretical model that will be probed and examined throughout the remainder of this dissertation. The model offers a parsimonious way to explain the variation in social order type across the region that has emerged in the aftermath of the collapse of socialism. As argued in section 2.2 of this chapter, the conceptual simplicity of this model is intended only as a starting point for future research; the case study chapters highlight other important variables (such as external factors) that might be incorporated into this basic framework to increase its explanatory power.

2.4 Conclusion

This chapter has outlined the methodological foundations on which this study is based and described the conceptual apparatus that will be employed to analyse political behaviour across the post-socialist region. It was argued that a rational choice variant of the historical institutionalist approach is most suitable for use in this study. After locating this study within the historical institutionalist approach to analyzing economics and politics, the second section provided an overview of the dependent variable. Social orders were shown to differ primarily in the degree to which competition is prevalent, and the extent to which this competition is resolved according to impersonal, universally enforced rules. The third section outlined a hypothesized explanation for the variation in the dependent variable across the region. It was suggested that different patterns of integration with the international economy, as manifested in the structure of a country's export profile, can help increase our understanding of the sources of social order development across the region. This was concluded with the presentation of the hypotheses that will be tested throughout the remainder of this study. This will be done in two parts. First, a stylized historical overview of the relationship between the two variables will test the first-order hypotheses on a general cross-country level. This will be followed by four cases study chapters that will test the hypotheses generated here in greater detail. The cases studies will afford the opportunity to test the second order hypotheses relating to the causal mechanisms linking the independent and dependent variables outlined above.

To summarize, economic systems characterized by competition are expected to provide the conditions for more competitive political orders, while high levels of market concentration within and across sectors increasing the likelihood of a concentration of political power, thereby reducing the probability of the development of open-access social order. Consequently, the sectoral profile that a country possesses, and the market structure of these sectors, will be the main focus of analysis in this study. However, as the previous discussion of structure and agency in institutional analyses highlighted, the relationship between sectors, the state and the international economy will be a dynamic, mutually constitutive relationship with actors from both types of organization effecting

changes in both the institutional landscape and upon each other that will then restrict or create different possibilities for future developments. This pattern of action and reaction on the part of organizations is the central tenet of institutional analysis. As such, each specific case will display its own historically contingent dynamic. The sectoral approach outlined above does, however, give a starting point for making a small number of simple hypotheses concerning the probability of institutional change or continuity.

In short, it is expected that concentrated production profiles will result in a concentration of economic power and lower levels of political competition, leading to limited-access orders, while more diverse production profiles will be reflected by greater levels of political competition, leading to open-access orders. The next chapter (Chapter Three) describes the data and measurement of the variables used throughout this study. Chapter Four sketches a broad historical outline of the relationship between the international economy, economic structure and the development of different types of social order, and tests the first order hypotheses outlined above. Subsequent chapters will focus on more detailed case studies of specific countries in order to test both the first order and second order hypotheses generated in this chapter with more rigour.

CHAPTER THREE

Data description, measurement and case selection

3. Introduction

This chapter reviews the data that are used to measure the relationship between the dependent variable (social order) and the independent variable (economic structure) since the collapse of socialism across the region between 1989 and 1991. The conceptual foundations of these variables were discussed in the previous chapter. Subsequent sections that refer to economic structure or type of social order before this period utilize a range of different sources and subjective assessments due to the unavailability of comparable data. However, the focus of much of this study is on developments since the collapse of socialism and it is for this period that data are available. The first section describes the data sources that are used to measure types of social order. The second section outlines the measures used to identify different types of economic structure across the region. The final section provides the rationale behind the case selection for subsequent chapters.

3.1 Measuring the dependent variable: social order type

The outline of the core distinguishing characteristics of social orders presented in Chapter Two indicates that any attempt to operationalize the dependent variable should focus on two key areas. First, it is essential to capture the extent to which impersonal, rule-based behaviour is prevalent within a society. Second, the openness of politics within a society should be measured. Open-access orders would be characterized by the dominance of impersonal, universally enforced legal frameworks in which competition between organizations (economic, political and otherwise) is conducted in a more open manner. By contrast, limited-access orders would be defined by the selective application of rules, both at the elite level and within wider society, and by the channeling of competitive tendencies through informal, personalistic (i.e. non-universally applicable) ties and relationships. Clearly, this dichotomy covers a number of different phenomena including

corruption, the nature of political competition (open or closed), and broader issues of the rule of law.

Naturally, any attempt to measure these phenomena is fraught with some difficulty. For example, assessing the extent to which a society, on aggregate, conforms to formal laws and regulations, is tainted by corruption, or is characterized by an open and transparent manner of channeling competition, all involve referring to subjective judgments about which criteria to include, how to weight criteria, how to observe these phenomena, who is best placed to observe them, and so on. However, this does not mean that analysts should avoid trying to measure these phenomena; merely that they should remain cognizant of the potential pitfalls that surround any attempt to do so. With this qualification in mind, the measurement of social orders employed throughout this study is a composite index utilizing three of the six 'governance indicators' (WBGI) constructed by Daniel Kaufmann, Aart Kraay, and Massimo Mastruzzi (2008). They are:

(1) *Voice and Accountability (VA)* – this measures the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media. Of the two components of social-order type discussed above, this indicator measures the openness of competition within a society;

(2) *Rule of Law (RL)* – this captures 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;

(3) *Control of Corruption (CC)* – this indicates the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. Indicators two and three measure the extent to which impersonal, rule-based behaviour is prevalent within a society.

Scores range between – 2.5 (the lowest level on each indicator) to +2.5 (the highest level on each indicator). The composite score is a simple un-weighted average of the three component indicators. The scores are based on extensive, multiple surveys and are available bi-annually for all major countries from 1996 to 2002, and annually from 2003 until 2007. The components for the three scores are composite perceptions-based indicators and are drawn from 33 data sources provided by 25 different organizations, including assessments by non-governmental organizations (NGOs), multilateral development agencies (e.g., European Bank for Reconstruction and Development, World Bank, etc.), other public sector data providers, and commercial business information providers (e.g. Economist Intelligence Unit, Global Insight, Political Risk Services, etc.). A comprehensive description of the data and the methodology used in its compilation is contained in Kaufmann, Kraay, and Mastruzzi (2007).⁴¹ The individual coefficients, as well as the composite scores, are described in Table 3.1. The two time periods – 1998 and 2006 – are chosen (i) because they approximate the earliest and latest points for which complete datasets for all three indicators were collected; and (ii) because they are temporally consistent with the data collected to measure the independent variable (see below). Data from several other countries from outside the region are included for comparison.

A number of weaknesses with the WBGI have been alleged (Arndt and Oman, 2006) and include: (i) the likelihood of correlation of errors among the sources from which the composite indicators are constructed, which significantly limits the statistical legitimacy of using them to compare countries' scores; (ii) their lack of comparability over time; and (iii) sample bias.⁴² The authors of these indicators have addressed these criticisms and have accepted that their attempts at measurement are not perfect

⁴¹ Kaufmann, Kraay, and Mastruzzi also provide standard error terms for each of the indicators in each given year.

⁴² The same study also highlights the strong and positive correlation between the governance indicators and measures of per capital national income. Indeed, the correlation between the dependent variable and per capita GDP (PPP) is strong ($r = .83$) among the cases under observation in this study. However, it is difficult to ascertain the direction of causality in the relationship between the two variables. Consequently, although it might be argued that high levels of economic development help cause higher scores on the dependent variable, it might also be argued with as much justification that higher scores on the dependent variable in this study (social order) is an important factor in facilitating economic development.

(Kaufmann and Kraay, 2007; Kaufmann, Kraay and Mastruzzi, 2007). However, their response suggests that while there is room for improvement, the existing indicators are both useful and superior to existing alternative indicators.⁴³

Table 3.1 Variation in type of social order across post-socialist region, 1998 and 2007 (scale from – 2.5 to + 2.5)

	Voice and Accountability		Rule of Law		Control of Corruption		Composite Coefficients		Change in Composite Coefficients
	1998	2007	1998	2007	1998	2007	1998	2007	1998-2007
Armenia	-0.54	-0.59	-0.41	-0.51	-0.78	-0.68	-0.58	-0.59	-0.01
Azerbaijan	-0.95	-1.13	-1.02	-0.83	-1.13	-1.04	-1.03	-1	+0.03
Belarus	-0.86	-1.8	-0.73	-1.09	-0.72	-0.88	-0.77	-1.26	-0.49
Bulgaria	0.38	0.65	-0.23	-0.14	-0.33	-0.22	-0.06	0.1	+0.16
Czech Republic	0.95	0.98	0.82	0.77	0.45	0.26	0.74	0.67	-0.07
Estonia	1	1.05	0.5	1	0.42	0.94	0.64	1	+0.36
Georgia	-0.41	-0.19	-1.18	-0.44	-0.84	-0.38	-0.81	-0.34	+0.47
Hungary	1.08	1.1	0.74	0.74	0.67	0.44	0.83	0.76	-0.07
Kazakhstan	-0.75	-1.06	-0.9	-0.83	-0.9	-0.91	-0.85	-0.93	-0.08
Kyrgyzstan	-0.73	-0.64	-0.71	-1.19	-0.71	-1.08	-0.72	-0.97	-0.25
Latvia	0.81	0.86	0.18	0.57	0.1	0.31	0.36	0.58	+0.22
Lithuania	0.89	0.93	0.41	0.49	0.19	0.17	0.5	0.53	+0.03
Moldova	0.03	-0.38	-0.26	-0.66	-0.35	-0.68	-0.2	-0.57	-0.37
Poland	1.05	0.81	0.69	0.28	0.6	0.14	0.78	0.41	-0.37
Romania	0.36	0.47	-0.11	-0.17	-0.35	-0.19	-0.03	0.04	+0.07
Russia	-0.58	-1.01	-0.84	-0.97	-0.88	-0.92	-0.77	-0.97	-0.2
Slovakia	0.71	0.98	0.23	0.35	-0.03	0.28	0.3	0.54	+0.24
Slovenia	1.2	1.08	1.07	0.84	0.94	0.9	1.07	0.94	-0.13
Ukraine	-0.32	-0.09	-0.96	-0.7	-1.16	-0.73	-0.82	-0.51	+0.31
<i>Memorandum items</i>									
United Kingdom	1.3	1.38	1.8	1.75	2.16	1.89	1.75	1.67	-0.08
China	-1.38	-1.7	-0.38	-0.45	-0.38	-0.66	-0.71	-0.94	-0.22
Mexico	-0.09	-0.02	-0.51	-0.58	-0.53	-0.35	-0.38	-0.32	+0.06
Burkina Faso (Upper Volta)	-0.48	-0.31	-0.71	-0.48	-0.03	-0.4	-0.41	-0.40	+0.01
Regional average (excluding memorandum items)	0.17	0.11	-0.14	-0.13	-0.25	-0.22	-0.07	-0.08	-0.01

Source: Kaufmann, D., A. Kraay, and M. Mastruzzi (2008); author's calculations.

⁴³ It should be noted that after assessing the strengths and weaknesses of World Bank Governance Indicators, Amdt and Oman (2006) do refer to the indicators as “probably the most carefully constructed governance indicators”.

In response to the first criticism, the authors argue that the presence of correlated errors among sources does not eliminate the benefit of constructing an aggregate governance indicator, although it does reduce it. However, as long as the errors among data sources are not perfectly correlated, the gains from the aggregation of data make the WBGI superior to using any single source.

The criticism of a lack of comparability over time is made on two points. The first refers to the fact that the world average governance indicators are scaled to have a zero mean and unit standard deviation in each period. While this only applies to the world average, and not to individual country scores, it does mean that any change over time in a country's score conveys information only about changes in that country's governance *relative to world averages*. As such, changes in governance coefficients over time do not necessarily indicate that any change has taken place within a given country. This weakness, while valid, can be overcome through a sensitivity to the margin of error; if large, a change in a country's score may be considered to be of less significance.

The second criticism, related to the first, is that the presence of margins of error in the indicators obviates the ability to make comparisons over time. However, the authors argue that it is precisely the presence of margins of error that enhances the WBGIs as they provide guidance as to which observed changes are likely to be meaningful. Again, users of the WBGIs should display a sensitivity to such methodological issues if the indicators are to be used responsibly. The contextual analysis that is presented within the case studies should perform the function of adding sensitivity to the WBGI data.

Finally, the third criticism accuses the authors of sample bias in their underlying data sources. Specifically, they are accused of an overdependence on the views of business elites, particularly foreign investors. These accusations are quite weak. First, the range of data sources is considerably broader than just the perceptions of businesses and includes the views of a range of other sources, including governments and multilateral organizations. Second, where data sources do consult firms, there are a wide

range of respondents, including domestic and foreign firms, as well as firms of different sizes.

3.2 Measuring the independent variable: the structure of exports

Four measures - three quantitative and one qualitative - are employed to measure the structure of export profiles across the post-socialist region. First, the degree to which export profiles are concentrated or dispersed will be measured using the Krugman Specialization Index (KSI), which identifies the overall concentration or diversity of a country's export profile. Second, an index of Revealed Comparative Advantage (RCA) is used to highlight the sectors that occupy a relatively important role within a country's export profile. Third, each of the 260 export activities are classified according to the level of technology intensity required in their production. Using these data, a Technological Development and Diversity Index (TDDI) is constructed to simultaneously measure the overall level of production diversity/concentration and technological development within a country's export profile. Finally, more detailed case-studies are used to gauge the level of intra-sectoral competition in a country's leading export sectors.

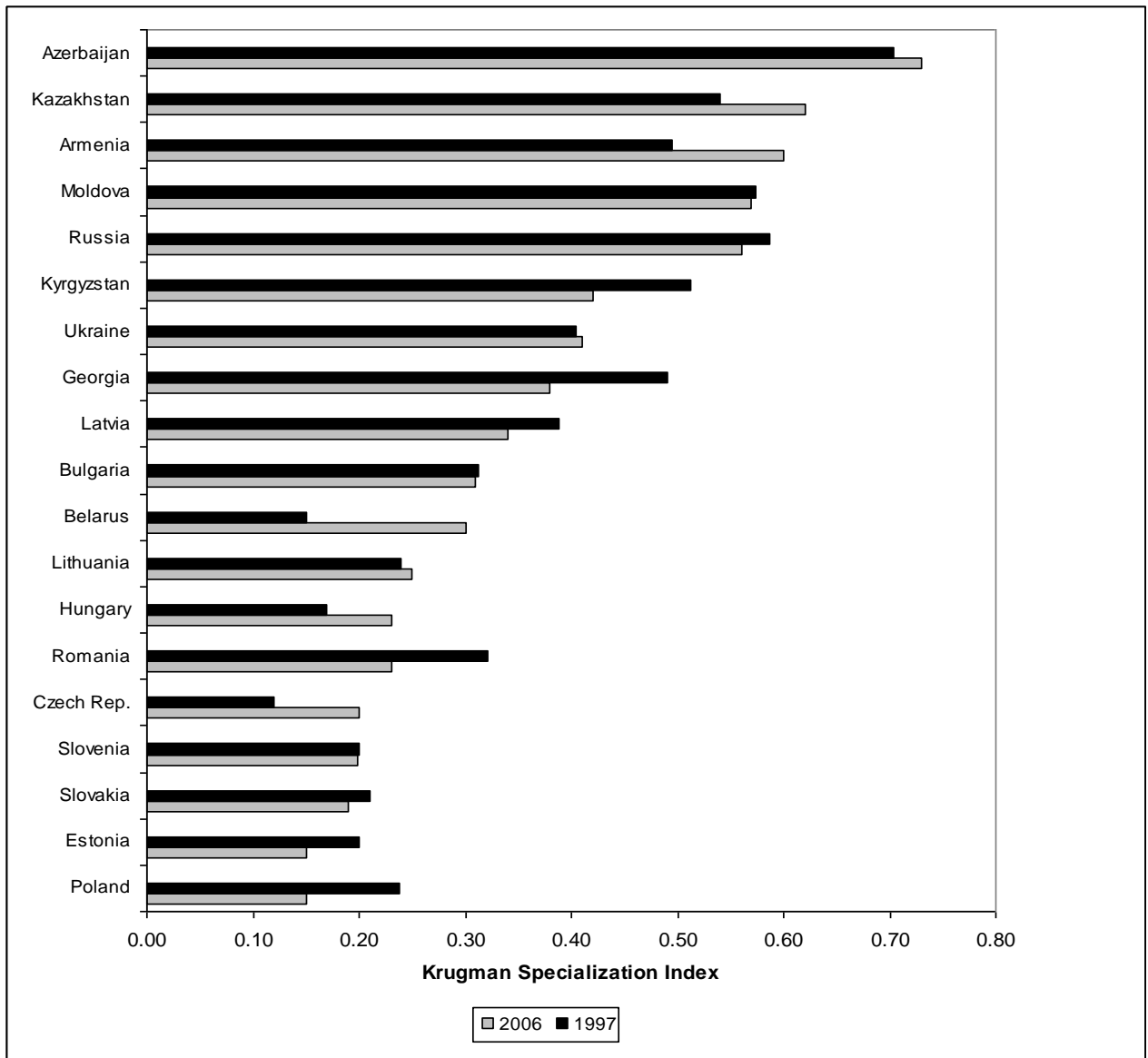
The data are taken from the Commodity Trade Statistics Database (UN Comtrade, 2008) from the United Nations Statistics Division, and there are some limitations. For example, the reporting of some goods is sometimes incomplete, and certain sensitive goods (such as some precious stones or armaments) can be hidden or included in different commodity groups. A note of caution also applies to any analysis that considers different countries at different periods of time due to the probability of fluctuations in exchange rates and in the relative prices of different products.

3.2.1 Inter-sectoral concentration and diversity

The Krugman Specialization Index. The Krugman Specialization Index (KSI) is a relative measure of sectoral specialization (Krugman, 1991), indicating whether a country possesses a concentrated or diverse inter-sectoral export profile. For each

country, the share of sector i in that country's total exports is calculated, followed by the world average share of sector i in total world exports. The index is the sum of the absolute difference of the sectoral structures of the two areas j (the country under observation) and w (the world average). Thus, $K_{jw} = \sum_i |S_{ij}^s - S_{iw}^s|$. The index is zero if the two areas have the same export structures, whereas its maximum value is 2.0, reached if the two areas do not have any commonality in export structures. It should be noted that the KSI tends to under represent the degree of specialization of larger countries. One-digit positions of the Standard International Trade Classification, Revision 3 (SITC, Rev. 3) are used for 1997 and 2006, the first year for which data are available for all countries under examination and the most recent year. The KSI coefficients for both years are presented below (Fig. 3.1)

Figure 3.1 Krugman Specialization Index, 1997 and 2006⁴⁴



Source: UN Comtrade Database (2008); author’s calculations.

The Balassa Index of Revealed Comparative Advantage. The Balassa Revealed Comparative Advantage (RCA) index is the ratio of the share of a product group i for country j and the share of the exports of the product group i in the total export for a group of countries (Balassa, 1965). The RCA index thus indicates whether country j has a comparative advantage with respect to a certain product i . The index for country j ,

⁴⁴ Countries are sorted in descending order by their KSI scores in 2006.

product i , is $RCA_{ji} = 100 (X_{ji}/X_{wi})/(X_{jt}/X_{wt})$, where X_{ab} is exports by country a ($w =$ world) of product b ($t =$ total for all products). Values higher than 1.0 indicate a comparative advantage in that product which, in the context of this study, indicates that it is a relatively important sector within a country's economy. RCA is calculated at the more detailed three-digit position of the SITC, Rev. 3 classification in 1997 and 2006.

3.2.2 The technology intensity of exports

In order to capture the technological intensity of sectors in which countries are competitive, the 260 activities described at the three-digit level are grouped according to the level of technological sophistication involved in their production. There are a number of ways in which activities can be categorized by technology. A commonly used method, based on Pavitt (1984), is to distinguish between resource-based, labor-intensive, scale-intensive, as well as differentiated and science-based manufactures. This can be difficult because the analytical distinctions are unclear, and there are large overlaps between categories. The OECD (1994) suggests a more detailed classification based on technological activity within each category. Lall (2000) has combined elements of both methods, grouping the three-digit data into five broad categories (primary products, resource-based, low-technology, medium-technology, and high-technology) containing nine subcategories within them. The classification employed here draws heavily on Lall's classification, with some modifications. Export activities are grouped under four categories: primary and resource-based; low-technology; medium-technology; and high-technology. Two further subcategories from within the high-technology group are identified and three from within the medium-technology group. The proportion of medium- and high-technology exports is used as an indicator of a country's overall technological development. A description of trends in changes in the structure of export profiles across the region is contained in the next chapter.

Primary and Resource-Based Products (PRBP). This category includes two types of activity—extractive activities and those that involve the simple processing of primary products extracted from the territory of a given country, including livestock,

metals, oil, and gas. In technological terms, the simple processing of these products does not generally involve much technological addition to the product itself.⁴⁵

Low-Technology Products (LT). These products tend to require stable, well-diffused technologies. Any technology that is used is primarily embodied in capital equipment, requiring simple labor skills to operate. Such products (e.g., textiles) are, in general, undifferentiated, with price being the main determinant of competitiveness. Given the relatively low capital intensity, scale economies and barriers to entry are generally low.⁴⁶

Medium-Technology Products (MT). These products, comprising the core of skill- and scale-intensive technologies in capital goods and intermediate products, constitute the largest proportion of export manufacturing activity in middle- to high-income economies. These activities tend to utilize relatively complex technologies, with moderately high levels of research and development, advanced skill-set requirements, and lengthy learning periods; they thus rely upon a higher level of human capital. These activities are split into three subgroups. Activities within the automotive and engineering subgroups (MT1 and MT3) are very linkage intensive, require significant inter-firm interaction, and emphasize product design and development. Many have mass assembly or production plants and extensive supplier networks, both domestic and foreign.⁴⁷ Barriers to entry tend to be high because of the high economies of scale and moderate to high capital intensity. Subgroup MT2 comprises industries that produce chemicals and process basic metals. Such process sectors tend to produce stable and undifferentiated goods; they too are often characterized by high economies of scale, and possess relatively high levels of technological sophistication, particularly in the production of high value-added steel products, chemicals, and plastics.

⁴⁵However, some products, such as oil and gas, may require advanced technology to perform the process of extraction itself. This type of machinery, however, is assigned to other categories.

⁴⁶Some low-technology products can be found in high-quality industries in which brand names, skills, design, and technological sophistication are very important, even if technology intensity does not reach the levels of other categories. Examples might include high-end, designer fashion products for which the brand name is important.

⁴⁷Small and medium-sized enterprises often are important in these sectors.

High-Technology Products (HT). High-technology activities utilize advanced and dynamic technologies, with substantial investments in research and development and a considerable emphasis on product design. The most advanced technologies require sophisticated technological infrastructure, high levels of specialized technical skills, and close interaction among firms, and also between firms and universities or other research institutions. Here, high-technology activities are split into two sub-groups.

The first (HT1) comprises activities that can be described as light industrial products. These include the manufacture of electronic equipment such as computers, computer components, audio-visual equipment, and office equipment. Many such products are labor intensive at the final assembly stage, and their high value-to-weight ratios make it economical to locate this stage of production in low-wage areas. The role of multinational corporations (MNCs) and integrated international production networks (IPNs) are of crucial importance, as the different stages of production can be distributed across countries to capitalize on labor cost differences. In this respect, the extent to which these activities reflect the development of indigenous technological capacities can vary, as in some cases a country may only be involved in the final, labor-intensive assembly stage and not in the higher value-added earlier stages (such as R&D, or earlier, high-tech production of components for assembly).

The second sub-group (HT2) comprises other high-technology activities that are more likely to involve the domestic production of the higher value-added components, with greater emphasis on domestic human capital, technological research and development, and denser local supply networks. This group includes products such as pharmaceuticals, power generation equipment, aircraft, optical and other precision instruments, and measurement equipment.

There are limitations associated with this method of categorization. Given the nature of the export data, it is not possible to capture every aspect of technological change from national statistics. Activities involving different levels of technological

complexity may be grouped together within the same product category.⁴⁸ Furthermore, it is not possible to gauge quality differences within product groups. It is thus difficult to distinguish between a low-technology, low-reliability personal computer and a top-end, machine designed for specialists. As mentioned above, it is difficult to identify the processes involved in manufacturing the same product across different locations. In the electronics sector, for example, high-end processes such as micro-fabrication or software development may take place in Japan, Germany, or the United States and the final assembly stage may take place in China or Hungary. However, the data treat the two processes as technologically equivalent. It is also difficult to determine whether technological upgrading has taken place within product groups over time. Thus, smaller N studies are desirable to draw out more subtle, intra-sectoral changes within economies. Notwithstanding these limitations, the data do display a considerable level of product differentiation and can provide useful insights into broad patterns of technological development across countries.

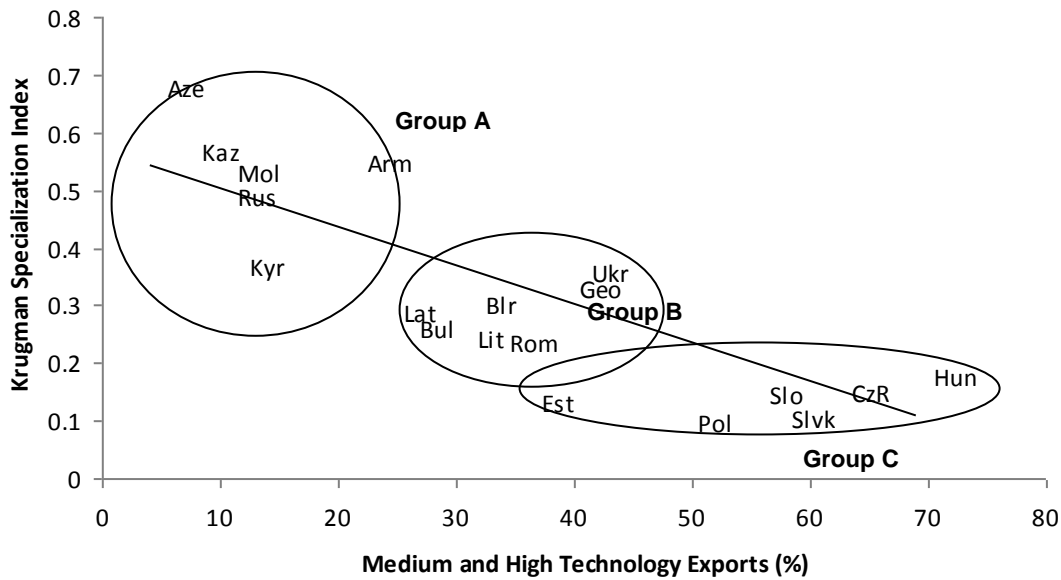
3.2.3 The Technological Development and Diversity Index

The discussion in Chapter Two suggests that, at least theoretically, a relationship exists between the diversity of production and higher levels of technological development. Figure 3.2 confirms that there is a considerable correlation (Pearson's $r = .82$) within the sample chosen for this study between a country's score on the Krugman Specialization Index and the proportions of medium- and high-technology products within a country's export profile. It is possible to observe three distinct groups. The first, Group A, comprises Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Moldova and Russia. All have concentrated export profiles and tend to export comparatively low levels of medium- and high-technology products. Group B consists of those countries that, while not overly specialized in terms of their export profiles, score moderately in terms of their total medium- and high-technology products as a proportion of their total exports. This group includes Bulgaria, Belarus, Georgia, Latvia, Lithuania, Romania, and Ukraine.

⁴⁸For example, office machines may encompass a range of technologies ranging from simple personal computers to more advanced, specialized equipment.

Finally, Group C contains Czech Republic, Estonia, Hungary, Poland, Slovakia, and Slovenia. They all possess export profiles that are diverse and score highly in terms of their proportion of medium- and high-technology products.⁴⁹

Figure 3.2 Krugman Specialization Index and the Technological Development and Diversity Index, 2006⁵⁰



Source: UN Comtrade Database (2008); author's calculations.

⁴⁹ Within this group it is interesting to note that this sector is composed of sub-sectors that should display a diverse mix of inputs and might be expected to display varying levels of capital intensity, economies of scale, asset/factor flexibility and production flexibility. For example, whilst the production of motor vehicles might be seen as an industry that would be dominated by few firms, the outsourcing of the production of components used within the production process is likely to be spread across a large number of smaller firms.

⁵⁰ This chart describes the association between the two variables in 2006. In 1997 - the other year for which export data are collected - the association is also considerable (Pearson's $r = .73$).

Table 3.2 Technology and Diversity Index, 1997 and 2006

Country	1997	2006	Change (1997-2006)
Armenia	0.36	0.31	-0.05
Azerbaijan	0.20	0.16	-0.04
Belarus	0.66	0.51	-0.16
Bulgaria	0.48	0.45	-0.02
Czech Rep.	0.69	0.71	+0.02
Estonia	0.57	0.61	+0.05
Georgia	0.43	0.50	+0.08
Hungary	0.68	0.73	+0.05
Kazakhstan	0.28	0.22	-0.06
Kyrgyzstan	0.33	0.34	+0.02
Latvia	0.40	0.45	+0.06
Lithuania	0.54	0.54	+0.00
Moldova	0.32	0.27	-0.05
Poland	0.54	0.67	+0.13
Romania	0.46	0.58	+0.12
Russia	0.27	0.27	0.00
Slovakia	0.60	0.69	+0.09
Slovenia	0.64	0.67	+0.03
Ukraine	0.48	0.50	+0.02
Regional average	0.47	0.48	+0.01

Source: UN Comtrade Database (2008); author's own calculations.

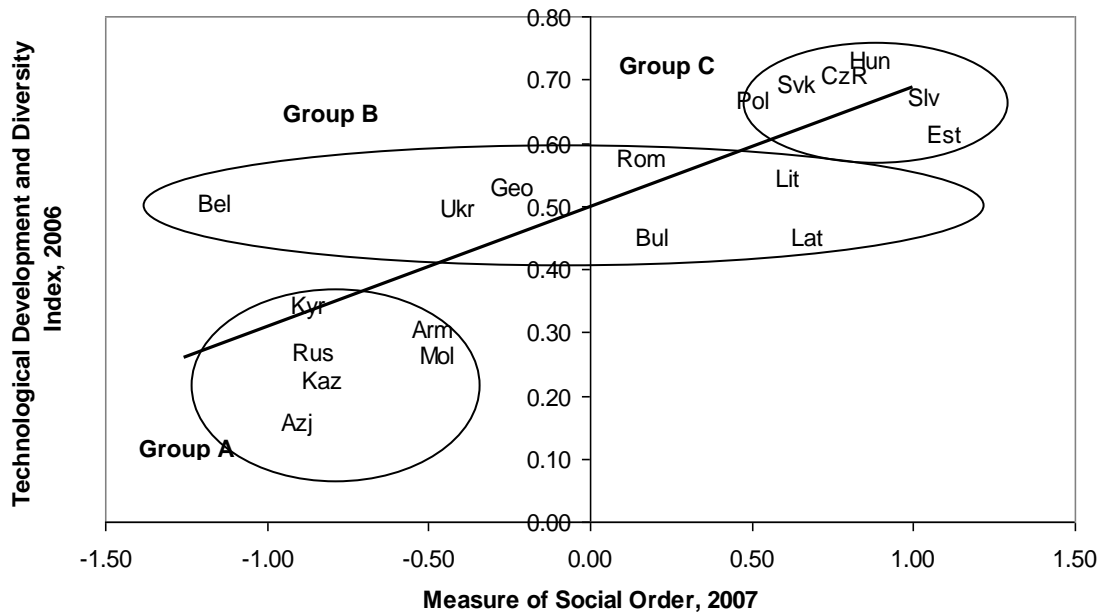
This observed association between the two variables allows the construction of a separate variable that captures both the KSI and the proportion of medium- and high-technology scores into a single coefficient, the Technological Development and Diversity Index. This index is the sum of the reversed KSI score and the proportion of medium- and high-technology exports. Both variables are given equal weighting by dividing the numerator by two. If K = Krugman Specialization Index, T = Medium- and High-Technology Exports, and $TDDI$ = Technological Development and Diversity Index, this can be expressed as $TDDI = ([1-K]+[T])/2$. The index is zero if a country's export profile

is concentrated in one resource-based or low-technology activity. A maximum value of 1.0 is reached if a country has an extremely diverse export profile and all of its exports are either medium- or high-technology products. The scores for each country within the region are listed above in Table 3.2. The classification of countries within the region into three groups provides the basis for case selection that will be employed throughout the rest of this study as it captures clear dividing lines between the export structures of the sample, with cases from each group examined in greater depth in subsequent chapters.

3.3 Case study selection and timeframe

So far this chapter has described the data that will be used to test the strength of the hypothesized relationship between economic structure and social order across the post-socialist region. The correlation between the two variables in 2006-07 is indeed strong (Pearson's $r = .80$) and is depicted in Figure 3.3. The three clusters of countries described here are the same groups that were identified in Figure 3.2 (i.e. according to their economic structure). Investigating what, if any, link exists between the two variables is the subject of subsequent chapters. This is done in several stages. First, the next chapter (Chapter Four) assesses the relationship between the international economy and the countries of the socialist bloc before 1989-91. This is followed by a more detailed description of patterns of continuity and change in economic structure across the region. The explanatory power of the TDDI variable in explaining variation of the dependent variable is then statistically tested against other alternative explanations. As will be demonstrated, the substantive and statistical significance of the explanatory variable is strong relative to existing explanations, thus warranting further investigation. This is the subject of the case studies that constitute chapters five to eight. Before describing which cases are to be examined, it is first necessary to briefly outline the method of case selection that is used in this study.

Figure 3.3 Association between Technological Development and Diversity Index and Social Order in 2006-7⁵¹



Source: UN Comtrade Database; World Bank Governance Indicators; author's own calculations.

The method of comparison can be divided primarily into two types of system design: 'most similar systems design' and 'most different systems design' (Faure, 1994). 'Most similar systems design' (MSSD) involves comparing cases that share some common features in order to neutralize some differences while highlighting others. Based on J.S. Mill's 'method of difference', MSSD seeks to identify the key features that are different among similar countries and which account for observed outcomes. 'Most different systems design' (MDSD), on the other hand, compares countries that do not share any common features apart from the outcome that is the object of explanation and explanatory factors that are viewed to important in explaining these outcomes. This method is based on Mill's 'method of agreement', which seeks to identify those features that are common among different cases in order to help account for a particular outcome.

⁵¹ The correlation between the two variables in 1997-98 is also strong (Pearson's $r = .71$).

In this context of this study, it can be argued that the countries of the post-socialist region all had broadly similar economic and political systems prior to the collapse of socialism, and that they all underwent a period of economic and political transformation at around the same period of time: from 1989 in Eastern Europe, and 1991 in the Soviet Union. As the data above illustrate, these countries exhibit varying levels on the explanatory variable (the TDDI) which, it is argued, accounts for the variation in outcomes across the region (social order type). This corresponds with MSSD, or Mill's 'method of difference'. Because there appear to be three main clusters of cases according to the explanatory variable, a case from each cluster is examined in greater detail in each case study to test the hypothesized relationship between economic structure and social order type in greater detail.

Chapter Five explores the role of economic structure in the collapse of the Soviet Union. Chapter Six examines a case from Group A, Russia, in greater detail. Chapter Seven explores two cases from Group B, Belarus and Romania. Both countries are roughly equivalent according to the measure of economic structure, but score quite differently on the type of social order. These two cases are chosen because they display the greatest changes in economic structure between 1997 and 2006 from within this group (see Table 3.2). Since 1997, the score for Belarus has declined from .66 to .51, while Romania has risen from .46 to .58. Furthermore, Belarus is selected due to it being an outlier case, with its score on the dependent variable being much lower than would be predicted by its score on the independent variable.⁵² Finally, Estonia, a case from Group C, is examined in Chapter Eight. This is a country that scores highly in terms of both economic structure and social order. It is also the only case from Group C that is a former Soviet republic, making its successful development even more interesting. These case studies are used to examine the mechanisms that might link economic structure with different types of social order. Because they afford a greater level of detail, it is also possible to establish what levels of intra-sectoral competition exist within leading export sectors, and also to test the second order hypotheses generated in Chapter Two.

⁵² Indeed, if Belarus is removed from the calculations the correlation is stronger (Pearson's $r = .88$).

3.4. Conclusion

The previous chapter outlined the conceptual framework, positing a theoretical link between economic structure and social order development. This chapter has reviewed the data that are used in this study to measure the relationship between economic structure and social order across the post-socialist region. The first section described the data sources that are used to measure types of social order. The second section outlined the measures used to identify different types of economic structure across the region. The final section provided the rationale behind the case selection for subsequent chapters. The following chapter provides a historical overview of the relationship between the two variables in the socialist and post-socialist region. The data described in this chapter are used to perform a rudimentary statistical exercise to illustrate that the hypotheses generated in Chapter Two appear to be supported by the data that are available, and that the conceptual framework used in this study also appears to compare favourably with other alternative explanations for variation on the dependent variable.

CHAPTER FOUR

The international economy and political economy in the post-socialist region: a historical overview

4. Introduction

Nearly two decades have passed since the disintegration of the socialist bloc. During this time, the countries of the region have achieved varying success in re-establishing themselves within the global economy, with some adjusting their production structures to occupy a higher rung in the global division of labour, while others have experienced continuity rather than change. This chapter examines what roles the countries of the region now play within the global division of labour and how these different positions might have shaped political developments across the region. Specifically, it examines the variation in export structures across the region between the 1980s, before the collapse of socialism, and in 2006, assessing not only whether they have changed over time, but, perhaps more importantly, how they have changed. According to the theoretical framework outlined in Chapter Two, countries with diverse and technologically sophisticated export structures will be more likely to support the development of open-access political orders. Conversely, countries with export structures that are less technologically developed and more concentrated in the production of a few products are more likely to become limited-access orders. Changes in economic structure across the region should therefore be expected to be of considerable importance in laying the foundations for specific forms of social order.

The overall objective of this chapter is to provide a historical overview of the development of both economic structure and social-order development across the socialist and post-socialist region. This should provide the historical context against which to test the conceptual framework developed in Chapter Two. The first section of this chapter traces the main patterns of interaction between the countries of the region and the international economy up until 1980. The second section considers the structure of the region's exports at the collapse of socialism and also the different regime-types that were

in existence at this point. The third section outlines the broad patterns of continuity and change in economic structure across the region. The final section explores the relationship between economic structure and social order type by comparing the explanatory variable with other possible explanations of variation in social order across the region.

4.1. Socialism and the international economy: 1917-1980

The revolutionaries that participated in the Russian revolution in 1917 had hoped that the imposition of Soviet rule would be the first step in the collapse of capitalism across the world. For Lenin, the spread of colonialism and conflict among the imperial powers that reached its apogee with World War I revealed the bankruptcy of capitalism as a way of organizing economic relations within society. However, as revolutionary movements elsewhere across the world failed to topple any more of the major capitalist powers, and after Joseph Stalin emerged ascendant in domestic politics after the death of Lenin, the optimistic internationalism of the socialist movement soon gave way to the more cautious ‘socialism in one country’. Now that the Soviet Union was no longer part of the capitalist ‘chain’, and in the context of heightened international antagonism between the USSR and the rest of the capitalist world, the period of Soviet industrialization that took place from the late 1920s up until the Second World War was largely conducted away from the outside world. Although not entirely autarkic – the USSR was, for example, one of the world’s largest exporters of oil and grain even in 1930 (Jensen, Shabad and Wright, 1983, p. 624; Goldman, 2008) – the almost total control of trade by the state meant that its place within the global economy was one of effective autarky (Lavigne, 1991).

In the Soviet Union, and later in the socialist countries in Eastern Europe, trade was conceived in very narrow terms; exports would earn hard currency which would in turn fill gaps that may have emerged in the planning process, usually technological products that could not be produced domestically (Kornai, 1992, pp.333-356). However, despite this limited dependence on foreign trade, the essence of ‘functional autarky’ lay in the manner in which central planning eliminated the effects of the price mechanism

and international competition; that is, international prices were not reflected in domestic prices, while the administrative allocation of imports and systemic export ‘aversion’ insulated firms from international competition.⁵³ Consequently, the traditional mechanisms through which international trade exerts an influence on the domestic economy – price and competition - were absent from traditional socialist economies.

The victory of the Soviet Union in World War II, and communist takeover in Central and Eastern Europe, afforded the Soviet Union the opportunity to establish socialist trading relations with a new group of countries. Whereas the sheer size and abundance of natural resources of the Soviet Union had enabled it to exist under autarky, the new socialist countries were much smaller and were therefore in much greater need of international trade. The formation of the Council for Mutual Economic Assistance (CMEA) in 1949, ostensibly in response to the introduction of the Marshall Plan in Western Europe, laid the foundations for closer ties between the Soviet Union and the newly socialist countries. Along with geopolitical considerations, economic and ideological factors also made the formation of the CMEA likely.

The Soviet strategy of economic growth was, with few exceptions, imposed on the smaller countries of Central and Eastern Europe and involved: (i) the prioritization of industrialization by the accelerated development of heavy industry, such as steel and machine-building; (ii) the shift of labour from agriculture to industry; and (iii) the allocation of a large proportion of national product to investment. This strategy was extremely intensive in its consumption of raw materials and consequently caused the smaller, more resource poor countries to become dependent on Soviet raw materials. Thus, the CMEA became a mechanism through which this dependence could be managed and, through the central planning process, in a manner consistent with socialist ideology. Any trade within the bloc would also be insulated from the effects of prices and

⁵³ The aversion to international trade was systemic because one of the fundamental objectives of a planned economy is to reduce uncertainty and risk through the administrative allocation of resources. Limiting trade is one way to achieve this. Indeed, the planned nature of Soviet-type foreign trade caused all trade to be organized at a central, macro-economic level. Direct trade between firms which is the foundation of trade between capitalist economies was simply not possible. It is for this reason that the mechanism of competition was eliminated for producers in Soviet-type economies.

competition that was a characteristic of trade between capitalist countries, thus characterizing trade between the socialist countries as effective ‘bloc autarky’.

The imposition of socialism heralded a period of industrialization that took place at different times across the region – in the 1930s in USSR, and, later, in the late 1940s and 1950s in Eastern Europe – and was based on the extensive increase of capital and labour into heavy industry. This initially resulted in periods of high output and considerable modernization as these countries made use of the classical benefits of backwardness; the ability to imitate technology and techniques as well as state direction of investment to achieve rapid growth from a baseline of a low capital to labour ratio (Gerschenkron, 1962). This model was not without its merits. The Soviet Union was able to overcome extreme backwardness and disarray at the end of World War I to emerge as one of only two superpowers at the end of World War II, while Central and Eastern Europe between 1950 and 1973 enjoyed an annual per capita growth rate of 3.9 percent, higher than any other region of the world during this period (Maddison, 1989). By the 1970s, however, the growth model that had served these countries so well during the initial stages of development began to atrophy as the extensive import-substituting industrialization strategy began to flounder.⁵⁴ This model achieved some success until the reserves of underutilized labour were all transferred from lower productivity branches of the economy (agriculture, household) to higher productivity industry. After this process was complete, and once socialist countries had achieved full employment, it became apparent that the factor extensive growth model needed to be replaced by a more factor intensive strategy of development; that is, it needed to be based on increased technological development, improvements in human capital and the rationalization of investment strategies. It was within this context that the trading arrangements that took place under the CMEA framework were to prove increasingly redundant.

⁵⁴ Import substitution industrialization refers to a trade and economic policy that is based on the premise that a country should attempt to reduce its foreign dependency through the local production of industrialized products. An overview of the literature surrounding both the theoretical underpinning of the concept, as well as review of its historical application, is contained in Chang (2003).

After the initial burst of output growth in the decade after the imposition of socialism the extent to which the trading arrangements within the CMEA framework could satisfy all of the domestic economic requirements within the bloc declined. Although trade remained most concentrated within the CMEA, this concentration decreased from the 1950s onwards insofar as the share of each country's exports to CMEA countries declined as a proportion of total exports (see Table 4.1).⁵⁵ Evidently, the centralized planning process had failed to adequately restrain the degree to which socialist countries had interacted with the rest of the world economy and was thus unable to generate the ideologically desirable functional autarky.

Table 4.1 Exports to CMEA countries as a proportion of total exports, 1952-80 (percent)

	USSR	Bulgaria	Hungary	Poland	GDR	Romania	Czechoslovakia
1952	80	89	71	67	80	85	71
1960	55	80	61	55	68	66	64
1980	49	69	53	53	66	37	65

Source: Lavigne (1991, p.17).

This increase in the proportion of total trade conducted with non-CMEA countries was a function of several interrelated systemic factors. First, as explained by the Hungarian economist, Janos Kornai, in centrally planned economies, demand tended to exceed supply, generating a 'seller's market' and perpetuating chronic shortages within the economy (Kornai, 1980). Because the main pressure on enterprises was to fulfill the excessively high targets set down in the plan, and because enterprises were not subject to hard budget constraints, there existed a systemic 'investment hunger'. This demand for investment, and the inability of the domestic economy to supply it, led to the micro-level enterprise 'investment hunger' that resulted in an import hunger at the macro, national level. This import hunger was, however, disguised in as much as the need to import was only acknowledged by central planners once all internal solutions, including import-substitution, had been exhausted (Lavigne, 1991, p.21). Whether the input in question would be imported depending on the priority assigned to it by planners. This would

⁵⁵ The only exception to this general trend was Czechoslovakia. This can perhaps be explained by the fact that Czechoslovakian policy was, after the events of 1968, more conservative and ideologically doctrinaire than its CMEA counterparts.

reflect the usual priority schedule of socialist planned economies, i.e. an emphasis on goods employed in heavy industry and for military purposes, and a neglect of agriculture and light industry.⁵⁶

Once import requirements had been defined, planners then had to identify which goods would be exported to generate the hard currency to pay for the imports.⁵⁷ As such, it was not any requirement to maximize profits at the enterprise level that stimulated the entry of socialist firms into the global economy. Rather, it was the macro-constraints of financing imports that impelled countries to export first so that they would be in a position to import later. Thus, whether it was ideologically desirable or not, the centrally planned economies became systemically oriented towards increasing their contacts with the global economy and reducing bloc autarky over time.⁵⁸ Indeed, as imports became increasingly important, so did exports. Because the maximization of exports had only one goal, that is, to increase the volume of resources available to fund imports, it was in effect deemed provisionally more important than imports, precisely because export policy was the mechanism through which import policy could be achieved. Therefore, the general slowdown in growth across the socialist economies from the mid-1960s onwards increased the pressure on planners to increase imports from non-CMEA countries, and thereby impelled the countries of the region to abandon functional autarky and to produce exports that were competitive on the world market.

However, political and ideological factors impeded any attempts at systemic reform, thus undermining efforts at restructuring their economies to become more competitive in global export markets, and locking in the level of technological

⁵⁶ Logically, this implied a need for greater interaction with non-CMEA countries. Because all countries within CMEA had the same systemic shortage economies and 'import hunger' caused by enterprise level 'investment hunger', the aggregate imports requirements of all of the countries could not be met by trade within the CMEA.

⁵⁷ This was not strictly the case with intra-CMEA bloc trade the considerations of planners resulted in money not being assigned the same importance as it was by capitalist countries. However, the focus here is on relations with the international economy outside of the CMEA.

⁵⁸ This tendency for socialist countries to become increasingly integrated within the international economy was equally true when the direction of trade was reversed, i.e. when imports of machinery were used to manufacture products manufactured by this machinery during the 'import-led growth' strategy developed by some countries within the region in the 1970s, see Hanson (1982a).

backwardness that was becoming increasingly apparent. The ideologically driven bias towards heavy industry, the geopolitical necessity to maintain large and capable armed forces, and the sheer power of entrenched bureaucracies and industrial ministries ensured that any attempts at shifting production towards a more rational mix of heavy industry, light industry and consumer goods would fail. This failure to effect any significant shift from industrial to consumer production, and the general structural and ideological constraints that favored industrial and military good production resulted in declining returns on investment and declining labour productivity. In addition, the paucity of consumer goods and the absence of any significant banking system that could provide more than a nominal return on savings reduced the incentive for socialist workers to earn higher wages by boosting productivity.

This disincentive for labour to become more productive was reinforced by the provision of full-employment, the existence of labour shortages and the absence of unemployment as a sanction that could be credibly employed by enterprise managers to increase productivity (Kornai, 1992, pp.228-255). Furthermore, excess investment demand, caused by the systemic ‘investment hunger’ of socialist enterprises, ensured that although socialist countries had some of the highest investment rates in the world (Kornai, 1992, pp.160-202), there was rarely ever enough investment to enable the majority of investment projects to be completed either on time or to a sufficiently high standard of quality. Only prestige projects that were consistently identified as priority areas by planners were ever assigned the requisite resources. Finally, these obstacles to productivity and the rational deployment of resources also resulted in socialist countries lagging far behind Western countries in terms of technological innovation (Amman and Cooper, 1982; Kornai, 1992, pp.298-300).

In short, while socialist economies were ‘modern’ in the sense that they had undergone a period of industrialization and were no longer agrarian economies, they possessed distorted industrial structures that were excessively capital intensive, low and declining levels of total factor productivity, and produced goods of generally low quality (except in areas connected to the military branches of industry). Consequently, in the

absence of systemic reform the socialist bloc was generally ill-equipped to sell enough competitive exports to fund the desired imported goods that were hoped would facilitate the next wave of modernization. Ideological imperatives thus trapped the countries of the region in a downward spiral in which planners' desire to import sufficient technology to compensate for systemic deficiencies were stymied by their inability to produce goods of sufficient quality to fund import purchases.

This became particularly unfortunate for the countries of the socialist bloc because the recognition that their economies were in need of modernization, and that their export capabilities needed to be restructured, occurred at precisely the same time that the rest of the world economy found itself in the midst of a technological revolution (Berend, 1996; Eichengreen, 2007). The postwar period saw the invention of technologies that, over time, resulted in the dawning of a new, post-industrial era in which traditional, 'Fordist' production techniques gradually gave way to newer, information technology intensive methods (see Chapter Two). This technological revolution required new infrastructure and new methods of organizing production. In particular, it was distinguished by three new important characteristics: refinement; complexity of production; and an increasingly complex division of labour (Berend, 1996, pp.226-228). 'Refinement' refers to the increasingly minute size of technology that contained within it increasingly large capacity. This affected, for example, the precision of machine tools and the purity of materials used in various production processes. The complexity of production was increased by these technological developments. Electronic circuits contained millions of independent elements, airplanes and automobiles were comprised tens of thousands of components, while the communications infrastructure that enabled and was itself a product of this technological revolution required computers and software that were capable of processing millions of different actions.

The increasing specialization of technology was reflected in the increasing specialization within the division of labour. Unparalleled complexity of technology entailed a concomitant narrowness of labour specialization. Modern technological achievements were at times a consequence of the well-organized interaction of thousands of

individuals, sometimes conducted across different countries. All three of these characteristics were interrelated and required both a new, advanced infrastructure and, perhaps most importantly, because of the dynamism of this highly complex system, an educated, flexible and adjustable labour force. While this technological revolution spread slowly and incrementally around the world, the socialist economies continued to be characterized by poor property rights structures, low incentives to work and innovate, an over reliance on a bloated central bureaucracy that was becoming increasingly ineffective in economic management (Rutland, 1993), and, perhaps, most importantly, was experiencing increasingly severe problems in securing the flow of accurate and reliable information throughout the system. The strategies employed by enterprises to overcome the deficiencies of the planned economy, such as the cultivation of informal networks and the emergence of patterns of ‘binding and bonding’ (Urban, 1985), encouraged the concentration of information and resources within enterprises, rather than their diffusion, as was the case in those countries in the grip of the technological revolution.⁵⁹

The 1970s represented a juncture for the world economy as the effects of the technological revolution became increasingly manifest, causing a structural crisis. This crisis contributed to the onset of ‘stagflation’ in developed economies – the combination of high inflation and low levels of growth. However, the crisis was even more acute in the developing world and those countries operating on the periphery of the world economy. These countries were unable to respond to the demands imposed by the structural crisis by developing new leading sectors based on new technology to replace those sectors that were becoming increasingly obsolete and uncompetitive. Those countries that failed to adjust their production and export structures became increasingly left behind with the consequences being similar in Latin America and the socialist bloc; in the absence of competitive export sectors, countries were either indebted as they attempted to import the technology that would enable them to ‘catch up’, or they became raw materials appendages to the more dynamic ‘core’, exporting raw materials and semi-processed manufactures. As Berend argues (1996, p.228), state socialism created

⁵⁹ Binding and bonding refers to the patterns of horizontal relations that emerged in socialist-type systems as agents within the hierarchy subverted the orders of their principals through informal co-operation. This is discussed in Urban (1985)

additional obstacles and: “on top of the ‘natural’ peripheral disadvantage was their continued fidelity to post-Stalinist ideology...[and] the rigid rejection of structural or even policy changes as ‘revisionism’ or as attempts to restore capitalism”. This caused a systemic rigidity that preserved the political, techno-economic conditions which had already proven to be anachronistic in light of the technological advances made elsewhere in the world.

By the 1980s the socialist countries found themselves in an invidious position. The period in which significant gains could be made through the employment of the extensive growth model that was employed earlier on in their development was over. Full-employment, declining total factor productivity and technological backwardness caused many leaders and intellectuals within the socialist bloc to acknowledge the need to shift towards a more factor ‘intensive’ model of growth. However, the political constraints imposed by the communist leadership in the Soviet Union effectively ruled out any systemic reforms of the sort that were required to result in any structural changes in the way that socialist countries participated in the world economy. These conflicting tendencies - the need to adopt decentralizing reforms in response to changes in the world economy in order to facilitate economic development domestically, on one hand, was balanced by the desire within the ruling elites to preserve party power on the other – occurred at a time of great change in the world economy. In effect, the more socialist countries prevaricated and avoided structural reforms, the further they fell behind countries in the West and solidified their position on the periphery of the world economy.

A wide mix of policies was adopted across the region in response to these challenges, none of which dealt with fundamental issues of systemic reform (Nuti, 2007a).⁶⁰ The USSR, due to its large natural resource endowment, was able to paper over some of the cracks within its system by using export earnings to import technology from

⁶⁰ Attempts at substantive reform were, until the mid-1980s, largely abandoned in the aftermath of the Soviet-led invasion of Czechoslovakia. The invasion signalled the beginning of the ‘Brezhnev doctrine’ and constrained the autonomy of countries within the socialist bloc to undertake reform. See Batt (1988) and Kornai (1992).

abroad, as well as food.⁶¹ This strategy began to fail as soon as the price of oil slumped in 1985-6. By contrast, Poland, Hungary, Romania and Bulgaria adopted variations on the import-led modernization strategy, some more aggressively (Poland and Hungary) than others (Romania and Bulgaria). These strategies involved borrowing on international capital markets to fund technology imports that would then be used to facilitate the modernization of their export sectors (particularly in medium-technology manufactures) in order to then increase their shares in foreign markets (Batt, 1988; Berend, 1990; Poznanski, 1996). This policy was largely deemed to be a failure for several reasons (Berend, 1996, pp.229-232). Firstly, changes in the lending conditions on international markets resulted in a 'credit squeeze', adversely affecting their ability to increase their borrowing and to service existing debt. Secondly, exports did not improve sufficiently to improve productivity or the general standard of living in these countries. Taken together, these two factors gave the impression that the group had taken on huge levels of debt for very little perceived positive effect.

However, as will be shown below, some restructuring did take place in the two countries that pursued the import-led strategy most aggressively (Poznanski, 1996). Thus, although most countries within Eastern Europe increased the proportion of total exports to Western Europe (Table 4.2), only Poland and Hungary saw a significant shift in trade towards more complex manufactures, showing the largest gains in terms of relative unit values (Poznanski, 1996, p.57). More conservative borrower-importers, such as Czechoslovakia, saw a declining significance of machinery exports to developed markets over the same period, although there was a shift in the direction of overall trade from CMEA to countries in Western Europe.⁶² In Romania, the desire to increase the technological level of exports was, like the USSR, eventually tempered by its ability to

⁶¹ The ability of the USSR to import foreign technology was reduced somewhat by two factors. First, the creation of CoCom (Coordinating Committee for Multilateral Export Controls) in 1949 placed an embargo on the transfer of high-technology material to socialist countries. This was reinforced by a further embargo imposed by the USA in response to the Soviet invasion of Afghanistan. There were limits to the effectiveness of the US embargo, however, as illustrated by the gas pipeline dispute between the USA, and the countries of Western Europe along with the USSR. See Mastanduno (1992) and Lavigne (1991).

⁶² Due to its higher level of prior development, Czechoslovakia did start from higher level of development than other countries within the region. Therefore its relative decline was not as pronounced as it might otherwise have been.

export raw materials. Although Romania had initially adopted a less aggressive version of the import-led growth strategy, the high levels of debt incurred in the process persuaded policy makers to concentrate more on debt repayment through raw material exports than on any attempts at improving the technological base to increase manufactures exports (Shafir, 1985; Roper, 2000). Because it possessed oil reserves and significant refinery capacity, Romania was able to quickly pay off its foreign debt, with it eliminated by 1989. However, this was at the expense of nearly all other imports, both consumer and industrial.

Table 4.2 Exports to Western European countries and USSR (percent of total trade)

	Western Europe		USSR	
	1980	1989	1980	1989
USSR	73	65	-	-
Bulgaria	27	41	-	18
Hungary	28	45	34	25
Poland	31	37	32	21
Romania	29	37	19	21
Czechoslovakia	50	52	38	31

Sources: IMF (2007); United Nations UNCTAD Database (2007); author's calculations.

There is, therefore, some evidence of a positive relationship between the scale of Western technology imports and export performance within the region during the late 1970s and early 1980s. The different strategies that were employed within the socialist bloc in response to both changes in the world economy and to domestic challenges left some countries in different positions vis-à-vis the international economy. Some, such as Poland, Hungary, and to a lesser extent, Czechoslovakia, possessed export structures that, while inefficient relative to Western countries, did possess some elements that had the potential to be competitive on the world market should the political conditions in the region improve. Others, such as the USSR, Romania and, to a lesser extent Bulgaria, had not undertaken any significant attempts at improving their technological level of export production in response to international and domestic challenges. With time, the need for more serious reform became imperative. Attempting to respond to challenges that the socialist system was unable to meet – both domestic and international – was, ultimately, the most significant factor in ensuring the collapse of socialism; the socialist model, in all

its different manifestations, simply wasn't able to compete on the international stage or to satisfy domestic demands and the burgeoning economic crisis, for which the state was entirely responsible, undermined whatever legitimacy the regimes of the region might have previously enjoyed (Lewis, 1994).

4.2 The collapse of the socialist system, 1980-1989

4.2.1 Export patterns among the socialist economies

By the 1980s the trends in both the international economy and within the individual economies of the region described above resulted in all of the CMEA countries having established deeper links with the international economy. The nature of these relations was not uniform, however. Some had export sectors that were better prepared for the onset of a new phase of economic relations with the rest of the world. With the removal of the constraints on the development of free trading relations imposed by the CMEA arrangements, the real value and competitiveness of the region's exports were to be tested, with significant shifts in terms of trade in store for all countries of the region.⁶³ Therefore, it is necessary to briefly survey the export structures across the region at the end of the 1980s. Sectors in which countries enjoyed a comparative advantage at this point, and that were already competitive on the world market, were likely to shape the direction of future of reintegration with the world economy. There are some inherent difficulties in using data from the socialist period, both in comparing them with each other and in comparing with data for the post-socialist period. First, the boundaries between states were radically different in the period up until 1989-91. Most significantly, the USSR disintegrated into 15 independent states.⁶⁴ Consequently, tracing precise changes in export profiles for newly independent states is particularly problematic. Second, the data that are available are at times sketchy and unreliable due to differences in definitions and reporting procedures that reduce the comparability of much of the data

⁶³ This applied both to countries that existed as states up until 1991, and also to those states that were newly independent following the collapse of multi-national states (the USSR, Yugoslavia and Czechoslovakia).

⁶⁴ Czechoslovakia and Yugoslavia also separated, causing similar problems for the collation and comparison of the data for the successor states in these countries.

that are available for the period (Lavigne, 1991, pp.356-7). With these qualifications in mind, it is still possible to observe a number of broad tendencies that were apparent at the end of the 1980s.

Table 4.3 Exports to the West in 1990 (percent of total trade with West)

Commodity Groups	Eastern Europe	Soviet Union
Primary products	28.5	23.1
Food	16.9	2.4
Raw materials (excluding fuels)	5.1	8.9
Mineral fuels	10.7	56.5
Oil	5.6	40.6
Gas	0.1	11.7
Manufactures	60	14.4
Semi-manufactures:	21.4	9.5
Iron and Steel	7.2	2.6
Chemicals	9.3	4.4
Machinery and transport equipment:	13.6	3.4
Road vehicles	1.6	1.6
Transport equipment	6.8	1
Specialised machinery	4.8	0.7
Industrial Consumer Goods	25	1.5
Textiles	3.4	0.4
Clothing	9.8	0
Total	100	100

Source: Lavigne (1999, p.85).

The commodity structures of exports from the USSR and the countries of the Eastern Europe to Western countries were radically different.⁶⁵ As Table 4.3 illustrates, the USSR's export structure was significantly more concentrated in primary product sectors than the countries of Eastern Europe as a whole. Exports from the USSR were

⁶⁵ Statistics that record the exports from the region to the West are used for two reasons. First, intra-CMEA trade figures are calculated by volume and not in internationally comparable prices. Secondly, they also contain a great deal of trade that would otherwise be uncompetitive in other markets. As such, exports to the West have the double advantage of being denominated in common prices and of also revealing those sectors that would be likely to continue to be competitive.

concentrated in primary products that required very little processing, including metals, gas and oil. As well as enabling it to import food and technology from the West (Khanin, 1998, p.76), the USSR's rich endowment of natural resources also served to subsidise the socialist economies in Eastern Europe (Bunce, 1986; Lavigne, 1991, pp.242-247), accounting for the majority of total exports from the USSR to Eastern Europe in 1985 (an increase in the share of fuels in the total exports of the USSR to the CMEA countries from 22 percent in 1973 to 55.5 percent in 1985). Higher technology exports accounted for a very small proportion of Soviet exports to the West. This was partially for political reasons, but also because the import-led growth strategy of the 1970s that had seen a sharp increase in technology imports had, by and large, failed to change the overall technological level of non-military output. The relatively low quality of higher quality manufactures was further exacerbated by systemic impediments to high-quality and effective marketing of manufactures that were produced (Hanson, 1982b, p.439).

Discerning the contribution of individual republics to the aggregate Soviet export profile is more difficult due to the production of different components for the same end product taking place in different republics. With this in mind, any statistics purporting to measure the export profile of Soviet republics prior to 1992 should be treated with even greater caution. United Nations data from 1992 that measure the sectoral distribution of republican export structures to non-USSR destinations are available (United Nations, 1992, pp.572-584). Given that these data include exports to CMEA countries and other 'client' states in the developing world, the proportion of higher technology goods exported should be treated with particular caution. However, what statistics are available do give at least a rough indication of which products republics would be more likely to export when independent. Several broad trends can be observed.

First, the export profiles of Azerbaijan, Belarus, Kazakhstan, Russia and Turkmenistan were dominated by fuels (ranging from 20 percent of total non-USSR exports in Turkmenistan to 61 percent in Azerbaijan), although Belarus is only included because of its refinery capacity rather than any significant endowment of natural fuels. Second, Armenia, Georgia, Kazakhstan, Kyrgyzstan, Russia, Tajikistan and Ukraine

(ranging from 10 percent in Russia to 79 percent in Tajikistan) all exported significant volumes of metals, both ferrous and non-ferrous. Third, Moldova, Georgia, Armenia, the three Baltic republics were all exporters of food and agricultural products. Finally, Armenia, Belarus, Latvia, Russia and Ukraine exported the highest proportions of machinery (ranging from 30 percent of total exports in Russia to 66 percent in Armenia). Again, these are very rough statistics as: (i) production of the same product took place in different republics, distorting the data; (ii) much of the machinery and higher technology manufactures would be unsellable on the world market; and (iii) the collapse of inter-republican trading arrangements upon the collapse of the USSR would terminate the production of many of the manufactures that were exported prior to 1991.

Despite this, it is reasonable to suggest several intra-USSR tendencies. First, the Baltic republics, particularly Estonia, were proficient in the production of light industrial goods, particularly in the food processing sector and in the production of light machinery (Arkadie and Karlsson, 1992). The republics of the Caucasus and Central Asia exported primary products, while Georgia and Moldova were more reliant on food exports. The three Slavic republics, Russia, Ukraine and Belarus were all reliant in the export of either fuels or metals, although both Belarus and Ukraine tended to process fuels or act as transit routes for export rather than extract it themselves. The subsequent export performances of the republics subsequent to the collapse of the USSR are largely consistent with these observations (see Tables 4.4 and 4.5).

By contrast, the export profile of the Eastern European economies as a whole was more evenly spread with a diverse mix of primary products and manufactures.⁶⁶ Within this bloc, most fuel exports were accounted for by Romania's oil exports (31 percent of total exports to the West in 1988) and by Poland's declining exports of coal (14 percent in 1988). Hungary was the leading exporter of agricultural products (SITC-0, 21 percent in 1988), closely followed by Poland (19 percent). The higher value-added manufactures (SITC-7) were exported by Czechoslovakia (11 percent in 1988), Hungary (11 percent)

⁶⁶ The following data are taken from: Vienna Institute for Comparative Economic Studies (1990), *COMECON Data 1989*, London: Macmillan Press. The data are presented at the Standard International Trade Classification (SITC) single digit level (ranging from 0-9).

and Poland (15 percent). Bulgaria and Romania exported a higher proportion of lower technology manufactures, such as agricultural products and light industrial goods, such as textiles and clothing. In 1988, over 60 percent of Romania's exports to the West were concentrated in commodities under the SITC-3 category (fuels) and SITC-7 category (light industry, including textiles), while nearly half of Bulgaria's exports to the West consisted of agricultural, crude and fuel products (SITC- 0 to 3), with chemicals (14 percent) and other light industrial manufactures (14 percent) accounting for much of the remainder. Therefore the Eastern European countries were, on aggregate, less reliant on only a few natural resource products for export earnings and appeared to possess a comparative advantage, at least relative to the USSR, in exporting manufactured goods on the world market, with the region exporting a broader range of higher technology products. However, intra-bloc variations are discernable with Poland, Hungary and Czechoslovakia exporting higher technology products than Bulgaria and Romania who instead tended to export more labour intensive, low technology products.

There were also significant changes in the direction of trade that had become increasingly apparent from the beginning of the 1980s. As Table 4.2 illustrated, the direction of exports from the Eastern European countries to the countries of Western European underwent a proportionate increase in most countries over the course of the 1980s. This was mirrored by a gradual decline in the proportion of total exports to the USSR so that by the mid-1980s, the countries of Eastern Europe were exporting proportionately more to the countries of Western Europe than they were to the Soviet Union. Thus, by the 1980s any pretence of bloc autarky within CMEA had evaporated. Although enterprises within the region were still not subjected to normal levels of competition and exposure to world prices, they were at least beginning to conduct the majority of their trade with the more developed countries of the West, thereby familiarising enterprises both with Western business practices and with the sort of quality that was required if manufactures were to be competitive on the world market in the future. Whereas the Soviet Union simply sold raw materials to the West, the countries of

Eastern Europe began to develop increasingly strong trading links with the Western Europe across a diverse range of products, including higher value added products.⁶⁷

In the context of the theoretical framework outlined in Chapter Two, the emerging patterns of engagement with the international economy that had begun to crystallize at the onset of the collapse of socialism suggested different prospects for the development of social orders across the region. In terms of economic structure, only Poland, Hungary, Czechoslovakia, Slovenia and, to a lesser extent, Estonia appeared to possess a relatively diverse and well-developed base on which they could build as they re-entered the international economy on market terms. Elsewhere, lower technology and more labour intensive sectors appeared to be dominant in Bulgaria, Georgia, Latvia, Lithuania and Romania. Primary products and semi-processed products dominated the export profiles of Armenia, Azerbaijan, Moldova, Russia and the Central Asian states. Finally, Ukraine and Belarus exhibited a hybrid mix of medium- to high-technology sectors (machinery, specifically tractors, in Belarus, and defence products and steel processing in Ukraine) alongside clear natural resource exploitation opportunities in the form of oil refinery capacity (Belarus) and gas pipelines that travelled west across both states. This diverse mix of export structures across the region would be expected to produce different social orders upon the collapse of socialism. Before examining the association between economic structure and social order in the post-socialist period, it is first necessary to briefly consider the range of different political orders that existed across the socialist region prior to its collapse.

4.2.2 Variation in state-type across the socialist bloc

The variation in patterns of interaction with the world economy was mirrored by patterns of state-type across the region (Robinson, 2004). Although all the socialist countries could be considered to be fundamentally limited-access political orders, the prevailing system of political relations was not uniform. This is not to suggest that all of

⁶⁷ This explains why the percentage of trade between the Soviet Union and the Western European countries took a downturn over the course of the 1980s – the price of oil was at a peak immediately after the Iranian Revolution in 1979 and began a steady decline thereafter (see Chapter 5).

the variation in state-type across the socialist bloc was solely caused by links with the international economy. Other factors such as levels of economic development prior to the imposition of socialism, cultural legacies, and varying degrees of regime legitimacy were also important in shaping the type of socialist rule that developed (Janos, 2000, pp.324-327). The regime-type at the point of the collapse of socialism should be considered as important because “historical legacies and actors’ strategic choices matter in the path-dependent process of creating new polities and economies” (Kitschelt *et al*, 1999, p.19). Indeed, the interaction between prior regime-type and the opportunities and constraints created by countries’ export structures would shape the sort of incentive structures and opportunities for collective action among political and economic actors that would exist in the post-socialist period. Kitschelt *et al* (1999, pp.36-37) outline a threefold typology of socialist regimes, based on their historical and institutional legacies.

Patrimonial socialism: These countries included Bulgaria, Romania, and all of the former Soviet Union, apart from the Baltic states. These regimes were imposed onto historically underdeveloped agricultural countries, in which society had been characterised by hierarchical traditions in which social classes were generally weak and unable to resist the socialist takeover. Over time, they became repressive systems in which pre-socialist forms of governance were recreated. These included the development of patron and client relationships in which a small, socially insulated clique ruled with low levels of popular interest articulation and low levels of rational-bureaucratic institutionalisation. In such regimes, the excessive dominance of the party-state system meant that forces emerging from the party-state were able to benefit from access to organisational and material resources that were unavailable to the other inchoate social forces that might emerge in the aftermath of socialism. Members of the party-state were thus best placed to emerge as ‘winners’ during the redistribution of state resources that followed the collapse of socialism and appropriate the most obvious sources of rent. This persistence of clientalist traditions and survivors from the previous regime, combined with the weakness of non-socialist organisational and ideological traditions, contrived to ensure that access to existing economic resources was largely denied to those outside of

the party-state elite (see, for example, Urban *et al*, 1994; Fish, 1995; Roper, 2000; Hale, 2006; Gallagher, 2006; Ganev, 2006).

National consensus socialism: These countries included Poland, Hungary, Slovenia and the Baltic states.⁶⁸ These countries had semi-democratic pre-socialist polities with a strong base for political mobilisation, but with weaker prospects for class-based politics. The socialist regimes existed alongside a weak working-class power base with a relatively weak domination of civil society. Such regimes adopted ‘national consensus’ strategies in which society was co-opted rather than repressed, and in which the regimes permitted moderate levels of contestation and interest articulation alongside strong professional bureaucratic organisations. Interest groups emerging from these systems tended to possess relatively strong reformist impulses due to the lack of legitimacy of the socialist regimes. There also tended to be higher levels of competition within post-socialist systems owing to the fact that the previous regimes had been less repressive of sources of power independent of the regime. Thus, access to material and organisational resources were somewhat higher for non party-state actors than that in patrimonial socialist societies.

Bureaucratic authoritarian socialism: Comprising Czechoslovakia and the GDR, these countries were relatively developed at the inception of socialism, with some experience of democratic politics and comparatively advanced industrial structures.⁶⁹ This created a stronger class basis for politics. The ruling socialist parties had strong links with the organised working class and access to a pre-existing professional state bureaucracy. This assisted the regimes in implementing repressive policies that suppressed the emergence of independent sources of social and economic power. They

⁶⁸ The inclusion of the Baltic republics in this category is somewhat spurious. All three republics were tightly integrated into Soviet political and economic system and the leaderships only displayed a marginal propensity to engage in ‘national consensus’ politics (see Lieven, 1993). However, the existence of semi-democratic polities and the presence of strong, if latent until the late 1980s, nationalist identities among the majority of the populations do suggest that their inclusion under this category is not entirely unreasonable.

⁶⁹ It is worth noting that there were significant differences between the Czech and Slovakian parts of Czechoslovakia. Even after the period of socialist modernization, Slovakia’s economic structure was considerably less developed than that of the Czech areas (see Myant, 1989). These differences were to prove significant in post-1989 politics in both the Czechoslovakian period (pre-1992) and afterwards.

were, however, able to preserve comparatively high levels of bureaucratic and state autonomy and resist the sort of clientalist relationships that were forged between rulers and ruled in other parts of the socialist bloc. However, because they had experienced much stronger pre-socialist levels of modernisation and democracy, bureaucratic-authoritarian regimes, and because their repressive nature had alienated most parts of society, they always faced much stronger competition from latent social forces that, although muted under the old regime, were more vocal in the post-socialist period. Therefore, once the socialist regimes collapsed the level of elite and popular competition increased sharply. Furthermore, the legacy of a strong bureaucracy left these countries more open to technocratic policy responses to the challenges imposed by political and economic transformation.

Although this typology is convincing in its description of different socialist regime types, the authors argue, somewhat curiously, that “there [was] no longer a close relationship between economic modernisation and the type of socialist rule by the 1970s or 1980s”, and that “patrimonial communist countries that began with a more ‘backward’ economy in the 1940s often had pretty much caught up with their initially more advanced neighbours in national-accommodative or bureaucratic-authoritarian communist polities” (Kitschelt *et al*, 1999, p.28).⁷⁰ Instead, they view the political institutions of socialist rule, not the levels of economic development, as the key determinants of political transformation strategies in the late 1980s and early 1990s. This is a spurious statement for two reasons.

First, there was at least a broad correlation between economic structure, the level of economic development of export profiles and regime type. For example, all of the *patrimonial socialist* countries tended to be exporters of primary products and low technology or labour intensive manufactures. The *national consensus* countries were among the most economically developed countries of the region. Poland, Hungary and

⁷⁰ The view of post-communist change in which ‘political’ variables are often viewed as the dominant factors in explaining change was discussed in Chapter 2. Here it was argued that this represents a rather narrow conception of what constitutes politics and demands a closer examination of the influence of economic variables in shaping prospects for change.

Slovenia exported the highest proportions of medium to high technology manufactures and also had per capita incomes (adjusted for purchasing power parity, PPP) that were among the highest in the region (Maddison, 2003). Indeed, Poland and Hungary had arguably pursued the most aggressive attempt at re-establishing themselves within the world economy through their import-led growth strategies of the 1970s and 1980s. Similarly, the Baltic republics had the highest per capita incomes (PPP) among all of the republics of the USSR, as well as possessing higher proportions of efficient light industry than the rest of the USSR (Arkady and Karlsson, 1992; Maddison, 2003). The *bureaucratic authoritarian* regime in Czechoslovakia was perhaps (along with the GDR) the most well developed in economic terms, exporting higher proportions of medium- to high-technology manufactures than all of the patrimonial socialist countries (Myant, 1989).

Second, the concentration or diversity of economic resources, market structures within sectors and the ease with which rent-seeking opportunities could be seized in the aftermath of the collapse of socialism were important factors in endowing emerging political actors with varying material and organisational resources and in forming constituencies that supported or opposed reform. As was argued in the previous chapter, economic systems tend to produce complementary polities, and so techno-economic variables, particularly the nature of a country's export profile, would be important factors in shaping institutional and political developments across the region. The remainder of the chapter will examine changes in export structures across the region in the post-socialist period and consider the extent to which this may have affected the development of types of social order.

4.3 Economic reform and re-integration with the international economy

The process of reintegration with the world economy that began with the collapse of socialism between 1989 and 1991 took place in a context of declining economic systems that were lagging further and further behind the West and that were now being overtaken by countries from East Asia. The evidence was clear: the previous decade of socialism

had resulted in declining output and living standards, increased levels of debt, and, most importantly, a general lack of adjustment to the changing mode of production that had shaped the international economy from the 1970s onwards. The project of economic transformation that was adopted as a guiding principle in most countries of the region had three main components, all with significant political implications: (i) stabilization; (ii) liberalization; and (iii) integration. Stabilization referred to macroeconomic stabilization; i.e. reducing state budget deficits, controlling money supply, reducing inflation, etc. . The second component involved the abolition of restrictive state regulations, the creation of a legislative framework to provide better conditions for business, price and import liberalization, reduction in state subsidies and the reduction, if not abolition, of ‘soft budget constraints’, and the privatization of state owned enterprises (Landesmann and Szekely, 1995, p.3-4). The final component required readjusting the economy to the demands imposed by the international economy, particularly the development of modern infrastructure, an increased service sector, technological and organizational improvements in agriculture and industry, and the establishment of new export sectors as well as the preservation of older, but more competitive ones.⁷¹

These three elements, if undertaken simultaneously, would be mutually reinforcing. For example, in order to achieve macroeconomic stabilization, exports would need to become competitive quickly if foreign trade balances were to be established and if a stable exchange rate was to be achieved. Furthermore, the three strands consisted of short- and long-term goals, some of which were ostensibly conflicting, such as the need to develop new infrastructure while reducing state expenditure, or improving the technological capacity of enterprises while at the same time cutting state support. Integration with the global economy played an integral role in the transformation process. Specifically, it has taken the form of increased trade flows between the region and the rest of the world, increased flows of foreign direct investment (FDI), and increased interaction with world capital markets and international financial institutions (IFIs). Indeed, integration with the world economy could be viewed as both an end to which economic reform was directed and a means of achieving this reform. In a mutually

⁷¹ Concise overviews of the varying reform strategies are contained in Aslund (2007a) and Nuti (2007a).

constitutive process, proponents of market reform hoped that increased integration would ‘lock in’ progress made in domestic reform, strengthening the ‘winners’ from the reform process and forming durable constituencies that would facilitate further integration and reform (Robinson, 2004).

In strictly economic terms, trade liberalization (including opening up to FDI) was expected to deal rapidly and most efficiently with two major flaws of the centrally planned economic system: (i) the distorted price structure, resulting from the previous system of state administered prices, and (ii) the centralized and highly integrated production system formed by large monopolistic enterprises. Essentially, increasing openness to trade was designed to ‘import’ world prices and to ‘inject’ more competition into national economies that were dominated by a few large domestic producers that had previously benefited from ‘soft budget constraints’. The role of FDI would be crucial in this respect as multinational companies (MNCs) would expose enterprises to competition as well as provide technological and organizational ‘spillovers’ to rest of the economy. Access to world capital markets would also enable firms with limited access to domestic sources of savings (due to both the absence of large-scale savings and the underdevelopment of satisfactory financial institutions) to borrow the funds required for investment. Similarly, it was hoped that assistance from IFIs would help stabilize the macroeconomic environment in which policymakers were formulating and implementing reforms.

The economic effects of increased integration with the global economy were not intended by reformers to be politically neutral. ‘Importing’ prices and ‘injecting’ competition would threaten the pre-existing particularistic exchange relations (Urban, 1985) that were prevalent in the economic sphere across the region prior to transition by exposing domestic enterprises to foreign competition and subjecting them to the remonetisation of the economy and the imposition of ‘hard budget constraints’. Therefore, integration with the global economy would also contribute towards political reform by undermining the social power of entrenched actors that had previously used particularistic exchange relations to generate “positions of power and advantage

unregulated by legal rules” (Elster *et al.* 1998, p.25). Consequently, moves towards greater integration with the global economy were viewed as only part of a much wider struggle to move towards a market economy and a more democratic polity.

However, the extent to which countries would follow this ideal-type transition process would depend largely on the array of structural economic and political forces that might oppose or support reform. It is in this respect that the degree of competition or concentration within the dominant sectors of the economy would prove crucial. For example, if concentrated rent-seeking opportunities existed within a few existing export sectors that were still competitive on the world market (e.g. in raw material extraction sectors), the opportunity for the concentration of political power would present itself to those that were able to capture them. Furthermore, the incentive to continue pursuing market reforms aimed at deepening integration with the international economy through diversifying and upgrading a country’s export profile would be lower, as ‘winners’ chose to maintain ‘partial reform equilibriums’ that favoured entrenched rent-seekers to the detriment of wider society (Hellman, 1998). In such cases, access to international sources of capital might be denied to potential domestic competitors, and entrenched rent-seekers might also exert influence over the state to limit the introduction of foreign competition.

If, on the other hand, reintegration with the wider international economy could be undertaken by a broad range of sectors, characterised by more or less competitive market structures, the opportunities for rent-seeking and the concentration of political and economic power would be curtailed. If these sectors were located in higher value-added industries, the organisational and technological impediments to political development would be reduced. Furthermore, the role of those countries that succeeded in upgrading their export capabilities would benefit materially, as well as politically, owing to the fact that higher technology manufactures have been the highest growing sectors in the world economy over the previous two decades (Lall, 1999).⁷² Thus, the first years of

⁷² According to Lall (1999), high-technology production by 68 developed and newly industrializing countries grew nearly 3 times faster over 1980-95 than total manufacturing production (5.9 percent and 2.7 percent respectively). Within these countries high technology exports grew at 11.2 percent while all other lower-technology manufactured exports grew at 6.5 percent per annum in this period.

reintegration would be crucial. Differing paths towards development or stasis lay open; success or failure early on could ‘lock in’ export profiles and wider structures of economic production that might promote or impede the development of open access economic and political systems. This in turn might then ‘lock in’ patterns of dependence or integration with the ‘core’ of the international economy.

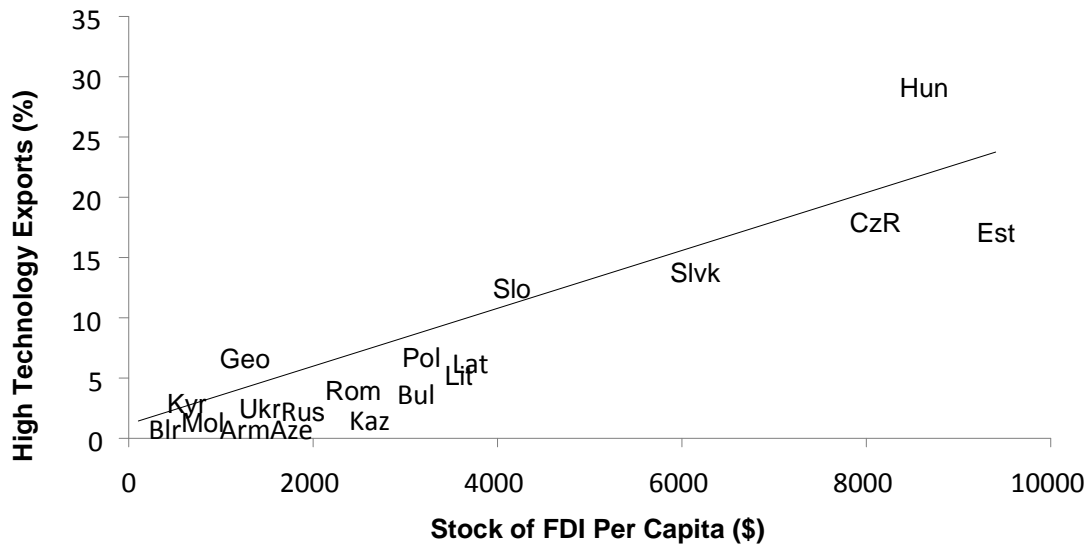
4.3.1 Post-socialist patterns of structural economic continuity and change

The export data presented in this section capture the main contours of structural continuity and change across the region. Tables 4.4 and 4.5 describe the structure and composition of export sectors at a three-digit level across the region since the collapse of socialism. These data are grouped according to the technology intensity classification outlined in Chapter Three. The left hand side of each column indicates the number of product groups in which a country enjoys a comparative advantage according to the Balassa index of Revealed Comparative Advantage. The figure on the right hand side of each column reveals the proportion of exports from each technology group. Figures are given for 1997, the first year for which data are available for all countries of the region, and 2006, the most recent year for which data are available. The countries are ranked in descending order by the change in the proportion of medium- and high-technology products exported between 1997 and 2006. It is possible to make several broad observations concerning the structure of exports across the region.

In terms of the development of high-technology exports across the region, only eight of the nineteen countries increased their relative share of high-technology products between 1997 and 2006: Hungary, Czech Republic, Slovakia, Estonia, Slovenia, Poland, Georgia and Kazakhstan. Indeed, the regional average has increased only modestly, from 6.2 percent to 8.8 percent. Kazakhstan enjoyed a rise in its proportion of high-technology exports only because the proportion of radioactive material (S3-525) exports increased. It did not develop a comparative advantage in any other product group since 1997. Georgia also has RCA in radioactive materials but also exports power generating equipment and helicopters owing to it having adjusted production in its Soviet-era Tbilisi Aircraft

Manufacturing plant (TAM, 2008). They are the only two countries from the former Soviet Union, except Estonia, to have increased their share of high-technology exports. Within the other six countries, the majority of growth in high-technology exports has taken place in HT1 products, ‘electronic and electrical products’. In the HT2 category, only Poland, Slovenia, Hungary and Czech Republic have RCA in ‘steam turbines’ (S3-712), while only Slovenia and Hungary enjoy RCA in ‘medicaments’ (S3-542). The most significant gains have been made by Hungary (19.4 to 30.4 percent) and Slovakia (6.1 to 15.5 percent). Overall, it is reasonable to suggest that the majority of the growth in high-technology products across the region is the result of: (a) growth in radioactive material exports; (b) socialist-era production facilities that have been maintained or converted; or (c) in electronic and electrical groups. Elsewhere, all other countries have, despite maintaining RCA in some product groups, experienced a decline in the proportion of high-technology exports. The proportion of high-technology exports is closely associated (Pearson’s $r = .87$) with levels of FDI (see Fig 4.1).

Figure 4.1 Cumulative per capita foreign direct investment (current U.S. dollars) and high-technology exports in post-socialist Europe, 2006.



Sources: UN Comtrade, (2008); UNCTAD (2008); World Bank (2008); author’s calculations.

Table 4.4 Structural changes in export activities, 1997-2006

Country	High-technology N of groups: 19				Medium-technology N of groups: 71				Low-technology N of groups: 45				Primary and resource-based products N of groups: 125				Change in medium and high technology (1997- 2006) Percent Change
	1997		2006		1997		2006		1997		2006		1997		2006		
	N, RCA >1	Percent of total exports	N, RCA >1	Percent of total exports	N, RCA >1	Percent of total exports	N, RCA >1	Percent of total exports	N, RCA >1	Percent of total exports	N, RCA >1	Percent of total exports	N, RCA >1	Percent of total exports	N, RCA >1	Percent of total exports	
Poland	3	7.3	4	8.8	27	23.6	29	39.9	25	33.6	21	21.3	56	35.5	42	30.0	17.7
Slovakia	4	6.1	4	15.5	36	35.2	28	41.9	18	30.6	21	19.9	38	28.1	25	22.7	16.1
Hungary	6	19.4	8	30.4	25	34.0	25	38.9	18	17.8	10	10.0	47	28.8	28	20.7	15.9
Romania	3	2.5	4	5.7	20	20.8	20	32.3	25	49.2	27	35.3	31	27.5	31	26.7	14.7
Czech Rep.	5	10.0	6	18.5	45	39.5	35	43.3	28	27.0	25	19.7	47	23.5	23	18.6	12.2
Latvia	4	9.1	2	7.9	12	9.0	13	16.5	19	30.5	25	24.7	36	51.4	35	51.0	6.2
Slovenia	6	12.8	6	14.4	30	36.0	30	40.3	27	28.3	22	22.8	33	22.9	25	22.6	5.9
Estonia	4	13.3	4	16.9	14	20.5	14	21.1	14	23.2	16	18.5	46	43.0	30	43.5	4.2
Georgia	3	2.7	3	8.4	11	31.8	13	30.1	3	4.0	3	3.5	31	61.5	23	58.0	4.0
Ukraine	2	4.3	4	3.6	15	32.1	16	36.6	12	25.5	12	25.7	43	38.1	35	34.1	3.9
Lithuania	2	7.4	2	7.0	20	24.9	21	26.8	20	22.5	18	19.2	49	45.2	43	47.0	1.4
Armenia	3	6.3	0	1.1	13	14.3	3	20.0	7	9.5	5	8.7	21	69.8	11	70.2	0.5
Russia	1	2.1	1	1.5	8	10.7	5	8.5	4	6.7	3	3.7	28	80.4	25	86.3	-2.8
Kazakhstan	1	2.1	1	2.4	7	8.8	4	4.3	3	10.8	4	3.5	35	78.3	29	89.8	-4.2
Azerbaijan	1	1.3	0	0.2	7	8.2	2	4.3	2	2.9	0	1.0	21	87.6	15	94.6	-5.0
Bulgaria	3	6.3	1	5.7	20	20.1	16	15.5	23	26.2	19	27.4	49	47.4	40	51.3	-5.1
Kyrgyzstan	2	6.4	1	3.4	7	10.4	5	7.4	5	4.6	8	12.0	32	78.7	33	77.2	-6.0
Moldova	1	10.0	0	3.0	8	10.9	8	7.1	6	9.0	17	38.6	34	70.1	29	51.4	-10.9
Belarus	2	5.4	2	2.5	28	41.8	16	28.6	20	23.3	14	13.1	38	29.6	16	55.9	-16.1

Source: United Nations Comtrade (2008); author's calculations.

Table 4.5 Structural changes in high- and medium-technology export activities, 1997-2006

	High Technology 1 <i>N</i> of groups: 11				High Technology 2 <i>N</i> of groups: 8				Medium Technology 1 <i>N</i> of groups: 5				Medium Technology 2 <i>N</i> of groups: 28				High Technology 3 <i>N</i> of groups: 38			
	1997		2006		1997		2006		1997		2006		1997		2006		1997		2006	
	<i>N</i> , RCA >1	Percent of total exports	<i>N</i> , RCA >1	Percent of total exports	<i>N</i> , RCA >1	Percent of total exports	<i>N</i> , RCA >1	Percent of total exports	<i>N</i> , RCA >1	Percent of total exports	<i>N</i> , RCA >1	Percent of total exports	<i>N</i> , RCA >1	Percent of total exports	<i>N</i> , RCA >1	Percent of total exports	<i>N</i> , RCA >1	Percent of total exports	<i>N</i> , RCA >1	Percent of total exports
Poland	2	5.6	3	7.5	2	1.7	1	1.3	0	5.4	4	12.8	13	7.4	11	7.1	16	10.6	16	20.0
Slovakia	2	4.1	4	14.4	2	2.0	0	1.1	2	10.1	2	19.9	17	11.0	12	6.9	20	14.0	16	15.1
Hungary	5	17.1	6	26.1	1	2.3	3	4.3	1	5.0	2	8.8	11	5.9	11	5.1	15	23.0	17	24.9
Romania	2	1.7	3	4.6	1	0.8	1	1.2	0	2.1	1	6.1	11	9.4	9	7.3	10	9.1	13	18.9
Czech Rep.	3	6.9	5	16.3	3	3.1	1	2.1	5	12.0	3	16.5	18	9.1	13	6.6	25	18.4	27	20.1
Latvia	3	6.1	1	4.1	1	3.1	1	3.8	0	1.1	0	4.3	8	3.8	8	5.2	5	4.1	6	7.0
Slovenia	4	6.8	4	6.4	2	6.0	2	8.0	1	11.3	3	12.8	12	7.0	13	7.9	18	17.7	20	19.6
Estonia	2	11.3	3	15.9	2	2.0	1	1.1	1	7.0	0	5.0	6	6.3	6	5.0	8	7.0	9	11.1
Georgia	1	1.4	1	0.6	2	1.3	2	7.8	0	1.4	2	7.1	8	26.5	5	15.5	3	3.8	7	7.5
Ukraine	2	2.3	2	2.3	2	1.9	2	1.4	0	1.2	0	1.4	10	22.8	10	28.0	7	7.9	8	7.2
Lithuania	1	4.9	2	5.3	1	2.5	0	1.7	2	6.7	3	7.1	11	9.5	8	9.3	8	8.7	12	10.4
Armenia	2	4.2	0	0.6	1	2.2	0	0.6	0	0.2	0	0.2	4	4.0	1	16.5	10	10.1	3	3.4
Russia	1	1.6	1	0.9	0	0.5	0	0.7	0	0.9	0	0.8	8	7.3	6	5.7	1	2.4	1	2.0
Kazakhstan	0	0.7	0	0.1	1	1.4	1	2.3	0	0.3	0	0.0	2	4.8	3	3.5	5	3.8	1	0.8
Azerbaijan	1	1.0	0	0.1	0	0.2	0	0.1	0	0.3	0	0.1	4	3.8	2	2.5	4	4.1	1	1.7
Bulgaria	2	3.1	1	3.3	2	3.1	0	2.4	0	0.4	0	0.5	12	11.9	9	5.4	9	7.7	11	9.6
Kyrgyzstan	1	4.3	1	2.7	1	2.0	0	0.8	0	2.9	0	1.9	1	1.3	2	1.6	7	6.2	3	3.9
Moldova	0	1.8	0	1.1	1	8.2	0	1.9	0	0.6	0	0.9	4	2.0	3	1.4	5	8.2	6	4.8
Belarus	2	3.4	2	1.7	2	1.9	0	0.7	4	11.8	2	6.7	12	16.1	6	11.4	15	13.8	9	10.5

Source: United Nations Comtrade (2008); author's calculations.

In the medium-technology group, the regional average of medium-technology products as a proportion of total exports increased from 22.4 percent to 25 percent. However, a clear bifurcation has occurred in terms of the growth of export products in this group. All of the countries of Eastern Europe and the Baltic states have increased their share of medium-technology exports, while in the other former Soviet states, however, only Ukraine and Armenia have increased their share. Increases in MT1, 'automotive' exports, have increased in Czech Republic, Hungary, Lithuania, Poland, Slovakia, and Slovenia. Nearly all of the East European and Baltic states have increased their share in MT2, 'process industries', along with Ukraine and Armenia. MT2 is a rather diverse category, with some machinery products, chemicals and semi-processed goods, including metals (such as steel) and wood. It is in steel and wood that Armenia and Ukraine accounted for much of their increases in medium-technology exports. In the MT3 category, only the countries of Eastern Europe and the Baltic states experienced any growth, with Hungary, Czech Republic, Slovakia, Poland and Romania experiencing the most growth. The sharpest decline in this area was suffered by Belarus (down 13.2 percent), followed by Bulgaria (down 4.5 percent).

Logically, low-technology and primary product exports exhibit the opposite tendencies to those observed in the high- and medium-technology products. As a region, low-technology products account for a lower proportion of total exports. There are only three countries that have significantly increased their low-technology exports since 1997: Moldova (29.5 percent), Kyrgyzstan (7.4 percent) and Bulgaria (1.2 percent). All have increased their exports of textiles, pottery and glassware. The other countries of Eastern Europe and the Baltic states have seen reverses in their shares of low-technology exports mainly owing to a shift towards medium- and high-technology exports. The most notable example within this group is Romania as it has seen a decrease of 13.8 percent since 1997 as it has seen its exports shift towards medium-technology exports, most notably automobiles (see Pavlinek, 2002; Egresi, 2007). Belarus has also seen its share of low-technology exports decrease since 1997, but this has been due to a sharp shift towards primary product exports, rather than any improvement in its technological base. Interestingly, Belarus' leading export is fuels, despite it possessing very limited reserves

of natural resources (with the exception of potassium sulphates). This derived from its ability, until recently, to import low-cost Russian oil, which it then refined and re-exported. In this case, the Belarusian state was not dependent on a domestic source of exports *per se*, but instead on its favorable relationship with Russia. The dependence of Belarus on this source for much of its foreign currency earnings (Lisovskaya, 2004) demonstrates a compromised autonomy of the state not from a powerful domestic export sector, but from another state. Recent Russian actions leading to the reduction in its exports of subsidized unprocessed oil products (Marples, 2008) could prompt a reversal of this process.⁷³

In the primary and resource-based products group, Azerbaijan, Bulgaria Kazakhstan, Lithuania and Russia have all seen their proportions of primary products exports increase since 1997. In Russia, crude oil accounts for the highest proportion of exports. This is complemented in Russia and Kazakhstan by exports in natural gas, and in Azerbaijan and Lithuania by exports of electricity and wood. With the exception of Lithuania, this has occurred at the expense of medium- and high-technology products with the proportion of these activities declining over the period under examination. It is highly probable that the sub-sectors within the primary and resource-based groups will be characterized by high levels of capital intensity, high economies of scale, along with low asset/factor flexibility and low production flexibility.

4.4 The relationship between economic structure and social order across the region

The second chapter outlined the conceptual framework that highlighted the association between economic structure and social order. The third chapter operationalized the dependent and independent variables, and described the data that will be used to measure any cross-country association between them. So far, this chapter has described the historical relationship between the countries of the region and the international economy and illustrated how economic structures as measured by export profiles have changed

⁷³ Because of their strikingly divergent fortunes, Belarus and Romania are discussed in greater detail in Chapter Seven.

over time. This section now focuses on testing the independent variable – economic structure as measured by the Technological Diversity and Development Index (TDDI) – against other possible explanations of variation in type of social order across the region in 2007.⁷⁴ The TDDI is tested against six other explanations: two economic, four political-institutional.⁷⁵ As will be shown, economic structure – as defined in this study - is both substantively and statistically significant, and stands up well against other alternative explanatory variables. While this does not necessarily indicate that economic structure is the best explanation of social order type across the region, it does suggest that it is an explanation that is worthy of further exploration. Before describing the results of the regression analyses comparing the competing explanations, it is first necessary to explain why the alternative explanations might be considered as plausible explanatory variables.

4.4.1 Alternative explanations of social order development

The first two alternative explanations of variation in social order give primacy to economic variables. The first measure uses GDP per capita in 1990 (purchasing power parity) as a crude but useful indicator of countries' starting points in terms of their level of economic development at the end of the socialist period.⁷⁶ The level of development in 1990 might be considered to be important because of the perceived benefits that might accrue to countries that had higher levels of economic sophistication and modernization at the point of the collapse of socialism (Lipset, 1959; Moore, 1966; Luebbert, 1991; Bunce, 2000; Janos, 2000). The literature that views economic modernization as causing greater levels of democratization might also lead one to expect it to be conducive to supporting open-access social orders. .

The second economic explanation is the stock of foreign direct investment per capita in 2006. Greater levels of foreign investment might be expected to facilitate the

⁷⁴ The construction of this variable is described in Chapter Three.

⁷⁵ A more extensive list of possible determinants of political change across the region is contained in Cameron (2007). All of the variables contained in Cameron's study were included in the initial statistical exercises that make up this section. However, only those that were deemed to be both of greater theoretical substance and statistically significant were selected for inclusion here.

⁷⁶ These data are taken from World Bank (2008).

emergence of open-access social orders through two main mechanisms (Feng, 2003): first, through the demands imposed by foreign investors for firmer protection of property rights and for improvements in the general business environment; and second, through the more indirect, but positive effect that foreign competition might have within the domestic economy. The presence of foreign firms may also be expected to inject greater competition into a country's economy, thus helping to establish greater competition at the political level.⁷⁷

The second group of explanations is political-institutional in nature. The first is based on the idea that the mode of transition from socialism might have created political path dependencies that shaped the possibility for later patterns of political behavior.⁷⁸ Originally, Kitschelt *et al* (1999) distinguished between four main modes of transition: transition by implosion; transition by negotiation; transition by preemptive reform; regime continuity. However, after performing an analysis of variance test (ANOVA) to compare the mean social order-type scores of countries within the four categories, this was reduced to three categories as the difference in mean scores between the second category (transition by negotiation) and the third (transition by pre-emptive reform) was only modest.⁷⁹ The three remaining categories range from total socialist regime implosion (coded 0), to those that experienced some negotiation between socialist elites and opposition forces (coded 1), and to those countries that experienced only continuity of elites (coded 2).

The second political-institutional explanation focuses on the level of elite dispersion at the point of socialist collapse, measuring the extent to which the socialist elite in each country was fragmented or consolidated in the transitional period.⁸⁰ This might be important because the structure of old regime elites, as they emerged from the

⁷⁷ The cumulative stock of per capita foreign direct investment is measured in current US dollars. The data are taken from: United Nations Comtrade (2008); United Nations UNCTAD (2008); World Bank (2008); and author's calculations.

⁷⁸ Data derived from Kitschelt et al (1999) and author's calculations.

⁷⁹ ANOVA involves comparing the mean scores of independent variables regressed on the dependent variable. In this instance, the mean scores on the dependent variable (social order type) were .60 for transition by implosion; .30 for transition by negotiation; .34 for transition by pre-emptive reform; and -1.04 for regime continuity.

⁸⁰ Data are derived from Easter (1997) and author's calculations.

breakdown phase, may have been an important factor in shaping the types of institutional choices made in the period of post-socialist politics (e.g., Stepan, 1986; Higley and Burton, 1989; Huntington, 1991). This variation in structure is seen to be determined by the continuity in the internal integrity of old regime elites and by the manner in which they retained access to the resources of power. The nature of elite cohesion or dispersion might be expected to affect the development of certain types of social order by shaping the institutional framework adopted (see below) or by facilitating or limiting both economic and political competition. Three categories of elite dispersion exist ranging from consolidated (coded 0), consolidated but reformed (coded 1), and dispersed (coded 2).

Linked to the previous point is the notion that the constitutional configuration of executive and legislative power chosen after the collapse of socialism is an important factor in providing the right environment for open political competition to flourish. Scholars are divided on the relative merits and deficiencies of parliamentary or presidential constitutional types in laying the foundations for more open and competitive politics. Proponents of parliamentary systems (e.g., Linz and Valenzuela, eds., 1994; Stepan and Skach, 1993) stress the flexibility of parliaments (i.e. legislatures may depose prime ministers and governments before the end of their terms) in contrast to the rigidity of presidential systems (where presidents serve fixed-terms). They also applaud the dependence of the executive on the legislature in parliamentary systems in contrast to the perceived unconstrained executive power in presidential systems. Supporters of presidential constitutional types (Horowitz, 1996; Mainwaring and Shugart, eds., 1997; Shugart and Carey, 1992) emphasize the fact that presidents may be capable of more decisive action than parliaments, and that the institutional separation of executive and legislature might reduce the hazards implicit in any temporary concentration of power. A government-type dummy variable is constructed to indicate whether a system is presidential (coded 0) or parliamentary (coded 1).⁸¹

⁸¹ Data are taken directly from Fish (2006).

The final political-institutional variable that is included in this test of alternative explanations of variation in the dependent variable measures the outcome of the initial elections after the collapse of socialism.⁸² This might be considered important because of the effect that this first election might have on elite turnover; if little turnover of elites takes place after the initial election it might be expected that political competition would be more limited than in countries which experienced significant elite turnover. This might then have important implications for the rapid reformation or marginalization of socialist elites, and also for the emergence of non-communist politicians (Grymala-Busse, 2002). If communist elites refused to contest elections or to relinquish power, the implications for political competition would be expected to be poor. Initial election scores range between 0 (no contestation by, or turnover of, communist elite) and 5 (robust contestation and high elite turnover).

Table 4.6 Bivariate regressions of social order type on hypothesized determinants

Variable	Coefficient	Adj. R ²
Technological Development and Diversity Index (2006)	3.38***	0.63
Initial election result	0.36***	0.63
Stock of cumulative FDI (until 2006)	0.0002***	0.61
Elite dispersion at collapse of socialism	.65***	0.60
Government-type (dummy variable)	1.28***	0.57
Mode of transition	-0.9**	0.42
Economic development (GDP per capita, 1990 at PPP)	.0002**	0.31

N = 19 countries

* *p* < 0.05; ** *p* < 0.01; ****p* < 0.001.

All seven of the variables tested here (i.e. the TDDI and the six alternative explanations) are suitable for Ordinary Least Squares (OLS) analysis: they have normal (i.e. Gaussian) distributions, and all exhibit a linear relationship with the dependent variable. Table 4.6 shows the results of bivariate regressions of the social order type score

⁸² Data are taken directly from Fish (1998).

on each of the independent variables. The regression coefficients for six of the variables are positive, while the coefficient for the ‘mode of transition’ variable is negative. All seven variables are statistically significant to a confidence level of at least 99 percent ($p < 0.01$). However, there is evidence of significant multicollinearity, especially between several of the political-institutional variables (Table 4.7).⁸³ This is unsurprising given the close conceptual links that exist between some of them and is overcome by applying caution to the specification of multivariate regression models. The hypothesized determinants are ranked by their explanatory strength. Here, the relative explanatory power of the TDDI variable is apparent.

Table 4.7 Correlation matrix of selected of independent variables

	<i>TDDI</i> <i>(2006)</i>	<i>Initial</i> <i>election</i> <i>result</i>	<i>Economic</i> <i>development</i> <i>(GDP per</i> <i>capita, 1990</i> <i>at PPP)</i>	<i>Government</i> <i>type (dummy</i> <i>variable)</i>	<i>Elite</i> <i>dispersion</i> <i>at collapse</i> <i>of socialism</i>	<i>Mode of</i> <i>transition</i>	<i>Stock of</i> <i>cummulative</i> <i>FDI (up to</i> <i>2006)</i>
TDI_2006	1						
Initial Elections	0.64	1					
PPP Per cap 1990	0.40	0.47	1				
Gvt Type	0.63	0.64	0.32	1			
Dispersion of elites	0.71	0.70	0.69	0.57	1		
Mode of transition	-0.62	-0.73	-0.40	-0.75	-0.55	1	
FDI Stock_2006	0.66	0.63	0.53	0.40	0.66	-0.52	1

Source: see above section and footnotes.

⁸³ For example, as illustrated in the correlation matrix, there are particularly strong correlations between mode of transition and initial election outcome (Pearson’s $r = .73$); and mode of transition and government type (Pearson’s $r = .75$).

Table 4.8 Multivariate regressions of social order type on hypothesized determinants

Variable	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6
Constant	-1.18 (3.17)*	-1.54 (-2.68)***	-2.14 (-7.06)***	-2.16 (-7.21)***	-1.8 (-3.13)***	-2.68 (-4.85)
TDDI (2006)	-	-	1.9 (3.18)**	1.82 (3.01)**	1.42 (2.15)*	1.50 (2.62)*
Initial Election	-	0.16 (1.89)	0.18 (2.85)*	-	.15 (1.95)	.16 (2.41)*
Cumulative FDI (until 2006)	0.00018 (3.98)**	-	-	-	0.00074 (1.76)	-
Elite dispersion at collapse of socialism	-	.29 (2.11)	-	-	-.03 (-.12)	-
Government-type (dummy variable)	-	.66 (2.18)*	-	0.67 (2.92)*	-	.64 (2.49)*
Mode of transition	-	0.11 (0.41)	-	-	-	.26 (1.17)
Economic development (GDP per capita 1990 at PPP)	0.00008 (1.39)	-	0.000073 (1.71)	0.000008 (2.45)*	0.00049 (1.13)	0.000079 (2.41)
F-Test	16.51***	15.84***	23.55***	24.07***	15.81***	19.34***
Standard Error	0.46	0.36	0.35	0.34	0.33	0.30
Adjusted R ²	0.63	0.77	0.79	0.79	0.80	0.84

N = 19 countries. Entries are un-standardized regression coefficients with standard errors in parentheses.

* $p < 0.05$; ** $p < 0.01$; *** $p < 0.001$.

Table 4.8 specifies several multivariate regression models utilizing the explanatory variables described above. The first column presents the results of a multivariate analysis that includes only the two economic variables described above. Although the adjusted R^2 is considerable (.63) for the overall model, only cumulative FDI is statistically significant. The second column presents the results when only the political-institutional variables are included. In this model only government-type is statistically significant (at the .05 level) with the other three variables insignificant at even the .05 level. Evidently, more robust specifications are required if these variables are to be

considered useful. The third column introduces the TDDI variable and is presented alongside the initial election and economic development variables. This model is substantially significant (Adj. $R^2 = .79$) with the TDDI variable proving the most robust explanatory variable. Model four in the fourth column tests the TDDI against government type and economic development in 1990. All three variables are statistically significant in this equation, although only the TDDI variable is highly significant ($p < 0.01$). Finally, columns five and six contain the results of multivariate analyses that comprise five independent variables. In both models, the substantial significance is considerable (Adj. $R^2 = .80$ and $.83$) with the TDDI variable remaining the only variable that consistently reaches a satisfactory level of statistical significance. The sixth column presents the model with the best fit in terms of R^2 and the standard error of the regression.

In short, the results of the regression analyses indicate that although there are a number of potentially useful variables, only the TDDI variable and the government-type variable consistently achieve statistical and substantial significance across a range of regression specifications. Consequently, the relationship between the economic structure of a country as measured by its export profile and social order-type appears, *prima facie*, to be worthy of further attention. This link is explored in greater detail in the subsequent case studies.

4.5 Conclusion

The first two chapters of this dissertation outlined the conceptual framework that is employed throughout and described the measurement of the independent and dependent variables. This chapter has provided a broad historical overview of the relationship between the countries of the socialist and post-socialist region and the international economy, positing a qualitative and quantitative link between economic structure and social order-type.

The first section of this chapter traced the main patterns of interaction between the countries of the region and the international economy up until 1980. Here it was argued

that despite the aspirations towards bloc autarky the countries of the socialist region became gradually more integrated with the world economy as time progressed. However, this interaction was not enough to compensate for the structural deficiencies of the planned economy that was the prevalent economic mechanism across the region. The second section considered the structure of the region's exports during the 1980s and at the point of the collapse of socialism. It was suggested that significant differences in patterns of integration with the international economy existed across the region. It was also proposed that these differences in economic structure were associated with different regime-types within the socialist bloc. The third section outlined the broad patterns of continuity and change in economic structure across the region in the post-socialist period. There is considerable variation among the countries of the region in their patterns of integration with the international economy, with some countries diversifying and upgrading their export base and others making less progress. The final section explored the statistical robustness of the relationship between economic structure and social order-type by comparing the explanatory variable with other possible explanations of variation in social order-type across the region.

The results of bivariate and multivariate regression analyses indicate that the explanatory variable that is tested in this dissertation is both statistically and substantially significant, and is worthy of closer attention. The subsequent four case studies explore this link in greater detail. They examine the intervening variables that were hypothesized in Chapter Two to act as the causal mechanisms that link the independent variable with the variation on the dependent variable. These case studies are intended to give greater substance to the tentative link between the two variables that is statistically illustrated in this chapter.

CHAPTER FIVE

Economic structure, the international economy and the collapse of the Soviet Union

5. Introduction

This chapter is the first of four case studies that aim to explore the link between economic structure, the international economy and social-order development. It considers the influence of the natural resource sector on Soviet politics. Whereas subsequent chapters examine the link between economic structure and politics in countries in the period after the collapse of socialism, this chapter examines the role of economic structure in causing a limited-access order to collapse. Two main arguments are made. First, that developments in the wider international economy directly affected the decision-making of Soviet leaders. Second, it is argued that the economic structure of the Soviet Union constrained the choices available to the Soviet leadership when events in the international economy, and its own systemic inefficiencies, compelled it to undertake increasingly radical reform measures in the 1980s.

This is done in three parts. The first section outlines the broad patterns of interaction between the Soviet economy and the international economy. After the 1960s, the Soviet Union developed much deeper links with the international economy (i.e. outside of the socialist bloc). The pattern of interaction was quite simple: the Soviet Union exported natural resource products and used the proceeds to pay for imported food and, increasingly, machinery that the domestic economy was unable to produce. The second section offers a stylized outline of the basic features of the Soviet system. Here it is suggested that the Soviet Union was a limited-access order in which the fusion of state and economy ensured that the Communist Party of the Soviet Union (CPSU) possessed unchallenged political power. However, the effects of a centrally planned economy reduced the efficiency of the Soviet economy and intensified the internal contradictions at the heart of the political system in which the CPSU possessed extreme formal powers that were increasingly undermined by informal practices. The deleterious effects of such a

system were masked by the export of natural resources that increased revenues at precisely the same time that the domestic economy began to falter. In the context of rising resource revenues, the incentive to engage in systemic reform was considerably reduced.

The third section considers the role of the precipitous drop in the price of natural resource exports in the mid-1980s on the decision of the Soviet leadership to engage in efforts at systemic reform. Although tentative efforts at reform were made in the early part of the 1980s, the decline in state revenues that accompanied the decline in world commodity prices induced the Soviet leadership to embark upon a considerably more rigorous reform program. However, the extent of the challenge that faced the Soviet leadership was profound and the weakening of the state through declining revenues exacerbated an already imposing situation. Faced with a recalcitrant party-state apparatus that proved unresponsive to the initial round of reforms, the Soviet leadership under Mikhail Gorbachev introduced increasingly radical reforms that were aimed at transforming the Soviet political system into a more open-access order. Unfortunately for the Soviet leadership, rising nationalist tendencies and a severe economic downturn weakened the credibility of the centre to govern and ultimately resulted in the collapse of the Soviet Union. The plethora of existing explanations of Soviet collapse suggest that it was an event that was, in many ways, over determined. However, the argument presented in this chapter suggests that even though the structure of the Soviet economy and its relationship with the international economy may not explain the collapse of the Soviet empire on its own, it was certainly a crucial factor in explaining the timing of the leadership's decision to undertake the radical reforms that ultimately led to the collapse of the Soviet system.

5.1 The role of natural resources in the Soviet economy

The Soviet economy was characterized by overspecialization in heavy industry and 'productive' sectors that were deemed to be of political importance to the party leadership (Nove, 1977, p.3). The roots of this emphasis on heavy industry were to be

found partly in the veneration of industry that was a feature of Marxian thought, and also in the need for a strong industrial base to support geopolitical competition with the West. In order to expedite the transition from an agrarian economy to a modern industrial economy, the period of rapid industrialization under Stalin saw the adoption of left-wing policies that caused a ‘big push’ in rates of investment in fixed capital at the expense of consumption (see Preobrazhensky, 1964). This heavily industrialized system built under Stalin’s rule provided the resources with which the Soviet Union was able to defeat Nazi Germany in World War Two and emerge as one of only two superpowers. After his death, the consumption needs of the population was given greater attention under the leaderships of Khrushchev and Brezhnev and led to increased investment and changes in incentives to increase output in the agricultural sector (Hanson, 2003, p.153). However, the general level of productivity within the economy began to wilt as the supply of inputs to increase output on a factor extensive model of development was exhausted. Consequently, output growth began to decline steadily towards the end of the 1960s (Table 5.1). This decline was manifested in a slower rate of technological innovation than Western countries (at least in non-military products) and in the continued failure of the Soviet economy to satisfy the needs of consumers.⁸⁴ Foodstuffs and other consumer products were, in general, either of poor quality or of limited availability (Mau and Starodubrovskaya, 2001, pp.85-88).

Table 5.1 Soviet economic growth rate, 1961-85 (average annual growth in Net Material Product (NMP), comparable prices, percent)

	1961-5	1966-70	1971-5	1976-80	1981-85
Official statistics	6.5	7.8	5.7	4.3	3.6
Unofficial recalculations	4.4	4.1	3.2	1	0.6
CIA estimates	4.8	4.9	3.0	1.9	1.8

Sources: Goskomstat, *Narodnoe khoziaistvo* (various years); unofficial calculations produced by Khanin and Selyunin (1987); CIA estimates from Central Intelligence Agency (1990).

⁸⁴ Investment planning was significant factor in causing this tendency towards technological backwardness. Because investment and the distribution of inputs across the economy was often planned years ahead, the system was not responsive to sudden changes in technology or to newly emerging opportunities, thus inhibiting the capacity of the system to absorb new technology and act upon it.

To ameliorate this situation, the Soviet Union began to import greater quantities of machinery and food. Technology that the inefficient and relatively un-innovative Soviet economy was unable to produce itself came from abroad, primarily from the capitalist countries of the West (Lavigne, 1991; Mau and Starodubrovskaya, 2001). These injections of advanced technology were intended to regenerate the productive potential of the economy and help close the widening productivity gap between the Soviet Union and the West (Hanson, 1982b). Improving the technological base of production would, it was hoped, also effect a corresponding improvement in the quality of consumer goods. The USSR also imported increasing amounts of foodstuffs to mask the inability of the inefficient domestic agricultural sector to produce enough food to satisfy the consumption demands of the Soviet population. The Soviet Union, which in 1913 (as the Russian Empire) was the largest exporter of grain in the world became the world's largest importer in the 1980s, accounting for more than 15 percent of the world's imported grain (FAO, 2007). Table 5.2 describes the secular increase in machinery and food imports. These data, however, do not reveal the full extent of agricultural decline. While the Soviet Union was importing record volumes of agricultural produce from abroad it was also, through lower prices, subsidizing both the inefficient Soviet agricultural complex and as well as the Soviet consumer. By the end of the 1980s, subsidies to the agricultural sector accounted for approximately a third of the state budget (Gaidar, 1997, p.433).

Table. 5.2 Soviet balance of trade for agricultural products and machinery and equipment imports, 1965-1985 (millions of constant 2000 dollars)

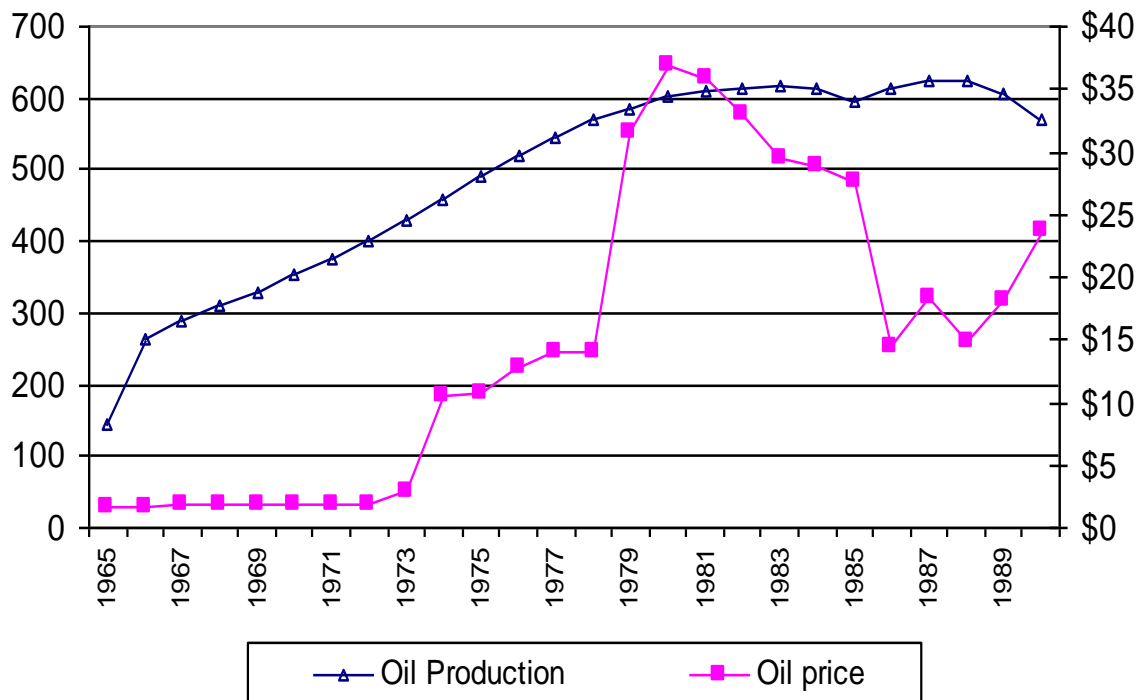
	1965	1970	1975	1980	1985
Agricultural products	-4,707	-3,654	-17,871	-27,615	-22,515
Machinery and equipment	-2,039	-3,709	-12,309	-12,455	-8,750

Sources: United Nations Food and Agricultural Organization, FAOSTAT data (2007); Goskomstat, *Vneshniaia torgovlia SSSR*, (various years); author's own calculations.

In order to pay the increasing import bill, the Soviet state became increasingly dependent on increased exports to earn the convertible foreign currency that was required to pay for the imports that maintained social stability, funded geopolitical and military

competition with the United States and its allies, purchased capital imports to compensate for the low level of Soviet technological innovation, and generally subsidized the more inefficient sectors within the economy (Khanin, 1998, p.76). It was thus fortuitous that the Soviet economy should begin to slow and exhibit signs of a drop in productivity growth just as the Western Siberian oil fields began to yield vast supplies of oil, the value of which increased sharply after the first oil shock in 1973, and again after the Iranian Revolution in 1979 (Goldman, 2008). Before the late 1960s the USSR had predominantly used the oil reserves from Azerbaijan and the Volga Oil Basin for domestic consumption and for export to its socialist allies with exports to non-socialist countries quite limited during this time (Gustafson, 1989, pp.22-25).

Figure 5.1 Soviet oil production, million tons of crude oil produced per year (left-axis) and average annual price per barrel of crude oil (right-axis), 1965-1990



Source: Production figures from Goskomstat, *Narodnoe khoziaistvo* (various years); price data from International Energy Agency (2007).

However, the discovery of huge oil deposits in Western Siberia during the 1960s led to a huge increase in oil production (Fig. 5.1) from 1970 onwards. Coinciding with the first oil shock, this stimulated even greater Soviet investment in oil and gas production. As Soviet oil production grew, more oil was available for hard currency exports. Oil exports to OECD (Organization for Economic Cooperation and Development) countries grew from just over \$2 billion in 1972 to over \$25 billion by 1980 (Goldman, 2008, p. 114). Accompanied by increased gas exports, as well as the periodic sale of gold reserves, this enabled the Soviet Union to fund its considerable and growing import bill (Lavigne, 1991, pp.334-337).

As well as providing hard currency for imports of food and machinery, the absence of an effective pricing system that could accurately measure the value of goods and activities in the Soviet economy caused the price of domestic energy to be artificially deflated, thereby enabling the state effectively to redistribute the value of fuels to other goods produced within the economy (Gaddy and Ickes, 2005). The opportunity cost from sacrificing the export revenue from a barrel of oil in order for it to be used elsewhere in the production of goods with a much lower value represented a considerable subsidy to inefficient enterprises. Indeed, the price of fuel and power in the Soviet economy has been estimated to have been as little as 5 percent of world prices (Lane, 2001, p.102). While subsidized energy may have disguised the inefficiency of many sectors within the economy, the low price did little to encourage the conservation or efficient use of energy. Consequently, as oil became more important to both the domestic economy in the form of transfers, and to the trade balance in terms of the imports from the West that energy exports bought, so the tension between the two end users mounted.

Thus, the Soviet leadership was in a bind; on one hand, oil transfers disguised the inefficiency of much of the economy, while on the other the machinery imports purchased with oil revenues were vital if the domestic economy were not to fall further behind the West, while food imports were vital if social stability were to be maintained. The energy production sector was thus assigned high priority by the Soviet leadership because of its importance as both a source of foreign currency earnings and as a subsidy to

domestic consumer, and ensured that it was assigned an increasingly large share of Soviet investment, effectively ‘crowding out’ investment resources for other parts of the economy (Hanson, 2002, p.174). Such was the importance of energy production that the increase in energy investment between 1981 and 1985 absorbed over 35 percent of total investment growth, with energy absorbing just under 90 percent of the 44 billion rouble increment allocated to industry, effectively leaving the rest of the industrial sector with stagnant investment budgets (Gustafson, 1989, p.39). By 1990 the situation had worsened, with the maintenance of existing levels of oil production estimated to have required resources approximating that of the entire Soviet investment budget (Kuikov, 2001, p.172).

The importance of the Soviet Union’s growing dependence on oil exports from the 1970s onwards cannot be exaggerated. It allowed the Soviet leadership to consolidate and expand upon the USSR’s newfound status as a superpower and continue its geopolitical competition with the West without having to address the systemic deficiencies within the economy that had caused declining rates of productivity. Indeed, the 1970s marked the height of Soviet military competition with the West, with the development of a blue-water navy, superiority over the United States in the number of strategic nuclear weapon systems that it was able to field, and increased assertiveness in foreign policy, as illustrated by Soviet activity in the 1970s, first in Africa, and then in Afghanistan (Arnold, 1993; Menon, 1986; Patman, 1990). The share of defence spending in the USSR’s GNP rose from 13 percent in 1970 to at least 16 percent in 1980 (Ofer, 1987), although this may have underestimated the real figure. This momentous defence burden was only made possible through the influx of export earnings on natural resource exports.

The oil boom also enriched many states in the developing world, particularly in the Middle East, who in turn spent heavily on military equipment from the USSR (Golan, 1990). Later, gas became more prominent as a source of export earnings when pipelines were built throughout the 1970s and 1980s to supply continental Europe. In addition, increased production and sales of gold also supplemented earnings from oil and gas

exports when they were lower, with gold exports tending to rise whenever oil prices declined and falling when oil prices were higher (Lavigne, 1991, p.334). The extent of the Soviet Union's natural resource export dependence was recognized by the Soviet leadership in the mid-1980s, with Gorbachev noting only three months after his election as General Secretary that the country should export more manufactured goods and less raw materials if the Soviet Union were not to find itself in a position of "inadmissible dependence" on the West (Gorbachev, 1987, pp. 263-264).

In short, the Soviet leadership had embarked upon a development trajectory based on using easily accessible natural resource revenues (primarily oil and gas) to solve the increasingly complex social, economic and political problems confronting them. As the share of fuels as a proportion of total exports increased from 16 percent in 1970 to 52 percent in 1982, so the USSR became more dependent on resource revenues to fund state expenditure (Gregory and Stuart, 2001, p.150). According to estimates by Gaddy and Ickes (2005, p.562), oil rents accruing to the Soviet state increased from only several billion dollars (in 2005 dollars) per year in the early 1970s to well over \$260 billion dollars per year in 1981. The availability of this lucrative source of income allowed the Soviet leadership to finance its goals without resorting to any significant economic or political reform that might alter the basic Stalinist institutional framework.

Different domestic constituencies competed over access to export revenues: the huge arms build-up, the support of client states, the subsidization of inefficient industries, the war in Afghanistan, and so forth. This led to a situation where competing claims on the commodity windfall caused revenues to be oversubscribed, while the depth of the Soviet Union's dependence on oil revenues left it especially exposed to any decline in commodity prices. It also left the USSR with an export profile that resembled an *undeveloped state*; it exported raw materials, rather than goods to which value had been added during the process of production, a point recognized within the top leadership (see Ryzkhov in Gaidar, 2006, p. 141).⁸⁵ If anything, Soviet production often created negative

⁸⁵ It has been argued that the extent of industrial waste and decay in the Soviet Union was exaggerated, and that in fact the Soviet economy, and Soviet manufacturing in particular, was value-adding to a greater

value-added goods (Gaddy and Ickes, 1998).⁸⁶ Through postponing systemic reform, natural resource revenues indirectly perpetuated the Soviet Union's backwardness, rather than help rectify it. Most significantly, perhaps, a state that aspired to a high level of self-sufficiency became increasingly exposed to the vicissitudes of the international economy because of its dependence on export earnings and the technology and consumer goods that these earnings enabled it to buy. The extent to which the Soviet Union was tied to the international economy was perhaps not as apparent to many observers in the early 1980s. However, the sudden decline in commodity prices that occurred around 1984-85 exposed the deficiencies of the Soviet economic system as the leadership began to run out of resources to pay for the imports on which it had become dependent.

5.2 The Soviet system: obstacles to systemic reform

The structure of the Soviet economy that is outlined above, and the positive terms of trade shift that accompanied its increasing integration with the international economy, enabled the Soviet leadership to avoid the sort of serious systemic reform that began to appear more urgent as the factor extensive model of development began to run out of steam. In order to understand what type of system was in place it is first necessary to consider the core elements of the Soviet system. In terms of the conceptual framework elaborated in Chapter Two, the Soviet Union was a limited-access order (LAO) with the intimate 'double balance' between the institutional structure of the state and economy an integral feature of the Soviet system; state ownership of the economy ensured complete political control (see Friedriech and Brzezinski, 1963). The Soviet LAO was, however, a hybrid system, combining elements of the absolutist-bureaucratic state-type and the

degree than now seems to be accepted. This argument is made in Kotz and Weir (2006). While it is certainly true that the Soviet manufacturing base did produce a high volume of goods, the true value of these goods is perhaps best measured by how competitive they are on the world market. In this respect, the true value of Soviet production was revealed. Quite simply, Soviet manufacturing was, outside of a few areas, only 'sold' to COMECON members as part of the managed trade process in which other socialist countries 'paid' for their cheap energy imports from the Soviet Union through imports of Soviet manufactures. Even within this system, the proportion of imports from the Soviet Union to COMECON countries declined after the 1970s, particularly as those countries attempting import-led modernization drives (e.g. Poland and Hungary) switched their purchases to Western countries. According to Aslund (1989, p.17), only around 7-8 percent of Soviet goods were exportable beyond COMECON countries.

⁸⁶ In the sense that the goods produced were of lower value than the market value of the inputs used to produce those goods.

absolutist-patrimonial state-type (Robinson, 2002). Absolutist-bureaucratic states ‘organize the exclusion of the mass of society from legislative activity and decision making by vesting power in bureaucratic organizations’ (Robinson, 2002, p.10). In the USSR, the bureaucratic organization was the CPSU, and its ideology provided the parameters within which policy was formulated. Because of the universal nature of the ideology of the CPSU, not only did it aspire to define all state goals, but those officials from within the CPSU itself were also subjects of ideological imperatives (Robinson, 1995). Consequently, because the state claimed ownership of all facets of Soviet life, party members were not supposed to use their positions in a proprietary manner, as is often the case in patrimonial, limited-access systems. State ownership of the means of production was an essential part of this system as the elimination of private property gave the state monopoly power within the economy and was thus a precondition for the party’s monopoly on power as well as an essential element of official ideology (Kornai, 1992). Goals were formulated by the upper echelons of the party, and the necessary actions to fulfil these goals were transmitted down to party functionaries. Enforcing the will of the leadership and ensuring that the economy served the requirements of the party meant that economic activity was conducted on strictly hierarchical lines; orders were given from above, and those lower down in the hierarchy were required to fulfil their allotted tasks (Nove, 1977; Zaleski, 1971).

This at least was the formal manner in which the Soviet state was supposed to function. In practical terms, the ideological imperatives imposed by the leadership caused the Soviet state and economy to consist of a vast network of inter-linked hierarchical institutions; central planning made this all the more pervasive. This complex hierarchy can be conceptualized as a chain of inter-linked principal-agent relationships in which ‘each individual...except at the ultimate levels, is simultaneously a principal and an agent when rights are transferred down the organizational ladder’ (Eggertsson, 1990). The central problem in principal-agent theory concerns information asymmetries, i.e. how principals can control agents who possess information that they lack. Two types of agency problems arise from this information asymmetry: ‘hidden action’ and ‘hidden information’ (Arrow, 1985, pp.38-40). These correspond to how hard the agent is

working (hidden action) and what maximum output level is possible given random factors and the agent's structural constraints (hidden information). Planners utilized several methods to address hidden action: precise output targets were set and monitoring agencies were created. Both mechanisms, however, were flawed. For example, meeting plan targets became the sole objective of each agent with non-monitored activities subordinated to plan fulfilment, thus exacerbating the hidden action problem.⁸⁷ The presence of monitoring organizations also provoked costly reactions by agents; officials engaged in horizontal 'bonding' practices to deal with the 'double bind' imposed by unrealistically high demands and the inability of cadres to meet them (Urban, 1985). Furthermore, hierarchies created for monitoring purposes also suffer from precisely the same problems of hidden information and hidden action as the subjects that they are required to monitor. In the Soviet Union, the CPSU was the pre-eminent monitoring organization. However, Party officials were not disinterested monitors as they often worked in or with the organizations that they were supposed to be monitoring, thus increasing the opportunity and incentive for agents to subvert the commands of their principals.

Even if monitoring mechanisms were effective, which they were not, the use of targets presupposed the supply of reliable estimates of agents' actual performance potential. It is here that hidden information undermines the system; accurate assessments of performance potential are known only by agents themselves. However, because of the demands imposed by principals within the Soviet organizational hierarchy, the incentive to provide distorted information was high. In an attempt to overcome this problem, planners estimated future performance capacities by employing information on the past performance of agents to set output targets. This led to the 'ratchet problem' in which principals adjusted output targets to reflect the performance of the agent in the most recent period, thus increasing the incentive of agents to hide their true productive potential. This inability to deter opportunistic behaviour was one of the central paradoxes of the Soviet system; a state with vast coercive potential was effectively unable to control

⁸⁷ Hewett (1988, p.179) describes how the shadow economy 'evolves from the enterprise director's search for ways to meet their plan; it is the consequence of an effort to achieve the most important targets set in the formal system, at the cost of less important targets and norms'.

its most important agents and ensure that the economy was operated entirely according to its will.

Thus, the practices that emerged from the within the Soviet institutional incentive structure eroded the bureaucratic impersonalism demanded by state ideology. In order to avoid censure, officials (and non-officials since all actors were subject to the same ideological imperatives) created ‘horizontal’ alliances with other officials, enterprise directors, etc. These alliances were then used to protect individuals as they selected which of the demands imposed on them could be met or that would be monitored by the authorities (Harrison, 2002). This led to the selective implementation of state policy and had the effect of undermining the formal rules and institutions of the state as official positions were used in a less impersonal and more proprietary manner; decisions on policy implementation were made at the discretion of the individual and the need for subordinates to undertake collective action and engage in collusive activity led to patronage and clientalist relationships, the opposite of what the system was supposed to achieve.⁸⁸ Thus, the risk-minimizing measures taken by agents at all levels within the hierarchy in response to the uncertainty imposed by the formal imperatives of planning led to the secretion of evolved practices that were the products of historically accumulated institutional experience. As noted in Chapter Four, the Soviet Union was a classic example of patrimonial socialism.

These institutional features – both formal and informal – had the perverse effect of preventing serious systemic reform on the one hand while, at the same time, making it all the more imperative by compromising the orders of the planned economy. The imperatives of official ideology with its concomitant fusion of state and economy led to a delicate balance in which patrimonial tendencies existed to mitigate the formal institutional demands of the ideology, despite their apparent dissonance. Such a system impaired state capacity because the goals of the leadership and its subordinates were

⁸⁸ According to Pipes (1974), the essence of a patrimonial society is that the ruler combined in his person both the right to rule over his subjects and the right to dispose of all property. In the absence of private property it is impossible to distinguish between politics and the economy; both power and property are entwined.

essentially in opposition to one another. What was supposed to be an absolutist-bureaucratic state in fact resembled a ‘giant kleptocracy’, a system whose dominant features were force, extortion and tribute, all hallmarks of a patrimonial system (Hedlund, 1999, p.19). The productivity decline in the economy – something that ensued as the dictates of ideology constrained the formation of a suitable incentive framework for the transition to a more factor intensive mode of production - was masked only by the boon enjoyed by the Soviet Union that was a function of both its natural resource endowment and developments in the wider international economy.

From the 1970s onwards, natural resource revenues offered a means for the leadership to meet state goals without having to resort to the coercion of the 1930s or engage in fundamental institutional reform. Indeed, while the Soviet leadership was able to meet its primary goals and satisfy the demands of most politically important domestic constituencies, it was faced with a very low incentive to engage in systemic reform that might become more urgent should conditions in the international economy deteriorate. In this respect, the structure of the Soviet economy - and its pattern of integration with the international economy - sustained a parasitic system in which the principal-agent hierarchy formed in response to the formal ideological demands of Soviet ideology sapped the very economic system in which they existed. Thus, while the state’s dependence on natural resource exports did not cause the institutional idiosyncrasies of the Soviet system, it certainly exacerbated them by providing the resources that masked the systemic deficiencies of the Soviet economic mechanism. This delicate equilibrium was, however, disturbed once reforms were initiated in the face of declining natural resource revenues. The dissonance between the formal and informal institutions within the Soviet system became increasingly apparent, ultimately leading to the collapse of the Soviet Union as self-interested agents within the state-economy responded opportunistically to a rapidly changing incentive environment by appropriating state resources and undermining the credibility of the CPSU to maintain the existing system.

5.3 Exogenous shocks, institutional disarray and the collapse of the Soviet Union

After the death of Yuri Andropov, quickly followed by that of Konstantin Chernenko, it became apparent to some sections within the Soviet leadership – most notably to the new General Secretary of the CPSU, Mikhail Gorbachev - that reform of the system was necessary to inject renewed vigour into an economy that even official figures had shown to have experienced declining growth and productivity rates since the late 1960s (Table 5.1). This became particularly urgent when in 1986 the price of oil dropped by nearly 70 percent (Figure 5.1), which along with a decline in other commodity prices, led to a reduction in earnings from foreign trade, primarily with the West (Table 5.3), and an increase in the state budget deficit (Figure 5.2). Indeed, total annual oil rents plummeted from a peak of over \$260 billion in 1982 to approximately \$75 billion in 1986 (Gaddy and Ickes, 2005, p.562). This is not to suggest that the fall in oil revenues was solely responsible for the rising budget deficit; Gorbachev had also initiated an expansion in capital investment across the economy, thus leading to an expansion in state expenditure, and had curtailed state revenue through the ill-conceived anti-alcohol campaign.⁸⁹ What it did do, however, was restrict the options available to the state at a crucial juncture. The decline in revenues destabilized the system, added urgency to the reformist impulse, and ensured that any such reforms would have to be undertaken in a climate of fiscal austerity. After some small and largely unsuccessful changes in policy, Gorbachev was able to persuade the CPSU that it needed to go further than it had done previously in reorganizing the Soviet system, with it being accepted that systemic reform was needed in order to revive the economic system on which the CPSU's legitimacy rested.⁹⁰ Without paying too much attention to the details of the events that were set in motion by *perestroika*, it is necessary to highlight some of the more important reforms that

⁸⁹ Between 1984 and 1987, tax revenues in the state budget from sales of alcohol products fell from 4.8 percent of GDP to 3.5 percent (Gaidar, 2006, p.23).

⁹⁰ Initially, Gorbachev had hoped to raise productivity in the economy through the tightening of administrative practices (i.e. though greater discipline within the party). Echoing Brezhnev's calls for the 'acceleration of scientific and technical progress' (*uskorenie nauchno-tekhnicheskogo progressa*), Gorbachev heeded the party to improve discipline in order to kickstart the 'acceleration of socio-economic progress' (*uskorenie sotsial'no-ekonomicheskogo*). Both proved ineffective and arguably the measures taken to support *uskorenie* (acceleration), such as the anti-alcohol campaign and increased capital expenditure financed through foreign loans, actually served to exacerbate existing problems. The failure to reinvigorate the economy using these methods led Gorbachev to undertake more radical measures.

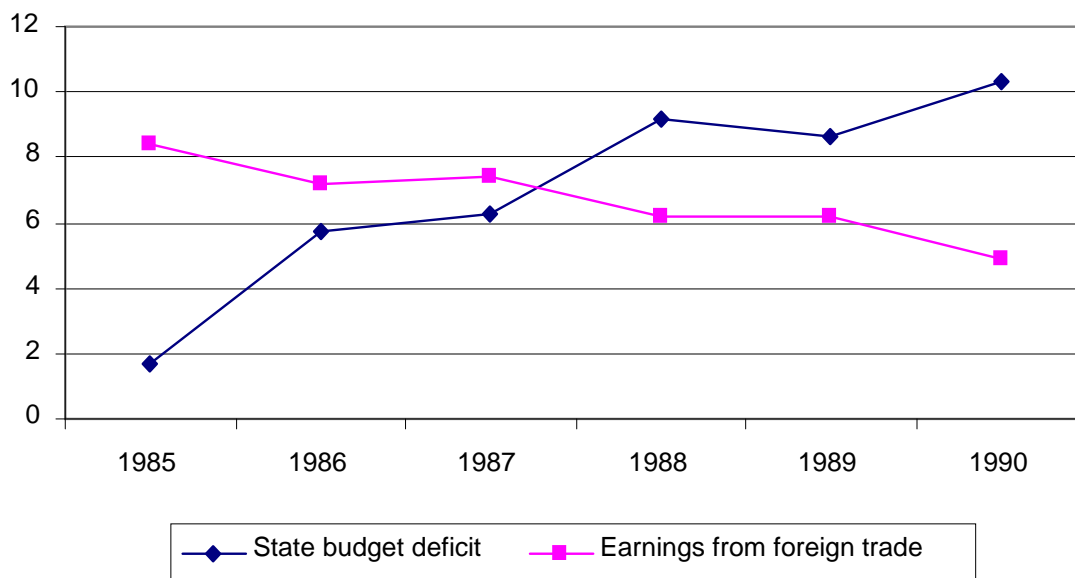
fundamentally altered the institutional environment of the Soviet Union and set it on the path to systemic collapse.

Table 5.3 Soviet trade with the West (OECD countries) 1984-90, (*Billions of nominal currency roubles*)

	1984	1985	1986	1987	1988	1989	1990
Exports to West	21.4	18.6	13.1	14.2	14.7	16.4	17.4
Imports from West	19.6	19.3	15.9	13.9	16.3	20.5	20.2

Source: Vienna Institute for Comparative Economic Studies (1990)

Figure 5.2 The Soviet state budget deficit and earnings from foreign trade, 1985-90 (*as a percentage of national income*)



Source: Adapted from Aslund (1989, p.192).

The first group of reforms from the *perestroika* period that would prove crucial in the unravelling of the Soviet system were the laws passed by the Soviet government guaranteeing increased autonomy for enterprises (the 1987 Law on State Enterprises, or LSE), and private economic activity (the 1988 Law on Cooperatives, or LC), which

facilitated the legal creation of economic activity independent from state control.⁹¹ Broadly, these changes were intended to improve the incentive environment for economic agents in order to raise productivity within the Soviet economy, and to weaken the industrial ministries that were seen as the main barriers to reform.⁹² They were not intended to bring about a free-market economy or the privatization of state property (Aslund, 1991). Instead, the aim was decentralization of decision-making to weaken the ministries and some liberalization at the margin in order to improve economic performance while maintaining political control.

The Law on State Enterprises was initially aimed at transferring power over enterprises from ministries to local party committees in order to establish a more decentralized form of ‘self-management’ that would still be consistent with the ideological precepts of the CPSU (Ericson, 1988). The main source of ministerial power, shared with Gosplan (the State Planning Agency), had been their right to appoint enterprises’ top managers, to determine production targets and investment plans, to set prices for goods, to allocate inputs, and to instruct enterprises where to deliver their output (Whitefield, 1993). The Law on State Enterprises reduced the legal rights of ministries over enterprises while also giving enterprises the autonomy to make production decisions themselves, to choose their clients, set wages, and determine what proportion of profits would be retained.⁹³ This should have effectively abolished central planning. However, under pressure from conservatives within the party and the ministries, the law also stipulated that enterprises should consider control figures, state order, quotas and long-term economic goals, thus giving the central planning authorities the formal power still to affect enterprise decision-making (Aslund, 1991, p.108). The right of workers’ committees to remove enterprise managers was removed in 1989, thus intensifying the confusion over who controlled what and fundamentally altering the incentive environment in which economic agents had previously acted. This removed

⁹¹ The Law on Cooperatives was preceded by the less radical and more limited Law on Individual Labour Activity which was designed primarily for small enterprises for craftsman. See Plokker (1990).

⁹² The power of the industrial ministries and their influence in shaping both Soviet and post-Soviet development is discussed in Whitefield (1993).

⁹³ As *perestroika* gave way to economic collapse, the shortages within the economy further weakened the ministries as they became less capable of guaranteeing the delivery of inputs that were becoming scarcer over time.

accountability as a consideration for enterprise managers while simultaneously handing quasi-ownership over to enterprise managers.⁹⁴

The Law on Cooperatives legalized private enterprise among any group of more than three adults and would take place entirely outside of any state direction or control. It was hoped that cooperatives would stimulate entrepreneurship that would in turn supply the demand for goods and services that the planned economy had hitherto been unable to achieve on its own (see, e.g. Hanson, 1988; Plokker, 1990). In addition, this would then mobilize latent labour, provide competition to the state owned enterprises, thereby impelling them to become more productive, and ultimately raise production across the economy. This at least was the intention. However, these economic reforms, alongside the political reforms discussed below, would fundamentally alter the institutional framework in which state and economic actors operated, changing the incentive structure that rational agents would respond to in a manner that none of the architects of the reforms could have imagined (Yasin, 2002).

The second significant group of reforms related to the development of the new formal political institutions that were intended to galvanise the Party into becoming more responsive to the needs of the population. Accordingly, Gorbachev initiated a series of reforms that led to the introduction of limited elections to the Soviet legislature, first at republican level and then at the All-Union level. Elections were supposed to introduce an element of accountability to party behaviour, with the potential sanction of being removed from office an incentive to improving the quality of party work and became more important bureaucratic resistance increased (see Gregory, 1989; 1990). Several issues became important at this point. Firstly, the sequencing of the elections – i.e. holding Republic level elections in 1989 and not holding All-Union elections until 1991 - had the unintended consequence of conferring more legitimacy on the institutions in the constituent republics than at the All-Union level (Linz and Stepan, 1996, pp. 365-400). Secondly, the creation of a directly elected Russian presidency in 1991 created a vehicle

⁹⁴ Anders Aslund (2007b) describes this as ‘freedom without accountability’.

for centrifugal forces to advance their efforts at gaining more sovereignty.⁹⁵ The fact that Gorbachev had not subjected himself to popular approval when he later created the role of Soviet President put the central Soviet authorities at a severe disadvantage vis-à-vis the republics.⁹⁶ Consequently, there later emerged different competing centres of powers, often with the formal powers concentrated in the hands of executive presidencies (or their equivalents) in both cases.⁹⁷

Taken together, the reform package termed *perestroika* fundamentally disturbed the delicate equilibrium in which formal and informal institutions had co-existed in the Soviet Union since the 1930s. The *de jure* decentralization of decision-making took place within a system that was, *de facto*, already more decentralized than the leadership had realized. The authority of the centre had previously meant that even if the economy was not strictly centrally *planned*, it was at least centrally *managed*. Even though agents within the hierarchy had not always obeyed every order, and had exercised considerable discretionary power, the potential sanctions available to the CPSU meant that it always remained a primary consideration in the calculations of any agent within the system. However, these constraints on agents' actions were considerably reduced as *perestroika* effectively made property rights (initially held unambiguously by the state) more ambiguous as the role of the central state subsided. By creating the perception that principals within the hierarchy were no longer in full control of state resources, agents became more opportunistic in utilizing the assets that were at their disposal, rapidly resulting in the organizational equivalent of 'multiple sovereignty' (Solnick, 1998, p.35). The 'horizontal' informal networks and practices that had existed as a response to the formal power of the state were now used to assert the interests of agents against their

⁹⁵ This was preceded by the Declaration of Sovereignty in 1990 which can be seen as the decisive factor in weakening the revenue raising capacity of the Soviet centre and so in strengthening separatist forces within Russia and the other republics; see Mau (1998). The creation of the Russian presidency is discussed in: Robinson (2000).

⁹⁶ Of course, this was not what Gorbachev had intended. However, as pressure grew from conservatives within the CPSU, Gorbachev was impelled to create a new institution that would give him more autonomy from the increasingly resistant party apparatus. Without the support base of the party, Gorbachev grew more isolated as no durable base of support existed for his presidency; see Robinson (1995).

⁹⁷ This was the case in Russia and the republics of Central Asia and the Caucasus. In the Baltic republics, opposition to Moscow was centred around parliamentary organizations. In Belarus, Moldova and Ukraine, the balance between parliament (the Supreme Soviet and the Congress of Peoples' Deputies) and the executive.

principals. As the situation of ‘multiple sovereignty’ intensified over the course of *perestroika*, so the credibility of the centre to enforce its will declined.

At the economic level, this resulted in ‘spontaneous privatization’ with enterprise managers tightening their grip on state assets.⁹⁸ Cooperatives were increasingly seen not as a vehicle in which to undertake private enterprise, but instead were used to appropriate state resources or to engage in speculation. Such phenomena were replicated at the political level as republics asserted their sovereignty against the centre. Indeed, the economic aspect exacerbated the centrifugal political tendencies as the LSE had negative effects on the revenue raised by the state. As the credibility of the centre to raise revenues eroded, the republics withheld transfers to Moscow as they focused on measures to rectify their own fiscal situations.⁹⁹ Ultimately, each ‘victory’ by agents within the hierarchy undermined the credibility of principals (with the ultimate principal being the central Soviet leadership), further increasing the incentive to engage in yet more opportunistic behaviour. In the end, the Soviet state was subjected to the political equivalent of a bank run as the centre gradually saw its credibility, and ultimately its viability, gradually compromised by agents responding opportunistically to earlier signs of weakness. The political and economic effects of this desertion by the party-state were disastrous, quickly leading to the collapse of the Soviet Union.

⁹⁸ The increased autonomy of enterprises facilitated what was, in effect, the first wave of privatization. As central planning controls disintegrated and private enterprise was legalized, a process of ‘spontaneous’ privatization occurred as various state enterprises (e.g., the Kama Truck factory) or even ministries (e.g., the natural gas ministry) were transformed into legal entities, labelled ‘state concerns’ or ‘holding companies’. Butressing this process was the emergence of start-up businesses that were initially registered as cooperatives. Both processes were closely entwined as the beneficiaries of the *de facto* wave of privatization often, for example, set up banks in the guise of cooperatives (often registered and operated under the auspices of Party organization such as the Komsomol) that were used to expropriate state funds and enterprise assets in order to engage in currency speculation and other activities that supported personal enrichment.

⁹⁹ Throughout the ‘war of laws’, both presidencies were the object of demands made from republic level political and economic actors, with these forces playing the two presidencies off against one another. As *perestroika* progressed, these institutional reforms entrenched and intensified the patrimonialism that was so prominent in the Soviet system as both presidents promised material rewards and assurances of increased sovereignty to their subjects in return for support in the battle being fought between the Soviet centre and the republics. This further weakened the centre as republics effectively took direct control of the monetary and fiscal functions of the centre, thereby exacerbating the fiscal tightening at the centre that accompanied the decline in commodity exports.

The economic effects were profound and further aggravated the deterioration of state capacity that had taken place over the course of *perestroika* and were to have important implications for the newly independent Russian state. Without the constraints previously imposed by central authorities, monetary emissions increased sharply within enterprises as pay restraints were discarded.¹⁰⁰ The incentive for enterprise directors to withhold taxes also grew, adding further pressure on the state budget deficit, leading to the centre to resort to borrowing on international capital markets (Figure 5.3), and to the printing of money to cover the gap of lost revenues. This led to a sharp increase in inflation, both in terms of the price level and in the shortages that became more acute. With directors focused on short-term goals, investment plummeted with a 7.4 percent decline in 1988, followed by a further 6.7 percent decline in 1989 (IMF, 1992, p.49).¹⁰¹ Soviet oil production declined considerably after 1989, further intensifying the decline in revenue even as prices began to rise, with production declining from over 600 million metric tonnes per year in 1988 to around 500 million metric tonnes in 1990 (Gaidar, 2006, p.281).

The economic collapse that ensued because of the failed policies of *perestroika* left the victorious Russian independence movement, led by the president, Boris Yeltsin, in control of new state, but it was a state that had been undermined by the very process that had brought it into existence.¹⁰² By ignoring the process of privatization from below in return for political support, the new Russian state perpetuated the same patterns of behaviour that existed under the Soviet state. This had the desired effect of undermining the collapsing Soviet state, but also laid the foundations for subsequent difficulties for the independent Russian state. Consequently, the Russian state that later emerged from the

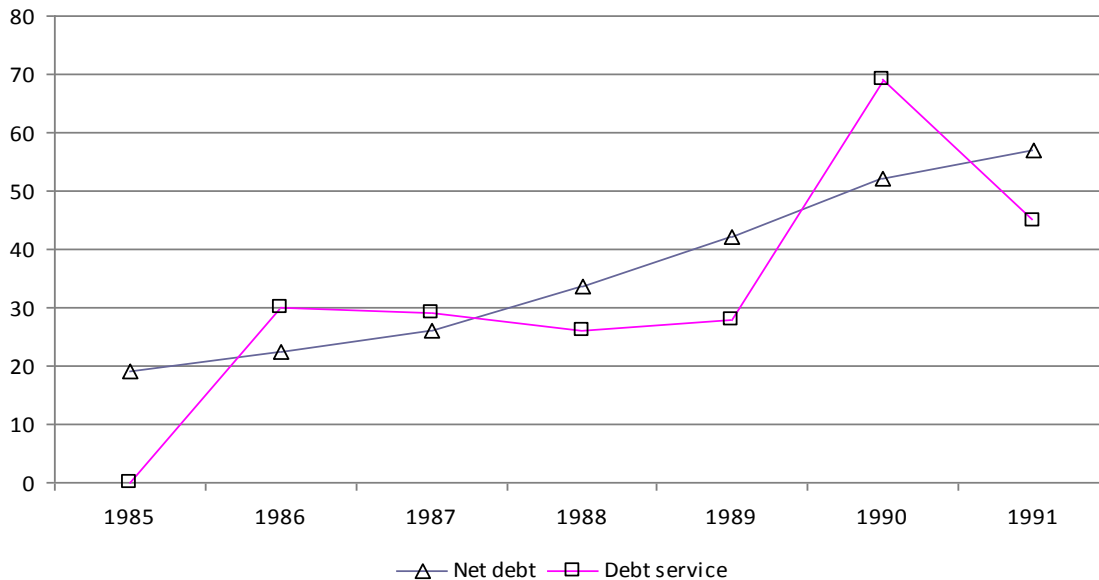
¹⁰⁰ *Perestroika* undermined the dual flows of money that had existed previously in the Soviet economy. 'Book' money had been used by enterprises to finance inventories and working capital, with cash used for wage payments treated separately. Thus it was difficult for enterprise directors to divert 'money' used by enterprises for the purchase of capital or inputs from other enterprises into cash. By loosening the controls over discretionary enterprise expenditure, and through the emergence of co-operatives whose primary function was to turn 'book' money into cash, the system of monetary and, by extension political, control that had existed previously was fatally undermined.

¹⁰¹ International Monetary Fund (1992, p.49).

¹⁰² The nature of the disintegration of the USSR, along with an assessment of the inevitability or otherwise of its collapse, is contained in Ellman and Kontorovich, eds. (1998).

wreckage of the Soviet Union faced a severe economic crisis, but was not equipped with the tools to deal with it.

Figure 5.3 USSR net foreign debt and debt service in convertible currencies, 1985-1991
(Net debt in billion US dollars; Debt service as a percentage of convertible currency exports)



Source: United Nations Economic Commission for Europe (1992); International Monetary Fund Financial Statistics (2007).

Although it can be argued that the collapse of the Soviet Union was over-determined, the defection of the party-state apparatus as it responded to the weakness of the centre by increasingly pursuing their own goals was the primary cause of the collapse of the Soviet Union. Popular forces, while prominent at some points, and in some republics (i.e. the Baltics), were of secondary importance in Russia. Here, the actions of the party-state resulted in a revolution ‘from within’ as the important decisions of ‘who gets what’ were made largely without reference to social movements and other civic organizations. In this respect, the nature of the ‘revolution’ was closed-access. Indeed, the nature of popular mobilization during this period was such that most autonomous social and political organizations that emerged during *perestroika* – alternative parties, strike committees and independent trade unions, voters’ clubs, and umbrella groups such as

Democratic Russia – assumed the form of ‘movement organizations’ (Fish, 1995; Urban, Igrunov and Mitrokhin, 1997; Evans, 2006). The principal purpose of such movements was the expression of broad, pandemic demands for the demise of the existing system of rule. Because these groups were not firmly rooted in any socially or economically framed constituency, they did not provide a durable base for any sustained interest articulation and representation once their goal of Soviet collapse was achieved (Fish, 1995, 2005; Urban, Igrunov and Mitrokhin, 1997; Hale, 2006). Indeed, it is notable that the Boris Yeltsin never felt compelled to commit to any of these groups, but instead relied on lavishing promises on other sections of the party-state elite for political support.¹⁰³ The process of winning independence for the new Russian state was thus essentially elite (i.e. party-state) led (Hedlund, 1999; Kotz and Weir, 2006). This further perpetuated the patrimonial, unaccountable and closed-access nature of economic and political relations that existed under the Soviet regime and would further inhibit the development of effective countervailing forces to the Russian state later on.

5.4 Conclusion

This chapter has examined the link between economic structure, the international economy and social-order development in the Soviet Union. The importance of the natural resource exports that linked the Soviet Union to the international economy was clear, with the decline in commodity prices and the subsequent loss of revenue on which the Soviet Union was dependent destabilizing the existing system and triggering the subsequent series of reforms and measures that were in turn taken in response to these reforms. The systemic rot that accompanied the end of the factor extensive mode of development set in around the end of the 1960s. Fortuitously for the Soviet leadership, the sudden rise in world commodity prices and the rapid increase in Soviet production of oil and then gas masked the inability of the planned economy to perform to a satisfactory level. The equilibrium in the Soviet economy caused by large resource revenues remained relatively undisturbed over the course of the natural resource boom that lasted

¹⁰³ During the struggle with Moscow, Yeltsin had implored regional leaders within Russia to “take as much sovereignty as you can swallow”; see Dunlop (1993, p.62)

from 1970 until the early 1980s. However, the decline in commodity prices on which the Soviet Union was reliant meant that the party leadership was suddenly forced to address, in the best way possible, the systemic flaws that had dogged the Soviet economy since the late 1960s. At this point, the new Soviet leadership under Gorbachev was effectively faced with two options: to cut imports and overall spending to match the decline in export earnings and other revenues, leading to a decline in consumption among the population, a decline in arms expenditure, and ultimately a decline in the legitimacy of the CPSU; or to increase the productivity of the wider Soviet economy relative to the natural resource sector through reform of the incentive structure within the economy to induce greater productivity among agents within the system. The first option was politically impossible. *Perestroika* represented the second option.

The decentralization of decision-making in the economy and of political power in general undermined the centralized hierarchy that had kept the system intact up to that point. Where previously the state had employed a combination of punishment and reward to elicit the cooperation of agents in meeting state goals, the reduction in the credibility of the state's capacity to administer punishment or reward that emerged because of failed policies led to lower expectations among agents of the state's ability to do so in the future. This erosion of the credibility of the Soviet centre led to a 'run' on the assets of the state as the mixture of costs and benefits to appropriating state assets quickly shifted towards lower costs and increased benefits (Solnick, 1998; Harrison, 2002). Thus, the structure of the Soviet economy and its integration within the international economy were crucial variables in explaining the timing of Soviet collapse. If commodity prices had not suddenly plummeted, and if state revenues had remained relatively high, the collapse of the Soviet Union would have been by no means certain (Ellman and Kontorovich, 1998).

The decline in commodity prices, however, exposed the systemic flaws that had appeared towards the end of the 1960s. In the 1960s, the upturn in world commodity prices that in turn stimulated the steep increase in Soviet natural resource production represented a panacea to these systemic flaws; grandiose state goals could be achieved while essentially preserving the existing system. For the Soviet leadership, it was

unfortunate that as the price of the exports on which the Soviet Union was dependent declined in the mid-1980s, it was then faced with the prospect of implementing systemic reform if economic productivity were to improve while simultaneously encountering the constraints imposed by heightened fiscal austerity. The reform process itself then disturbed the vast, interlinked hierarchy within the Soviet political and economic system, ultimately leading to a ‘revolution from within’ as members of the party-state defected en masse, resulting in the collapse of the Soviet Union. In summary, therefore, it is perhaps accurate to suggest that although the systemic deficiencies of the Soviet Union were not caused by its economic structure, the *timing* of the crisis encountered by the Soviet leadership in the mid-1980s was determined by the nature of the Soviet position within the international economy and through its dependence on natural resource export revenues.¹⁰⁴ The subsequent three case studies test the conceptual framework outlined in Chapter Two in the post-socialist period.

¹⁰⁴ A number of other studies place the actions of individual actors at the centre of their analysis (e.g., Brown, 1997). However, as was argued in Chapter Two, the decisions of political (and economic) actors take place within historically contingent contexts. In this instance, Gorbachev’s personal predispositions, decisions and reactions to the unfolding crisis that the Soviet Union found itself in were undoubtedly of great significance. This is undeniable. What this chapter argues, however, is that the structure of the Soviet economy left Gorbachev with only a limited array of choices, making some courses of action more probable than others.

CHAPTER SIX

Russia: natural resource sectors and limited-access politics

6. Introduction

This chapter continues from the previous chapter by examining the role of the natural resource sector on the political development of the Soviet Union's largest successor state, the Russia Federation. As was argued in Chapter Three, Russia is one country from a wider group (Group A) that score lowly on the Technological Development and Diversity Index, and also display low scores on the measures of social order development. Unlike the subsequent case study chapters, this chapter does not treat the whole post-socialist period together. Instead, two distinct periods are examined. First, the period between 1991 and 1999 is discussed. This period coincides with Boris Yeltsin's presidency and is followed by an examination of political economy under Yeltsin's successor as President, Vladimir Putin. A separate treatment of these periods is considered necessary because of the contrasting trajectories of political economy in Russia during these two periods. By examining the two periods separately, the second order hypotheses generated in Chapter Two relating to the causal mechanisms linking economic structure with social order development can be tested with more sensitivity than would be possible if the post-socialist period were considered as a whole.

In the previous chapter the revenues the Soviet state derived from the natural resource sector were shown to have played a crucial role in postponing much needed reforms and in perpetuating an inefficient system. Once these revenues declined, the system was plunged into economic and political crisis. The reform package - collectively known as *perestroika* – implemented under the leadership of Mikhail Gorbachev failed to save the Soviet system and it ceased to exist after 1991. The failed reforms of *perestroika* and the political struggle for Russian independence did, however, bequeath a set of institutional legacies that would interact with the inherited economic structure to prevent the Russian Federation from developing into an open-access order. As will be argued throughout this chapter, elements of institutional and economic path dependency

weighted the dice heavily against the emergence of a broad array of economic, political and social forces that would compete openly for political power. Instead, limited economic competition in leading export sectors, an institutional legacy that promoted the perpetuation of patrimonial politics and the dependence of the state on natural resource revenues all conspired to produce a polity characterised by the concentration and fusion of economic and political power. However, while the structure and level of economic competition were broadly similar over both the Yeltsin and Putin periods, the balance of power between business and state has shifted considerably since 2000. As will be argued, events in the wider international economy have contributed towards this tendency.

This chapter proceeds as follows. The first section highlights the main economic and political legacies inherited by the Russian Federation from the socialist period. Of particular importance are the dependence on natural resource revenues, the concentration of economic resources, and the legacy of patrimonialism. In the second section data are presented to identify the natural resource sectors as having dominated the export profile of the Russian economy since 1991. The distinguishing organizational characteristics of these sectors are shown to produce a tendency towards a concentration in market structure, while the international trends in these sectors indicate that they are also subject to quite frequent and sharp fluctuations in price.

A third section examines developments from the early stages of independence through to the economic crisis of August 1998. This broadly covers most of the period in which Boris Yeltsin served as president of the Russian Federation. During this period, ownership of the leading export sectors was concentrated either in the state or in powerful financial-industrial groups (FIGs). These existed alongside a moribund ‘virtual’ domestic economy in which the informal institutions developed under Soviet rule continued and acted to undermine attempts at market reform. Weakened by the exit from the Soviet system, the state was unable to prevent the corrosive informal practices from continuing within the domestic economy and instead contributed to its perpetuation through the provision of subsidies. Without a durable support base in society or a reliable source of tax revenue within the domestic economy, and unable to introduce and implement market

reforms with too much success, the Russian leadership became dependent on a loose coalition of powerful business interests that controlled significant portions of Russia's export base. The virtual economy, predatory FIGs and a weak state existed in an uneasy equilibrium until events in the wider international economy triggered a sharp decline in commodity prices and, ultimately, an economic crisis in August 1998. During this period the concentration of economic resources within the hands of a few, and the overwhelming preponderance of formal institutional power that resided in the presidency, saw big business and the Presidential Administration (PA) formulate policy in an informal and often unaccountable manner. Furthermore, these same factors hindered the development of effective political parties, business associations and civil society in general that might have forced politics in Russia to develop along more competitive and transparent lines.

The final section considers the period after the 1998 crisis up until the end of 2007. This period encompasses the last year of Boris Yeltsin's presidency and the majority of the tenure of Vladimir Putin as president. The August crisis, along with a steady and enduring rise in commodity prices, resulted in the remonetisation of the economy with the resultant decline of the virtual economy, a period of sustained economic growth, and the resurgence of the fiscal capacity of the Russian state. Empowered by rising revenue, the state then reasserted itself relative to those powerful business organizations that had previously preyed upon its weakness. Initially this took the form of attacking only a select few of the previously more politically assertive business interests. However, as the natural resource boom strengthened the state further, the confidence of the leadership grew and it began to de-privatize a considerable portion of the economy and take a more active role in industries both within and outside of the commodity export sector. This was accompanied by the continued centralization of political power in the hands of the president and the suppression of political opposition. As economic and political power were recentralized, organizations such as political parties, business associations or civic associations that might be expected to compete with the state or big business for political power were either repressed or co-opted by the state. While this period witnessed the longest period of economic expansion in Russia's

post-socialist history, it also saw Russia slip down on those indicators that are used to measure its development as a social order.

6.1 The socialist legacy

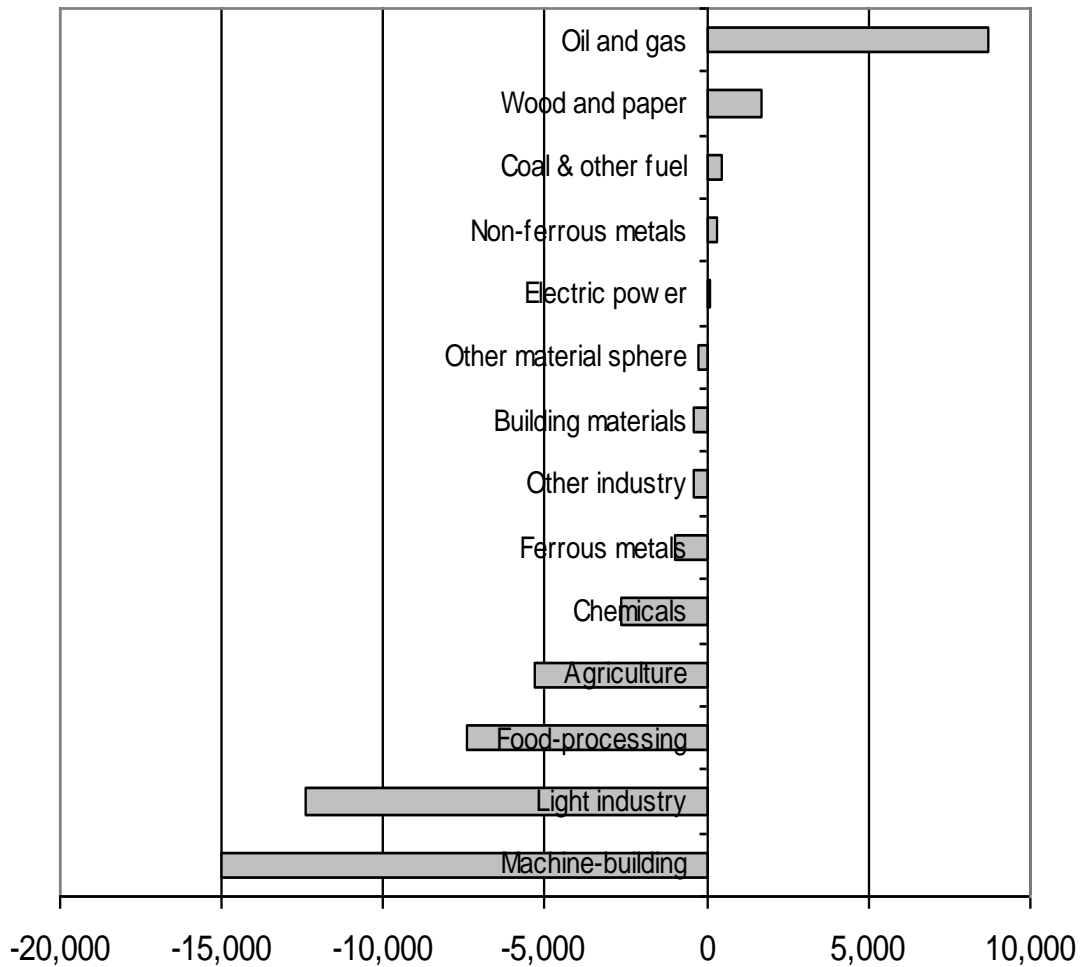
The main features of the collapse of the Soviet Union were described in the previous chapter and these factors were of crucial importance for the newly independent Russian Federation. Two sets of legacies of the Russian ‘exit’ from Soviet rule would be of particular importance, the first group economic in nature, and the second political.

6.1.1 Economic legacies

First, the capacity of the nascent state was severely weakened by rampant inflation, high foreign debt obligations, a severe contraction in output across the economy, a sharp drop in investment, and low tax revenues. Second, the defection of the party-state in reaction to the failed reforms of *perestroika* (Solnick, 1998) led to the appropriation of a large proportion of state enterprises by Soviet ‘insiders’ and left many value-subtracting entities intact. Thus, many of the enterprises that had been the object of reform during *perestroika* were now in private hands. Under Soviet rule, these enterprises had effectively been reliant on the provision of soft-budget constraints, something that was a systemic outcome of planned economies in general (Kornai, 1992). Restructuring the economy would require altering the behaviour of these organizations so that they would shift towards operating under hard-budget constraints. Third, the concentrated organizational structure of the Soviet economy, along with the appropriation of large swathes of the economy by the party-state elite, meant that property continued to be concentrated in the hands of either the state (in those sectors where spontaneous privatization had not been possible) or in the hands of former directors. Consequently, little change occurred in the production structure of the economy with the Russian economy exhibiting a strong concentration of both production and ownership almost

from the outset.¹⁰⁵ The relative strength of export sectors in Russia, while difficult to measure (see Chapter Four), is depicted in Figure 6.1 and indicates that the primary and resource-based sectors were to be of particular importance in the early stages of economic development in Russia.

Figure 6.1 Foreign trade balance of the Russian Soviet Federal Socialist Republic (RSFSR) by sector, 1988 (million roubles)



Source: Vestnik Statistiki in IMF (1992, p.229).

¹⁰⁵ Indeed, the monopolistic nature of many markets was a contributory factor in the inflationary surge of the early 1990s. Because so many sectors were dominated by one or a few large enterprises they faced very little competition. Consequently, when prices were freed in 1992 they faced very little incentive to exercise restraint in terms of pricing.

6.1.1 Political legacies

Of paramount political importance was the fact that Russia was emerging from a legacy of *patrimonial communism* (Kitschelt *et al*, 1999) in which the regime combined elements of extreme repression, extensive networks of patron-client relations and subtle competition among competing factions (Pipes, 1974; Hough and Fainsod, 1979; Afanasiev, 1997). The distinguishing features of patrimonial socialist systems (vertical chains of dependence, extensive patronage networks, low rational—bureaucratic institutionalization of rules, and repression of opposition groups) made the selection of certain new post-socialist institutional structures more likely than others by forming particular patterns of interests and specific distributions of resources among these interests (Easter, 1997). For instance, since non-state forces in Russia were generally quite weak (Fish, 1995; Urban, Igrunov and Mitrokhin, 1997) due to a legacy of repression and limited resources for groups outside of state patronage networks, the probability of the adoption of a political system that concentrated power in the hands of an executive was high. Because the state was the source of patronage resources, this meant that the balance of political power in patrimonial socialist systems was very often tilted in favour of those already wielding state authority (see Hedlund, 1999; Kotz and Weir, 2006). In Russia and other such cases, electoral institutions were enacted that tended to favour incumbents, with presidential systems preferred, or where parliaments were present, single-member-district (SMD) election systems rather than proportional representation (PR) election systems (Hale, 2006, p.29).

The concentration of resources within the Russian economy, particularly within those highly lucrative export sectors, intensified these tendencies; access to the state patronage network was crucial to the acquisition of access to or ownership of state assets, particularly those export enterprises that were a source of foreign currency earnings. In the late Soviet and early post-Soviet period, success in acquiring state assets or in forming banks and other new economic organizations (see Rutland, 1999) was very often

contingent on accessing the state and long standing patronage networks.¹⁰⁶ Consequently, the activities of budding political and economic entrepreneurs were to be directed at penetrating the state rather than building or co-opting strong, non-state organizations, such as those groups that form the liberal conception of civil society (Keane, 1988), or political parties. Thus, the weakness of civic groups and political parties – which were largely wound down or ineffective after the collapse of Soviet power (Fish, 1995, 2005; Uhlin, 2005) - reflected both the lack of competition at the economic level (sectors tended to be dominated by small numbers of enterprises) and the precarious nature of economic activity that took place outside patronage networks. Unless there was a shift in the production profile and ownership structure of the economy from a closed-access economic order, in which access to state patronage networks was central to both property acquisition and the establishment of ownership rights, to an open-access one, the existing economic structure would not be able to sustain meaningful political competition.

At this early stage, therefore, path dependencies that ‘weighted the dice’ in favour of certain outcomes (strong executive, patrimonial politics, concentration of economic resources) over others (economic competition, parliamentary political system, open and transparent politics) were very much in evidence. As the rest of this chapter will show, the institutional legacies and the economic structure inherited from the Soviet period played a large part in hindering the development of an open-access economic and political order in Russia. But first, the next section outlines the most important features of Russia’s transnational sectors and their place in the wider international economy.

¹⁰⁶ For example, the late Gorbachev period saw the embezzlement of public funds from state organizations such as the Communist Youth League (*Komsomol*). Access to state resources enabled cynical and ambitious officials to create new enterprises from nothing. For instance, the ambiguity of newly established laws enabled individuals or enterprises to establish under-capitalized banks that often diverted Central Bank money into private hands. Alternatively, state officials sometimes engaged in the creation of co-operative enterprises where the incentive to engage in the creation of networks of transfer-pricing among shell companies for private gain outweighed that of generating profitable enterprises.

6.2 General features of economic structure in Russia

6.2.1 *Leading sectors and Russia's position in the international economy*

Fuels, metals and weapons link Russia to the international economy.¹⁰⁷ The data presented in Chapter Three show that Russia has one of the most specialized export profiles in the region, with a comparatively low level of technology intensity.¹⁰⁸ Since the collapse of the USSR, Russia's economy has been comparatively open for what is a large economy.¹⁰⁹ However, Russia has perpetuated the Soviet dependence on earnings derived from a few natural resource export products. Although world prices for Russian commodity exports have fluctuated considerably over the past 20 years, by 2006 sales of primary and resource based products accounted for over 86 percent of total merchandise exports (Figs. 6.2 and 6.3). Of this, oil and gas exports alone account for over 60 percent of exports, nearly 30 percent of GDP and nearly half of total state budget revenues.¹¹⁰ Even in 1999, when the prices for primary and resource-based products were significantly lower, they still contributed over 80 percent of total exports with official statistics revealing that the state was reliant on the oil and gas sectors for around 25 percent of its revenue (Tabata, 2002). The dominance of these sectors and their importance in anchoring Russia to the international economy looks set to continue due to Russia's failure to diversify its export profile and become competitive in a broader range of manufactures (Cooper, 2006; Connolly, 2008).

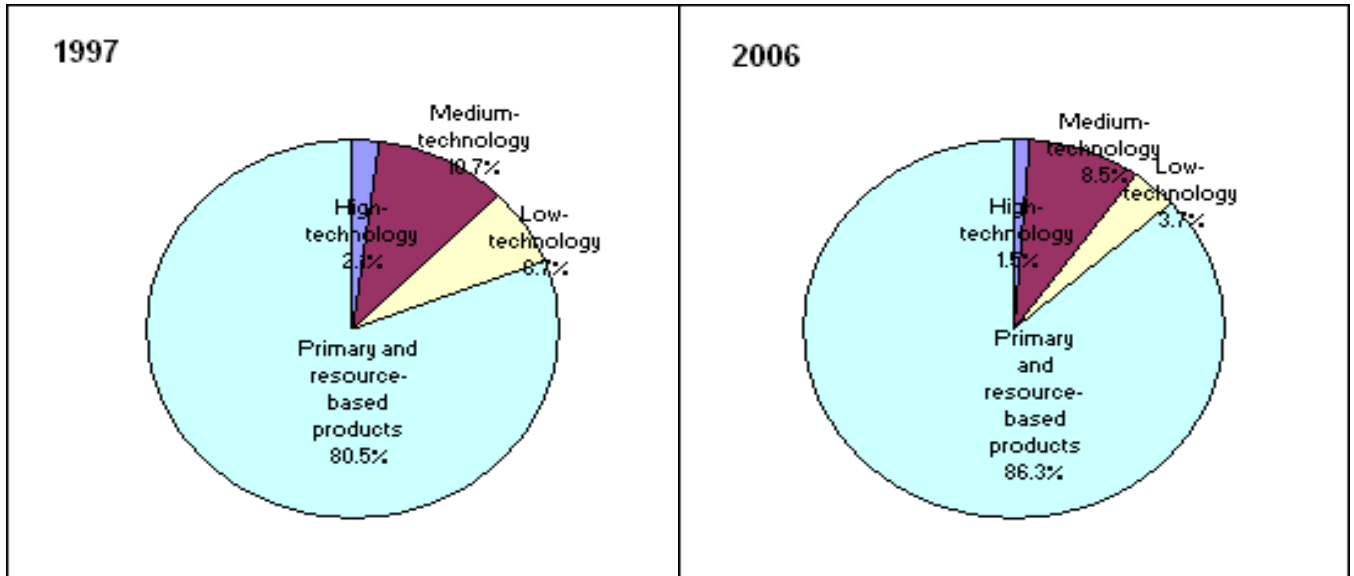
¹⁰⁷ Primary and resource-based exports from Russia include oil, gas, gold, nickel, copper, ferrous metals, aluminium, wood, fish, and many others. This chapter focuses on products on those sectors that occupy a prominent place within the export profile, most notably oil, gas and some other metals.

¹⁰⁸ According to the Krugman Specialization Index, Russia has one of the most specialized export profiles within the region. In 1997, it had a score of 0.60. By 2006, this score had gone down slightly to 0.56 indicating that Russia's export profile was slightly more diversified. Despite this, the technological intensity of Russian exports (as measured by the proportion of medium- and high-technology goods in total manufactured exports) declined from 12.8 percent in 1997 to 10 percent in 2006. To some extent this is a function of higher commodity prices relative to other Russian exports. However, such a low proportion of manufactures indicates that Russia's competitiveness in medium- and high-technology goods was low to begin with and has not significantly changed.

¹⁰⁹ In comparison with other large economies Russia's openness to trade is comparatively high. In 2006, the sum of imports and exports as a percentage of GDP was 26 percent in the USA, 27 percent in Japan, 55 percent in Russia, 60 percent in the United Kingdom, 72 percent in China, and 85 percent in Germany. Data taken from World Bank, World Development Indicators.

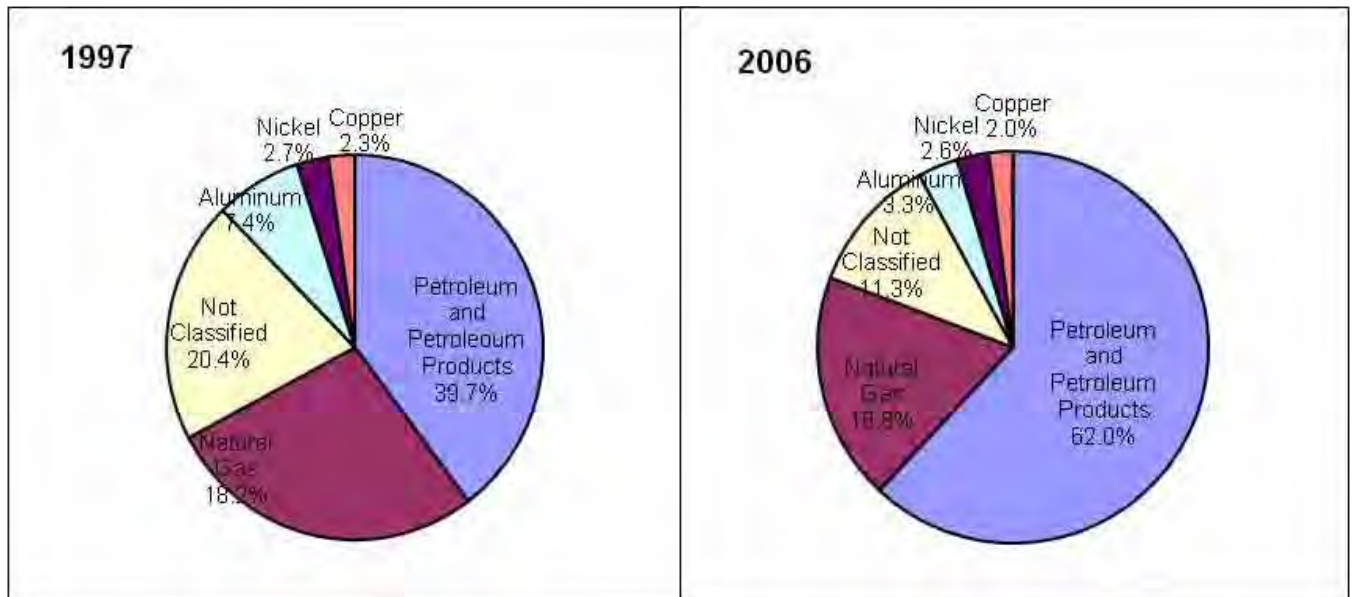
¹¹⁰ Data taken from UN Comtrade Database (2008) for exports, and Russian Central Bank (2007) for budget and GDP data.

Figure 6.2 Technology intensity of Russian exports, 1997 and 2006 (percent of total exports)



Source: United Nations Comtrade Database (2008); authors own calculations.

Figure 6.3 Leading Russian primary and resource-based exports, 1997 and 2006 (percent of total exports)¹¹¹



Source: United Nations Comtrade Database (2008); authors own calculations.

¹¹¹ These charts are based on 2-digit level data (United Nations Comtrade, 2008) that describe product-type rather than technology intensity.

Even these statistics disguise the true extent of Russia's dependence on natural resources. Oil and gas have, from the Soviet period onwards, been used to subsidise many other less productive sectors of the domestic economy (Kuboniwa, Tabata and Ustinova, 2005; Gaddy and Ickes, 2005). The true importance of the oil and gas sectors, while sizeable as shown in official statistics, is revealed through transfer pricing schemes. Here, Russian gas and oil companies typically sell their output below the market price to associated firms, whether in Russia or abroad. Consequently, value-added that may be derived from oil or gas output may show up in official statistics as increased output in, for example, the trade and transportation sectors (Tabata, 2002). Alternatively, the state may forgo tax revenues from oil or gas companies in return for the supply of below-market price energy to other enterprises within the domestic economy. A World Bank study (2005) estimated that such transfer pricing schemes increased the actual share of Russian GDP originating from oil and gas output by approximately 12 percent.

6.2.2 Sectoral characteristics

The sectors that have dominated Russia's export profile are characterised by high levels of capital intensity and economies of scale as well as by high asset specificity and low levels of production flexibility. These factors result in the need for specialized infrastructure, management and labour, leading to high barriers to entry for other organizations. The high cost of sector-specific investments in capital, infrastructure and labour ensure that barriers to exit are also high. High switching costs among consumers further reinforce the market position of producers (Shafer, 1994, p.25). These factors tend to result in monopoly or oligopoly characterising the market structure of these sectors, with relatively low levels of intra-sector competition leading to a concentration in economic power. In Russia, this tendency towards market concentration was aggravated by the Soviet industrial structure that it inherited where planners had previously incorporated entire economy-wide industries under the rubric of a single organizational entity (see, for example, Berliner, 1957; Rutland, 1993; Whitefield, 1993).

Market power in such sectors can also often fluctuate sharply between consumers and producers. Because sector-specific investments in these areas tend to increase in response to rising prices and growth in demand as organizations seek to increase rents, the lag between the decision to invest and the point at which those investments become active can often lead to increased supply capacity, just as demand either peaks or declines, which in turn exacerbates the downturn in prices. Market participants, experiencing lower returns on their investments, are often reluctant to invest in extra capacity until prices rise again, thus creating the possibility of future sudden price spikes due to limited supply. According to the theoretical framework outlined in Chapter Two, these fluctuations in price levels might be expected to affect the relative distribution of resources between organizations (both public and private) within a country's political economy quite suddenly.

Unpredictable fluctuations in price, as well as the obvious rents available when prices are high, increase the *incentive* among private organizations to employ 'voice' strategies in relation to the state in order to increase rents when times are good and to ensure protection when times are bad (Hirschman, 1970).¹¹² Furthermore, the high degree of market concentration inherent to natural resource sectors increases the potential *capacity* of organizations within these sectors to achieve success in eroding the autonomy of the state in their favour. Another factor that might lead to closer relations between the state and organizations within natural resource sectors is the geographically fixed nature of the resources themselves. Because the source of the resources cannot be moved across state boundaries, private organizations are often dependent on the state for access to these resources. When private organizations are responsible for production, the state benefits indirectly, e.g. through the taxation of output and exports. However, as prices and resource rents rise, the incentive for the state to tap these resources directly (i.e. through direct ownership) increases.¹¹³ Furthermore, the pressure for rent distribution rises in line

¹¹² 'Voice' and 'exit' are terms used by Hirschman to describe two types of strategy employed by agents (workers, managers, etc) within an economy. The 'voice' strategy manifests itself in attempts by agents to shape market 'rules' in their own favour to further their own interests. 'Exit' strategies involve agents leaving a market.

¹¹³ Historically this has proven to be the case, particularly in the oil industry where price rises have often been accompanied by new waves of nationalization of private enterprises.

with prices, with greater attention given to the spending of resource rents when prices are high. This can lead to an emphasis on short-term rent extraction (consumption) rather than on long-term rent creation (investment).¹¹⁴ Finally, in cases where the administrative capacity of the state is low – as is often the case in developing economies – there is perhaps a greater incentive for politicians to increase their control over natural resources precisely because rents are more easily appropriated and reallocated than is the case with most other forms of economic activity (Jones-Luong and Weinthal, 2006).

6.2.3 International trends in natural resource sectors

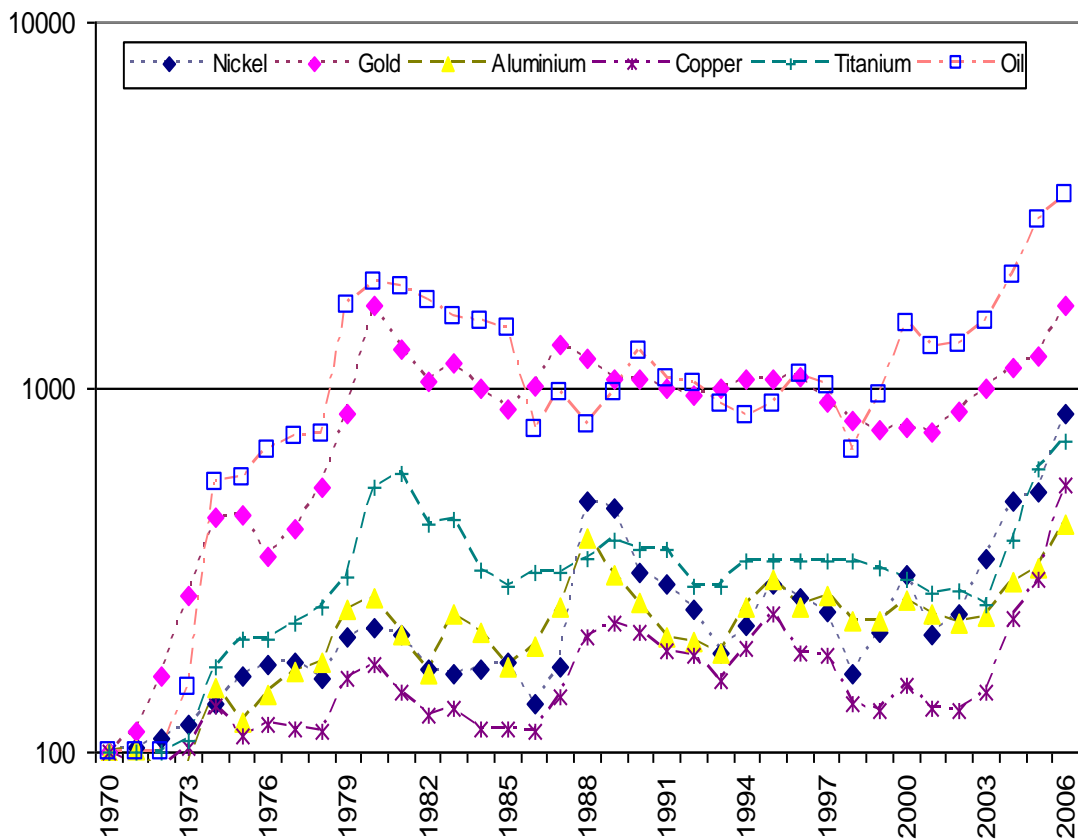
Figure 6.4 traces the average price (since 1970) of those commodities that constitute a large proportion of Russia's exports. The prices for these commodities are broadly correlated with each other and largely reflect major developments within the wider international economy. The oil shocks of 1973 and 1979 were a function of increased aggregate global demand, expansionary monetary policies in both developed and developing countries, and of the move towards the nationalization of oil assets in oil producing nations. These sudden increases in nominal oil prices were mirrored in direction, if not quite in magnitude, by prices in other commodities.¹¹⁵ All commodities saw either steady decline or stabilization of price levels as the reduction of world demand for energy (due to increased energy efficiency and reduced aggregate growth rates) and for metals (primarily due to a decline in demand). This pattern continued until 1998, but has since been dramatically reversed by the increasing importance of large emerging market economies (EMEs) such as China, India, Brazil and other newly industrialised

¹¹⁴ This tendency is described by Terry Lynn Karl in *Paradox of Plenty* (1997). During the period of high oil prices in the 1970s and early 1980s countries as seemingly diverse as Venezuela, Iran, Indonesia and Algeria all displayed the same pattern of nationalization of production, followed by the short-term exploitation of reserves to pay for vast public spending projects as well as increased borrowing on international capital markets on the back of further projected increases in export earnings. As prices declined, governments were unable to maintain existing public spending commitments and were left with higher levels of national debt.

¹¹⁵ The explanation for this correlation is not the same across commodities, however. Because of the inflationary effects of expansionary monetary policies and increased oil prices, the demand for gold grew as investors sought safety from the erosive effects of inflation. However, some of the other commodities grew in price due mainly to increased demand as, for example, more refined metals were required in the manufacture of high-technology goods that increased towards the end of the 1970s.

economies in the world economy.¹¹⁶ By 2006, over half of world GDP was being produced in Asia, with the region being responsible for an even higher proportion of world growth (Glyn, 2007, p.153). High growth rates, the relative inefficiency in the use of inputs across this region compared to OECD countries, and a slowdown in supply growth, has resulted in a rapid increase in the price of those commodities in which Russia is a major producer and exporter.

Figure 6.4 Average price of selected commodities in which Russia is a major exporter, 1970-2006 (1970 price = 100), nominal prices.



Source: International Monetary Fund (2007).

¹¹⁶ If the Emerging Market Economies are defined to include Argentina, Brazil, China, Chile, Hong Kong, India, Indonesia, Malaysia, Mexico, Singapore, South Africa, Thailand, Turkey and Vietnam, then their collective share of total world output (at purchasing power parity) increased from under 15 percent in 1980 to nearly 30 percent in 2007 (World Bank, 2008; author's calculations).

6.3 Structure and ownership in the Russian economy and the role of leading export sectors, 1991-1998

6.3.1 Market reforms under Yeltsin and the failure of structural transformation

Boris Yeltsin, who was elected to the newly created Russian presidency in 1990 and who subsequently led Russia and the other Soviet republics to independence from the Soviet Union, saw economic reform and the creation of a market-based economy in Russia as a crucial component of his rule (Robinson, 2000). Against the backdrop of an economic crisis caused by the failed reforms of the late Soviet period and the subsequent struggle for independence, and in which the capacity of the state was being weakened almost by the day, market reforms were seen as the only solution to the chaos that existed within the economy. Economic reform – led by Yegor Gaidar – was supposed to involve limiting the role of the state in many areas of the economy by cutting subsidies to existing enterprises and imposing hard-budget constraints.¹¹⁷ This was to be buttressed by the liberalization of prices which would have the effect of improving the incentives for organizations to be profitable (by allowing the price mechanism to reflect supply and demand) and to shift production away from value-subtracting activities to areas that that would be more beneficial to the economy.

If successful, this process would effect a shift in the relative distribution of resources within the economy from the Soviet party-state elite (who would have to restructure and become profitable to survive) and towards new economic actors that would emerge in response to the changing incentive structure. This would reduce the informal, patrimonial practices that were rampant under Soviet rule and increase the autonomy of the state relative to economic organizations. The state's role would be limited to reducing expenditure and controlling the money supply to provide the public good of price stability that would support the wider reform package. The state would then gradually become stronger through its share of increasing output (i.e. through taxation).

¹¹⁷ The economic reform program of the early 1990s is discussed in: Gaidar (1996); Mau (1996); Aslund (1995); Shleifer and Treisman (2000); Gustafson (1999).

Finally, the privatization of a large proportion of state assets would further increase the incentive among economic organizations to become profitable and would have the added political advantage of further reducing the influence of the Soviet party-state elite. Increased competition, firm private property rights and price stability would then lead to the formation of more durable socio-economically defined forces within society that would ensure political competition mirrored economic competition. Or so the theory went.

In practice, Gaidar's reformist government was challenged immediately by the representatives of the Soviet party-state elite that resided in the Soviet-era legislature, primarily represented by Civic Union, led by Arkadii Volskii.¹¹⁸ Gaidar's reforms threatened them with destruction, particularly as the dearth of capital within the economy – partially a function of the monetary tightening by the state, but also due to fact that access to the state was the best source of funds - limited the prospects for an investment-led restructuring process.¹¹⁹ This resistance took two forms. First, on the formal, national level, the state was pressured by factions within parliament to ease monetary controls and to increase state expenditure, primarily through the continued provision of subsidies.

Second, on an informal and sub-national level, economic organizations, particularly those appropriated by the Soviet party-state elite, simply carried on with the particularistic practices that had enabled them to avoid state sanction under Soviet rule.¹²⁰ In effect, organizations that were simply not profitable under hard-budget constraints continued to engage in trade between themselves, building up a vast 'virtual economy' in

¹¹⁸ Volskii had close contacts with many of the enterprise directors within the domestic economy and was the chairman of the Russian Union of Industrialists and Entrepreneurs (RUIE). Civic Union and its economic policies are discussed in: Ellman (1993); McFaul (1993).

¹¹⁹ The partial reforms over this period meant that the opportunity for vast profits from speculation, links with the patronage networks connected to the state, etc. resulted in those banks that did have access to capital often using it for speculative purposes rather than for lending to enterprises. Thus, finance was not a link between savings and investment in the traditional sense, but instead was a vehicle through which a narrow elite could engage in speculation and profit from arbitrage opportunities provided by close links with the state.

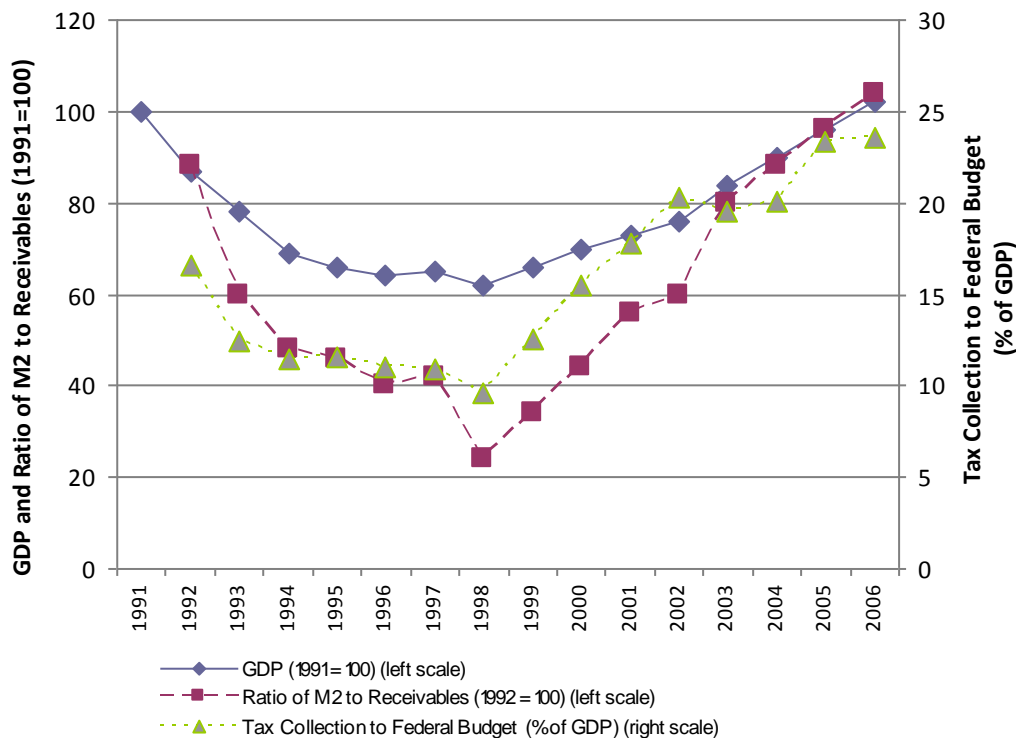
¹²⁰ The continuity of elites in the economy is described through the use of unpublished data compiled by the Russian sociologist, Olga Kryshtanovskaya, in Kotz and Weir (2006, p.114). According to Kryshtanovskaya's research, over 60 percent of 100 top Russian businessmen in 1992-93 were directly connected to the former elite. This strong representation of the old *nomenklatura* was mirrored in the state positions at both the national and regional level. See also: Kryshtanovskaya and White (1996).

which payment for goods and for labour was provided either in kind (through barter payments), through the build up of inter-enterprise debts ('receivables'), or through access to subsidies from central and local governments, either through monetary transfers or through the provision of subsidised energy.¹²¹ The government was complicit in this process as it helped keep unemployment, and social discontent more generally, from rising even further.

The continuation of value-subtracting economic activity in the virtual economy represented a type of 'socialism from below' as the continuation of economic activity in these areas provided *de facto* soft-budget constraints (Bernstam and Rabushka, 2006). The perpetuation of the virtual economy – in conjunction with rising inflation expectations, itself in some part caused by monetary emissions solicited by actors within the virtual economy - resulted in the demonetization of the Russian economy (see Fig. 6.5) as the ratio of money (M2) as a proportion of total receivables (i.e. inter-enterprise debts) declined (Bernstam and Rabushka, 2006).

¹²¹ The virtual economy was a type of economy in which value-subtracting production was protected, often through resource transfers from profitable parts of the economy to unprofitable ones. The virtual economy is discussed in: Gaddy and Ickes (1998, 1999); Johnson, Kaufmann and Shleifer (1997); Barter, demonetization, and other aspects of the unofficial economy in Russia during this time are discussed in: Commander and Mummsen (1999); Woodruff (1999a, 1999b); OECD (2000); Shleifer and Treisman (2000); Bernstam and Rabushka (2006).

Figure 6.5 Indices of GDP (1991 = 100) (left scale), the ratio of M2 to receivables (year end) (1991 = 100) (right scale) and tax collection to Federal budget (% of GDP) (right scale), 1991-2006

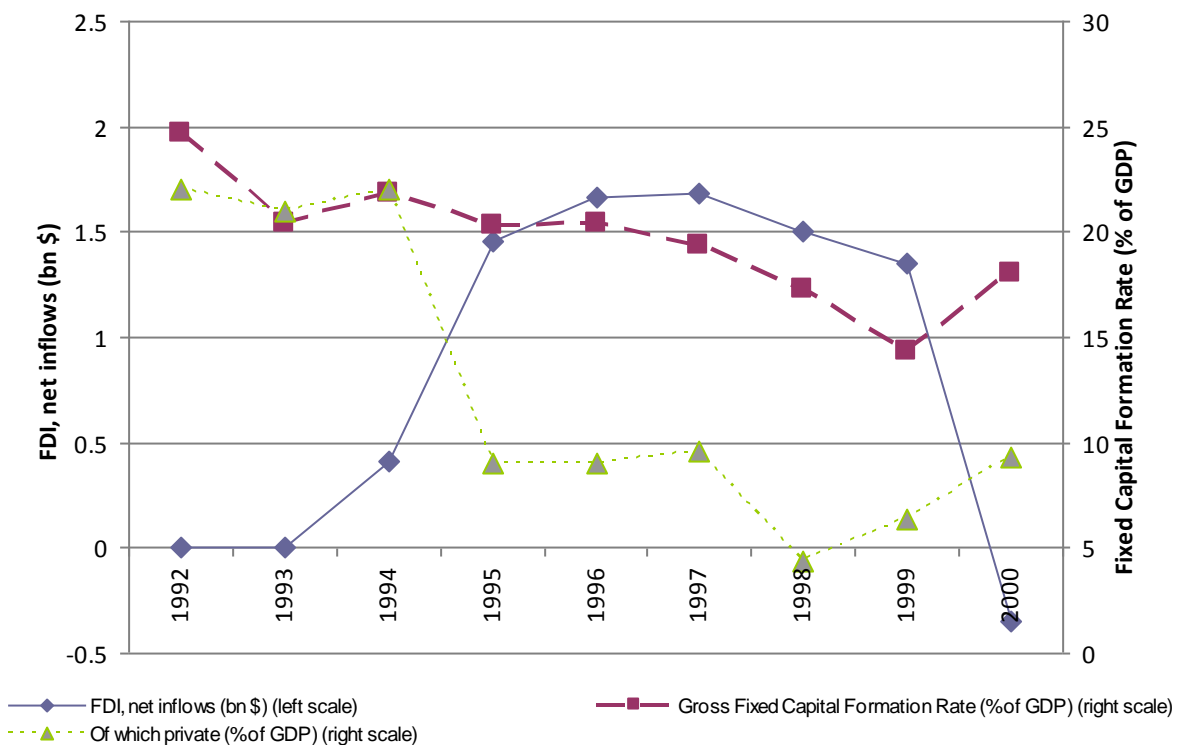


Source: adapted from Bernstam and Rabushka (2006); tax collection from Russian Federation Ministry of Finance (2007); figures for 2005 and 2006, author’s calculations.

Thus, despite the tumultuous economic change that took place in the early 1990s, the Russian economy and its export sectors experienced very limited structural change. Primarily, this was caused by a collapse in investment, particularly in the private sector (Fig. 6.6). The perception, and indeed reality, of low state capacity to protect private property rights was clearly a major factor in discouraging investment (Buiter, 2000). This sentiment was shared by foreign investors with net foreign direct investment (FDI) very low, particularly when compared with other countries of the region (see Chapter Four). Of this very limited level of FDI, most was concentrated in the natural resources sector

(Robinson, 2007, p.252). The role of FDI is strongly associated with the technological upgrading of the economy, helping to diversify the production profile of those countries that receive high levels of outside investment (Connolly, 2008). This absence of significant investment – both domestic and foreign - resulted in the perpetuation of the prevailing production structure and export profile with the level of technological development still low in most sectors of the economy. Furthermore, as will be discussed below, low investment coupled with the patrimonial character of the privatization process meant that the market structure and distribution of ownership in Russia’s leading export sectors remained very concentrated. Indeed, by 1998, the economic structure of Russia still bore many similarities to that of the Soviet Union.

Figure 6.6 Gross capital formation as a percentage of GDP, private gross capital formation as a percentage of GDP, and net foreign investment inflows (\$ bn), 1992-2000



Source: Goskomstat (2005), Russian Central Bank (2008), UNCTAD (2008), IMF (2008); author’s calculations.

6.3.2 Structure and ownership in leading Russian export sectors, 1991-1998

The importance of the fuel and mineral extraction companies to the Russian economy was considerable. As Table 6.1 illustrates, 11 out of the 25 largest companies by market capitalization in Russia in 1997 were involved in the oil and gas sector. Together they accounted for just under 70 percent of the top 25 firms' sum of market capitalization. Although this reveals the size of enterprises in the natural resource sector relative to others within the economy, this still does not reveal the extent to which the rest of the economy was reliant on the 'value redistribution' that took place as oil and gas rents were used to subsidize other, less efficient parts of the economy (Gaddy and Ickes, 2005; World Bank, 2005). As has been discussed previously, it is estimated that these less visible transfers have been of significant importance.

Elsewhere, the development of small- and medium-sized enterprises (SMEs) was also impeded by the same factors that constrained investment elsewhere in the economy (e.g., poor business environment, weak property rights, etc). Whereas SMEs typically account for around two-thirds of employment in developed economies, in the mid-1990s legally registered smaller enterprises in Russia employed no more than a tenth of the workforce, with large firms (over 500 employees) accounting for around 63 percent of official employment in 1996 (Aslund, 1996, pp.12-16). This was not helped by the dominant method of privatization that gave insiders – managers and workers – an overwhelming degree of control over most enterprises, often hindering the restructuring process (see Earle and Estrin, 2001). In conditions of state weakness, and in which private property rights were only weakly protected, many smaller enterprises either chose 'exit' strategies, in which they avoided the recognition and monitoring of state authorities, or simply ceased to exist in the first place (Yakovlev, 2006, 2007).

Although the overall picture was bleak during this period, there were some success stories. For example, companies in consumption industries (e.g. food processing, breweries, furniture producers, etc) bucked the trend of declining productivity and

output.¹²² However, such examples were of marginal significance when compared to the overwhelming economic and political importance of the natural resource sectors.

Table 6.1 The twenty-five largest companies in Russia by market capitalization, 1997

Rank	Name	Sector	Capitalization	Proportion
			Billion \$	of Top 25 (%)
1	Lukoil	Oil and Gas	5401	21.0
2	Surgutneftegaz	Oil and Gas	4085	15.9
3	Gazprom	Oil and Gas	3955	15.4
4	United Energy System	Electric Power	2989	11.6
5	Sibneft	Oil and Gas	1511	5.9
6	Rostelecom	Communication	912	3.6
7	Mosernego	Power	763	3.0
8	Onako Vostochnaya	Oil and Gas	675	2.6
9	Neftyanaya	Oil and Gas	639	2.5
10	Norilsk Nickel	Metallurgy	471	1.8
11	Niznekamskneftehim	Chemical	468	1.8
12	Irkutskernego	Electric Power	445	1.7
13	Sberbank	Finance	425	1.7
14	Tatneft	Oil and Gas	418	1.6
15	Slavneft	Oil and Gas	380	1.5
16	Baltica-Brewery	Food	346	1.3
17	MokiTEK	Oil and Gas	286	1.1
18	N. Novgorod Machine Works	Machine Works	273	1.1
19	Yukos	Oil and Gas	234	0.9
20	St. Petersburg Tel	Communication	210	0.8
21	Moscow Tel	Communication	196	0.8
22	Sibneftegazperarabotka	Chemical	188	0.7
23	GAZ Autoworks	Machine Works	141	0.5
24	Magnitogorsk Metal	Metallurgy	130	0.5
25	Rosneft-Purneftegaz	Oil and Gas	130	0.5

Source: Expert.ru; author's calculations.

Russia's export profile mirrored this tendency towards a reliance on the natural resource sectors as well as the concentration of ownership within these sectors. In 1997 nearly three-quarters of Russian exports were probably of primary and resource-based products (see p.149). Of this, nearly 45 per cent of exports were oil and gas. Metals

¹²² Between 1990 and 1998, the percentage change in industrial production was positive in only the fuel and energy sector (19.2 percent), the metallurgical sector (3.1 percent) and the food industry (1.7 percent). In other sectors, industrial production contracted over this period with the mechanical engineering sector declining 10.6 percent, light industry 10.3 percent and the chemical and wood sector 2.4 percent. Figures from Goskomstat (1999).

accounted for around 20 percent of total exports. The third largest sector export sector in 1997 was labelled ‘goods not classified by kind’. This refers to goods that are likely to include precious metals, such as gold and diamonds, and also armaments exports. This, however, says little about the market structure of each of these sectors.

Although the data are only sketchy, there was not much evidence of intra-sectoral competition either. The average 4-firm concentration ratio in the Russian economy (the sum of the market shares of the top four producers) was about 60 per cent. Although, this is not that dissimilar to the 4-firm concentration ratio in some US industries, the majority of Russian industrial sectors was, during this period, characterized by a dearth of small- and medium-sized firms resulting in correspondingly low levels of intra-sectoral competition (Broadman, 2000). This was further exacerbated by the cross-ownership that was a defining feature of the financial-industrial groups (FIGs) that are described below.¹²³

In terms of intra-sectoral market structures, the natural resource extraction industries exhibited monopolistic and oligopolistic tendencies almost from the outset of Russian independence. This was perhaps unsurprising given the structure of these sectors within the Soviet economy and also because they are sectors that are traditionally dominated by large, capital intensive firms in other countries. The character of the privatization process reinforced these tendencies, with all of the natural resource sectors exhibiting a high concentration of ownership with relatively low levels of competition. In the gas sector, the old Soviet gas ministry was privatized (nominally) into a joint stock company, Gazprom, which retained a monopoly over the production, sale, and distribution of natural gas.¹²⁴ Although nominally privately owned at this point, Gazprom

¹²³ The owners of the FIGs were a mixture of former state officials and entrepreneurs that had made their initial fortune in the aftermath of perestroika. Very often this was based on either illegal and semi-legal arbitrage activities, particularly using natural resource products, or on the exploitation of the nascent and wild financial system. The origins of FIGs are discussed in: Johnson (1998); Freeland (2000); Brzezinski (2002); Hoffman (2002); Klebnikov (2002).

¹²⁴ Discussions between the Ministry of Fuel and Power of the Russian Federation (Mintopenergo, or Ministerstvo topliva i energetiki RF) and the management of the State Committee for the Management of State Property (GKI, or Goskomimushchestvo) in 1992 resulted in the oil and gas industries successfully resisting reformers’ efforts to privatize the fuel and power complex according to the same rules as other industries as an attempt to ensure greater competition.

was closely linked to the state. Similarly, Transneft enjoyed a monopoly in the management of the oil pipeline system and, like Gazprom, was nominally a private joint stock company, but was *de facto* controlled by the federal government. Just over a dozen companies were prominent in the oil industry, and by 1997 around half of these were mostly privately owned, with the state retaining a controlling share in the other half (Khartukov, 1997, p.38). Therefore, despite the privatization of some sections of the oil industry sector, the oil and gas industry *as a whole* was, by the end of the 1990s, predominantly state-controlled and characterized by monopolistic or oligopolistic market structures.

In the metallurgical sector, private ownership was more prevalent and during the early to mid 1990s there was a slightly higher level of competition. However, the tendency towards concentration of ownership increased as FIG owners began to consolidate their holdings after gaining a foot-hold during the shares-for-loans period (Fortescue, 2006a, 2006b). Over the course of the mid- to late-1990s a number of large corporate control transactions resulted in a diminishing number of owners, increasing the oligopolistic structure of these sectors. Notable examples include Vladimir Potanin's Norilsk Nickel which controlled the majority of Russia's nickel, copper, and palladium production, and faced only fractured competition within Russia. This is significant given that Russia produces around 20 percent of the world's nickel. The titanium market was dominated by Vladislav Tetyukin's VSMPO-Avisma which was, and remains, the world's largest titanium company, controlling 30 percent of the global market and all of Russia's exported titanium. The iron, steel and coal industries were dominated by Severstal, Evraz and Magnitogorsk Iron and Steel Works. Elsewhere, Alrosa enjoyed a monopoly in the diamond industry while aluminum production was dominated by Rusal and SUAL, owned by Oleg Deripaska and Viktor Vekselberg respectively.

The only other significant export sector outside of the natural resource sector that remained competitive in the world economy was the arms industry. It also exhibited a monopolistic market structure. In 1992, there were 12 special exporters but this was drastically reduced in November 1993 when Rosvooruzheniye was created in a

reorganization and consolidation of the entire system of military-technical cooperation. After this, only MAPO (the Moscow Aircraft Production Organization) remained intact of the original 12 exporters. Indeed, by 1997, Rosvooruzheniye had effectively monopolized the arms trade, accounting for 90 per cent of Russian arms exports by 1997. Attempts at curtailing the monopoly of Rosvooruzheniye by allowing other enterprises to act as special exporters failed in 1996, and a year later the state succeeded in establishing Rosvooruzheniye as a unitary state enterprise after a number of Presidential decrees (Kommersant, 1997, 30th July). This centralisation of arms export activity was significant because exports accounted for around 60 percent of all arms production (domestic orders plus exports) in the 1990s, making arms exports integral to the welfare of the wider defence industry, enabling one of the only high-technology sectors within the Russian economy to survive (Sanchez-Andres, 2004). According to calculations made by researchers at the Stockholm International Peace Research Institute (SIPRI), the average annual value of Russian arms exports between 1996 and 2000 was \$3.4 billion (current US dollars), making armaments one of Russia's most important manufactured exports (SIPRI, 2009). However, unlike other high-technology sectors in the post-socialist region, the continuation of state ownership negated any potential positive spill over effects of competition and innovation that are often prevalent in high-technology sectors (Connolly, 2008).

6.3.3 The Russian economy under Yeltsin: conclusion

In summary, the market structure within the leading export sectors was either monopolistic or oligopolistic during the period in which Boris Yeltsin served as the president of the Russian Federation. The de-monetization of the economy, the parasitic tendencies of many non-export industries and low levels of investment all contributed to limited structural change (Robinson, 2007). The nefarious character of the privatization process, the sectoral characteristics inherent to the natural resource sector, and continued high levels of state ownership in 'strategic' industries (i.e. lucrative export sectors) all ensured that levels of competition were low. Combined with the patronage politics that are discussed next, this resulted in a limited-access economic order. The Russian state

was fiscally and politically reliant on an economy characterised by ‘enclaves’ specializing in the export of natural resources. This provided poor conditions in which to stimulate the development of the wider domestic economy.¹²⁵ The only links that existed between the export sectors and the domestic economy were primarily manifested in the transfer of value from oil and gas output to the virtual economy.

As will be discussed in the next section, the concentration of economic resources in the hands of either the state or powerful FIGs hindered the development of an open-access political system, with the state fiscally dependent either on direct natural resource revenues from the state-owned organizations or on the banking arms of the FIGs for sporadic payment of taxes and, increasingly after 1996, the provision of loans. The owners of the natural resource sectors – whether private or public – provided the lion’s share of tax revenues and consequently acquired a greater ‘voice’ over policy and a sharper capacity for collective action than other sections of Russian society. The next section examines the role of the economic structure described above in shaping the capacity for collective action among economic and political organizations between 1991 and 1998.

6.4 Capacity for collective action among organizations in Russian politics, 1991-1998

6.4.1 Financial-industrial groups (FIGs) and the state: the politics of patronage

The capacity of organizations to engage in collective action within Russia during the 1990s was primarily framed by two factors: the economic structure described above, and the formation between 1990 and 1993 of a strong executive presiding over a federal

¹²⁵ Wade (2004) argues that internal integration is a “dense set of links between sectors...and a structure of demand such that a high proportion of domestic production is sold to domestic wage earners”. Here, export demand is not the primary source of economic growth and “robust political coalitions between capitalists and employees become possible...because capitalists, employees, and government recognize a common interest in wages as a source of sales and economic growth, not just as a cost of production”. In contrast, economies with a low level of internal integration and a high level of external integration see wages as a cost, and not as a source of demand. Because domestic consumption is only weakly connected to domestic production, exports serve as the primary stimulus to economic growth with export sectors existing mainly as enclaves largely detached from the domestic economy. Prime examples of enclave export sectors include oil, gas and other mineral extraction sectors.

system. The regression analysis in Chapter Four indicated that the economic structure of a country and government type were the two most statistically robust indicators of social order type across the post-socialist region. This was particularly apparent in Russia where the two existed in a dynamic relationship that gradually resulted in the most important political activity at the national level being conducted on an informal basis between the Presidential Administration (PA) and the owners of FIGs, thus limiting any dialogue between state and any other socio-economic interests outside of the FIGs (e.g., Hedlund, 1999; Robinson, 2000; Rutland, 2001; Jensen, 2001; Freeland, 2001). With the autonomy of the state compromised by its close links with FIGs, the development of political parties and other civic organizations was relatively muted (e.g. Urban, Igrunov and Mitrokhin, 1997; Evans, Henry and Sundstrom, 2006; Hale, 2006). Furthermore, the business-state nexus was replicated at the regional level where provincial governors¹²⁶ often governed in close conjunction with powerful economic organizations (Orttung, 2004a; Orttung, 2004b; Wenger, Orttung and Perovic, 2006; Hale, 2006).¹²⁷

This close business-state nexus emerged from the specific features of the Russian exit from the Soviet Union. As described previously, the economic crisis that Russia faced forced Yeltsin and the Gaidar government to undertake market reforms immediately (Aslund, 1995; Gaidar, 1997; Robinson, 2000). However, the weakness of the state also undermined its capacity to implement these reforms. As the credibility of Yeltsin's commitment to market reform was eroded over the course of 1992 in the face of fierce criticism from the Soviet-era legislature and the recalcitrance of much of the inefficient industrial complex, the presidency gradually began to make a number of alliances and compromises in the name of political expediency rather than economic reform. Initially, this involved strengthening the links between the state and the banking sector through the provision of special dispensations that favoured organizations with close links to the state. However, the capacity of the state remained low despite the fact

¹²⁶ For the sake of simplicity the term 'governor' is used to refer to the heads of the executive branch in Russia's provinces even though the formal title does in fact vary across regions.

¹²⁷ There is, however, considerable variation in the openness of political competition across Russia's regions (see Petrov, 2004). The argument put forward in this study would suggest that economic structure would be an important factor in explaining this variation, although this remains an under-researched area.

that export revenues from the natural resource sectors had propped up the fiscal capacity of the state during a period of otherwise low revenues.

In the context of weakening state capacity, Yeltsin employed one of the remaining tools at his disposal: the sale of valuable state assets – particularly in the natural resource sectors - to domestic financiers, in return for both revenue (the proceeds of the sale of state assets, and taxes) and political support against his opponents.¹²⁸ This process of patrimonial privatization ensured that some of the most lucrative assets were transferred to a relatively small number of financiers and led to the creation of powerful financial-industrial groups on whose support the state became increasingly dependent.¹²⁹ A considerable portion of the oil industry was privatized in this manner, along with much of

¹²⁸ Under this scheme, the Presidential Administration auctioned off significant packages of shares in some of the most desirable state-owned enterprises, such as those in the oil industry, the metallurgical sector, and also in telecommunications, as collateral for bank loans to shore up the state's poor fiscal position. In exchange for the loans, the state handed over assets worth many times as much. Under the terms of the deals, if the Yeltsin government did not repay the loans by September 1996, the lender acquired title to the stock and could then resell it or take an equity position in the enterprise. The first auctions were held in autumn of 1995 and were often conducted by the same FIGs that had provided the loans. The auctions themselves were usually held in such a way so as to limit the number of banks bidding for shares and thus to keep the auction prices extremely low. By the summer of 1996, major packages of shares in some of Russia's largest and most profitable firms (often in export industries) had been transferred to a small number of FIGs, thus facilitating the privatization of valuable enterprises at a low cost. In many respects this process represented the apogee of Yeltsin's strategy of securing political support through the use of patrimonial privatization, particularly in the period before the 1996 Presidential elections. However, while the auction prices have been considered by many to be exceptionally low, it should be noted that the Communist Party of the Russian Federation (CPRF) was, at the time of the auctions, considered to be a serious electoral threat to Yeltsin. Given that a CPRF victory in the Presidential election carried with it the prospect of the expropriation of private sector assets, the low auction prices may very well have reflected the uncertainty surrounding the outcome of the election (see Allan, 2002). A number of studies describe this episode in some colour: Freeland (2000); Brzezinski (2002); Hoffman (2002); Klebnikov (2002).

¹²⁹ The financial-industrial groups were composed of those individuals that had built up a capital base during the chaos of the late Soviet period. Although each FIG comprised banks, industrial interests and media outlets, it was primarily through their positions as financiers in the early 1990s that they were able to later acquire assets in the 'real' economy. The close connections between the businesses that composed each FIG were often a product of Gorbachev's reforms, most notably the 1987 Law on State Enterprises and the Law on Cooperatives. These two laws enabled savvy individuals to create banks that were used to extract resources from their industrial assets and also from the state. After the shares-for-loans round of privatization, the ten largest FIGs had expanded to control around a third of Russian GDP and much of its export capacity. Although these FIGs were the most prominent due to the concentration of wealth that they represented, they were 'unofficial' FIGs. Official FIGs were created at around the same time in an attempt by 'statists' within the Russian government to create large integrated industrial groups owned by the state similar to the Korean *chaebols* and Japanese *keiretsu* (which were privately owned). Although considerable legislative and organizational attention was paid to the creation of these official FIGs in the mid-1990s, the fiscal incapacity of the state meant that their economic size never rivalled that of the unofficial FIGs. The emergence of FIGs and the individuals that owned them are discussed in: Johnson (1998); Rutland (2001); Jensen (2001); Starodubrovskaya (1995).

the metallurgical sector (see above). Those sectors over which the state retained control were also used to increase state capacity by transferring value from the natural resource sector (mostly the gas industry) to the rest of the economy. In this way, the government was able to inject liquidity into illiquid parts of the economy, “not in the form of money, but in the form of fuel” (Shleifer and Treisman, 2000, p.76). The concentration of political power in the hands of the executive and the concentration of real economic power in only a few extractive industries facilitated this informal, patrimonial relationship between business and state.¹³⁰

The close, informal relations between business and state were also prominent at the regional level, particularly in regions in which there existed a high level of concentration of economic power in the hands of a few organizations. On one hand, the patrimonial pattern of Yeltsin’s rule ensured that governors in powerful regions were often given significant latitude in governing their constituencies in return for providing political support at the national level (Stoner-Weiss, 1997, 1999; Treisman, 1997, 1999; Solnick, 2000, Hale, 2005). On the other hand, provinces in which economic power was concentrated in a few areas – often in natural resource sectors linked to the international economy – tended to see closer links between business and state. Thus, regional FIGs were often able to establish themselves through the penetration of regional political structures. In such instances, Russia's governors and the regional business community formed close and mutually beneficial ties, often giving the governors monolithic control over their regions (Petrov, 2004; Orttung, 2004a; Orttung, 2004b; Wenger, Orttung and Perovic, 2006). The governor in turn provided business organizations with access to state resources, licenses, favorable legislation, and protection from law enforcement agencies in exchange for electoral support and help dealing with potential challenges from Moscow or local opposition groups. For example, in Perm Oblast, LUKoil-Permneft was the dominant economic organization and possessed a correspondingly powerful political

¹³⁰ Although it is worth noting that mechanisms for resolving disputes or for ensuring co-operation were never established. Consequently, the ‘state capture’ was only very loose and did not represent a systematic domination of the state by FIGs. It was this failure to establish a mechanism of co-ordination between FIGs that undermines any attempt to label Russia an ‘oligarchy’ during this period.

apparatus that outstripped that of any other potential contenders, enabling it to pursue its economic agenda largely autonomously (Hale, 2006, pp.164-5).

6.4.2 The weakness of organizations outside of the state and leading economic sectors

This close relationship between business and state observed in the executive branch at both the national and regional level was not effectively checked by other independent organizations from elsewhere in Russian society. This was in part caused by the failure of economic restructuring, as new sources of economic power unconnected to the already powerful state and FIGs did not emerge on a scale necessary to provide a socio-economically defined constituency that might act as a counterweight. The weakness of other organizations was also a consequence of the low incentive to form political parties, active civic groups and business associations, etc. that was a function of the institutionally weak legislature. For budding economic or political entrepreneurs, FIGs and government networks connected to the executive (both national and regional) acted as attractive ‘party-substitutes’ because they alone possessed either the formal institutional power or the organizational and financial resources necessary to be politically effective (Hale, 2005c; Hale 2006).

This was not always the case. Before October 1993, the Soviet-era legislature (the Supreme Soviet and the Congress of People’s Deputies) exploited the institutional ambiguity caused by the collapse of the Soviet Union and acted as a focal point for ‘red directors’ against the economic reforms of President Yeltsin and his Prime Minister, Yegor Gaidar (Colton, 1995; Brudny, 1995; Lowenhardt, 1995; Shevtsova, 1999). In the absence of a constitutional settlement after the collapse of the Soviet Union, groups within the legislature were able to contest the legality of Yeltsin’s actions. After all, both the executive and the legislature had been elected in close proximity to each other in the late Soviet period. However, the struggle that culminated in military action by the President against the legislature resulted in the formation of a new constitution that removed any ambiguities that might have surrounded the power of the executive (Brown, 1993; Ostrow, 2000). In many ways this episode summed up Boris Yeltsin’s attitude to

working with alternative power bases outside of the Kremlin-backed patronage networks and signalled a ‘revealed institutional preference’ for a style of governance based on informal ties with powerful regional and economic organizations (Hedlund, 1999).

The newly formed bi-cameral legislature, composed of the State Duma and the Federation Council, were afforded relatively weak institutional powers (Remington, 1999; Hale, 2006; Oversloot and Verheul, 2007) which were, in effect, further weakened by the imposition of an electoral mechanism that saw elections to the State Duma split between Single Mandate Districts (SMDs) and a party list (PL) system. This hybrid system discouraged the formation of broad national political parties as SMD candidates were often those connected with FIGs or the regional political elites. In this environment, only the Communist Party of the Russian Federation (CPRF) was able to consistently appeal to a socio-economically defined constituency and perform well across the country in parliamentary elections, securing the largest share of the party list component in the Duma elections of 1995 and 1999 (see March, 2004). Notwithstanding the serious challenge posed by the CPRF in the Presidential election of 1996, two factors appeared to limit the importance of the CPRF as an opposition force. First, it failed to extend its electoral appeal beyond its core support, i.e. the elderly, the weak and those that generally felt most disadvantaged by the transition away from the planned economy. Second, the ‘super-presidential’ constitution limited the ability of the CPRF to translate its strength in the Duma to serious influence over government policy.

Other parties that aimed themselves at a specific socio-economic group, such as Yabloko, which pitched its message at the aspiring ‘middle classes’, were only of marginal significance (Hale, 2004). State-backed ‘parties of power’ were also present in both the 1993 and 1995 State Duma elections, but as well as registering mixed performances - Russia’s Choice (*Vybor Rossii*) achieved 15.6 percent of total seats in 1993, and its successor as ‘party of power’, Our Home is Russia (*Nash Dom Rossiya*) achieving 12.2 percent in 1995 – did not have an organizational base outside of their connections to the state. As such, the party of power’s political centre of gravity was always the president; in fact they never existed as real parties nor, because of the

institutional power of the executive, did they ever do much 'ruling' either (Oversloot and Verheul, 2007). Thus, in general, participation and membership of political organizations was, outside of the CPRF, low (Remington, 1999; Howard, 2003; Fish, 2005).

Other potential alternative sources of power independent of the state or FIGs might have been found within civil society, or through the articulation of business interests wider than that of FIGs. Again though, the institutional strength of the state relative to non-state groups discouraged the emergence of a sufficient number of non-governmental groups that might challenge the state or big business (Howard, 2003; Evans, Henry and Sundstrom, 2006). Participation in social organizations was, like political parties, low, with informal networks often supplanting formal, non-governmental organizations (Wegren, 2006). The 1990s also signalled a failure for the development of effective business associations. Although the years 1992-1994 saw the peak of interest-group creation by business, they were mostly ineffective due to either internal incohesion or a lack of access to politically powerful circles (Markus, 2007). Even the most prominent association, the Russian Union of Industrialists and Entrepreneurs (RUIE), waned in significance after the constitutional settlement of 1993 reduced the importance of the legislature. In response, business leaders found it more fruitful to access the PA directly (Robinson, 2002, pp.72-90).

In some ways, this weakness of civil society was a legacy of the exit from the Soviet period where social movements were primarily anti-regime and lacking in any durable socio-economically defined support bases (Fish, 1995; Uhlin, 2005). However, the constraints imposed by limited economic change must also be seen as important (McFaul and Treyger, 2004). Quite simply, "Russia's new non-governmental organizations generally possessed insufficient material and human resources to allow them to become institutionalized – that is, to act as stable, recognized channels for societal constituencies to express their demands to the state and the wider public" (Sundstrom and Henry, 2006, p.311). Those that did emerge quickly found the "contradiction...between the rapid appearance of civil society actors and their limited power in practice" (Rutland, 2006, p.75). Thus, it was the institutional strength of the

executive at both the national and regional level that reduced the incentive to build organizations that would aggregate and articulate the interests of other sections of society.

This was further exacerbated by the economic stagnation that was a feature of the 1990s; limited structural change impeded the development of new socio-economically defined interest groups that might stimulate the development of new organizations. Instead, the organizations that owned the prized resource exporting sectors that were privatized approached the PA or regional governors directly, bypassing groups that might have otherwise claimed to have represented a broader cross-section of Russian society (Graham, 1995). In short, the emergence of alternative organizations in Russia was hampered by both supply and demand: the lack of economic change restricted the supply of potential new constituencies for change; while the demand from political and economic entrepreneurs for such organizations was also low due to the fact that it was either the PA or the regional elites that controlled the material or institutional resources to be politically effective. The preponderance of executive structures and FIGs therefore effectively ‘crowded out’ the emergence of other alternative sources of power.

6.5 Social order-type in Russia, 1991-1998

The argument so far suggests that, over the course 1990s, a concentration of economic power in the hands of a relatively small number of industrialists emerged that mirrored and buttressed the concentration of formal state power in the hands of the Russian President and the regional governors that ruled beneath him. Both tendencies reinforced one another, with Yeltsin compensating for the lack of state capacity by using state resources – particularly those connected to the natural resource sector – to underpin his patrimonial style of rule. In effect, a limited-access economic order was created in which assets and other rent seeking opportunities were provided to selected actors within the Russian economy in return for political support. This resulted in a system of mutual dependence between the state and the FIGs, eroding any potential autonomy that the Russian state may have had.

The natural resource sector was the main target for FIGs as it represented the most lucrative source of foreign earnings as well as providing a source of leverage within the national economy through value-transfers. While ownership of organizations within the national economy was often viewed as an opportunity for asset stripping during this period, the natural resource sector held the key to a stable source of high returns and to political power. The strong influence of the natural resource sector on the Russian government during this period is illustrated by both the close links that were developed between them, and through this, by the manner in which government policy often reflected the interests of these leading sectors. The most obvious example of the dependence of the state on the natural resource sector can be found in the close links with the oil and gas sector. This was the largest sector in the Russian economy and its export earnings were a major source of taxation revenue, accounting for around 40 per cent of budget receipts during this period (Rutland, 2001). These sectors were particularly important as they offered a source of revenue that ill-performing enterprises within the virtual economy could not, and were tapped to provide the subsidies that the sector provided to the virtual economy in the form of value-redistribution and rent sharing.¹³¹ However, while the natural resource sector provided revenue to the state, it was only a fraction of the money earned by FIGs over this period as they exploited state weakness by evading much of the tax burden imposed on them (Tikhomirov, 1997).¹³²

¹³¹ The TEK (*toplivo-energeticheskii kompleks*) was in effect the ‘cash cow of the reforms’. Its leading members were rewarded with direct representation in government and the ability to formulate its own ‘reform’ agenda. As well as appointing former Gazprom chief, Victor Chernomyrdin, as prime minister in 1992 until 1998, the head of Tyumen Oil, Yurii Shafranik was appointed as minister for fuel and energy and Gazprom’s Vladimir Kvasov was given the position of government chief of staff. Even after Chernomyrdin was replaced by Sergei Kirienko as prime minister in 1998, Sergei Generalov, former vice president of Yukos, was appointed minister for fuel and energy. The TEK included both private organizations (from the oil industry) and state organizations (Gazprom, Rosneft, etc). This cross-representation between government and large natural resource organizations continued later under the presidency of Vladimir Putin.

¹³² Other government policies also satisfied the preference of the FIGs. For example, monetary policy throughout the mid to late 1990s was focused on the creation of stable money in order to suppress inflation and maintain a strong currency. This satisfied the preferences of those competitive export sectors (oil, gas, arms, metals, etc.) that were represented by the FIGs and who also controlled many of the major commercial banks. These benefited from the government’s monetarist policies as well as enjoying special privileges conferred upon loyal FIGs to run segments of the state’s finances in place of the Central Bank. Thus, well-positioned actors within the banking sector were able to exploit the monetary policies that were a feature of the period of financial liberalization while most other Russians suffered. By contrast, directors and employees in the virtual economy were the obvious ‘losers’ in this process as not only were they often

Such close links between business and the state, and with the failure of significant structural change within the economy hindering the development of alternative sources of power, stifled the development of an open-access political order in Russia over the 1990s. Although World Bank Governance Indicators are not available until 1998, it is possible to make several broad observations on Russia's development along the three indicators selected to measure social order type across in this study.

6.5.1 Voice and accountability

The level of political competition during this period was certainly an improvement on the Soviet period. After the military solution to the standoff between Yeltsin and the Soviet-era legislature in 1993, parliamentary elections were held in 1993 and 1995 as well as a presidential election in 1996. Furthermore, state ownership of media outlets was considerably curtailed with a large proportion of media outlets owned or controlled by non-state organizations (Belin, Fossato and Kachkaeva, 2001; Oates, 2006). Freedom of expression and association was, despite some flaws, at its highest level in Russian history. Unfortunately, while Russia appeared to make progress on at least the procedural indicators of an open and complete polity, the reality was somewhat different. As noted above, the close links between state and business, at both the national and regional levels, ensured that even freely elected parliaments exerted only limited control over government policy.

Media outlets, while independent of the state, were often owned or connected to FIGs or regional political elites thus limiting their utility as checks on the power of the state or FIGs (Belin, Fossato and Kachkaeva, 2001; Ryabov, 2004). It is perhaps accurate to describe Russia as a delegative democracy during this period; the absence of strong counterweights to the state and business resulted in a failure to institutionalize the level of

denied access to capital from the state, but banks' more lucrative activities in exploiting the partial reforms of the government meant that they rarely lent to domestic economic organizations. The process of 'reform' therefore saw interests outside of the FIGs largely ignored as the state became reliant on the FIGs – and by extension, natural resource exports – for tax revenue and, increasingly as time went on, loans.

accountability that is present in stronger, healthier democracies (O'Donnell, 1994; Kubicek, 1994). Instead, the formal electoral accountability acted as only a nominal restraint upon executive power and policy was generally conducted in an informal, non-transparent manner between the state and the owners of powerful export sectors. The concentration of economic power described above, and the institutional disincentive to form organizations independent of the state patronage network, both ensured that only a select few actors in Russia had *voice* over government policy and that such actors were rarely *accountable* to anyone outside the elite.

6.5.2 Rule of law

In terms of the rule of law, excellent formal provisions have not been given substance by actions on the ground (Krasnov, 2004). The Russian procuracy - the central legal institution – was, after making some progress toward greater independence in the 1990s, ultimately humiliated, subordinated, and placed under intense political pressure after it decided to investigate corruption in Yeltsin's government in the late 1990s. The parliamentary elections of 1999 allowed the owners of FIGs to obtain seats in the Duma, thereby acquiring parliamentary immunity. In the final months of 1999, major privatizations permitted members of the powerful elite to grab key Russian resources at bargain prices, perpetuating the insider deals of the loan-for-shares period in the mid-1990s. Again, such venal behaviour was essentially facilitated by the absence of independent sources of power that could act as a check on the activities of the political and economic elites. As long as the economy failed to support the formation of durable interest groups and provide a demand for the substantive application of formal legal provisions, the executive and state officials in general did not feel obliged to supply it.

6.5.3 Control of corruption

During the Yeltsin period, the state was simultaneously privatized and stolen as it was preyed upon from within - by venal state officials and regional elites - and outside – by powerful economic organizations. In many ways this represented a continuation of

practices in the late Soviet period (Solnick, 1998). Those close to President Boris Yeltsin were inextricably linked with massive tax evasion, insider privatization and licensing, and the siphoning off of financial assets, natural resources, and the state's industrial output. In this context, the state was weakened as it could not deliver on its promised functions (public goods such as maintaining order or providing social and medical services, for example) because of corrupt state administrative structures and, as a partial consequence, inadequate revenues. Although the shares-for-loans episode represents the most well-known and perhaps most lucrative example of corrupt collaboration between state and business, similar types of corruption were ubiquitous throughout the Russian system during this period. The absence of strong levels of economic competition ensured that national and regional elites could operate with autonomy, safe in the knowledge that they alone had access to the material and human resources to be politically effective forces.

6.5.4 Conclusion: the culmination of the Yeltsin period and the 1998 crisis

The practical outcome of the Yeltsin period described above was the concentration of the most lucrative economic assets in the hands of a small group of politically connected organizations, and the fortification of the nexus between power and property in Russia. Yeltsin's need for support in winning the 1996 presidential elections reinforced these tendencies. The role of the natural resource sector during this period was crucial: firstly, the 'gift' of ownership of assets within this sector underpinned the state-FIG nexus; secondly, although tax evasion in the natural resource sector was high, what revenues were derived from this sector contributed to the demonetization of the economy and the maintenance of the virtual economy through the transfer of value from the natural resource sector to the moribund industrial sector; thirdly, the transfer of these assets to the FIGs, weakened the state through the loss of a large portion of their revenues and compromised its autonomy by raising the power of FIGs relative to the state, leading to state 'capture' (Hellman, 1998; Hellman and Kaufmann, 2001; Hellman, Jones and Kaufmann, 2003).

The interaction between export sectors, the domestic economy and the state all combined to leave Russia in a ‘partial reform equilibrium’ at the end of the Yeltsin’s rule. A weak state co-existed with a domestic economy that continued to suffer from many of the negative legacies bequeathed by the Soviet planned economy. Only those sectors that were competitive in the international economy, primarily the natural resource sector, performed well during this period, and despite many rents accruing to private owners who avoided taxation, the stream of revenue that it provided proved just enough to sustain this delicate balance. It was during this period that the Russian political leadership began to resemble a regime - an under-institutionalised power system which was not constrained either by a constitution or by institutions of mass representation - rather than a government - which is located within a form of legal-constitutional power relations (Sakwa, 2002, pp.454-8; Sakwa, 2004, Ch.4). Thus, the limited-access economic order described above, with its concentration of economic power in the hands of either the state or the FIGs, supported a limited access political order in which the holders of economic power supported the existing political order in return for continued access to economic assets.

The delicate balance that existed between the virtual economy, predatory business groups and a weakened and ‘captured’ state began to deteriorate from 1997 and culminated in the 1998 financial crisis. The build up to the 1998 crash marked the nadir of state dependence on big business. Consistently unable to secure the required tax revenues from either the FIGs or the wider virtual domestic economy, the government resorted to the issuing of high-interest short-term state bonds (GKO) as a non-inflationary way of funding the budget deficit. As with the shares-for-loans agreement, the major beneficiaries were the banks attached to the FIGs who on the one hand evaded paying their full tax bill, and on the other exploited the government’s resultant need for cash by monopolizing the market for high interest bonds. Therefore, the dependence of the state on big business not only impaired its autonomy, capacity and its will for reform, but also created the foundations for the 1998 financial crisis. Ultimately, the 1998 crisis can be seen as a function of the interaction between the prevailing economic structure and

the political system (regime and coalitions with FIGs) that had crystallized over the 1990s.

Without a deep pool of taxable economic activity throughout the economy, the state was fiscally dependent on those sectors that were able to provide tax revenues or provide loans. In an attempt to reduce the cost of borrowing and decouple the state from its dependence on the FIGs for loans (which covered the persistent inability to raise enough taxes to match expenditure), the Russian government opened up its debt market to foreign investors, leading to rapid inflows of foreign capital.¹³³ The Asian financial crisis of 1997 that soon spread to other emerging market economies then caused a flight to safety among foreign investors and the sudden withdrawal of short-term capital from Russia (Roubini and Setser, 2004). The weakening of global demand for commodities caused by the slump in output across emerging economies also resulted in a decline in prices across the range of Russian natural resource exports. Russia was plunged into crisis as the state defaulted on much of its domestic debt and the private sector defaulted on its foreign debt, leading to a collapse of confidence in Russian banks and the devaluation of the rouble.¹³⁴

In short, the experience of Russia during the Yeltsin period appears to offer support to both the first order and second order hypotheses generated in Chapter Two. An economic structure dominated by only a few economic sectors, themselves exhibiting monopolistic or oligopolistic market structures, stymied the emergence of a wider array of social forces that might have acted as a counterweight to the state and the most important economic organizations. Ultimately, this had broadly negative implications for social order development. It is also true, however, that many of the negative aspects of Russian social order development during this period are over determined; a range of other political, cultural and social factors are no doubt also important. The next section reviews economic structure and social order development in Russia under the leadership of

¹³³ This is estimated to have been over \$40 billion in 1997 (Robinson, 2002).

¹³⁴ Full accounts of the 1998 crisis include: EBRD (1999); Illarionov (1999); Sapir (1999); Hanson (1999) OECD (2000).

Vladimir Putin. As will be argued, economic structure was a crucial variable in explaining the trajectory of social order development in Russia during this period.

6.6 The reassertion of the state under Vladimir Putin, 1999-2007

6.6.1 The capacity for collection action among Russia organizations: the strengthening of the state

The first consequence of the 1998 crisis was the weakening of the financial branches of the FIGs. These banks had preyed upon the state's fiscal weakness through the provision of loans. However, as the market for state-issued bonds dried up, the opportunity for further profits from these activities ended. Although these groups still possessed considerable economic assets in the real economy, particularly in the oil and metallurgical sectors, the severing of the financial links between the state and the FIGs left them significantly weaker vis-à-vis the state. The second significant result was the beginning of the remonetisation of the domestic economy (Fig. 6.5). This was caused by two events. First, the Central Bank of Russia mandated the repatriation and domestic sale of foreign exchange reserves in order to accumulate foreign exchange reserves in response to the currency crisis (Bernstam and Rabushka, 2006). This restricted the capital flight from enterprise export earnings that had previously characterised the Russian natural resource export sector. As the Central Bank printed roubles to purchase foreign exchange reserves it expanded the monetary base. Second, international commodity prices rebounded after 1998 (Fig. 6.4). This resulted in increased export revenues, revenues that were now repatriated under the new rules. The third major effect of the crisis was that the remonetisation of the economy increased tax remittances that strengthened the fiscal position of the state (Table 6.3). This influx of revenue gradually increased the power of the state relative to other organizations in the economy, as it was no longer reliant either on loans or on redistributing property to shore up its political position.

Remonetisation and increased earnings on exports also contributed considerably to the wider economic recovery. Combined with the effects of a devalued currency, output within the economy increased sharply as spare capacity within the economy was utilized in the face of increased costs for imports, particularly in sectors that had previously faced stiff foreign competition, such as in the dynamic food processing industries which found themselves more competitive with a weaker rouble. This created a virtuous circle that reduced the prevalence of the virtual economy; expansion of the monetary base injected funds into enterprises that reduced the problem of arrears and non-payments. Increased domestic demand then buttressed and intensified the effects of remonetisation. Value redistribution from the natural resource sector continued, but was less important to the functioning of the wider economy than it was under the conditions of the virtual economy.

Because of rising tax revenues, the state could now afford this value redistribution as the effective subsidisation of the economy that existed under the virtual economy declined. The role of natural resource exports in the recovery was intensified by the repatriation of foreign currency earnings. Between 1998 and 2004, Russian GDP increased by 48 percent. Of this, gross domestic spending (the sum of consumption, investment and government spending) accounted for 75 percent, with exports, predominantly from the natural resource sector, accounting for the remaining 25 percent (Goskomstat, 2005). Along with the influence of the continuation of value redistribution from the oil and gas sector, the natural resource sector clearly remained the leading sector within the Russian economy with the state increasingly empowered from earnings in this sector (Tables 6.2 and 6.3).

Table 6.2 Earnings from oil and petroleum product exports, 2000-2006 (\$ billion)

	2000	2001	2002	2003	2004	2005	2006
Earnings from Oil and Petroleum Product Exports	34.9	33.4	38.7	51.1	74.6	101.7	141.3

Source: Russian Federation Ministry of Finance (2007).

Table 6.3 Tax payments of the oil sector, 2000-2006 (\$ billion)

Tax payments (\$ billion)	2000	2001	2002	2003	2004	2005	2006
Total tax payments	15.04	17.88	21.42	29.06	48.8	88.41	117.46

Source: Russian Federation Ministry of Finance (2007).

Like Yeltsin in 1990, Vladimir Putin began his reign as Russian president in 2000 with overwhelming popular support, suggesting that he may have possessed an opportunity to exploit this window of opportunity and create the foundations of an open-access economic and political order.¹³⁵ Indeed, on the eve of his accession to power, Putin emphasised the need to develop a society based on the rule of law (Putin, 1999). The potential to achieve this was all the greater for the autonomy that the state now enjoyed from both the FIGs and from the burden of subsidising the ill-performing enterprises within the virtual economy. Both of these changes were a direct consequence of the 1998 crisis.

Initially, the reassertion of the state under Putin was focused on two areas. First, Putin concentrated on reining in regional leaders through reforms of the federal structure of the Russian Federation that resulted in the creation of seven federal *okrugs* (administrative regions) led by presidentially appointed envoys that were tasked with tightening the centre's grip on Russia's 89 regions (Hyde, 2001; Hale, 2005b). This represented another blow to business as they had often aligned themselves with regional actors against the centre. Instead, both business and regional elites were now encouraged to work through the new 'party of power', United Russia (see below). Second, Putin launched an assault on two of the most prominent FIG owners, Boris Berezovskii and Vladimir Gusinskii. Under the guise of formal legal proceedings, both were expropriated of their major business interests in Russia, including two major media organizations as well as other industrial assets. It was the first instance of the use of a newly drafted

¹³⁵ It should be noted that Putin's popularity was initially based on his perceived direction of the second military campaign in Chechnya that began in the summer of 1999. The fact that his popularity had its roots in the military action in Chechnya also helped shape the composition of the Russian state for years to come; officials from the *siloviki* (a term that loosely describes persons with a security or military background) became more numerous in the upper echelons of government. See Bacon, Renz and Cooper (2006).

bankruptcy law that was to prove useful in forcing mergers and acquisitions within the Russian economy over the next few years (Barnes, 2007, p.52). This realignment in the distribution of power between state and business signalled a renegotiation of the state's dependency on big business and the reassertion of a re-invigorated executive.

Despite the fates of Berezovskii and Gusinskii, the balance of power between the state and business initially appeared to have reached only a more even level when compared to the dependency of the state under Yeltsin. Now that a healthy level of respect between state and business had been established, there appeared to be a greater chance than ever of moving towards an open-access political order; a more equal balance of power between state and big business might have represented the beginning of a more competitive era. The so-called *shashlychnoe sagleshenie* (the 'shashlick agreement') of July 2000, where Putin and the owners of the FIGs ostensibly agreed to a negotiated compromise to end the excesses of the Yeltsin-era, indicated that while Putin would be more demanding in terms of extracting tax revenue from the FIGs, he would also preserve the distribution of property that had taken place under Yeltsin.¹³⁶ Indeed, between Putin's victory in the 2000 presidential election and 2003, the state's role in the economy was relatively benign under the stewardship of economic liberals such as German Gref, Mikhail Kasyanov, Alexei Kudrin and economic advisor Andrei Illarionov; this period saw the introduction of a 13 percent flat tax which helped boost taxation revenues, a reduction in corporation tax, and later the creation of a stabilization fund for surplus export earnings.

6.6.2 The continued weakness of counterweights to big business and the state

While the balance of power between the state and business, and between the centre and the regions, might have changed, independent organizations remained extremely weak (Knox, Lentini and Williams, 2006). In a formal sense, political parties, business associations and civic organizations appear to play a more prominent role than

¹³⁶ This period has been labelled the 'period of compromise'. See Bunin (2004). However, there remains much uncertainty as to whether anything concrete was actually agreed between Putin and the business leaders; see Tompson (2005).

ever in Russian politics. The parliamentary elections that preceded Putin's victory in the 2000 presidential election saw the emergence of a genuinely popular 'party of power' in Unity (*Yedinstvo*), which after merging with Fatherland-All Russia (*Otechestvo-Vsya Rossiya*) later become United Russia (*Yedinaya Rossiya*). Although parties of power were not new in Russia, the degree of electoral support far outweighed that previously enjoyed by Yegor Gaidar's Democratic Choice in the 1993 Duma and, later, Viktor Chernomyrdin's Our Home is Russia in the 1995 Duma. This success of Unity – a party created just in time for the 1999 Duma elections without any form of organizational support or indeed grass-roots membership – presaged the electoral success of other 'virtual parties' (such as Just Russia) that existed solely to capture votes in elections and support the president in parliament.¹³⁷ The success of virtual parties of power subservient to the president further emasculated an already constitutionally weak legislature. Unity, its successor, United Russia, and a number of other state-backed parties have since performed well in parliamentary elections. However, while they might be electorally successful and well organized, "describing them as 'ruling parties' reverses cause and effect and inverts its members' actual dependencies and loyalties" (Oversloot and Verheur, 2007, p. 194). The absence of independent groups with the material and human resources to challenge the state made its job of dominating the political party 'market' much easier. In this sense, the wave of de-privatization since 2000 bodes ill for the development of anything approaching a genuinely competitive political party system. Thus, while the state's role has made the *party-system* stronger (i.e. a more institutionalized relationship between state and party), it has had the effect of making *parties* weaker (Mankoff, 2003; Wilson, 2007).

The formal involvement of business associations has also increased under Putin, suggesting that a more institutionalized dialogue between state and business has taken place. In 2000, Putin instigated the inclusion of many of the FIGs owners who had previously accessed the state through informal channels into RUIE, creating a new council that included FIG owners as well as representatives from some medium-sized enterprises (Rutland, 2003; Hanson and Teague, 2005). This was intended to

¹³⁷ For a discussion of the role of virtual parties in Russia and other post-Soviet states, see Wilson (2005).

institutionalize relations between business and state and place relations on a more formal footing. In addition, the Union of Business Associations of Russia (OPORA), representing small- and medium-sized enterprises (SMEs) enjoyed deeper and more institutionalized channels of communication with the state, acting as “the prime interface for the exchange of information between governmental structures and the SMEs” (Markus, 2007, p.286).

Elsewhere, the Russian Chamber of Commerce and Industry (RCCI) assumed a much greater lobbying role after the appointment of former Prime Minister Yevgenii Primakov to the leadership role of the RCCI in 2001. This group represents over 20,000 companies and associations and also enjoyed greater consultative links with government after 2000, playing a considerable role, for example, in formulating the simplified Tax Code for SMEs (Markus, 2007, p.288). However, as with political parties, the extent to which business associations integrate and then articulate the interests of their members to the state is still quite limited. Instead, the state has tended to use business associations as a mechanism through which it can impose its will, using them as a tool through which it can implement policy more effectively (Markus, 2007).

Thus, the state’s relationship with business resembles that of its relationship to political parties; they are tools in which the flow of decision-making is generally one-way. Moreover, in important matters, such as the appropriation of private resources employing pseudo-legal de-privatization strategies, the timidity of business associations becomes apparent, making a mockery of attempts at institutionalizing property rights and state-business relations. This has the added demonstrative effect of weakening the perception of private property rights at lower levels (from interviews).¹³⁸ Again, while the most lucrative economic resources are in the hands of either the state or FIGs with close links to the state, the probability of business acting as a counterweight is quite low.

¹³⁸ A number of experts interviews were conducted in the course of the author’s research for Chapters 6, 7 and 8. However, many interviewees expressed discomfort with specific remarks being attributed to them. In order to maintain the anonymity of interviewees, all material derived from interviews is cited as ‘from interviews’, without identifying the informants. A full list of interviewees is contained at the end of the bibliography.

Mirroring the state's efforts to create quasi-parties in the legislature, and supplicant business associations in the economy, the Kremlin-funded youth group *Nashi* has increased its share of the civil society 'market', using its superior material resources and state-backed status to effectively nullify other independent groups within Russian civil society. Ostensibly, *Nashi* was created in 2005 to eliminate the "regime of oligarchic capitalism" (Interfax, 2005, April 15th). However, in practice it has acted as tool of the regime to mobilize Russian youth, act as a vocal supporter of regime, and Putin in particular, and to 'crowd out' other groups that might not be so supportive of the regime.

Again, in the absence of strong, independently funded civic associations, the concentration of economic resources in the hands of the state or FIGs has both the active role of ensuring that vast material resources are at their disposal, and the more passive effect of reducing the probability of independent groups emerging in the future. Elsewhere, the media outlets appropriated from Berezovskii and Gusinskii were effectively taken over by the state and used to advance the interests of the ruling elite in a manner reminiscent of the Soviet-era. Although some independent print media remains, national television networks are either state-owned or practice a form of 'self-censorship' that borders on obsequious (Ryabov, 2004; Oates, 2006). This 'management' (Balzer, 2003) and 'creation' of civic associations renders the term 'civil society' effectively meaningless in the Russian context; groups dependent on the state cannot act as counterweights to it.

In short, the structure of the economy and the general institutional weakness of the state further undermined the prospects of Russian politics developing into an open-access order. Between 2000 and 2002, the distribution of ownership in the leading export sectors was, on the face of it, relatively evenly balanced between FIGs and the state. However, as commodity revenues increased, so did the relative strength of the state. Although revenues from the domestic economy had increased, the incentive to appropriate more rent from the natural resource sectors heightened. In this respect, the failure of the state to develop institutionalised links with the wider economy since independence was crucial. With a low capacity to administer tax and regulate the

economy, the incentive to tighten control over natural resources was considerable (see Tompson, 2006).

Arguably, the defining moment in the move towards greater state control over the natural resource sector came with the assault on Yukos, the largest private oil company, over the course of 2003 and 2004 (Hanson and Teague, 2005; Thompson, 2005; Fortescue, 2006b; Barnes, 2007; Goldman, 2008; Sakwa, 2009).¹³⁹ The behaviour of Yukos, and its owner, Mikhail Khordorkhovskii, had signalled a potential weakening of state control over the oil industry. Yukos was involved in negotiations with foreign oil companies over a possible merger that would have increased the integration of the Russian oil industry with the global economy and entrenched its independence from the Russian state (see Goldman, 2008). In addition, Khordorkhovskii had become increasingly prominent in domestic politics, establishing close links with independent groups in civil society and political parties not controlled by the Kremlin (Robinson, 2007). This may have represented the beginning of a move towards a more open-access order as the separation of the state from a significant economic organization may have supported the emergence of politically independent actors. However, the increasing value of oil exports both increased the incentive for the state to appropriate extra rents, but also raised the cost of allowing them to remain in the hands of potential opponents (from interviews). Although the coercive power of the state had increased, along with greater fiscal capacity, the institutional weakness continued. The concentrated structure of the export sector both invited and facilitated de-privatization; a greater number of organizations or a wider dispersion of resources may have balanced the ambitions of the state. This tendency towards the increased concentration of ownership within the state is described below.

¹³⁹ There are a number of views as to why Yukos was chosen as the object of the state's attention. Furthermore, it is not entirely clear from where within the ruling elite that the decision to expropriate Khordokhovskii's assets emanated. The competing theories are summarised in Fortescue (2006, pp.121-148) and Sakwa (2009).

6.7 Structure and ownership in leading Russian export sectors, 1999-2007: the de-privatization of leading export sectors

By 2006, the economic structure and export profile of Russia had not, in many respects, fundamentally changed since 1998, or indeed, 1991. Instead, because of historically high prices for oil and other commodities, the resource extraction sectors dominated the Russian economy more than ever, causing some concern that Russia is comparatively ill equipped to diversify its economy and end its dependence on resource extraction (Ahrend, 2005; Ahrend, Tompson and de Rosa, 2007; Cooper, 2006). Investment has not matched the levels seen in other emerging economies, and has fluctuated quite wildly since 2000 (Simola, 2008). In terms of the extent to which resource extraction companies dominated the domestic economy, Table 6.4 reveals that they accounted for over 80 per cent of the total sales volume of the 25 largest companies in Russia. In addition, the top three export sectors now accounted for 87 per cent of all exports, with the oil and gas sector accounting for nearly 50 per cent, goods ‘not classified by kind’ (probably including arms and precious metals) accounting for nearly 22 per cent, and manufactured goods (dominated by metals) accounting for 15 per cent. The state’s dependency on revenues from these sectors, particularly the oil sector, is also clear. Table 6.2 reveals that earnings from oil exports nearly tripled between 2000-2005, while Table 6.3 illustrates the dramatic increase in the taxation burden imposed on these earnings (an increase of over 500 percent). Again, this does not reveal some of the other less visible ways in which the state relies on the oil and gas sector to support other less efficient sectors within the economy through value distribution.

Table 6.4 The twenty five largest companies in Russia by sales volume, 2006

Rank	Name	Sector	Sales	
			Volume '000 \$	Proportion of Top 25 (%)
1	Gazprom	Oil and Gas	489058	15
2	Lukoil	Oil and Gas	462840	14.2
3	United Energy System	Electric Power	270292	8.3
4	Russian Railways	Transport	264645	8.1
5	TNK-BP	Oil and Gas	248374	7.6
6	Rosneft	Oil and Gas	176700	5.4
7	Surgutneftegaz	Oil and Gas	157775	4.8
8	Sibneftegazperarabotka	Oil and Gas	145853	4.4
9	Sberbank	Finance	110248	3.3
10	Severstal	Ferrous Metals	79645	2.4
11	AFK Systems	Communications	75935	2.3
12	Svyazinvest	Communications	74884	2.3
13	Norilsk Nickel	Nonferrous Metals	68680	2.1
14	Slavneft	Oil and Gas	67776	2
15	Evrast Group	Ferrous Metals	65081	2
16	Transneft	Transport	64166	1.9
17	Rusal	Nonferrous Metals	63055	1.9
18	Tatneft	Oil and Gas	60072	1.8
19	Russian State Insurance Company	Health	56128	1.7
20	Magnitogorsk Metal	Ferrous Metals	53800	1.6
21	Avtovaz	Machinery	46847	1.4
22	Novolipetsk	Ferrous Metals	44687	1.3
23	Mechal	Ferrous Metals	38050	1.1
24	GMK Holdings	Nonferrous Metals	34939	1.1
25	AK Alrosa	Precious Metals	34229	1.1

Source: *expert.ru*, 2007; author's calculations

The key difference lay in Putin's attack on key FIG owners that ensured that this increased dependence on natural resource sectors was accompanied by a rise in state ownership or effective control in these and other sectors.¹⁴⁰ It is estimated that the state-owned share of Russia's equity market capitalization rose from 20 percent in mid-2003 to 30 percent in early 2006 with a disproportionate increase in the role of the state in the

¹⁴⁰ Whether this increase is a result of design or of opportunism is unclear. Those who cite the de-privatization process based on ownership of the commanding heights of the economy, specifically the natural resource sector, note the content of Putin's doctoral dissertation; see Balzer (2005). Evidence of any pre-conceived 'plan' is largely irrelevant, however. Such an extreme concentration of wealth in key export sectors would probably have increased the incentive for the government to assert state control and centralize rents under most circumstances.

natural resource sectors (OECD, 2006, p.2). This has risen since a large proportion of the remaining production assets from Yukos have come under state control along with the sale of Roman Abramovich's Sibneft to the state controlled Gazprom in October 2005 (Vedomosti, 2005, October 13). Rosneft purchased Yukangskneftegaz (the primary production arm of Yukos), and stakes in Tuapse oil refinery, Verkhnechonskneftegaz and Udmurtneft. Along with other state acquisitions and pressure exerted upon major foreign investors, this period has seen a general increase in the concentration of state ownership in the country's leading export sectors. Foreign investors also saw their role in the oil sector diluted over this period. Royal Dutch-Shell's participation in the exploitation of the Sakhalin energy reserves was circumscribed when it was forced into ceding its majority ownership in the Sakhalin 2 project to Gazprom and was followed by TNK-BP's forced sale of its majority share of the license to develop the Kovytko gas field (Gazeta.ru, 2007, December 28). Later, the ongoing struggle between British Petroleum and TNK (Tyumen Oil) also signaled the intention of the state to further its control of the oil industry. Although the major shareholders in TNK (Mikhail Fridman, Viktor Vekselberg and Leonard Blavatnik) are private businessmen, it is seen as likely that they are acting on behalf of the state (Goldman, 2008). Of the major private oil companies, only Lukoil and Surgutneftegaz remained outside state control at the end of 2007.¹⁴¹

Formal state control is less prevalent in the metallurgical sector, but its influence remains strong. By 2006, the Russian metal industry was the country's third largest in terms of output (19 percent of total industrial output) and the second largest exporter after the oil and gas sector (18 per cent of exports) (Comtrade, author's calculations). Over the period 1999 - 2006 the output of ferrous metallurgy increased by 60 percent, that of nonferrous metallurgy by 58 percent. Against a backdrop of rising prices, metal companies made especially high profits which enabled them to expand investment and acquire new assets in Russia and abroad (Petrosyan, 2006).¹⁴² Companies have pursued

¹⁴¹ The details surrounding the state acquisition of private assets is catalogued in much greater detail in OECD (2006, pp.33-34).

¹⁴² These acquisitions were, however, funded by capital raised on markets abroad. This is reflected in the increase of private debt to the extent that it now dwarfs public debt; see Hanson (2007b, p.871). Because many of these organizations are state-controlled (e.g. Gazprom and Rosneft), the effective level of state debt is probably much greater than official statistics indicate.

vertical integration by taking over suppliers of iron ore and coking coal as well as steel mills, thereby gaining control over raw material costs and smoothing out fluctuations in their income streams. This, however, has resulted in the metallurgical industry becoming more concentrated in those areas that were not already monopolies. In 2006, for example, Rusal merged with SUAL to form a monopoly in an already concentrated aluminium industry (Vedomosti, 2006, October 30). Indeed, throughout 2007, Rusal was attempting to further its control of the Russian metal sector through the hostile acquisition of Norilsk Nickel (Kommersant, 2007, December 21). Activity in this sector has increasingly taken place under the shadow of the state. Pro-Kremlin industrialists, such as Oleg Deripaska (the owner of Rusal), have been favoured in their commercial endeavours over those who are not as close, such as the once influential Vladimir Potanin, owner of Norilsk Nickel, the subject of Rusal's advances (Vedomosti, 2008, April 7).

In 2000, the Rosoboronexport State Corporation was created to take over the activities of the Rosvooruzhenie State Corporation and the smaller Promexport Federal State Unitary Enterprise (rosoboronexport.ru). This, in effect, simply reinforced a pre-existing monopoly in arms production. The value of arms exports increased considerably between 2001 and 2007 with average annual sales reaching \$5.6 billion (current US dollars; SIPRI, 2009). What is perhaps most notable about the behaviour of Rosoboronexport is its acquisitions of other sections of the economy that are unrelated to armaments exports. It has increased its stake in the country's diamond monopoly, Alrosa, acquired a 62 per cent stake in AvtoVAZ in October, 2005, and purchased a 41 per cent stake in the titanium monopoly, VSMPO-Avisma in September, 2006. This signalled the move from state control over assets in the natural resource sector towards greater involvement in other 'strategic' sectors.¹⁴³

¹⁴³ The definition of strategic appears quite loose and fluid and seems to suit the mood of elite. For example, after grain prices reached high levels during 2008, the state soon moved to announce its intention to form a State Grain Corporation (Rossikaya Gazeta, 2008, August 16).

Table 6.5 Selected state representation in major business organizations, 2007¹⁴⁴

Name	Relationship with State	Business and Position
Sergei Chemezov	Close Putin Ally	Rosoboronexport (Chairman/CEO); Rostekhnologi (CEO)
Sergei Ivanov	1st Deputy Prime Minister	United Aviation (Chairman)
Viktor Ivanov	Deputy Head of Kremlin Administration	Aeroflot (Chairman of Board); Almaz-Antey (Chairman of Board)
Viktor Kristenko	Minister of Industry and Energy	Transneft (Chairman)
Alexei Kudrin	Minister of Finance	Sberbank (Supervisory Board member); Alrosa (Chairman of Board of Directors)
Igor Levitin	Minister of Transportation	Sheremetyevo Airport (Chairman)
Dmitri Medvedev	1st Deputy Prime Minister	Gazprom (Chairman)
Sergei Naryshkin	Deputy Prime Minister	Rosneft (Vice Chairman)
Segei Prikhodko	Foreign Affairs Advisor to President	Tvel (Vice Chairman)
Igor Sechin	Kremlin Staff	Rosneft (Chairman)
Analtoli Serdyukov	Minister of Defence	Khimprom (Chairman);
Yevgenni Shkolov	Presidential Aide	Transneft (Board of Directors)
Igor Shuvalov	Economic Advisor to President	Russia Railways (Board of Directors); Sovcomflot (Chairman)
Sergei Sobyenin	Chief of Staff to President	Tvel (Chairman)
Vladislav Surkov	Kremlin Staff	Transnefteprodukt (Chairman)
Vladimir Yakunin	Putin Ally	Russia Railways (President)

Source: author's record from various newspaper sources, December 2007.

Since 2005, a number of other state corporations have been formed that have been charged with leading a state-led modernization process.¹⁴⁵ This represents a further

¹⁴⁴ This list includes selected examples of the cross-representation of business and state and is accurate to the end of 2007. Subsequent changes have taken place in individuals' positions in both the state and business.

¹⁴⁵ This process has been underway for several years with several enterprises already formed, either through the amalgamation of existing companies or through the creation of new ones. These comprise, *inter*

example of the state asserting its control over the economy, extending its remit beyond the natural resource sector and into the manufacturing sector. Investing public resources into state corporations also signals the lack of trust that the current regime appears to have in the market mechanism of resource allocation. The representation of the state on the boards of these corporations (see Table 6.5), as well as in the natural resource sector has also increased, and suggests that any institutionalization of the relationship between state and business will be based on state penetration of economic organizations. This fits the trend established by links that the state has established with political parties, business associations and civic associations. Notwithstanding intra-elite competition (as seems to be the case between Gazprom and Rosneft, for instance), this trend within the economy indicates that levels of competition could well decline further.

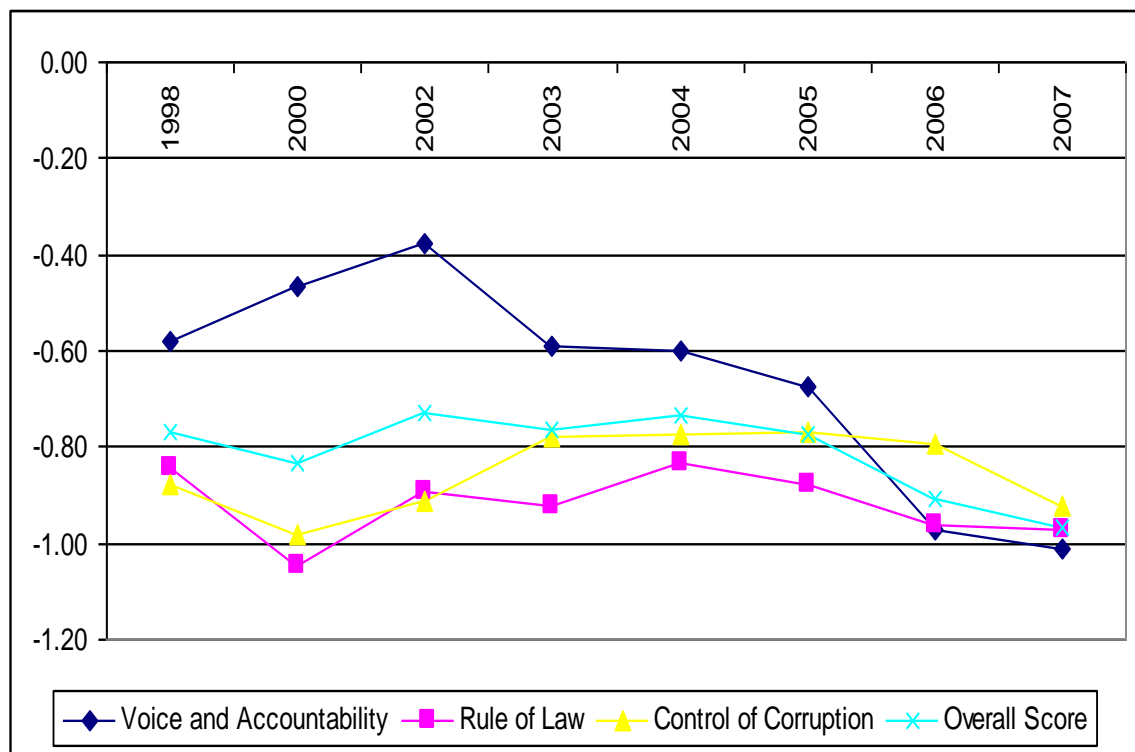
6.8 Social order type in Russia under Putin: a further decline in the level of competition

If the concentration in structure and ownership within the economy in Russia has been a constant feature since independence, the story of social order development in general has shown a similar trajectory. After political power shifted to Vladimir Putin, first as Prime Minister in 1999, and then as President from 2000 to 2008, Russia first saw a brief increase in its scores on the Governance Indicators that are used here to measure social order type before declining steadily ever since. As Figure 6.6 illustrates, immediately after 1998 the score on the Voice and Accountability indicator actually increased until 2002, while the scores for Rule of Law and Control of Corruption stayed roughly constant. Since 2002, the reassertion of the state in the economy and the recentralization of political activity have resulted in a decline on all three components. This supports the

alia, Rostekhnologii (the core of which, Rosoboronexport, encompassess armaments, metals and the car manufacturer VAZ), Rosatom, Rosnanotekh, United Aircraft Company and the United Shipbuilding Company (although the latter two are not legally defined as state corporations). The role of state corporations in the future of the Russian economy is outlined in the Ministry of Economic Development and Trade draft programme for social and economic development to 2020 (the '*Kontseptsiya dolgsrochnogo sotsial'no-ekonomicheskogo razvitiya Rossiiskoi Federatsii*' [www.economy.gov.ru/wps/portal/e-russia]). Although this draft programme does acknowledge the importance of competition, reduced corruption, foreign investment, and institutional development in general, the emphasis is firmly on the development of technologically innovative companies through greater state investment (raising R&D as a proportion of national income threefold in little over a decade) and through the creation of innovative establishments. This programme is assessed in Mau (2008)

basic proposition of this study: that economic competition is essential to guarantee political competition.¹⁴⁶ While the component indicators were quite low to begin with, a minimal level of competition within the economy could be observed in the Yeltsin period. However, as even this small degree of pluralism was eliminated in the leading sectors of the economy after 2002, so the levels of corruption and lawlessness deteriorated further, accompanied, and perhaps caused, by a more severe decline in the Voice and Accountability component. These developments are discussed in more detail below.

Figure 6.7 Components of Social order development in Russia, 1998-2007



Source: Kaufmann, Kraay, and Mastruzzi (2008); author's calculations.

¹⁴⁶ It is worth noting, however, that a reassertion of state control in the economy does not by itself indicate that only low levels of economic and political competition cause states to increase their role within the economy. There are numerous historical instances where states have increased their role within an economy through an open, transparent and politically contested process as seen, for example, in the expansion of the state in many advanced democracies after the Second World War.

6.8.1 Voice and Accountability

The suppression of big business that started with the persecution of Boris Berezovskii and Vladimir Guisinskii in 2000 began the process of shifting power from FIGs to the state, while the regional governors were placed under greater control through Putin's federal reforms of 2000. The reduced influence of these two sources of voice over state policy was considered quite positive, as indicated by the upward trajectory of the VA line on Figure 6.6. Since then, the 'management' by the state of political parties, the media, business associations and some 'civic' associations has limited any other independent sources of voice over state policy. Moreover, the formal or procedural aspects of democracy began to be curtailed after the Beslan terrorist attack in 2004. Federal governors were no longer popularly elected, but were instead appointed by the President. This removed any semblance that Russia was a federal state. The SMD element of parliamentary elections was removed in 2006. As a result, only candidates on party lists were able to obtain a seat in parliament, something that suited the Kremlin as it controlled the most popular political party in Russia. Even those pro-democracy parties such as Union of Right Forces (SPS) and Yabloko were either co-opted into United Russia or effectively excluded from parliament through the introduction of a rule that raised the barrier to entry in the Duma to 7 percent. Consequently, there no longer existed any significant forces that could hold the Russian authorities accountable for their actions. Instead, the state controls all institutions of power within Russia. The encroachment of the state further into the economy reduces the prospects for the emergence of any forces that might exercise a greater voice and hold the state accountable in the future.

6.8.3 Rule of Law

The suppression of independent voices described above, and the concomitant reduction in already low levels of accountability described above had negative implications for the rule of law in Russia. Putin, with his background in law and the security services, has often asserted the importance of establishing a law-based state in

Russia. However, without effective economic and political competition the incentive for state institutions and the population to obey the law has in general has been low and is declining. On the national stage, the law has frequently been used as an instrument of the state, used for political purposes. The state's use of legal instruments, particularly the 2002 Bankruptcy Law, in its own favour has been seen most prominently in its dealings with Berozovskii, Guisinskii, Khordorkhovskii, Yukos more generally, and foreign oil companies, flagrantly disregarding the property rights of even the richest businesses (Barnes, 2007). It has also frequently flouted the key document in Russian law, the constitution. Putin's abolition of the direct election of provincial governors in the aftermath of Beslan, for instance, was in direct contravention of constitutional law (Nemstov and Milov, 2007). Contracts with foreign countries are also changed unilaterally as, for instance, energy is used as a tool of foreign policy (Duncan, 2007; Goldman, 2008; Mankoff, 2009).

The degree to which the law is obeyed at lower levels reflects the general contempt for the law displayed by the authorities (Shevtsova, 2007). This is curious given the fact that members of the security apparatus (*siloviki*) became increasingly prominent within the state apparatus.¹⁴⁷ Initially, this group was balanced by the presence of economic liberals and state administrators. However, as time passed *siloviki* became increasingly influential and populated many of the most important positions within government (see Bacon, Renz and Cooper, 2006). Furthermore, as the state extended its control over the economy, *siloviki* became increasingly active in the management of state controlled enterprises. Despite the formal concentration of immense political power in the authorities, and despite the appointment of *siloviki* in key public positions, the state has found that it has become increasingly impotent in achieving rule compliance among the general population. The absence of economic competition and, in turn, political competition is evidently a key factor in the persistently low incidence of rule compliance.

¹⁴⁷ The presence of the *siloviki* in the Russian government was not new. Putin himself owed his rise to power to the tendency of *sioloviki* to be represented in influential positions within the state. The two prime ministers that preceded Putin, Sergei Stepashin and Yevgeni Primakov, both had intelligence backgrounds, while Boris Yeltsin's once influential bodyguard, Alexander Khorzhakov was also former KGB. Individuals with similar backgrounds were also prominent in the security organizations employed by wealthy businessmen.

6.8.3 Control of Corruption

This decline from an already low starting position in Russia in the respect for law has, quite logically, led to the perpetuation and intensification of corrupt practices throughout the state apparatus. The size of the state apparatus has ballooned since the Soviet period, rising from around 700,000 under Leonid Brezhnev to over 1.5 million in 2007. Indeed, in the Federal Veterinary Inspection Service alone, the number of employees has risen from 116 in 2004 to 20,469 in 2007 (Shevtsova, 2007, p.59). This increase in the size of the state administration has taken place against a background of declining tolerance of public scrutiny and has allowed corruption to penetrate even the highest offices. State officials in prominent positions of economic power (e.g. in executive positions within Gazprom and Rosneft), have been widely implicated in the fraudulent appropriation of vast sums (see Nemtsov and Milov, 2007). Further down the scale, officials from the police to university admission officers are recorded as having frequently engaged in abusing their positions for personal gain. Such is the extent of corruption that Transparency International's corruption ratings place Russia as lower than even Togo, Gambia and Angola (Transparency International, 2007). According to a spokesperson from the INDEM foundation in Moscow, the absence of countervailing forces in Russia that are capable of holding state officials to account is central to this increase in corrupt behaviour (from interviews). The more economic resources are concentrated in the state, the lower the probability of a reversal of these insidious tendencies.

6.8.4 Conclusion: social order regression under Putin

To reiterate, developments under Putin, who was replaced as President by Dmitri Medvedev in 2008, saw a clear intensification of the traditional (inherited) patterns of state co-ordination and control of the leading sectors of the economy, particularly in the commodity export sectors. While dominance in the state-business nexus has shifted towards the state as increased growth and tax revenues empowered its fiscal capacity, the absence of any significant diversification of the economic base has ensured that the

concentration of ownership and mutual dependence of state and business remains the same. In essence, the Russian state remains fundamentally dependent on the revenue that it receives from the leading sectors of the economy. With commodity prices high, the incentive to engage in serious attempts at encouraging diversification is again, like the Soviet Union before it, low. The incentive system inherent to such a concentrated array of ownership in the economy encouraged Putin to rely on direct control and management of the economy rather than contract, regulation and taxation. These incentives were probably all the greater precisely because, whatever its other weaknesses in terms of its institutional capacity, the Russian state continued to possess considerable coercive capacities, capacities that are arguably out of all proportion to any of its other capabilities (from interviews). This assertion of state control, and the ambiguity that it confers on existing property rights, might also slow the spontaneous diversification of the economy ‘from below’ as the development of smaller enterprises may be impeded by the perceived fragility of property rights (from interviews; Gavrilentov, 2006).¹⁴⁸

6.9 Conclusion

This chapter has traced the relationship between economic structure and political development in Russia since 1991. Specifically, it has examined the structure and ownership of leading export sectors that have, over time, ebbed between private and state ownership. It has been argued that the concentration of economic resources in the hands of the state and, at times, powerful FIGs has interacted with an inherited institutional structure that has concentrated formal power in the hands of the executive to produce a limited-access order in Russia. During this time, the strength of the state relative to domestic organizations has been closely correlated with commodity prices, particularly oil. When prices hit a low point in 1998, the state experienced a crisis. When prices rose under Vladimir Putin, the state became increasingly assertive, extending its ownership over ‘strategic’ areas of the economy and, more importantly, increasing its control over these sectors. The quality of governance in Russia that was low in the 1990s has

¹⁴⁸ According to the World Bank’s *Ease of Doing Business Report* (2007), Russia was ranked 96 out of 175 countries worldwide. This was below countries such as Columbia, Ghana and Pakistan. Russia also ranked 15th out of the 19 countries that are examined in this study.

deteriorated since as economic and political competition has declined. The non-state economy is becoming increasingly limited to consumer sectors, leading some to describe Russia as a 'dual-economy' where the state controls the more dynamic, export oriented sectors, while the domestic, consumer facing economy is left to the market (Sutela, 1999). It is this duality that explains the puzzle of how Russia has developed many features of a market economy while remaining an essentially authoritarian system (Aslund, 2007). While the state no longer controls the economy to anything like the degree that it did in the Soviet Union, it controls the main sources of revenue in Russia, enabling it to suppress any potential alternative sources of economic and political power. Moreover, access to these sectors is limited to those involved in state patronage networks, limiting the chances of 'entry' by outsiders. Until the Russian economy experiences significant structural diversification, this situation is unlikely to change.

Whether the planned modernization and diversification of the Russian economy through the channelling of state resources (i.e. natural resource revenues) towards state corporations will be successful remains to be seen. This course of action is fraught with potential pitfalls. Most notably, large ongoing state commitments to financing and developing a more diverse and technologically advanced economy hinge on continued high commodity prices as well as an ability to continue to maintain, if not increase, existing production levels, something that it considered quite unlikely at this point (Hanson, 2007b). The last two crises experienced by Russia have come immediately after oil prices have dropped: in 1986 and in 1998. Without a more diverse economic base to tap for tax revenues, the state will remain dependent on the leading sectors of the economy and the vicissitudes of world commodity prices irrespective of whether these sectors are in state control or not. The experience of many oil rich countries in the 1980s, as well as its own experience under Soviet rule, highlights the dangers to this approach (Gaidar, 2006). As a result, Russia finds itself in a position whereby without a diversification of economic activity, the political system will remain closed and uncompetitive, and economic performance will remain beholden to the serendipity of forces within the international economy. Any crisis in Russia may result in more, not less, state control as the existing regime has succeeded in eliminating any significant

alternative sources of power that can offer a credible alternative to what is currently on offer.

This first case study in the post-socialist era appears to confirm the hypotheses generated in Chapter Two. In terms of the two main first order hypotheses, limited economic competition and a vulnerability to fluctuating commodity prices that are set by international conditions has helped shape a social order that is becoming more limited-access over time. The second order hypotheses also appear to be supported by the evidence in Russia. Limited economic competition has constrained the development of political parties and civil society, resulted in pliant and ineffective business associations, and invited a fusion of the state and the most important parts of the Russian economy. However, it is also possible that negative social order outcomes are over-determined in Russia by a range of equally significant factors. Indeed, the model used throughout this study may be mis-specified with other variables being of greater analytical significance. Three more cases are examined in the subsequent two chapters. If the hypotheses are further supported by the evidence in these chapters, raising the number of observations should permit greater confidence in the conclusions that have been drawn in this chapter. The next chapter examines Belarus and Romania, two cases that have experienced contrasting fortunes in terms of both economic restructuring and social order development.

CHAPTER SEVEN

Belarus and Romania: contrasting cases in structural transformation and social order development

7. Introduction

This chapter compares the relationship between economic structure and political development in two countries from the second cluster of cases identified in Chapter Three (Group B): Belarus and Romania. These cases are selected for comparison primarily because they display the greatest degree of change in the structure of their transnational sectors – the independent variable. Because Belarus has experienced an increasing dependence on natural resource exports, the hypotheses generated in Chapter Two would lead one to expect a decline negative social order development. Conversely, the diversification of the Romanian transnational economy, and the improvement in the technological sophistication of its production profile, would suggest an improvement on the indicators of social order development. Indeed, the two countries have displayed strikingly divergent patterns of integration with the international economy more generally, as well as different trajectories in social order development, and thus represent excellent test cases for the conceptual framework employed in this study.

Because two countries are under examination in this chapter, the level of detail is not as high as in the other case studies. Consequently, only broad trends and patterns are highlighted. However, what this chapter loses in detail is outweighed by its comparative focus; the hypotheses generated in Chapter Two are tested with more rigour by analysing two countries that exhibit opposite tendencies on the independent variable. In short, increasing the number of observations that are given greater attention increases the strength of the overall conclusions drawn at the end of this study. As will be illustrated, Belarus has resembled Russia in both its record on economic restructuring and social order development, while Romania has, in recent years at least, tended to resemble Estonia, the case that is discussed in the next chapter. In both cases, the experience or

otherwise of economic restructuring has been the crucial variable in explaining social order development.

Belarus has, from a starting point of relatively favourable initial economic conditions - although not as favourable as in Estonia (discussed in the next chapter) - simultaneously displayed an aversion to foreign capital and a rejection of market-oriented economic reform. This has resulted in a significant decline in the technology intensity of its export profile as well as a corresponding failure to develop competitive market structures within its leading export sectors. While output levels have not suffered the same severe decline as many other ex-Soviet republics did in the 1990s, this has largely been facilitated by the provision of cheap energy supplies from its larger neighbour, Russia. This has resulted in Belarus exhibiting many of the same characteristics as countries with large natural resource endowments. As in Russia, the Belarusian state has used revenues from natural resource exports to sustain a model of economic development that has not involved positive structural or institutional transformation of the economy. Rather Belarus has experienced a de-industrialization of its transnational economy, becoming more dependent on natural resource revenues to sustain both its economic model and its structure of political development. The absence of a diverse economic structure and a corresponding dearth of intra-sectoral competition inhibited the development of socio-economically defined actors that are independent of the state. Instead, the concentration of economic power within sectors that are closely linked to the state has stymied the emergence of an open-access order in Belarus. The selective disbursement of economic rents has been used to maintain a regime that is non-transparent, unaccountable and based on the selective application of rules.

By contrast, Romania has, despite an inauspicious beginning, used the anchor of international integration to facilitate both structural and institutional change in the economy, and to help build the foundations of an open-access political order. Progress has not been smooth; interludes of regression in economic policy, and an enduring inability to stamp out a deep-rooted tendency towards corruption, have at times slowed Romania's journey towards the higher levels of governance displayed by its neighbours

in Central and Eastern Europe. Of crucial importance is the role of the EU in shaping the policies of domestic elites within Romania (Vachudova, 2005; Gallagher, 2006; Hanson, 2007a). Pressure from the EU, and the conditions imposed by it for Romania to undertake certain institutional changes, has at times been as important as internal, domestic factors in shaping the actions of Romania's rulers.¹⁴⁹ The capacity for the EU to exert such pressure through the conditionality process is related to the pattern of development of Romania's transnational economy. Over the course of the 1990s, the EU became the most important destination for Romanian exports, as well as the primary source of FDI. This gave the EU considerable leverage and enabled it to appeal to domestic constituencies within Romania that were benefiting from closer links with the EU. Moreover, as investment flows increased, so the economy diversified, introducing greater competition into economy. Furthermore, specific exhortations from the EU to make progress in dealing with corruption and improving the quality of the legal system have also played an important role in encouraging social order development in Romania. This process is ongoing and Romania is far from the level of its Western neighbours in social-order development. However, the direction of progress has been positive, even if the speed has been disappointing at times.

The argument contained within this chapter proceeds as follows. The first section identifies the most important economic and political legacies inherited from the socialist period. The second section locates the two countries within the wider international economy, describing the most salient features of the two countries' export profiles since the collapse of socialism. The third section highlights the most important economic developments relating to industrial restructuring in the transnational sector, and patterns of intra-sectoral competition in leading export sectors. In the fourth section, the effects of the contrasting degrees of economic competition within the two economies on the

¹⁴⁹ The main focus of the EU during accession was on ensuring that the single market would work in states that aspired to join. Thus, in general terms, the EU encouraged the general marketization of accession economies so that such states would possess the basic formal institutional framework that would enable economic agents from within those countries to withstand the competitive pressures imposed by the single market. Hence, accession partnership agreements emphasized privatization, financial liberalization and a general reduction in the role of the state in the economy. In tandem with the general encouragement of broad marketization, accession countries were required to adopt the community's *acquis communautaire*, the body of EU law.

capacity of socio-economic organizations to engage in collective action are considered. The fifth section examines basic patterns of social-order development since 1989-91. A final section summarises the main conclusions from within this chapter.

7.1 The socialist legacy

As in the two other post-socialist case studies contained in this study, the era of socialist rule represented a period of dramatic change, bequeathing a number of important economic and political legacies.¹⁵⁰ In both cases, socialist rule facilitated the rapid industrialization of the two countries' economies and, despite many of the attendant negative characteristics associated with planned economies, represented perhaps the most rapid period of modernization in the history of the two countries. By the end of the socialist-era this period of modernization endowed both countries with considerable industrial capacities that left them with the potential to re-engage with the international economy on a competitive basis. However, the common affliction of concentrated intra-sectoral market structures, a dependence on imported fuels, macroeconomic disarray, and essentially elite-led exits from socialist political systems that both facilitated insider-led spontaneous privatization of key industries and also led to a concentration of formal institutional political power with the socialist-era elite, all left both countries with much to do if they were to develop open-access social orders.

7.1.1 Economic legacies

As was often the case under socialist regimes, the socialist period radically changed the structure of the two economies under examination here. Indeed, in both countries there remains a perception that the socialist period had a broadly positive effect on economic development. Prior to the Second World War, Belarus was, despite the increased industrial investment that took place in the first two Soviet five-year plans, a

¹⁵⁰ It is also the case that both countries experienced considerable geographic change in the aftermath of the Second World War. The redrawing of borders after the war resulted in a significant expansion of the Belarusian Soviet Socialist Republic, whereas Romania lost considerable land in the east to the Soviet Union (northern Bucovina to Soviet Ukraine, and Bessarabia to Soviet Moldova), while gaining sections of Transylvania from Hungary (see Vakar, 1956; Shafir, 1985; Marples, 2000; Light, 2006).

largely agrarian economy (Vakar, 1956). By 1940, only 21 percent of Belarus' population lived in cities and towns, compared to a figure of 34 percent in Russia and Ukraine (Ioffe, 2004). Belarus then suffered particularly badly in the war which caused a reduction in the population from 9.2 million in 1940 to only 6.3 million in 1945, and resulting in 80 to 90 percent of buildings being destroyed (Ioffe, 2008, p.106). Unfortunate as this was, the post-war reconstruction process facilitated a massive expansion of industrial capacity within Belarus. From the 1950s onwards, Belarus emerged as one of the major Soviet manufacturing regions, specializing in tractors, heavy trucks, oil processing, electronic components and other high-technology industry. A significant factor here was the strong presence of military-industrial (VPK) enterprises (IMF, 1992). Much of the industrial production within Belarus was located within and around Minsk and the eastern part of the country, with western parts remaining largely dependent on agrarian or labour-intensive industries, such as textiles and food processing. However, productivity in both industry and agriculture was higher in Belarus than in most other Soviet republics. Belarus' industry was one of the most technologically advanced regions of the USSR and also had an unusually high share of export-oriented enterprises, with over 80 percent of industrial output exported to other republics or foreign countries (IMF, 1992).

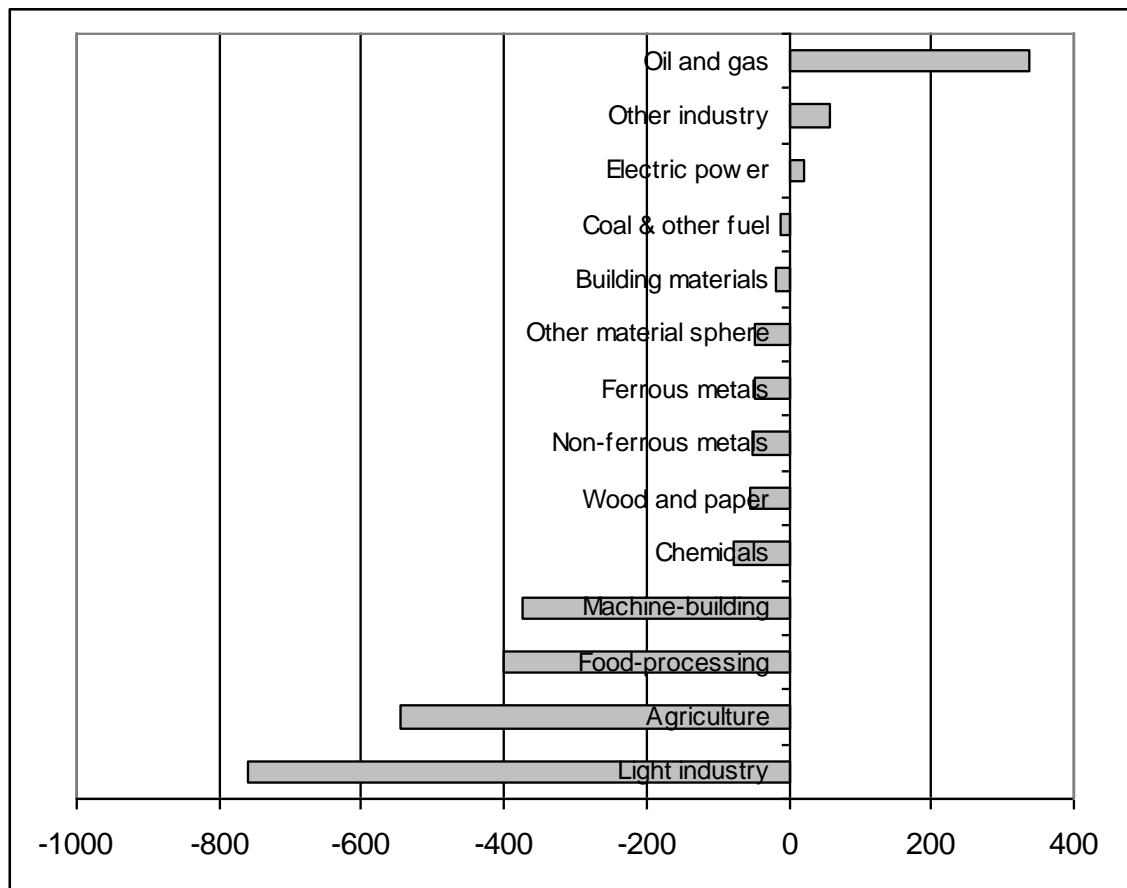
The foreign trade balance of the Belarusian Soviet Socialist Republic in 1988 is contained in Figure 7.1. This gives a picture, albeit imperfect due to the inter-linked Soviet economy, of where Belarus might tend to be competitive upon independence. This reveals that the processing and export of fuels were of particular importance to Belarus. From the 1970s onwards, Belarus became an important and strategic transit route for the expansion of Soviet oil exports to Western Europe as well as a location for considerable refinery capacity (Ioffe, 2008, p.106).¹⁵¹ This would prove to be one of the most important economic legacies of the Soviet period, exerting both positive and negative effects on the development of the Belarusian economy. While the relative diversity and

¹⁵¹ The petrochemical industry is based on two refineries: NAFTAN, based in Novopolotsk, and Mozyr NPZ in Mozyr. NAFTAN remains the largest refinery in Europe, possessing a processing capacity of twenty million tons of crude oil annually. Mozyr NPZ has a capacity of twelve million tons a year. The combined capacity of the two refineries exceeds domestic demand by a factor of three, thus implying an export orientation. No other refinery in Russian and Eastern Europe possesses such a large surplus of refinery capacity after domestic demand is satisfied. Consequently, Belarus was to continue to be a key producer of fuel for export to Europe. See Ioffe (2004, 2008).

technological sophistication of the Belarusian production profile appeared positive, the size of firms across these sectors implied a monopoly position if the planned economy were dismantled. For example, the four main industrial branches, mechanical engineering, petrochemicals, radio-electronics and ferrous metallurgy, were dominated by just ten major industrial enterprises along with a similar number of smaller subsidiaries (Ioffe, 2004). The collapse of the Soviet Union also gave license to well placed insider managers to appropriate significant portions of Belarusian industry once the authority of the centre was irrevocably impaired (Kotz and Weir, 1997; Solnick, 1999). Finally, of considerable significance was the effect of the Chernobyl disaster. Although this did not exert a direct effect on the structure of the economy, its demographic effects were considerable and signified a more general malaise in the capacity of the Belarusian authorities to respond to the needs of the population (Marples, 1996, 1999).

Overall, Belarus' role within the Soviet economy as a relatively efficient producer of high-technology products and energy transit route enabled it to enjoy one of the highest levels of living standards in the USSR, roughly comparable to Russia and Kazakhstan, and behind only the Baltic republics and Georgia (Maddison, 2003, p.110-11). It was, however, also traditionally one of the most conservative republican leaderships within the Soviet Union, leading to the Belarusian party leadership being perhaps the most resistant to the economic and political liberalization that took place under Gorbachev (Marples, 1999). This is discussed further below. For now it is sufficient to note only that Belarus experienced very little in the way of even minimal institutional reform, even during the *perestroika* period. Indeed, the relative success of economic development in Belarus was, and remains, considered by some to be one of the most important factors shaping modern day developments; quite simply, Belarusians associate the Soviet period with stability and development, thus suppressing the urge to engage in radical change, both among the elite and the wider population (Marples, 1999; Ioffe, 2004, 2008).

Figure 7.1 Foreign trade balance of the Belarusian Soviet Socialist Republic (BSSR) by sector, 1988 (million roubles)



Source: Vestnik Statistiki in IMF (1992, p.229).

Like Belarus, the post-war period of rapid industrialization that took place under socialist rule transformed Romania from a relatively backward, essentially agrarian economy, in which around 75 percent of the working population were employed in agriculture at the end of the Second World War (Earle and Sapatoru, 1994, p.89), into a more modern, albeit Soviet-type economy, in which a large proportion of overall investment was directed to more technologically advanced heavy industries, such as steel, chemicals, and refining (Linden, 1986, pp.352-4). This resulted in gross industrial output increasing annually by an average of 10.6 percent in 1950-55, by 9.5 percent in 1955-58, 15.4 percent in 1958-60, and 12.2 percent in 1960-63, one of the highest rates of industrial growth in socialist region (Montias, 1967, p.56; Shafir, 1985, p.107). The post-war Romanian economy was not completely skewed towards heavy industry, either; until

1963, consumer goods and heavy industry contributed in equal measure to total industrial product (Montias, 1967, p.15). If the structure of the Romanian economy was familiar to observers of socialist-type economies, the trade policy that emerged first under the leadership of Gheorghe Gheorghiu-Dej, and was then maintained by Nicolae Ceausescu, was something quite different. As part of wider foreign and domestic policy strategy that sought to achieve at least some autonomy from the Soviet Union, Gheorghiu-Dej encouraged the development of trade relations with a range of countries outside of COMECON.¹⁵² This divergence from standard COMECON practice took place as early as 1958 when trade with Western economies increased by 70 percent between 1958-61, in contrast to growth of trade with the Soviet Union of only 12 percent (Montias, 1967, p.136).¹⁵³ Indeed, the proportion of exports to COMECON countries steadily declined so that by 1980 63 percent of Romanian exports went to non-COMECON countries (Farlow, 1978; Lavigne, 1991, p.17).

After the death of Gheorghiu-Dej in 1965, the same independent trade policy and program of industrialization continued under the new leader, Nicolae Ceausescu, with some success. During the Fifth Five Year Plan (1971-1975), Romanian industrial output increased faster than any other COMECON country and its GNP growth rate was the highest in Europe (Nelson, 1995, p.199). However, these impressive figures masked the reality of a decline in the standard of living for the vast majority of Romanians as the persistently high rate of industrial investment (approximately 35-40 percent of GNP) left increasingly limited resources for the consumer-oriented sectors of the economy (Nelson, 1995). Furthermore, while the emphasis was on acquiring its own industrial base for political reasons, the economic rationale was not quite as clear. Romanian industry

¹⁵² Throughout the 1950s and 1960s, the Romanian leadership viewed COMECON with much suspicion. While the Ministry of Foreign Trade had a strong preference for buying machinery and equipment from countries that would in turn purchase Romania industrial products (known as “reciprocity”), other more industrially advanced countries such as East Germany and Czechoslovakia expressed a preference for trade based on comparative advantage. The program of reciprocity enabled Romania to build its industries at a substantially faster rate than other countries, and also decreased the degree of economic dependence on the Soviet Union (see Montias, 1967). This issue was the focus of economic policy disputes throughout the 1950s and 1960s.

¹⁵³ In this respect Romania was ahead of other Central and Eastern countries that began their switch towards trade with Western European economies some years later. This re-orientation of trading partners in Central and Eastern Europe was discussed in Chapter 4.

tended to produce goods of inferior quality that were not acceptable in the West or, indeed, in more advanced COMECON countries (Roper, 2000, p.53). In some part, this impelled the Romanian leadership to cultivate trade relations with Less Developed Countries (LDCs) that did not require the same quality of goods demanded by its more immediate neighbours (King, 1978). As the 1970s progressed, the domestic industrial policy aimed at increasing self-sufficiency faced severe problems. Internally, the reserves of labour and raw materials, particularly petroleum, were becoming exhausted, problems that also faced other socialist economies as the extensive model of economic development became less effective (Berend, 1996). Abroad, the oil shocks that followed 1973 had the dual effect of increasing the price of Romanian fuel imports while the oil shock-induced recession in Western economies reduced demand for Romanian exports (Cojanu, 1994). Consequently, Romania developed persistent trade deficits in both hard currency and roubles that forced it to borrow heavily from abroad to finance its balance of payments deficits. The stock of external debt expanded rapidly, leading Ceausescu to announce that the government would repay all outstanding external debt ahead of schedule, a feat that was achieved in 1989 (Ben-Ner and Montias, 1991, pp.164-65).

The debt payment plan marked the end of Romania's industrial policy that had been pursued since Gheorghiu-Dej's leadership after the Second World War. Whereas the 1980s saw most other socialist states pursue variations of the decentralization and liberalization of the planned economies, the opposite was true of Romania.¹⁵⁴ Control over the economy was tightened, imports of foreign goods, most notably higher-technology goods, were cut dramatically, and living standards quickly dropped (OECD, 1993, pp.11-13). Consequently, resources available for investment were drastically curtailed, while the return to what capital that was invested declined from 1.51 leu of value-added for each leu invested between 1976-1980 to a mere 0.21 lei in 1986-90 (Pop, 2006, p.16). The 1980s thus saw a period of deterioration of the industrial base and represented a step backwards in the economic development of Romania.

¹⁵⁴ Attempts at decentralization and reform of the planned mechanism of resource allocation are discussed in Kornai (1992), Berend (1996) and Eichengreen (2007).

Romania was further afflicted by the same distorted production structure that was evident in other socialist economies. It was dominated by large enterprises, with 49 percent of production taking place in firms of 3,000 employees or more (OECD, 1993, p.11). For many products, the industrial structure was often monopolistic or monopsonistic, with trade links between firms organized along closed, vertically integrated production chains (Pilat, 1996). However, while these were serious problems, Romania did possess a diverse export profile, with no obvious leading sector (Table 7.1). While refined fuel exports were the dominant export, they were by this stage in decline as domestic reserves were depleted and access to external supplies was limited by balance of payments pressures. There were also significant exports of medium- to high-technology goods, such as nuclear machinery and railway equipment, as well as evidence of low-technology, labour intensive activities, such as apparel production. Finally, much of this industrial capacity was particularly energy intensive. By 1990 the gross primary energy intensity of Romanian economy was roughly three times the average of OECD economies and even higher than most other Central and Eastern European countries (World Bank, 1994). This would present considerable challenges in the post-socialist period.

Table 7.1 Romanian exports (HS-92 classification), 1988 (percent of total exports)

HS-92 Code	Percent of total exports	Description
27	18%	Mineral fuels, oils, distillation products, etc
84	14%	Nuclear reactors, boilers, machinery, etc
72	9%	Iron and steel
87	9%	Vehicles other than railway, tramway
94	6%	Furniture, lighting, signs, prefabricated buildings
62	5%	Articles of apparel, accessories, not knit or crochet
76	4%	Aluminum and articles thereof
86	3%	Railway, tramway locomotives, rolling stock, equipment
73	3%	Articles of iron or steel
44	3%	Wood and articles of wood, wood charcoal
	27%	Other
Total:	100%	

Source: United Nations Comtrade (2007).

Thus, both countries approached the post-socialist era from a mixed position. On the one hand, both had experienced significant benefits from the post-war industrialization drive, transforming them from agrarian economies to modern, albeit over-industrialized economies. Because of this, both countries had some level of industrial capacity that could help form the basis for reintegration within the international economy based on some relatively productive sectors. Moreover, both economies did not suffer from the same dependence on a few industries that, for example, characterised Russia's integration with the international economy. Belarus' relatively diverse industrial profile (at least by Soviet standards), its intra-USSR specialization in higher-technology activity, and strategic position as a processing and transit route for Russian fuel exports could be seen as a positive legacy, while its conservative economic management of the economy and concentrated market structure of its main industries were perhaps more negative tendencies. Similar features defined the Romanian economy. However, the severe contraction of industrial investment, the extreme energy intensity of Romanian industry, and the recentralization of economic management of the 1980s, would later serve as significant handicaps for economic development.

7.1.2 Political legacies

Both Belarus and Romania were described by Kitschelt *et al* (1999) as countries experiencing forms of *patrimonial communism* in which regimes combined elements of extreme repression, extensive networks of patron-client relations and subtle competition among competing factions (Marple, 1999; Ioffe, 2008; Linz and Stepan, 1996; Gallagher, 2006; Pop, 2006). The distinguishing features of patrimonial socialist systems (vertical chains of dependence, extensive patronage networks, low rational—bureaucratic institutionalization of rules, and repression of opposition groups) made the selection of certain new post-socialist institutional structures more likely than others by forming particular patterns of interests and specific distributions of resources among these interests (Easter, 1997).

Within the context of overall CPSU control, Belarusian politics was dominated by Kiryl Mazurau (1956-1965) and his successor as First Party Secretary of the Belarusian SSR, Pyotr Masherau (1965-1980). Intra-republican elite circulation was quite limited and both leaders vigorously asserted the interests of the Belarusian SSR at the all-Union level while using the fruits of national economic development described above to maintain a high degree of popularity within Belarus (Urban, 1989; Marples, 1999, pp.20-21). Perhaps because of the perception that Soviet rule had exerted broadly positive effects on Belarusian development, the leadership often adopted more doctrinaire and conservative positions than other member of the Soviet elite. This bore some similarities to the situation in Romania where Gheorghiu-Dej and Ceausescu both constructed a regime based on patronage that derived its legitimacy from its nationalist tendencies and economic achievements (Roper, 2000; Gallagher, 2006). However, by the 1980s, this system had atrophied under Ceausescu to become what has been described as a “sultanistic state” in which previously existing patrimonial tendencies became more exaggerated and associated with the ‘sultan’, in this case Ceausescu and his immediate family (Linz and Stepan, 1996). The close connections between rulers and economy that form the basis of patrimonial regimes, along with the repression of any other form of independent political activity, ensured that the exit from socialism was, in both cases, an essentially elite-led process in which popular forces played a role that was limited both in scope and duration, despite the decapitation of the most important political actors from the socialist period.

In Belarus, the events that led up to the Belavezha settlement that formally ended the Soviet Union and created an independent Belarusian state were orchestrated by members of the existing party elite with little reference to the views of the Belarusian Popular Front (BPF). This contrasted with, for example, Estonia and even Russia, where opposition forces located outside the party-elite were much more prominent and were able to co-operate with reformist elements from within the party-elite. Indeed, while the BPF did enjoy some support (around 25 percent of the population), it failed to present itself as a viable alternative to the existing elite and had little impact on, for example, institutional design in the late-Soviet-early independence period (Marples, 1999; Ioffe,

2008). Instead, key decisions on both political and economic matters continued to be made by Vyachaslau Kebich, chairman of the Council of Ministers, and Stanislau Shushkevich, the speaker in the Soviet-era parliament. As such, there was very little change at the elite level, something that was further facilitated by a rather passive approach to events by the more general population (Marples and Padhol, 2002). This represented a political environment that exhibited very weak signs of competition. Intra-elite disagreements aside (e.g., between Kebich and Shushkevich), the Belarusian political landscape seemed to be dominated by the incumbent party-state elite, with only a marginal role enjoyed the main opposition force.

Broadly speaking, the situation was again quite similar in Romania. While the events surrounding the removal of Nicolae Ceausescu and his family remain contested, the outcome of the revolution was clearer (e.g., Siani Davies, 2005). In short, *communists* rather than the *communist party* exerted the most influence after the collapse of the Ceausescu regime (Gilberg, 1991, p.270). Two factors explain the ease with which the existing elite were able to quickly take control of the trajectory of post-socialist politics. First, the role of the elite in the revolution, while contested, has been painted as pre-meditated, implying that sections of the elite that were disaffected with Ceausescu's rule moved to remove him under the pretence of a popular revolution that in fact enabled them to move swiftly to capture the post-revolutionary political process (Codrescu, 1992; Verdery and Kligman, 1992). Second, evidence supporting this thesis is provided by the extreme weakness of Romanian civil society at this point. Decades of political repression during which Ceausescu's regime was considered one of the most repressive in the socialist bloc severely limited the capacity for groups independent of the state to organize.¹⁵⁵ Thus, the revolution of 1989 was a not a genuinely 'bottom-up', popular uprising. Subsequent events further support the view that the anti-Ceausescu elite was able to 'capture' events at the popular level, if not fully 'script' the revolution to achieve their own ends. The National Salvation Front (FSN), established during the revolution, was quickly appropriated by leading communists under the influence of Ion Iliescu. Over

¹⁵⁵ See Linz and Stepan (1996, p.352) for comparative data on numbers of social movements across the region in the revolutionary period.

the course of 1989-90, Iliescu and the FSN were able to achieve emphatic victories in the initial post-socialist elections and then proceed to engineer a constitutional design that gave more power to the President, Iliescu, than was common in most other Central and Eastern European countries (Fish, 1998; Pop, 2005; Gallagher, 2006). Indeed, while not a formally Presidential system, the fact that the FSN was linked so closely to the President gave the ex-socialist elite a firm grip on political and economic policy in the aftermath of the revolution.

7.1.3 Conclusion

The initial conditions in Belarus and Romania were neither as favourable as those in Estonia, examined in the next chapter, nor as unfavourable as in Russia. Both countries possessed relatively dispersed production profiles, albeit marked by concentrated intra-sectoral production structures, as was common in many other socialist economies. However, the level of technological sophistication in some sectors was high, particularly in Belarus. Romania, by contrast, suffered from the decline in investment over the 1980s that accompanied the period of debt repayment. It was on the political level, perhaps, that both countries inherited more negative features. Like Belarus and Russia, both countries experienced essentially elite-led exits from the socialist period with very little evidence of sustained, broadly based popular participation. This enabled the ex-socialist elite in both countries to capture the political process after the collapse of the respective socialist regimes. Again, while this was certainly a negative tendency, it was not a wholly disappointing period. The leaderships in both countries indicated a commitment to market-based economic reform and democratic political systems, albeit systems that were controlled by, and run for the benefit of, ex-socialist elites. Compared to the other case studies contained within this study, both Belarus and Romania resembled Russia more than Estonia.

In short, only tentative foundations were laid for the development of open-access social orders. But it was equally not apparent at this point that either country would develop into limited-access orders. Instead, the situation seemed evenly poised. However,

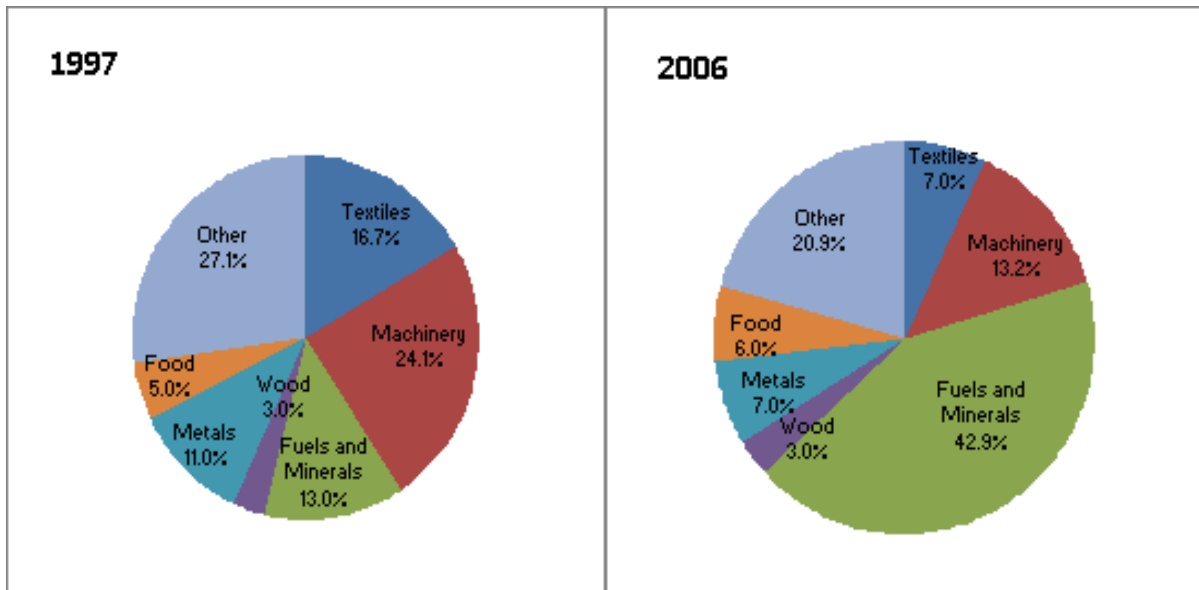
as subsequent events were to illustrate, the two countries would develop along markedly different lines. As will be argued throughout the remainder of this chapter, events relating to the structural transformation of the economy were crucial in explaining the different trajectories of social-order development that were to occur over the next decade and half. These issues are examined in the next section.

7.2 General features of economic structure in Belarus and Romania

7.2.1 Leading sectors and the position of Belarus and Romania in the international economy

The collapse of the Soviet Union and the socialist trading bloc had a profound effect on both countries. Belarus suffered a severe contraction in economic activity shortly after independence that exacerbated the more general decline of the Soviet economy that occurred over the course of the *perestroika* period. The nature of the exit from socialism in which the existing party-elite continued to hold all powerful positions within government led to a general resistance to fundamental economic change (Marples and Padhol, 2002; Zlotnikov, 2002). Although some reforms were undertaken in the early 1990s, they were much more limited than in most other countries of the region (EBRD, 2002). Initial challenges included defence conversion, modernization of existing capacity, and an increasingly dire situation for consumer goods. Trade with former Soviet republics declined dramatically, causing significant disruption to a number of key Belarusian industries, not least the fuel industry which suffered a 43.3 percent decline in output over 1991-2 (Marples, 1999, p.32).

Figure 7.2 Structure of Belarusian exports, 1997 and 2006 (percent of total exports)¹⁵⁶



Source: United Nations, Comtrade Database (2008); author's calculations.

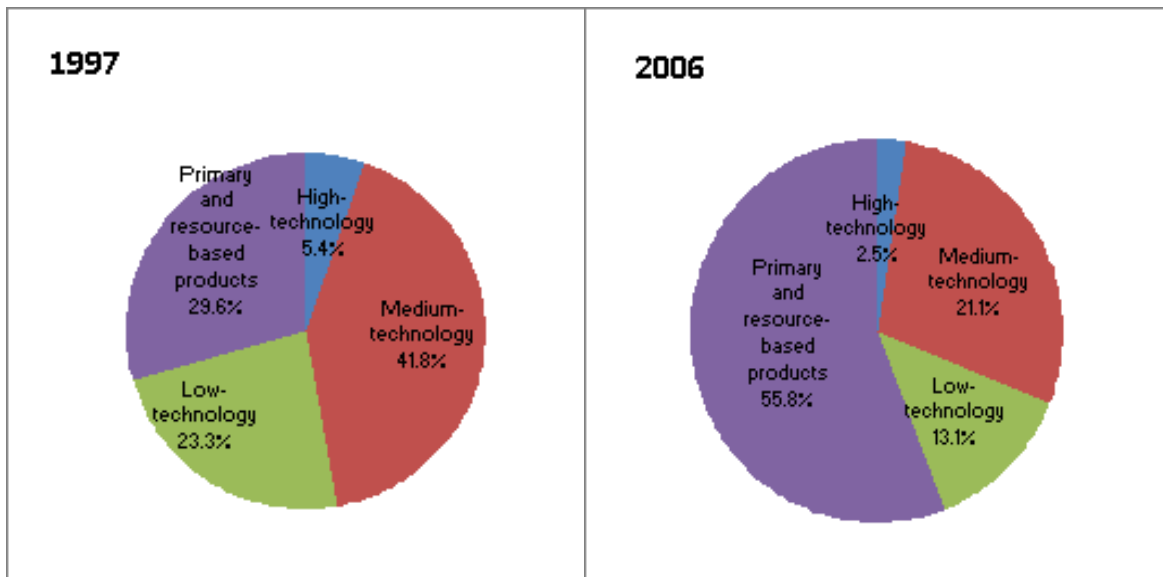
However, by the early 1990s the volume of trade with both Russia and the wider international economy increased, leading a gradual crystallization in the composition of its export profile (Fig.7.2). Despite the reluctance of the Belarusian leadership to engage in substantial economic reform or to re-orient its trading links away from traditional (i.e. Soviet) trading partners, Belarus experienced both an increase in its overall ratio of trade to Gross Domestic Product (GDP) and a switch in the direction of its trade away from the former Soviet Union to European countries.¹⁵⁷ In 1997, the Belarusian export profile was quite diverse; by 2006, however, the processing and export of imported (subsidised) fuels

¹⁵⁶ These charts are based on 2-digit level data (United Nations Comtrade, 2008) that describe product-type rather than technology intensity.

¹⁵⁷ As a proportion of GDP, trade (imports plus exports) increased from 70 percent in 1991 to 123 percent in 2007. Although this is a common feature of small economies, it worth considering that this proportion is comparable to that of much more liberal and openly integrationist economies. For example, in 2006, Estonia's trade turnover was 138 percent of GDP, 109 percent in Latvia, 129 percent in Lithuania, 399 percent in Hong Kong, and 462 percent in Singapore (World Bank Development Indicators, 2008). In this respect, this belies accusations that Belarus is a more closed economy than its neighbours. In terms of the direction of trade, former Soviet republics absorbed 69 percent of Belarusian exports in 1992. By 2006, this had steadily declined to a more modest 44 percent of total exports. This decline was mirrored by an increase in trade with European countries which increased from 24 percent in 1992 to 58 percent in 2006 (IMF Direction of Trade statistics).

from Russia had clearly become the leading Belarusian export activity.¹⁵⁸ Unsurprisingly, this was accompanied by a decline in the technology intensity of exports (Fig 7.3). Indeed, the proportion of low, medium-, and high-technology activities has decreased relative to primary and resource-based products. Perhaps most significantly, the share of machinery exports – one of the more technologically advanced sections of the Soviet economy that contained considerable potential – has almost halved. To be sure, Belarus remained competitive in certain machinery exports, particularly of heavy trucks and tractors, which maintained a prominent share of overall exports, albeit one that has diminished over time. In these areas, Belarusian exporters were successful not only in former Soviet markets, but also in more advanced economies. However, this has been largely overshadowed by the sharp increase in fuel exports. As discussed below, this was as much a political decision by the Belarusian leadership under Alexander Lukashenka (since 1994) as a function of purely economic processes. This had generally negative implications for political development as well as the economy.

Figure 7.3 Technology intensity of Belarusian exports, 1997 and 2006 (percent of total exports)

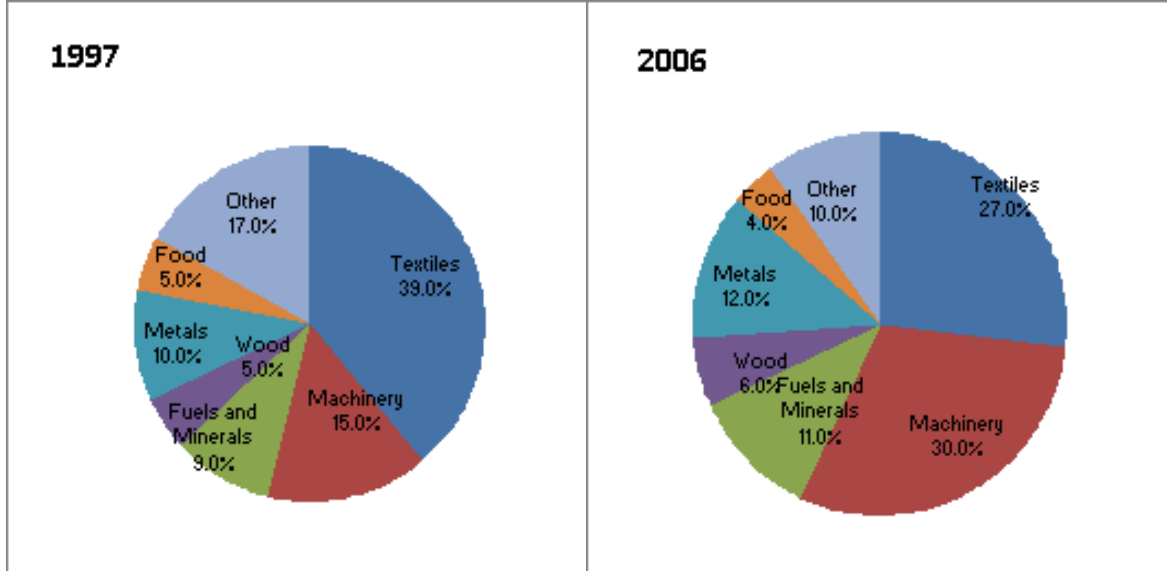


Source: United Nations, Comtrade Database (2008); author’s calculations.

¹⁵⁸ Belarus registered a score of 0.15 on the Krugman Specialization Index in 1997, one of the lowest in the sample. By 2006, this had increased to 0.30.

Romania, like Belarus, experienced slow institutional reform, with market reforms being shallower and taking much longer than in most other countries of Central and Eastern Europe (EBRD, 2002). As in Belarus, the grip of the socialist party-elite on the main levers of power certainly made them more resistant to the implementation of vigorous economic reform. Rather, well-connected individuals embarked on a process of wide-scale appropriation of state property (Pop, 2005; Gallagher, 2006). Initially, the most obvious challenge was familiar to the Romania leadership: how to obtain affordable fuels that could be processed using Romanian refinery capacity at a rate that would: (a) supply the energy intensive domestic industrial structure; and (b) leave a surplus that could be exported for hard currency earnings. Despite these constraints, trade became larger as a proportion of GDP and the already westward-oriented direction of trade intensified.¹⁵⁹ The Romanian export profile has also become more diversified since 1997, registering a score of 0.32 on the KSI in 1997, moving to a lower score of 0.23 in 2006.

Figure 7.4 Structure of Romanian exports, 1997 and 2006 (percent of total exports)¹⁶⁰

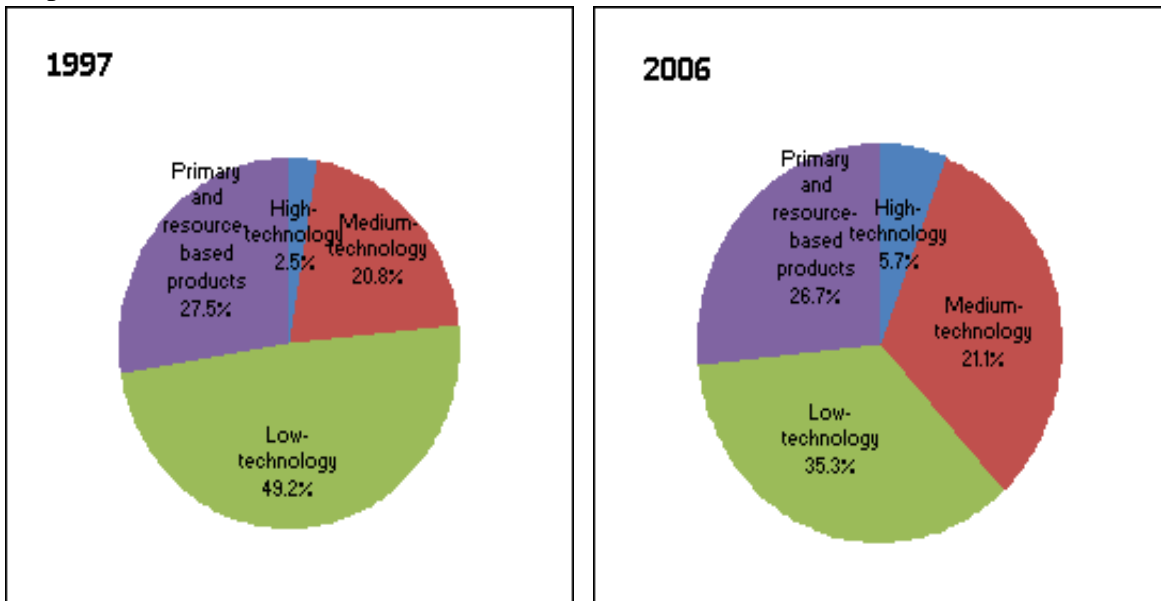


Source: United Nations, Comtrade Database (2008); author's calculations.

¹⁵⁹ As a proportion of GDP, trade (imports plus exports) increased from 42 percent in 1990 to 78 percent in 2006 (World Bank Development Indicators, 2008). In terms of the direction of trade, former Soviet republics accounted for only 21 percent of Romanian exports in 1989, declining to 5 percent in 2006. Trade with European countries continued to increase from a starting point of 52 percent in 1989 to over 92 percent in 2006 (IMF Direction of Trade statistics).

¹⁶⁰ These charts are based on 2-digit level data (United Nations Comtrade, 2008) that describe product-type rather than technology intensity.

Figure 7.5 Technology intensity of Romanian exports, 1997 and 2006 (percent of total exports)



Source: United Nations, Comtrade Database (2008); author's calculations.

However, despite sharing some of the same initial problems as Belarus, such as a dependence on cheap imported fuel, an elite-led exit from their respective socialist regimes, and a general reluctance on the part of leadership to engage in deep economic reform, Romania's pattern of integration with the international economy has gone in the opposite direction. Where Belarus has showed signs of de-industrialization and an increasing dependence on fuel exports, Romania has experienced a diversification in its export profile and an increase in the general level of technological sophistication of its activities. Figure 7.4 shows how low-technology textile exports have gradually been replaced by medium-technology machinery manufacturing as the leading export sector. The share of most other sectors at the two-digit level has remained roughly stable. Medium-technology manufacturing encompasses a range of activities ranging from the manufacture of electrical components and motor vehicles, associated with FDI, to more traditional activities such as iron and steel production (Egresi, 2007). High-technology exports have also doubled as a proportion of overall exports between 1997 and 2006 (Figure 7.5). Possible causes for these two quite different trajectories of industrial development in the two countries' transnational sectors are discussed later on, followed

by an examination of some of the political implications of the divergent patterns of economic development.

7.2.2 Sectoral characteristics

The export profiles of both countries are quite diverse. However, the main trends appear to be de-industrialization of Belarus' transnational economy, particularly of its machinery exporting sectors, and an increasing dependence upon fuel exports, with an increase in machinery exports in Romania and a continued specialization in textile activities. Hence, this section will briefly outline the defining characteristics of these three types of activities.

The oil sector in Belarus displays some important differences between most other oil exporters, most notably the absence of any domestic oil deposits and the reliance on subsidised imports from Russia. Notwithstanding this peculiarity, the Belarusian oil industry continues to display the same core characteristics of other natural resource sectors in the extent to which it is characterised by high levels of capital intensity and economies of scale, as well as by high asset specificity and low levels of production flexibility. Such characteristics tend to result in specialized infrastructure, management and labour, and often raise the barriers to entry for other organizations (Shafer, 1994, p.22-24). The high cost of sector-specific investments in capital, infrastructure and labour also tend to ensure that barriers to exit are also high. As was evident in the case of Russia, as well as a range of other oil-exporting economies, such factors also tend to result in monopolistic or oligopolistic market structures as well as close links with the state.

The importance of Russia as a supplier of subsidised oil adds a further dynamic to this set of sectoral characteristics as the entire Belarusian oil industry is dependent on the actions of an external set of actors, i.e. the Russian state and, to a lesser extent, Russian oil companies. This is added to the more general problem of fluctuating oil prices. As was noted in Chapter Two, dominance by natural sectors can increase the incentive for rent-seeking among elite actors and reduce the incentive for the state to promote the

diversification and restructuring of the economy (Auty, 1990; Chaudhry, 1997; Karl, 1997; Ross, 2001).

Textile industries are traditional Romanian activities that have continued to occupy an important part in the overall export profile. In 1997, it accounted for 39 percent of total exports, although by 2006 this share had diminished to around 27 percent. The textile sector exhibits almost the opposite characteristics to the natural resource sector (Shafer, 1994, pp.106-107). Generally speaking, capital intensity tends to be low with labour tending to account for the bulk of production costs, while the prevalence of small firms also indicates limited economies of scale (Glyn, 2006; Dahlman, 2008). Because of low capital requirements, asset specificity tends to be low and production flexibility tends to be high. As a result, barriers to entry are often low: fixed capital costs are low; economies of scale are unimportant; production is often divisible; skill requirements tend to be low; technology is often standardized and easily available; and infrastructure requirements are unspecialized. Low barriers to entry ensure competitive market structures and relatively low profit margins. Strong competition – both domestically and internationally - ensures that neither firms nor states possess the capacity to control the market; instead, firms can only conform to it. Together, these factors reduce the incentive for textile firms to pressure the state, as well as their capacity to do so.

The third group of export industries discussed covers a range of medium-technology activities. This group comprises a technologically diverse range of manufacturing activities with differing sectoral characteristics. In Belarus and Romania, these tend to include activities that were described in Chapter Three as medium-technology products, encompassing the automotive and engineering subgroups of medium-technology production (MT 1 and MT3), as well as MT2 activities such as iron and steel production. The MT1 and MT3 sectors are of particular importance in this chapter due to the contrasting fortunes of the two countries in developing competitiveness in these areas.

MT1 and MT3 activities, which in 2006 accounted for 25 percent of Romanian exports and 17.2 percent of Belarusian exports, tend to be very linkage-intensive, and require significant inter-firm interaction. The automotive and engineering sectors emphasize product design and development and require a higher standard of human capital. Many have mass assembly or production plants and extensive supplier networks, both domestic and foreign (small and medium enterprises are often important in these sectors). Barriers to entry tend to be higher due to economies of scale and moderate to high capital intensity. Production flexibility and asset specificity are also lower. However, these sectors do not tend to display the same degree of market concentration as natural resource sectors due to the importance of dispersed supplier networks. Thus, levels of competition can vary, and the potential for sectorally organized collective action lies somewhere between primary- and resource-based activities and high-technology activities. In addition, the role of foreign investment and international production networks (IPNs) is particularly prominent in these industries.

MT2 activities, which in 2006 represented 11.4 percent of Belarusian exports and 7.3 percent of Romanian exports, comprise industries that produce chemicals and process basic metals, such as iron and steel. Such process sectors tend to produce stable and undifferentiated goods; they too are often characterized by large economies of scale, and possess relatively high levels of technological sophistication, particularly in the production of higher value-added steel products, chemicals, and plastics. Barriers to entry tend to be larger due to economies of scale and moderate- to high-capital intensity. Production flexibility and asset specificity are also lower. Fierce international competition ensures that firms are often price-takers, while cyclical investment cycles that are contingent on changes in international demand can cause sharp variation in average annual prices. Consequently, the incentive for firms to pressure the state to insulate them from international pressures can be considerable.

7.2.3 Conclusion

This section has identified the contrasting patterns of structural transformation and integration within the international trading system experienced by Belarus and Romania since the collapse of socialism. Perhaps the most important contrast is in the different trajectories taken on by medium-technology industries in the two countries. Whereas Belarus has seen the relative decline of medium-technology activities, particularly in MT1 and MT3 industries, Romania has experienced the largest proportional increase of these industries in their share of overall exports. In Belarus, this decline in manufacturing competitiveness has been mirrored by an increased dependence on the import, processing and export of subsidized Russian oil. These tendencies have been accompanied by a wider diversification of the Romanian transnational sector and an increased concentration in the export profile of Belarus. The general organizational features of the most important sectors were then described, along with several basic implications for the market structure and capacity for collective action that these sectoral syndromes imply.

The contrast in fortunes of the two countries in upgrading and diversifying their export profiles indicates varying success in integration with the international economy more generally. These broad patterns are discussed in the next section. However, at this point it is useful to note that the initial conditions described in the previous section did not appear to weight the dice in favor of any particular direction of structural development: both entered the post-socialist period with similar political dynamics and a broadly comparable array of industries of varying technological intensity. Indeed, the change in fortunes experienced by the two economies did not become significantly apparent until the end of the 1990s. As will argued in the following section, the role of privatization patterns, external influences and divergent patterns of investment – both domestic and foreign - appear to have been the most crucial variables in explaining the different outcomes. This then exerted opposite pressures on the development of the social orders of the two countries.

7.3 Main economic developments and market structure of leading export sectors

7.3.1 Main economic developments in the post-socialist period

The elite-led political transition following the collapse of the socialist regimes in both countries left them governed by political elites that were broadly resistant to fundamental economic reform (Marples, 1999; Zlotnikov, 2002; Roper, 2000; Gallagher, 2006). In this respect, both countries bore more similarities to Russia than Estonia, although it could be argued that even Russia undertook more rapid economic reform than these two countries, at least in the early 1990s. Belarus has occupied an outlying position on indices of economic reform since 1991, leading it to be described as a ‘command economy without central planning’, in view of the persistent dominance of administrative controls over prices, output and foreign trade (Nutti, 2000). While Romania did at least register greater progress than Belarus in the early 1990s, both countries were relative laggards when compared to other countries within the region, particularly those in Central and Eastern Europe (see, e.g., Nutti, 2000; EBRD, 2001). Both countries experienced a protracted burst of inflation as ailing industries in both countries were able to influence each respective political leadership and exact burdensome subsidies that the state was unable to afford through existing revenues. Consequently, the money supply was increased and inflation was the inevitable consequence.

Prolonged bouts of inflation, falling state revenues, and underdeveloped financial systems limited the availability of capital that might have facilitated economic restructuring. This meant that access to foreign capital was essential to effect meaningful restructuring of the two economies. In this respect, both countries performed quite poorly relative to the regional average, at least throughout the 1990s. However, large FDI inflows from 2002 onwards enabled Romania to experience rapid restructuring thereafter. Space constraints do not permit an analysis of all of the important economic developments in both countries. Instead, this section will assess three areas that are of particular importance to this study: privatization; investment patterns; and the role of external actors. Developments in these three areas have exerted a strong influence over

the degree to which competitive tendencies have existed in both economies with important implications for social order development.

7.3.2 Privatization

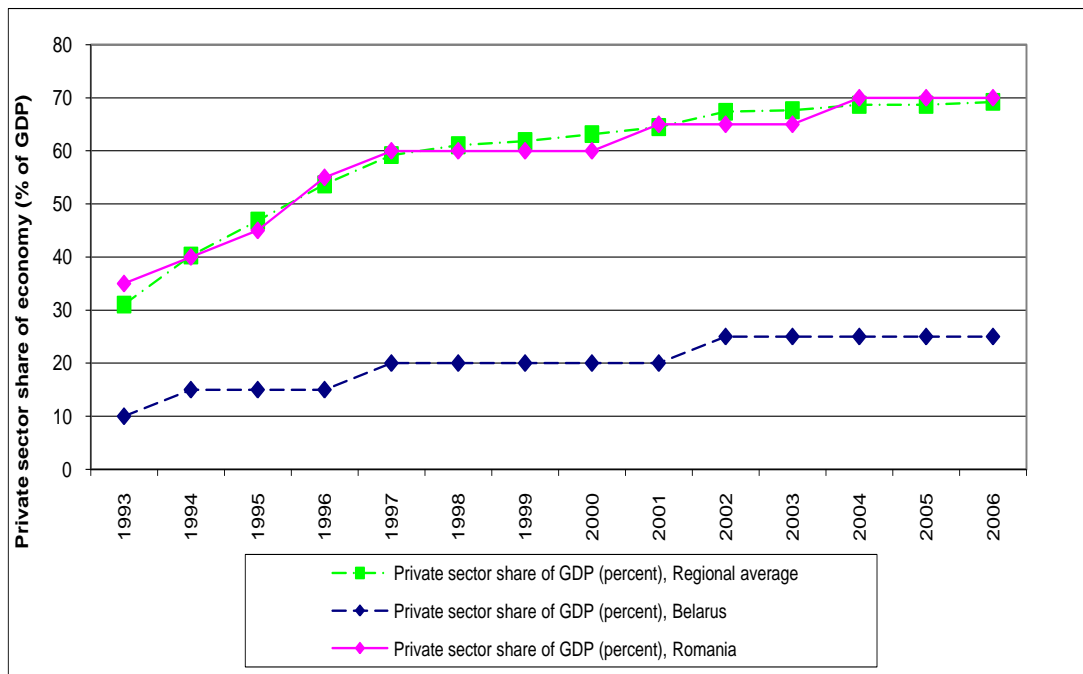
The pace of privatization was slow in Belarus, even before the ascent of Alexander Lukashenka to power in 1994 (Brukoff, 2002; Zlotnikov, 2002). While a number of laws on privatization and the transition to a free-market economy more generally were promulgated in the early 1990s, they remained only paper commitments (Marples, 1999, p.33). The ruling elite were, as indicated previously, generally resistant to radical change, with only the minority opposition, the BPF, in favour of wide-scale privatization of state assets. Between 1991 and 1993, only 308 enterprises were privatized, encompassing just 2.8 percent of the workforce (Mamenok, 1996, p.5). Of this, many were those managed by managers that were close to the political leadership, representing only a mild case of insider-privatization (Zlotnikov, 2002). However, even this slow pace was reversed under Lukashenka, who was elected as President in 1994, who repudiated the market-based reforms that were undertaken in many other countries across the region and maintained heavy state control of the economy, leaving Belarus with a comparatively feeble proportion of private sector economic activity (Figure 7.6).¹⁶¹ This domination of economic activity by the state caused a fusion of economic and political power and represented a situation not too dissimilar from the preceding Soviet period.

Privatization in Romania was considerably deeper than in Belarus, approximating the regional average since 1993 (Figure 7.6). In the immediate aftermath of the revolution, only ‘spontaneous privatization’ took place as well-connected insiders, as well as farmers, appropriated state assets while the state was weak and before it could formulate a consistent privatization program. In many ways, this suited the FSN and the supporters of Iliescu as they were more often than the primary beneficiaries of insider

¹⁶¹ Even where privatization has occurred, it has not improved the efficiency of Belarusian enterprises, due to the fact that the high degree of state ownership that is present elsewhere in the economy has reduced the overall institutional environment in which Belarusian firms operate (see Estrin and Bakanorova, 2007).

deals (Pop, 2005, Ch.3). Furthermore, the state was reluctant to privatize the most profitable enterprises, most notably in the energy and resource-extraction sectors, because of their fundamental importance in state subsidization of less efficient industries as value-added from profitable sectors was transferred to loss-making sectors (Smith, 2006, p.30). Consequently, governments from both ends of the ideological spectrum implemented privatization programs in a slow and fitful manner. After 2000, however, the private sector share in the economy began to accelerate again largely as a result of direct sales of enterprises and financial institutions to foreign owners (IMF, 2006; Smith, 2006).

Figure 7.6 Private sector share of GDP (percent) in Belarus and Romania compared with un-weighted regional average, 1993-2007



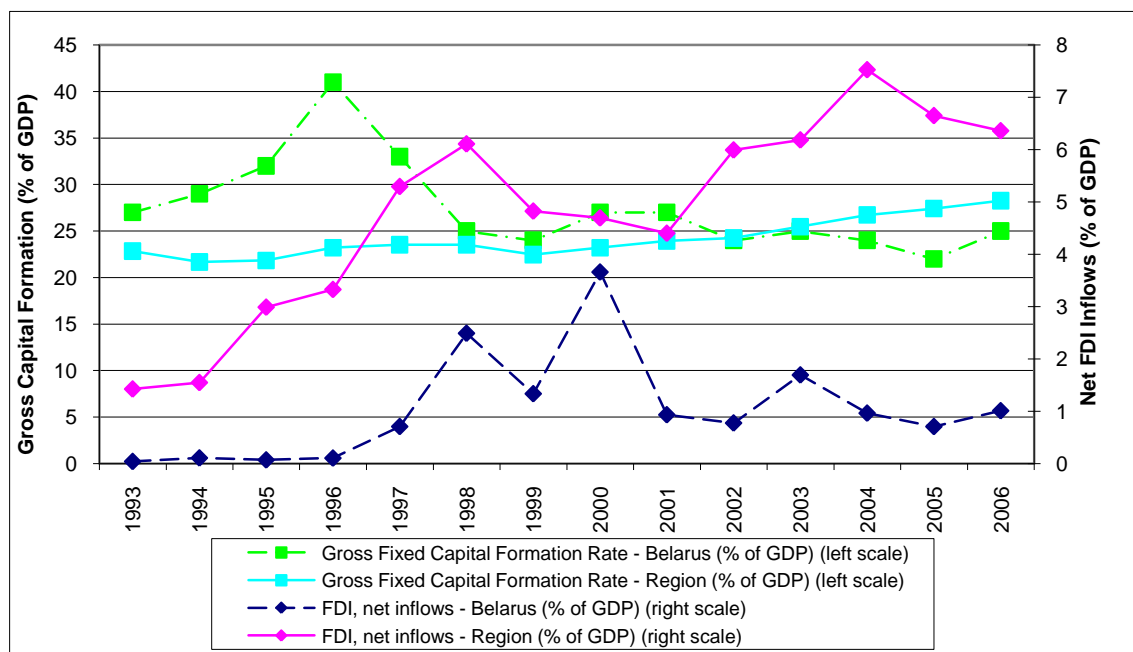
Source: EBRD (2008); author's calculations.

7.3.3 Investment

After initially impressive figures, the slow pace of privatization and its eventual reversal after the mid-1990s caused investment levels to track below the regional average in Belarus (Figure 7.7). This was further exacerbated by some of the lowest levels of net

FDI inflows in the region. The focus on ties with Russia meant that it also shunned FDI to a large degree (Balmaceda, 2002; Brukoff, 2002; Zlotnikov, 2002; Sannikov, 2002). Foreign ownership was met with enthusiasm by neither the state, which controlled most of the economy anyway, nor the general population (Colton, 2002). Consequently, the amount of capital that was available for improving the technological sophistication of the Belarusian economy was much reduced. Moreover, the level of capital formation contained in Figure 7.7 disguises the nature of Belarusian investment over this period. The financial system was under-developed and subject to state repression, leading to savings being diverted towards camouflaging state deficits caused by a high degree of subsidy of state-controlled industry (Korosteleva, 2004). Indeed, much of what was invested in the Belarusian economy was focused on sustaining existing state-controlled industry rather on developing new industries. Instead, the Belarusian state came to rely increasingly on revenues derived from existing oil refinery capacity from the Soviet-era and the disbursement of subsidized energy supplies.

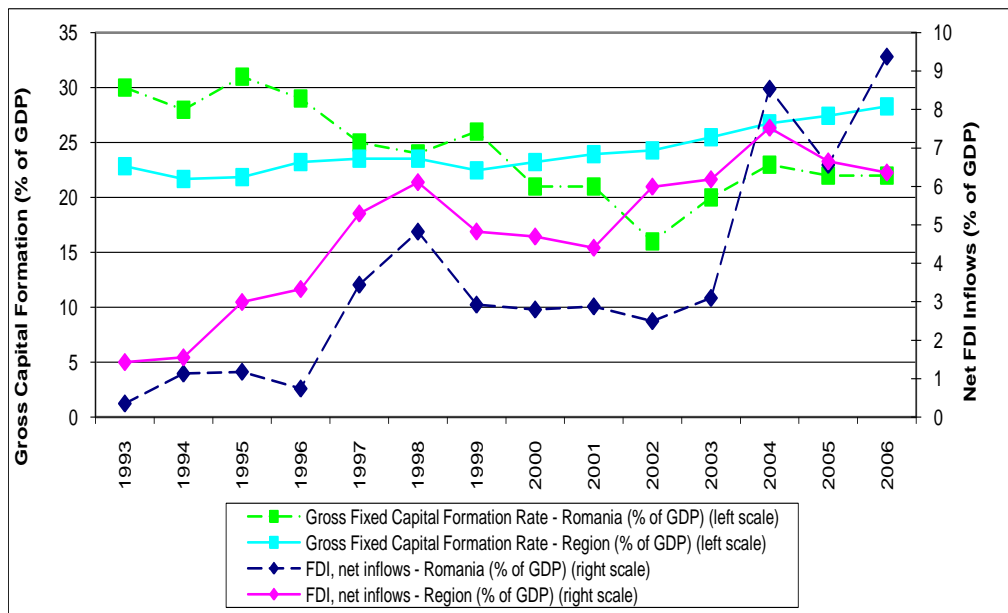
Figure 7.7 Gross capital formation rates (percent of GDP) and annual net inflows of FDI (percent of GDP) in Belarus compared to an un-weighted regional average, 1993 to 2006



Source: Gross capital formation statistics from EBRD (2008); FDI data are taken from UNCTAD (2009); author's calculations.

By contrast, Romania was far more successful in attracting FDI inflows, particularly after 2001-02 (Figure 7.8). Large FDI inflows can be observed in the motor vehicle industry and the electrical components industry (Smith, 2006; Evers, 2007). This helped develop industries that were, prior to these inflows, of minor importance to the Romanian transnational sector. Such inflows compensated for an otherwise low level of domestic investment, a characteristic that was in large part a function of the rent-seeking and corruption that defined much of Romanian political economy in the 1990s (Pop, 2005; Gallagher, 2006). As in Belarus, much of the domestic investment that took place over the course of the 1990s was largely directed towards industries linked to members of the ruling elite (Roper, 2000; Gallagher, 2006). The role of foreign investment was thus of crucial importance in explaining these divergent patterns of investment. In this respect, the roles of external forces in both countries were important and are discussed below.

Figure 7.8 Gross capital formation rates (percent of GDP) and annual net inflows of FDI (percent of GDP) in Romania compared to an unweighted regional average, 1993 to 2006



Source: Gross capital formation statistics from EBRD (2008); FDI data are taken from UNCTAD (2009); author's calculations.

7.3.4 External factors

The role of external factors also separates the two countries. For Belarus, the determination of the political and economic elite to maintain strong ties with Russia has caused it to largely shun the process of integration within EU structures that has taken place in its western neighbours (Balmaceda, 1999; Marples, 1999; Drakohrust and Furman, 2002; Ioffe, 2008).¹⁶² Domestic political choices were of crucial importance here; ignoring the views of the main opposition force in Belarus, the western-oriented BPF, Lukashenka has instead focused on exacting favourable terms of trade, particularly in energy imports, from Russia (Balmaceda, 1999; Lewis, 2002; Korosteleva, Lawson and Marsh, 2005). Specifically, this has involved maintaining cheap oil imports as well as securing market share in the former Soviet space for industrial exports (Nuti, 2004). Russia and other former Soviet countries have proven to be vital export markets for Belarus, acting as ‘un-demanding customers’ for Belarusian manufactures. This is particularly true outside the richest areas of Russia and in other poorer post-Soviet economies where Belarusian goods serve as substitutes for unaffordable imports from other countries. In the 1990s relations were so close that Lukashenka was assertive in his attempts to achieve closer political integration between the two countries, perhaps even a formal union. However, the Russian side was less keen and Lukashenka has since distanced himself from such integrationist tendencies (see Danilovich, 2006). It should be noted that this choice was not without domestic support; opinion polls, as well as election results, indicate that the majority of the Belarusian population have supported this pro-Russian tendency in trade policy (Colton, 2002; Ioffe, 2008).

However, while the Belarusian elite and general population have supported stronger ties with Russia, events within Russia – most notably, the desire to maximize revenues from fuel exports, particularly from regimes that did not pledge fealty to

¹⁶² Belarus has, like Russia, also failed to achieve membership of the World Trade Organization, while Romania achieved WTO membership in 1995. Belarus is, however, a member of the Eurasian Economic Community, a collection of former Soviet states that includes Belarus, Kazakhstan, Russia, Tajikistan and Uzbekistan. Given that these former Soviet republics have traditionally served as markets for Belarusian goods, it is not clear that links with these countries have had a discernibly positive effect on Belarus’ economic development.

Moscow - began to undermine Lukashenka's model of development from 2004 onwards. As the export data presented in this chapter illustrate, Belarus had, by 2006, become increasingly reliant on cheap fuel imports from Russia which were processed and re-exported. Furthermore, while the EU has acted as an agent of transformation in Estonia and Romania, Russia's influence in Belarus has not been as positive, largely leaving domestic politics to run its own course. However, the decision of Russian policy makers to exact better terms for Russia from its trade relations from 2005 undermined this policy of dependence on Russia. Efforts to increase the price of oil sold to Belarus revealed the fragility of the Belarusian development model to that date. Moreover, the lack of investment, particularly in new industries, has left Belarus in a precarious position.

By contrast, Romania did look to the West and the EU in particular (Phinnemore, 2006). Over the course of the 1990s, two trends were apparent in Romanian attitudes towards the prospect of integration with EU structures. On the one hand, the elite surrounding the President and his parliamentary supporters from the successor parties to the FSN spent the early period of the 1990s denying the right of the EU to intervene in Romania's affairs. Content with promoting 'original democracy' in Romania (i.e. democracy without political parties), the EU was viewed as an irritant that opposed the actions of the predatory elite that was ruling Romania throughout this period (Gallagher, 2006). On the other hand, however, opinion poll evidence suggests that the general population was well-disposed towards EU integration (Light, 2006, p.22-4). Consequently, as the grip on power of Iliescu and his supporters weakened in the face of internal splits, weak economic performance and a resurgent opposition, Iliescu was forced to perform a *volte face* and campaign on a policy of deeper ties with the EU.

With both the ex-socialist elite and the more Western-inclined opposition promulgating pro-EU policies, the EU was able to act as an agent of real institutional change in Romania, using the prospect of membership and lucrative transfers as an incentive for even the predatory ex-socialist elite to change their behaviour. In this respect, EU pressure caused the Romanian elite to see a change in the broad direction of marketization as a necessary step towards securing the 'carrot' of EU membership; thus,

they were able to maintain some of the specifically Romanian elements of capitalism, while still moving in the direction demanded by the EU (see Pop, 2005; Gallagher, 2006; Hanson, 2007a). As the prospect of membership became stronger so foreign investment increased, causing a sharp restructuring of the Romanian transnational sector. Moreover, the presence of foreign firms and local enterprises linked to these, injected much needed competition into the Romanian economy after a period of stagnation (OECD, 2002).

7.3.5 Market structure of leading export sectors

The divergent patterns of transnational sector diversification and upgrading that have emerged in the two countries since the early 1990s have also resulted in distinct market structures characterising the leading sectors within each respective economy. In Belarus, the state has maintained an overwhelming share in the economy, investment has been directed predominantly at existing state-controlled industries, foreign investment has been severely limited, and the government have strived to sustain close links with the Russian economy, primarily as a means to acquiring cheap energy supplies. This has led to minimal structural and institutional change within the Belarusian economy. The Soviet pattern of industrial concentration remains largely untouched. As was mentioned in section 7.1, the Belarusian fuel processing industry is dominated by two large enterprises, NAFTAN and Mozyr NPZ. This is consistent with the dominant pattern of market structure in energy sectors in most other countries. The fact that both companies are controlled by the state is also perhaps not too surprising.

The market structure of other leading Belarusian transnational industries is also highly concentrated, often in sectors where concentration of production is not usually the case elsewhere. This point is particularly important. As will be shown below, the development of the machinery, automobile and electronic component industry in Romania appeared to facilitate, if not cause, greater intra-sectoral diversification. However, in Belarus this was not the case. MTZ (tractors), MAZ, (trucks), MoAZ (self-propelled scrapers, earth movers), Gomsel'mash (harvesting combines), MZKT (heavy-duty tractor trailers), and BELAZ (heavy mining trucks) all dominate every stage of the

production process in each of their respective sectors (Ioffe, 2008; Smith, 2008). Competition within each of these sectors is nearly non-existent. Moreover, each company is state-controlled. These patterns are repeated elsewhere. For example, the Minsk-based Integral dominates the radio-electronics industry, while Belarusian Metallurgic Plant in Gomel region dominates the steel products industry. In short, the heavy hand of the state and a lack of investment have left Belarus with much of the Soviet-era production structure intact and un-reformed. Moreover, the fact that many of these products are exported to relatively undemanding former Soviet customers has further reduced the incentive for restructuring and modernization of these sectors. The limited role of small- and medium-sized enterprises in Belarus (SMEs) leaves very few sections of the economy characterized by competitive market structures. Indeed, even in the non-state owned sections of the economy, company performance is hindered by the poor institutional environment that is present in Belarus (Estrin and Bakanorova, 2007). As will be discussed in the next section, this has not necessarily caused the political system to become more closed; however, it has reduced the scope for the emergence of any future counterweights to the Belarusian state.

In Romania, on the other hand, diversification of the overall inter-sectoral export profile has been accompanied by an increase in the level of intra-sectoral competition. This is primarily a function of the types of industry that were dominant in the past (e.g., textiles) or have become increasingly important in the aftermath of increased flows of foreign investment (e.g., automobile manufacturing, electronic components). As was described in section 7.2, the labour-intensive textile industry in which Romania has traditionally specialized in exporting (it was the leading sector in 1997; see section 7.2) tends to be fiercely competitive and dominated by large numbers of small firms. This is no different in Romania where over 50 percent of enterprises of domestic origin employ less than 10 members of staff, and only 3 companies employ over 250 (Romania Institute for National Statistics, 2007). This was Romania's second most important sector in 2006.

In the sectors that have emerged in response to increased foreign investment flows since 2000, including automobile production and the manufacture of electrical

components, levels of competition are also high (EBRD, 2002; Smith, 2006; Egresi, 2007). Collectively, the machinery manufacturing sector is now the leading export sector in Romania. Such industries often have a large impact on local economies as they stimulate the growth of a wide range of local enterprises that supply components and services. This is certainly the case in the automotive industry. Here, production plants use a wide array of components and materials, and are linked to an equally wide range of manufacturers, ranging from textiles to plastics to steel (Havas, 2000; Dicken, 2003). Moreover, the dominant just-in-time production model common in the automotive sector requires domestic suppliers to locate close to the main assembly plants, exerting positive multiplier effects on the local economy and stimulating the growth a range of SMEs (Dicken, 2003; Egresi, 2007). Major foreign investors in the Romanian automotive industry include Renault (through Dacia) and Daewoo (through Automobile Craiova). Although the two companies do dominate the automobile assembly industry, their substantial investments in Romania have caused the growth of a large number of SMEs that act as suppliers of services and components (Egresi, 2007), resulting in a high level of intra-sectoral competition. Thus, despite the fact that Romania was slow to embrace structural change in the 1990s, the inflows of foreign investment since 2000 have helped diversify the overall Romanian production profile and introduce higher levels of competition into a number of leading export sectors, as has been the case in other countries from the region that have opened up to outside investment (see, e.g., Drahokoupil, 2008).

7.3.6 Conclusion

Overall, the three contours of economic development in Belarus and Romania described in this section – privatization, investment patterns, and the contrasting role of external actors – all played a crucial role in shaping the economic structure of the two countries. The contrast in these areas between Belarus and Romania largely explain how they have experienced divergent patterns of development in their export profiles (described in section 7.2). This has resulted in little or no structural change in Belarus, while the dominance of the state within the economy has left very limited evidence of

intra-sectoral competition. In contrast, while Romania got off to a slow start in privatization and attracting foreign investment, the positive role of the EU stimulated greater investment after 2000. This has resulted in considerable change in the Romanian export profile, with increasing numbers of medium- and high-technology enterprises replacing more traditional low-technology and resource-based activities. This change in the sectoral composition of Romanian production has also caused an increase in intra-sectoral competition. As the next section argues, the positive structural change observed in Romania exerted a positive influence over social-order development in Romania after 2000. By contrast, the absence of significant structural change in Belarus, and the heavy influence of the state in the economy, have consolidated a limited-access order in Belarus and suppressed the emergence of forces that might act as a counter-weight to the state.

7.4 Capacity for collective action in Belarus and Romania

The stylized facts surrounding structural transformation in the transnational sectors of Belarus and Romania suggest two contrasting trajectories. Belarus has seen an increase in the concentration of significant production within only a few sectors along with a concomitant concentration of intra-sectoral market structures. By contrast, Romania has experienced a greater degree of dispersion in both the overall export profile, and in the level of intra-sectoral competition evident within leading sectors, particularly after the upturn in foreign investment after 2000. According to the hypotheses generated in Chapter Two, the two countries should experience different trajectories of social-order development. In Belarus, the concentration of economic activity within a few sectors, and the low level of intra-sectoral competition caused by a high proportion of state ownership, should lead to a non-transparent, sometimes arbitrary social-order in which a state that has direct control of economic resources is able to formulate and implement policy with little reference to non-state interests. Indeed, non-state agents in the form of civil society, political parties or independent business associations should be expected to exist in only a limited and ineffective form.

In Romania, on the other hand, increased economic competition that is a function of a more diversified production profile should be expected to cause the state to operate with more autonomy from the wider array of socio-economic organizations. Such competition should ensure that business-state relations are more open and transparent, facilitating the development of an open-access social order. As a consequence of greater dispersion of economic activity, groups within civil society, political parties and independent business associations should be more effective in acting as a counter-weight to state activity. The existence of strong, socio-economically defined organizations independent of the state should ensure that Romania has a greater chance of developing into an open-access order. The presence or otherwise of such independent forces and their capacity for collective action are examined in this section. Again, due to constraints on space, only the most salient contours of development along these four intervening variables will be presented.

7.4.1 Business associations

As in most other countries, organizations representing businesses in Belarus and Romania can be classified into two groups: sectorally defined business associations (BAs) that represent the interests of enterprises according to their industry; and broader umbrella organizations that encompass a broader range of industrial interests.

In Belarus, the high proportion of state ownership in the economy, along with the presence of monopolistic or oligopolistic market structures in most of the important transnational (and national) industries, has reduced business associations to a subservient status for much of the time since independence. The prominent role of the state in the economy in general is unsurprisingly translated into state control of business associations. For example, the Belarusian Chamber of Commerce and Industry – a nominally independent organization - is composed of 1,400 enterprises accounting for over 80 percent of industrial production (BCCI, 2008). 90 percent of these enterprises are estimated to be owned directly or controlled indirectly (through joint-stock status) by the state. The ability of the BCCI to act as an independent voice is thus severely

compromised. Moreover, SMEs are cajoled into signing up to broader umbrella organizations, such as the National Federation of Entrepreneurship or regional Unions of Entrepreneurs and Employers, where their actions can be monitored by the Presidential Administration (PA) and the state more generally (IFC, 2006, p.3).

The more diversified economy of Romania, and the higher number of enterprises within sectors, has helped facilitate the emergence of a much broader base of sectorally-organized and umbrella business associations, most of which are not controlled by the state. The largest BA, the Romanian Chamber of Commerce and Industry (CCIR), is like the BCCI in Belarus, a nominally independent organization encompassing over 23,000 enterprises of different sizes and from a broad panoply of industries (CCIR, 2008). The relative importance of different sectors within the BCCI does vary, however. For example, enterprises with close links to the state, or those from sectors characterised by concentrated market structures such as energy and resource extraction, are reputed to be more influential in setting the CCIR agenda than smaller, less powerful enterprises. However, if the degree of pluralism is not quite as high as in Estonia, the CCIR does appear to be a more representative and independent organization than comparable BAs in Belarus and Russia. Moreover, the diversification of the Romanian economy that has continued apace since 2000, and the corresponding increase in levels of competition, should ensure that a broader array of businesses will compete with each other in seeking to shape state policies.

7.4.2 Civil society

During the initial post-socialist period, civil society in both countries was inchoate and weak, with what popular activity there was quickly de-mobilizing after the collapse of the ancien regimes (Nicholson, 2006; Marples, 1999; Ioffe, 2008). To a large degree, this partial and essentially weak level of mobilization helped members of the socialist elite in both cases to capture the transitional political process.

After a period of only limited mobilization in which the BPF was the most prominent organizer of civic activity, independent civil society in Belarus has been effectively suppressed and marginalized by the government. State control of the majority of the economy has reduced the scope for socio-economically defined civic activity to flourish. Quite simply, independent funding of independent movements is severely limited. This process of repression has increased incrementally since Lukashenka's ascension to power in 1994. The arbitrary use of state power has been frequently deployed to prevent the emergence of even limited independent civic activity. For example, in 2005, articles to the criminal code were adopted that criminalized unauthorized social activism. In the run up to the March 2006 presidential election, these provisions began to be applied to nongovernmental organizations (NGOs) that were vocal in opposing the Lukashenka regime (Financial Times, January 27th, 2006). The government harassed legally existing NGOs by demanding retroactive tax payments and evicting them from state-owned premises. Moreover, the state has also attempted to maintain control over the internet in Belarus (OpenNet Initiative, 2007). While this has not been wholly successful, it has resulted in some self-censorship in the media. This repression of civic activity (and of other forms of organized opposition) appears to follow the electoral cycle, with elections bringing increased state repression. Despite this persistent suppression of Belarusian civil society, a number of groups continue their activities. According to the Ministry of Justice, there were 2,247 NGOs, 16 unions of NGOs, and 41 trade unions in Belarus as of March 2006 (Freedom House, 2007). However, many of these are either state-sponsored or deemed to be de-politicized to the point that the regime does not consider them a threat.

After a slow start, Romania, which shared with Belarus a weak and disorganized civil society in the immediate revolutionary period, has experienced an upsurge in the level of independent civic activity (Nicholson, 2006; Gallagher, 2006). In the 1990s, this weakness persisted and appeared to present a serious challenge to the emergence of independent forces that might help counter-act the activities of the ex-socialist elite that were driving the political process during this period. However, according to Freedom House (2007), Romanian civil society started to organize more effectively after 1999 and

was able to become increasingly assertive on an array of issues, ranging from issues relating to parliamentary corruption (e.g., the Romanian Coalition for a Clean Parliament) to raising the issue of crimes committed under the socialist regime. Two factors appear to have been crucial in influencing the development of an increasingly active and assertive civil society in Romania. First, the dispersal of economic activity has enabled groups to form that have access to funding independent of the state or state-linked enterprises (Light, 2006). Second, once EU membership was placed on the agenda, external funding disbursed through the Romanian Civil Society Development Foundation was instrumental in facilitating increased independent civic activity. Moreover, the bipartisan commitment to EU accession that was to prove electorally popular also forced governments of all persuasions to take note of EU concerns regarding the suppression of civil society (Gallagher, 2006; Phinnemore, 2006).

7.4.3 Political parties

The development of political parties in the two countries has also moved in different directions. Again, both countries started from similar starting points; opposition parties formed around the main opposition movements in the revolutionary period – the BPF in Belarus and the FSN in Romania – were either electorally marginalized (the BPF), or captured and manipulated by the ex-socialist elite (the FSN). However, the institutional design chosen in the aftermath of the collapse of socialism was also crucial in laying the foundations for the future emergence of strong political parties independent of the state. In Belarus, the failure to establish post-Soviet institutional arrangements in the immediate period after the collapse of the Soviet Union impeded the emergence of a range of viable and independent political parties (Marples, 1999; 2006). Instead, the Soviet-era institutional distribution of power between the Supreme Soviet (led by Shushkevich) and the Council of Ministers (under the leadership of Kebich) perhaps contributed to the general dissatisfaction of the electorate in 1994 with the existing system, ultimately leading to Lukashenka's emergence as president (Marples, 1999; Marples and Padhol; Ioffe, 2008). This suggests a failure on the part of key politicians during this period to undertake a course of institutional design that would have

encouraged the development of political parties. Instead, political success in the initial independence period was based largely on the personality of key political actors. However, it is also plausible that this failure to generate independent, electorally viable political parties can be explained by the economic legacies inherited from the Soviet system and the failure to institute rapid privatization and economic restructuring. Even before Lukashenka created a system based on super-presidential power, a socio-economically defined base from which opposition forces might have emerged was suppressed by the concentration of economic power in the hands of the state and the associated failure to create a class of independent private property owners. The only party without strong links to the state that has persisted throughout the independence period has been the BPF. However, its appeal is based not on socio-economically defined constituencies, but on an appeal to an independent Belarusian identity that does not appear to be shared by the majority of Belarusian voters (Ioffe, 2008). Consequently, independent political parties have enjoyed only a marginal role in Belarusian politics.

With regards to political party development, the Romanian case is less clear-cut than the Belarusian case. Initially, the ex-socialist elite was able to shape institutional design in its favour (i.e. the selection of a semi-presidential system that initially endowed Iliescu with considerable formal and informal power) and the emergence of viable opposition forces took place slowly, eventually emerging victorious in the 1996 elections (Light, 2006). Indeed, the development of political parties in the 1990s was as much defined by splits within the ex-socialist elite as by the emergence of genuinely independent political forces. Throughout the 1990s, and for much of the time since, political parties in Romania have been stricken by accusations of corruption and a general disregard for the interests of the electorate (Pop, 2005, Gallagher, 2006; Light, 2006).¹⁶³ Moreover, the ex-socialist elite have been able to maintain a grip on power and remain electorally successful (1990-1996 and 2000-2004). Some have argued that this is indicative of a party system that exists only for the benefit of the elite and that is not responsive to the needs of the general population (e.g., Gallagher, 2006).

¹⁶³ This, of course, is true of a number of other countries from the region.

This is, however, perhaps a harsh judgement. While Romanian party politics could be characterised as a battle between the ex-socialist elite and an anti-socialist elite of comparable venality, this fails to appreciate the fact that while the parties have often remained the same (in substance, if not in form, due to the repackaging of different elements of elite parties), the policies have changed significantly over time. First, EU accession proved an issue on which the ex-socialist elite were encouraged by popular sentiment to adapt to electoral pressures, although members of the elite connected to certain economic sectors also saw EU accession in more self-serving terms (Phinnemore, 2006). Second, once the EU accession process and its attendant conditionality were underway, both groups of political parties were forced to adjust their behaviour to external demands. Indeed, the influence of the EU appears to have been crucial in the development of Romanian political parties since the late 1990s; however, this is largely due to the effects that this had upon on Romanian political economy. Once a commitment to accession was accepted by the most important political groups in parliament, the emergence of socio-economically defined organizations that benefited from closer links to the integrationist process helped buttress calls for further integration (Pop, 2005). Such views were then incorporated into the policy agenda of the most prominent political parties. In short, the generation of a more dispersed economic structure facilitated the emergence of a range of interests that in turn helped shape party policies.

7.4.4 Direct links between state and business

Direct links between state and business that are not mediated by representative organizations can be a source of corruption, increasing the incentive for state officials to use their offices for personal gain and for business to ‘capture’ state policy. Indeed, the essence of limited-access orders lies in the limiting of market access and competition by the state in order to ensure that organizations – whether private or public – are able to accrue rents. In Belarus, after an initial case of ‘mild oligarchy’ between 1992-94, in which links between the state and independent businesses were stronger than any point before or after, the Lukashenka regime has limited market access to most important sectors of the economy and has channelled accrued rents directly to the state (Zlotnikov,

2002). This has enabled Lukashenka to transfer wealth from the more profitable sectors (fuels, trucks, etc) to subsidize the wider Belarusian economy, thus maintaining a system that is functionally very close to the Soviet-era planned economy (Nutti, 2000, 2004, 2007b). Thus, state-business relations are strong in Belarus precisely because the state is the business in the majority of cases, a situation even more extreme than observed in the late Putin-era described in the previous chapter.

The situation in Romania has been altogether different. Strong informal (i.e. not mediated by organizations such as business associations that conduct their affairs on a more formal basis) links between business and the ex-socialist elite were developed in the 1990s and continue to exist today (Roper, 2000; Gallagher, 2006, Light, 2006). Thus, in contrast to the Belarusian case, the intertwining of business and power was considered to be more of a case of ‘state capture’, in which well-connected and powerful economic interests exerted a disproportionate influence over state policy, than of domination of business by the state (Roper 2006).¹⁶⁴ In this respect, state-business relations Romania in the 1990s resembled that in Russia during the same period. After 2000, however, the influence of business over the state has waned. Again, the EU accession process has helped here by exerting pressure on the Romanian state to become more transparent in its ties with business, and also through its funding of civic organizations that have exerted pressure ‘from below’ (Nicholson, 2006; Freedom House, 2007). Furthermore, the diversification of the economy has also been of some significance as increased levels of economic competition have forced the state to at least try to reduce its use of differential access to markets and rents.

7.4.5 Conclusion

The emergence of two contrasting economic structures in the two cases under review here appears to have directly shaped the development of organizations that represent and articulate the views of interests outside of the state. This has, in turn,

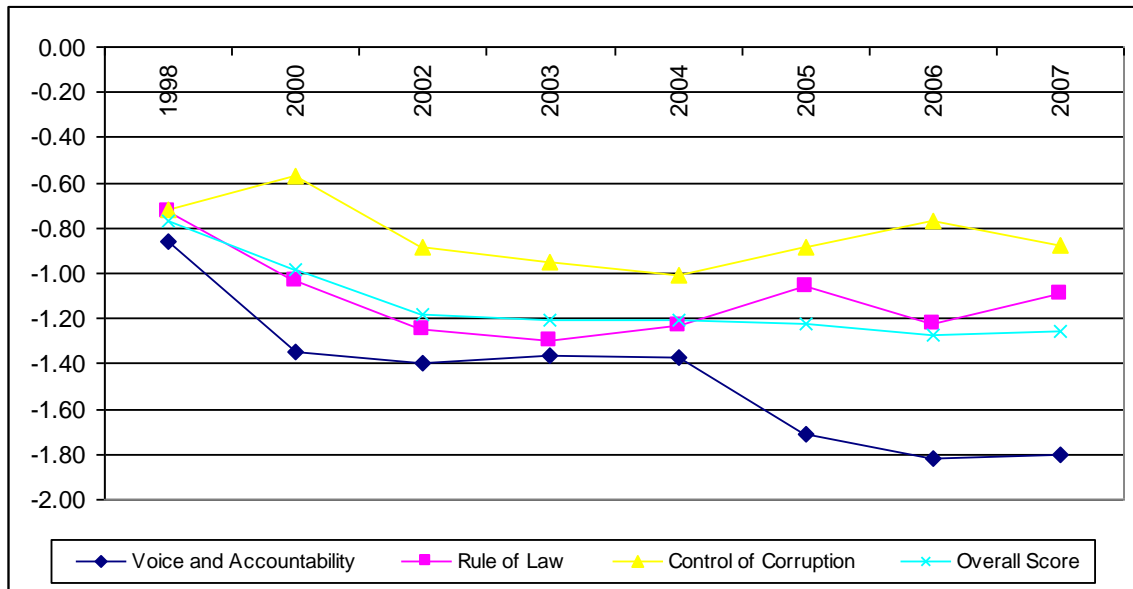
¹⁶⁴ Similar tendencies have been observed elsewhere in the region; see: Hellman (1998); Grzymala-Busse and Jones-Luong (2002); Grzymala-Busse (2002, 2006); O’Dwyer (2004, 2006); Ganev (2005, 2007); Haughton (2008).

caused divergent patterns of state autonomy. In Belarus, a concentrated industrial structure owned and controlled entirely by the state has resulted in extremely limited capacity for collective action among any independent groups. The absence of competitive tendencies in the four areas examined here suggests that social-order development will be largely negative. On the other hand, while economic competition took time to emerge in Romania, when it did, after 2000, it facilitated the emergence of a diverse array of groups independent of the state. The situation in Romania is by no means perfect; the political party system remains fluid as an ever-growing number of parties appear to be represented in each parliament, civil society is perhaps too reliant on external funding, and ties between state and business remain disconcertingly close in some instances. However, the direction of change has been broadly positive, if not the magnitude. As will be argued in the next section, the emergence of an increasing number of organizations on the back of a diversifying industrial structure has affected social-order development in a broadly positive manner.

7.5 Social order types in Belarus and Romania, 1991-2007

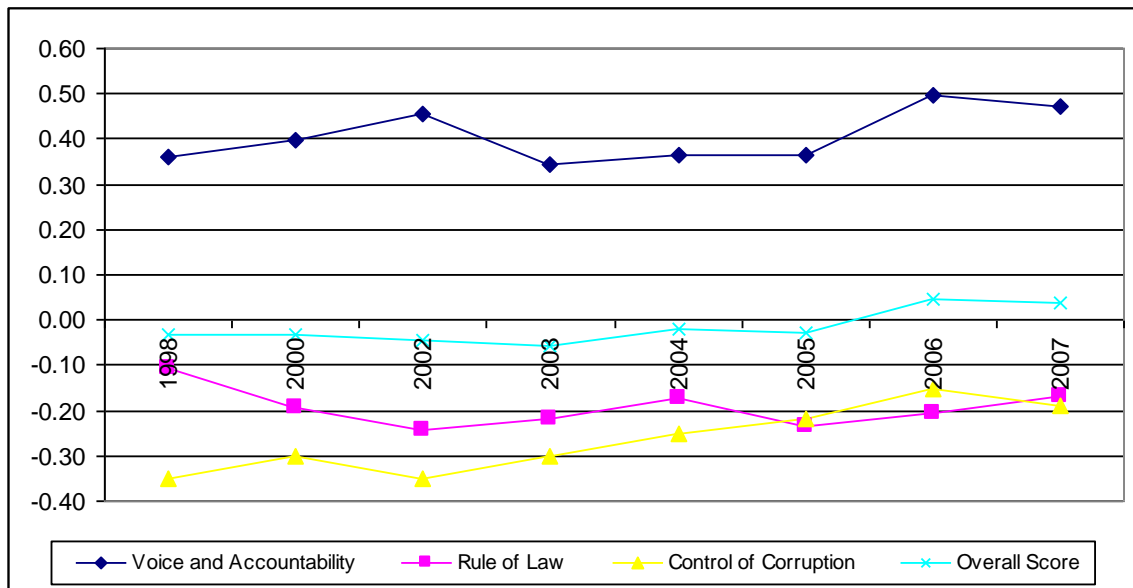
The different trajectories of structural economic transformation, and the effects that these have had on the emergence of independent organizations with the capacity to compete with each other and pressure the state, have resulted in divergent patterns of social-order development. This section highlights the most striking characteristics on the three component indicators of social-order development: voice and accountability; control of corruption; and the rule of law. The data for these indicators are contained in Figures 7.9 and 7.10. Broadly speaking, the overall trajectories of social-order development according to these data are consistent with the hypotheses generated in Chapter Two. Belarus, which has suffered an absence of economic competition and from a dearth of independent groups, has deteriorated on all three indicators since 1998, dragging the average score down with it. Of course, Belarus already had a low score at the starting point from when the data are available. The direction of social-order development in Romania has reflected the diversification of the economy and the increased level of political and economic competition that has occurred since 2000.

Figure 7.9 Components of social order development in Belarus, 1998-2007



Source: Kaufmann, Kray and Mastruzzi (2008); author's calculations

Figure 7.10 Components of social order development in Romania, 1998-2007



Source: Kaufmann, Kray and Mastruzzi (2008); author's calculations.

7.5.1 Voice and Accountability

Belarusian politics experienced some limited positive political change between 1992 and 1994. However, after Lukashenka was elected the first president of the newly independent state in 1994, there has been a gradual deterioration of open-access politics in Belarus. In 1995-6, he extended his own formal powers, and proceeded to stretch even these loose constraints on his considerable powers (Marples, 2007; Nuti, 2007b). This was accompanied by an assault on the powers of the elected parliament, replacing it with an appointed Palace of Representatives and extending his five year tenure to seven. This pattern was repeated again in 2004 when he amended the constitution and extended his powers further. Compounding an already dire situation is the fact that the opposition in Belarus is both divided and unpopular, leaving no credible alternative to Lukashenka (Frear, 2008). The minute proportion of private economic activity in Belarus is surely an important factor here; without independent economic actors, the state has a Soviet-like control over all important aspects of political life. The government in Belarus is now effectively based on unlimited presidential authority. While elections are periodically held, the autocratic power of the state impedes the emergence of organized opposition groups. This has led some observers to describe the Belarusian political system as a ‘demagogical democracy’ and as ‘isolationist authoritarianism’ (Korotseleva, 2003; Wilson, 2007). Whatever the description, Belarus is most certainly a limited-access order, with Lukashenka assuming full control over all important aspects of its politics.

In contrast, Romania started slowly, but gradually increased its progress in developing a system that provided adequate room for the expression of different voices to that of the successor socialist party that initially captured the political process after 1989. Furthermore, as greater political competition has resulted in more voice for different sections of Romanian society, so the state has become more accountable to its citizens. As will be described below, there is still much evidence of corruption and weakness in the rule of law in Romania. However, the turnover of parties during parliamentary elections since 2000 is evidence of a much healthier and more competitive political system (Pop, 2005). Again, while this progress appears modest on the chart above, it does

compare favourably to the situation that characterized Romanian politics in the early- to mid-1990s, when the FSN and its associates and successor groups dominated the political system. This improvement appears to have coincided roughly with the gradual diversification of the Romanian economy that occurred after 1999. Indeed, conflict resolution between the governing coalitions that have ruled in recent years has improved.

7.5.2 Rule of law

The dominance of Lukashenka and his supporters over the economy and political life has resulted in one of the lowest scores for Rule of Law in the region. Without a credible alternative to Lukashenka, the extent to which the state is pressured into obeying legal requirements has remained low. Judges are not considered to be impartial, and the Soviet-era use of psychiatry as a tool of political harassment highlights lack of independence of the legal system. Indeed, at around the time of the 2006 presidential elections, there was an increase in the arbitrary arrests of political opponents, amid allegations of physical and mental abuse of detainees in jail. Opposition figures have found it difficult to defend themselves against the state, particularly in the absence of significant financial support.

Perhaps surprisingly, given the progress that has been made in economic diversification and on the voice and accountability score, the rule of law indicator displays a slight decline in Romania since 1998. This suggests that institutional change – both formal and informal – can take time to develop, with negative practices persisting even when other indicators are improving. Although a very modest improvement can be observed after hitting a low point in 2002, a number of problems within the judicial system prevent the universal application of law in Romania. A particularly important constraint on the development of an independent judicial system is related to the adoption of a Latin American model of a self-governing judiciary. This involved the creation of an independent body – the Superior Council of Magistrates (SCM) - that is elected by magistrates. However, the judicial administration was able to exploit the lack of conflict-of-interest regulations to elect itself as head of the first SCM. This has attracted criticism

from the EU, who argue that a clear distinction must exist between the controller and administrative positions of SCM members. This is indicative of a wider problem that impedes the consistent interpretation and application of the law in Romania. EU pressure has seen a range of formal measures adopted; however, there remains a dissonance between formal and informal practices.

7.5.3 Control of Corruption

Before 2000, control of corruption was considered to be an area where Belarus performed relatively well; its score was low, but did not reflect the low levels of voice and accountability that were present in Belarus. The state was considered by some to be a relatively benign force, providing much needed *porjadok* (order) to a population that was still reeling from the collapse of the Soviet Union (Leshchenko, 2004; Ioffe, 2008). However, even if this assessment were accurate, it is no longer. Since 2000, Belarus has experienced a downward slide in corruption ratings by the independent surveys that make up the Control of Corruption indicator used in this study. The country's highly centralized economy creates ubiquitous opportunities for bribery and abuse by authorities, whereas the government's anticorruption measures have been largely ineffective in tackling the root problems - a lack of transparency and accountability. The prosecution of top government officials on corruption charges is subject to approval by the presidency, which creates possibilities for bargaining in criminal cases or bypassing the legal system altogether. It appears that it is corruption within the state that is the primary problem in Belarus; evidence of corruption in the lives of ordinary citizens does not appear to be as prevalent as in, for example, Russia or Ukraine. Instead, the domination of the Belarusian economy by the state appears to cultivate patterns of 'managed corruption' in which bribery and abuse takes place within the state-controlled economy by the state. This is consistent with the hypotheses that underpin this study; limited economic competition prevents the emergence of political competition, thus reducing transparency and accountability.

Since 1998, control of corruption in Romania has improved, albeit slowly. The existence of close state-business relations that was more prevalent in the 1990s has persisted, although the diversification of the economy, increased foreign investment and more private economic activity have reduced the scope for the abuse of official positions that was a feature of the 1990s. Under pressure from the EU, as well as from domestic organizations, the quantity and quality of nonpartisan investigations into allegations of high-level corruption has steadily increased up to 2007. Since the appointment of Daniel Morar as the anticorruption prosecutor general in 2005, over 1,000 defendants (including 7 MPs, 2 ministers and a deputy minister, several magistrates, and numerous employees in law enforcement agencies) have been charged with corrupt practices, with over 400 convictions secured (up to 2007), leading to praise by the European Commission (EC Report, 2007). Despite this improvement in anticorruption efforts, there remains a widespread use of official positions for private gain, from low level officials in universities to higher ranking state officials. Thus, the effects of increased economic and political competition that have been evident since 2000 do appear to be exerting a slow but positive influence over the control of corruption in Romania.

7.5.4 Conclusion

This section has highlighted some of the most notable tendencies and developments in social order development in Belarus and Romania since the collapse of socialism in 1991 and 1989 respectively. Reflecting their divergent fortunes in economic restructuring, both countries have experienced different types of social order development. Belarus, like Russia, is a limited-access order. The domination of the economy by the state has restricted the scope for the emergence of any groups independent of the state that are able to provide significant political competition. Consequently Belarus scores lowly on the three indicators of social order used in this study: voice and accountability are almost non-existent; the state is not constrained by the law; and corruption is high, particularly within state structures which, given the fusion of state and economy in Belarus, extends to a large portion of Belarusian society.

Romania, on the other hand, has improved on all three indicators since the mid- to late-1990s. Initially, the low level of competition evident within the economy hindered positive political competition. However, as economic restructuring picked up in pace towards the end of the 1990s, greater political competition became evident. This has resulted in slow but steady progress, particularly on the voice and accountability indicator. Progress has, however, been slower on the other two indicators. This might indicate either that the model used to explain social order development in this study is lacking, or that improvements in rule of law and control of corruption lag developments in economic restructuring, particularly where informal institutional practices were relatively deep-rooted, as they were in the socialist and initial post-socialist periods. Again, where the role of the EU in promoting and facilitating economic restructuring has been successful, it remains to be seen whether external pressure might help Romania become more successful in reducing corruption and improving its quality of rule of law. Notwithstanding this qualification, it does appear that levels of economic competition are strongly correlated with social order development in these two cases.

7.6 Conclusion: contrasting trajectories of economic and political development

This chapter has examined the relationship between economic structure and political development in Belarus and Romania in the post-socialist period. The first section highlighted some of the more salient economic and political legacies inherited from the socialist period. It was argued that, in terms of economic structure, both countries possessed advantages and disadvantages at the beginning of the post-socialist era. However, both had experienced an elite-led exit from the socialist era, undermining the prospect for immediate progress in social order development due to the disorganized and essentially insignificant nature of opposition forces in the two countries. The third section highlighted some of the more important economic developments relating to industrial restructuring in the transnational sector, and patterns of intra-sectoral competition in leading export sectors. Here, it was argued that Belarus became increasingly dependent on subsidized Russian fuel imports. Coupled with low levels of investment – both domestic and foreign – this has led to a deterioration in the technological sophistication

of the Belarusian economy. Furthermore, the continued high level of state ownership has kept economic competition in Belarus at a very limited level. By contrast, Romania has, after a slow start, enjoyed more success than Belarus in diversifying its transnational sector. This has resulted in greater economic competition. These positive tendencies only became evident after 2000 once serious steps were made towards EU accession. In this respect, the EU has played an important part in stimulating economic restructuring in Romania due to the increase in FDI flows that accompanied progress in accession negotiations. These FDI inflows compensated for a relatively low rate of domestic investment, although this has also picked up in recent years.

A fourth section described the effects of the contrasting degrees of economic competition within the two economies on the capacity of socio-economic organizations to engage in collective action are considered. In Belarus, the absence of a diverse economic structure and a corresponding dearth of intra-sectoral competition inhibited the development of socio-economically defined actors that are independent of the state. Instead, the concentration of economic power within sectors that are closely linked to the state has stymied the emergence of an open-access order in Belarus. The selective disbursement of economic rents has been used to maintain a regime that is non-transparent, unaccountable and based on the selective application of rules. Furthermore, the continued dependence on Russia to sustain the existing system in Belarus has meant that external pressure to conform to more rigorous standards on corruption and the rule of law has been decidedly absent. In Romania, by contrast, economic restructuring has correlated with greater political competition, something that has occurred alongside more active pressure from the EU in encouraging better standards on corruption and the rule of law in general. Finally, the fifth section examined basic patterns of social-order development since 1989-91, arguing that Belarus has experienced a continued decline along the indicators used in this study, while Romania has shown signs of slow but steady improvement since 2000.

In the context of the theoretical framework elaborated in Chapter Two, both cases appear to confirm the first order hypotheses contained in the conceptual framework. A

decline in economic competition in Belarus was accompanied by a corresponding decline in social order quality. This was facilitated by the dependence on Russian subsidised fuel imports. In contrast, the increase in economic competition in Romania has been accompanied by a steady improvement in social order quality. As in Estonia, wider developments in the international economy – in particular the motivation of MNCs to exploit the opportunities for cost reduction through FDI – helped stimulate levels of competition within the Romanian economy that were previously evident. The two opposing tendencies observed in these two cases were then further reflected in the capacity for collective action evident elsewhere in the two countries. Limited economic competition in Belarus has left the state as the only significant economic and political actor in Belarus with negative consequences for social order development. However, in Romania, increased economic competition since 2000 has helped support the emergence of a broader array of competing forces in both the economy and in political spheres, helping to shape a steady improvement in social order quality. This higher level of economic and political competition was buttressed by external pressure from the EU to make progress along the social order indicators used in this study. Indeed, the importance of the EU suggests that external political influences can be of considerable importance. Thus, the evidence contained within this chapter appears to confirm both the first and second order hypotheses that make up the conceptual framework employed throughout this study.

CHAPTER EIGHT

Estonia: economic diversification and open-access social order development

8. Introduction

This chapter examines the relationship between economic structure and political development in Estonia, a country that represents the third group of countries identified in Chapter Three (Group C). Estonia is an example of a country that has developed a diverse, and in some areas, technologically sophisticated, economy. Because of favourable initial economic and political conditions, and as a result of judicious and autonomously formulated policy choices made early after independence from Soviet rule, economic pluralism and competition have been defining characteristics of Estonian development. Estonia's integration within the wider international economy has been deep (i.e. it displays a high degree of openness to trade) and based on a diverse range of activities, meaning that no single sector dominates Estonia's export profile. This has been complemented by vibrant competition within sectors, thus facilitating the development of an open-access political system that has so far proven to be one of the success stories of post-socialist Europe. Rapid economic restructuring based on deep integration with the international economy, a diversification of the production profile, and market structures characterised by high levels of competition, have all helped cultivate a competitive political system, resulting in a broadly positive trajectory of social order development. Indeed, Estonia's experience – both in terms of its economy and its political development - contrasts sharply with the three other countries that are examined in the other case studies contained in this study.

Unlike many other former Soviet republics, the *perestroika* period did not bequeath a set of generally negative institutional legacies. Indeed, as will be argued throughout this chapter, elements of institutional and economic path dependency weighted the dice heavily in favour of the emergence of a broad array of economic,

political and social forces that would compete openly for political power. In particular, a vibrant independence movement acted as a counterweight to the state, first during the latter years of Soviet rule, and then in the period immediately after the collapse of the Soviet Union. After independence, the vibrancy of opposition, and a general (although not always exclusive) desire to remain independent of Russia, both contrived to propel Estonian policy makers in the direction of rapid integration into European economic and political structures. Estonia's success in doing so was in many ways a function of the autonomous nature of decision-making that has characterised Estonian politics since independence. This autonomy was, in turn, a consequence of the fierce economic competition within the country; in the absence of a single or a few dominant economic sectors, the Estonian government has been able to formulate policy relatively independent of powerful economic forces. This has resulted in policy making that is more technocratic than political due to the autonomy afforded to the Estonian state by the diverse distribution of economic forces within the economy. This economic pluralism, along with robust growth levels, has helped sustain a broad range of groups that are independent of the state, and which compete with each other for influence, resulting in an open-access political order.

The argument contained within this chapter proceeds as follows. The first section locates Estonia within the wider international economy and describes the main features of Estonia's export profile since independence. The second section identifies the most important economic and political legacies inherited from the Soviet period. Of particular importance is the relative diversity of Estonia's production profile under Soviet rule, and the strong desire to forge a destiny independent of Russian influence. The third section considers the main economic developments since independence, and examines the degree of competition that is present within Estonia's most important export sectors. Here, the most salient characteristics are rapid levels of economic growth, a competitive currency, macroeconomic stabilization, an open privatization process, high levels of investment, and a widespread absence of monopolistic or oligopolistic tendencies across sectors. The fourth section examines the effects of economic competition on political competition within Estonia. The diversity and competition of the economy supports formal

institutions that represent a broad cross-section of societal forces, a relatively vibrant civil society, and a ferociously competitive business community. The final section considers how the strong levels of competition between such diverse interests all ensure that competitive tendencies – both economic and political – are channelled in an open and transparent manner. In sum, Estonian society is shown to have benefitted from strong and open economic competition that has, in spite of half a century of Soviet occupation, facilitated the rapid emergence of an open-access political order.

8.1 The socialist legacy

8.1.1 Economic legacies

The period of Soviet occupation that followed first the Molotov-Ribbentrop pact in 1939, and then after Nazi occupation, in 1944, had a profound effect on the structure of the Estonian economy. First, the Second World War caused severe damage to the Estonian economy, both in the loss of human life through death or displacement, and in terms of the loss of material stock. Following the end of the war and the resumption of Soviet occupation, the Stalinist model of forced industrialisation was imposed upon Estonia. The previously dominant agrarian sector suffered as a result of this, although in subsequent years the level of productivity in this sector still outstripped the all-union average (Raun, 2001). Most significantly, Soviet centralised investment in industry rose substantially, leading to an increase in the share of industry in the wider Estonian economy (Misiunas and Taagepera, 1983; see Table 8.1). This served as a mechanism for Russification as large scale industrial development required a significant influx of workers from outside Estonia. Subsequently, Estonian industrial production rose dramatically. As a result of this integration within the Soviet economy, Estonian industry and agriculture were heavily dependent on intra-union deliveries which were administered by the central planning mechanism. As a result, Estonia was, according to Soviet calculations, only a net exporter (i.e. to states outside of the USSR) of three product groups: oil, processed food products, and wood and paper products (Figure 8.1).

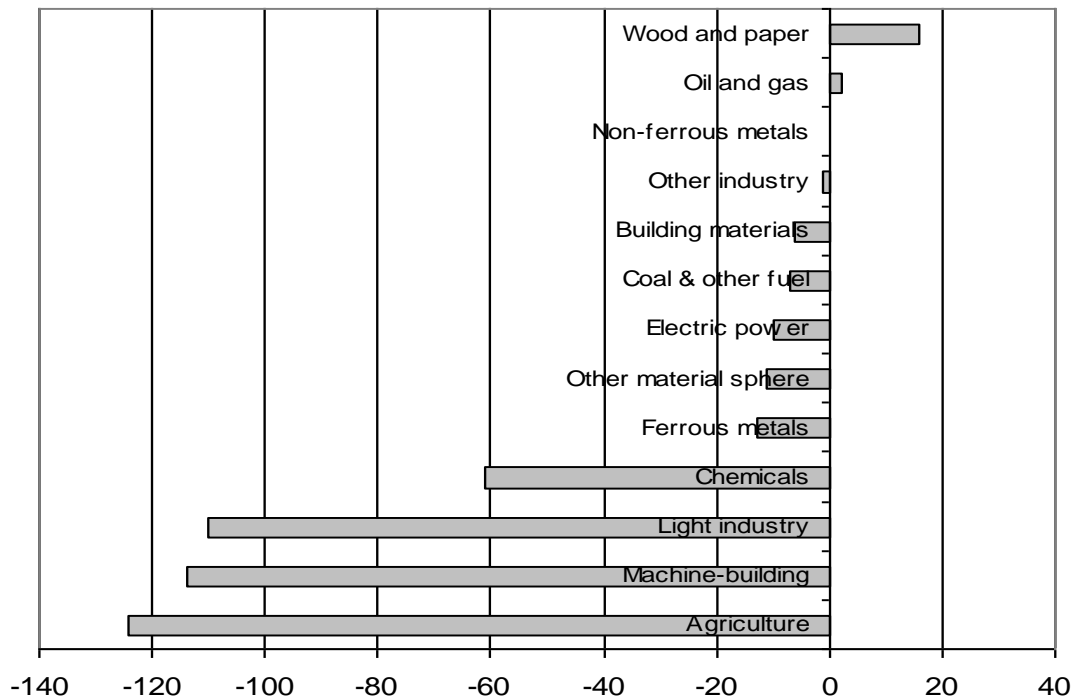
Despite the constraints placed upon the Estonian economy, material living standards in Estonia remained well above the Soviet average; in 1990, the Estonian per capita income (at purchasing power parity) exceeded that of all other Soviet republics (Maddison, 2003, p.110). There were problems, however. The industrial sector represented the largest proportion of the republican economy, and was also the sector that was most strongly integrated into the Soviet planned economy. This model of industrial development produced a large number of effective oligopolies and oligopsonies, resulting in a larger average size of industrial enterprise than would be the case in developed economies, both in terms of employment and production, and also in terms of market share within the Estonian economy. Despite this perversion of the sectoral characteristics of the Estonian economy there were some features of the Estonian economy under Soviet rule that distinguished it from the wider Soviet economy, leading it to retain a relatively high level of diversity both across and within economic sectors.

Table 8.1 The sectoral division of Estonian employment in 1934 and 1989 (percent)

Sector	1934	1989
Industry	18	32
Agriculture and forestry	45	13
Education and culture	12	12
Construction	4	10
Trade	6	9
Transport and communication	3	8
Other	12	16
Total	100	100

Source: Van Arkadie and Karlsson (1992, p.97).

Figure 8.1 Foreign trade balance of the Estonian Soviet Socialist Republic (ESSR) by sector, 1988 (million roubles)



Source: Vestnik Statistiki in IMF (1992, p.229).

The agrarian sector was, by Western standards, characterised by disproportionately large farming units. For example, total production in 1990 was concentrated in only 325 collective and state farms, with each employing an average of 300 persons (Van Arkadie and Karlsson, 1992, p.101). Despite this concentration in agricultural production, the number of private farms was, by the end of the 1980s, much higher than in other republics, with Estonia leading the way in exploiting the opportunities afforded by economic liberalization under Gorbachev. Indeed, by early 1991, over 4000 private farms had been established. Although this was in the context of wider efforts at legalising and promoting private farming (such as the Law on Cooperatives in 1988), this ratio was still high when compared to other republics. It is noteworthy that Estonia had 4119 private farms in 1991 with 143,000 workers in the agricultural sector, representing a ratio of 34.7 workers per farm. In contrast, Latvia had a ratio of 35.1 and Lithuania a ratio of 91.6 (Van Arkadie and Karlsson, 1992, p.290).

Thus, private agricultural activity was relatively high in Estonia, and, as a result, the average size of each farm was smaller than elsewhere within the USSR, therefore dispersing agricultural production.

In industry, traditional activities were complemented by new growth sectors, including electricity generation, machine tools and metallurgy, and chemicals. In addition, existing centres of industry were supplemented by new industrial concentrations based almost entirely on immigrant labour, especially in the oil-shale region in the north-east. Sectors that were important before the war, such as light industry and the food industry, remained important. Table 8.2 summarises the sectoral composition and structure of Estonian industry in 1989. Several observations can be made about the structure of Estonian industry at the end of the Soviet period.

Table 8.2 Estonian industrial structure, 1989

	Share of industrial production (%)	No. of enterprises	Employees (thousands)	Share of employment (%)	Average number of employees per enterprise
Electrical energy	6	10	7.2	3.3	720
Fuel energy	2.6	14	11.3	5.1	807
Chemicals	9.2	17	16.2	7.3	953
Machinery/metalwork	14.4	46	58.2	26.3	1265
Timber, pulp, paper	9.1	48	28	12.7	583
Building, materials	3.6	21	14.3	6.5	681
Light industry	26.4	45	43.3	19.6	962
Food industry	23.9	51	28.2	12.7	553
Others	4.8	28	14.6	6.6	521
All enterprises	100	280	221.3	100.0	779

Source: *Eesti statistika aastaramat* (1990); author's calculations.

First, there was no single sector that overwhelmingly dominated the economy. The food industry and light industry together accounted for around half of Estonian industrial production, but this was supplemented by the machinery/metalwork, chemical and timber related products sectors that together represented nearly a third of production.

Therefore, sectoral concentration was relatively low in Estonia, which was perhaps surprising given that this structure had crystallized in the context of a heavily industrialized Soviet-type economy. Second, the relative efficiency of light industry and the food industry was clear. While the machinery/metalwork sector accounted for over a quarter of industrial employment, it produced only 14.4 per cent of industrial production. In contrast, both light industry and the food industry employed a smaller proportion of workers, but accounted for proportionately more output. Third, the average number of employees in each enterprise was considerably higher in the machinery/metalwork sector than in other sectors. Finally, Estonian industry was characterised by lower levels of all-union enterprises controlled in Moscow than other republics. For example, while in Lithuania and Latvia around 40 per cent of all enterprises were controlled by all-union structures in 1989, this share was only 20 percent in Estonia. This was probably due to the fact that Estonia possessed lower levels of heavy industry than most other republics within the USSR. Indeed, this is reflected in the comparatively small importance of enterprises subordinate to the Soviet Military-Industrial Commission (VPK). For example, while the all-union share of industrial employment in the VPK sector in 1985 was 21.3 percent, it was only 5 percent in Estonia (Van Arkadie and Karlsson, 1992, p.253).

As well as possessing a more dispersed production profile than the other republics of the USSR, Estonia also spearheaded a number of institutional experiments which ultimately served as the model for many of the all-union reforms undertaken later by Gorbachev and his government during *perestroika*. The first reforms took place in the agricultural sector in 1975. Initially they were only organizational, but were gradually extended to a reduction in plan indicators and an increase in the use of self-financing. The next set of reforms was implemented in 1985 and introduced the use of contracts as a substitute to vertical plans and directives. From 1985 onwards, Estonia also pioneered the reform of the hierarchical branch-oriented production structure through a reorganization of light industry. Again, plan indicators were reduced as enterprises and the ministries were given more autonomy and flexibility. However, as the ministry itself constituted a natural monopoly, the reforms were too limited to increase competition. The importance

of these limited reforms should not be exaggerated. However, they did place Estonian firms in a relatively healthy position to take advantage of the changes that would take place during the *perestroika* period and also served to infuse Estonian officials and economists with enough confidence to continue to advance calls for further decentralisation of the Soviet system even after Gorbachev's reforms in 1987-88.¹⁶⁵

Table 8.3 Joint ventures in the Baltic republics, 1990 (thousands of valuta roubles)

	1st January 1990				1 July 1990			
	No. of joint ventures	Exp.	Imp.	Sales (Soviet market)	No. of joint ventures	Exp.	Imp.	Sales (Soviet market)
Estonia	91	3285	7947	4097	105	2861	3967	2748
Latvia	30	1122	4706	1528	47	2884	1234	498
Lithuania	13	989	2204	991	18	541	3057	2627

Source: Van Arkadie and Karlsson, (1992, p.267).

Estonia also led the way in attracting foreign capital to participate in joint ventures, something that was permitted after the introduction of new Soviet joint-venture laws in January 1987. Table 8.3 illustrates the proliferation of Estonian joint venture policies relative to the other two Baltic republics. It is probably safe to assume that the figures for joint ventures were considerably lower in other Soviet republics, so the fact that Estonia greeted the opportunity to set up joint ventures with more alacrity than its Baltic counterparts demonstrates how unique Estonia was in this respect. This success in promoting joint ventures may well have been related to the earlier experiments carried out in Estonia that enabled Estonian officials to cultivate closer foreign economic relations in the late 1980s (Van Arkadie and Karlsson, 1992, p.265). Again, these reforms should not be exaggerated. As was discussed in Chapter Four, other factors such as

¹⁶⁵ The effects of this on Estonian 'exceptionalism' are perhaps illustrated by survey data collected by Soviet authorities in 1990. When asked whether they viewed individual capitalist activity favourably, 30.1 percent of Estonians agreed, while only 21.9 percent of Latvians and 14.8 percent of Lithuanians agreed. The all-union average was just 14.7 percent (Laar, 2002, p.56). Evidentially, the Estonian population appeared more receptive to a more market-based economy. Also, see Norkus (2007) for a discussion of possible cultural explanations for the unusually positive – when compared to other Soviet republics - reception of free-market ideas in Estonia.

geographical proximity, historical links and cultural ties (particularly to Scandinavia) were also likely to have been of some importance, although presumably this would have also applied to Lithuania and Latvia where joint ventures were much less numerous.

Overall, the Estonian economy was, despite occupation and the imposition of the Stalinist economic model, comparatively well equipped to make the transition to a more open economic system. Unlike many other republics, its economy was not beset by the same degree of industrial concentration. Instead, a broader array of economic organizations existed in Estonia than was usual in the USSR, even during the late Soviet period. This would have positive implications for the development of the Estonian state once it was free from Soviet occupation as no single sector would be in a position to direct or obstruct the course of economic and political reform. Furthermore, Estonia was also in the privileged position among Soviet republics of having experienced at least some degree of institutional decentralisation during Soviet rule, thus giving it a slight head start over other Soviet republics.

8.1.2 Political legacies

Kitschelt et al (1999) describe Estonia as experiencing a form of *national consensus socialism* in which a semi-democratic pre-socialist polity existed, with a strong base for political mobilisation, but with weaker prospects for class-based politics. These socialist regimes were said to exist alongside a weak working-class power base with a relatively weak domination of civil society. Such regimes adopted 'national consensus' strategies in which society was co-opted rather than repressed, and in which the regimes permitted moderate levels of contestation and interest articulation alongside strong professional bureaucratic organisations. As was argued in Chapter Four, this is almost certainly an exaggeration in relation to Estonia; the Communist Party was unchallenged in Estonia, until at least 1987, and civil society was extremely limited. Consequently, no groups outside a few politically repressed dissidents existed which the ruling party could co-opt, even if it had been inclined to do so. Furthermore, while traces of Estonian national identity (such as language) were not eradicated entirely, they were certainly

subservient to supra-national (or pro-Russian) ideology of the ruling Communist Party (Hosking, 2000; Smith, 2001; Raun, 2001).

Where Estonia did differ with most other Soviet republics, however, was in their historical experience of both independence and democracy in the inter-war period (Lieven, 1993; Raun, 2001; Uhlin, 2004). This provided the basis for a vigorously assertive independence movement to emerge in response to the gradual liberalization of the political space under Gorbachev (Lieven, 1993; Uhlin, 2004). Indeed, while in Russia and Belarus, the move to independence featured only sporadic participation from popular forces (Fish, 1995; Marples, 1999), in Estonia the move towards independence was characterized as a “profound and broadly based desire for the restoration of political, cultural, and economic self-determination” (Raun, 2001, p.222). Initially, this took the form of environmental movements that were “environmental in form... [but] nationalist in content” (Smith, 2001, p.44). This mobilization of popular forces, such as the Estonian National Independence Party and the Popular Front of Estonia, along nationalist lines quickly became the most important factor in Estonian politics (Misiunas and Taagepera, 1993). As early as 1988, grass-roots mobilization was credited with being at least partially responsible for the removal of the unpopular Karl Vaino as Estonian Communist Party first secretary (Lieven, 1993, p.227). Popular mobilization intensified over the course of *perestroika* and resulted in the emergence of a number of independent political parties.

By the middle of 1990, the Estonian political spectrum had developed an array of political parties representing various different interest groups, ranging from environmental organizations, such as the Estonian Green Party, to groups articulating the interests of socio-economically defined constituencies, such as the Estonian Entrepreneurial Party and the Estonian Rural-Centre Party (Lagerspetz and Vogt, 1998). This diverse and dispersed array of political forces ensured that politics was far more openly contested in Estonia than in all other Soviet republics outside of the Baltic region (Easter, 1997). By 1990-1991, perhaps the only issue on which there was a national consensus was on the need for national independence and for rapid economic reform

(Lumiste, Pefferly and Purju, 2008). Following the failure of the coup in August 1991, the Estonian legislature moved quickly to call for the convocation of a special assembly to draft a new constitution (Taagepera, 1994).

The relative dispersion of economic resources described above, and the open and fiercely contested nature of the political struggle for independence, all moved post-independence Estonian politics along a different trajectory to the cases examined elsewhere in this study. Compared to most other Soviet republics, the ‘pre-privatization’ or ‘spontaneous privatization’ of state assets by well-connected individuals was not as prevalent. While it did occur, it was not as widespread as in, for example, Russia (from interviews). Indeed, even when it did occur, the open and competitive political environment ensured that it was placed under critical public scrutiny and resulted in much popular dissatisfaction, later leading in a popular disillusionment towards the privatization process in general (Frydman *et al.*, 1993, p. 188; Terk, 2000). Along with a relatively dispersed production structure, this tendency to avoid turning a blind eye to the enrichment of the Soviet elite prevented the ‘capture’ of large swathes of Estonian economic resources, further facilitating the maintenance of competitive politics due to the failure of any single group to appropriate a decisive portion of economic resources (from interviews).

Thus, the exit from the Soviet Union, and the emergence of an independent state, saw Estonian politics develop according to principles inimical to those experienced under Soviet rule. A competitive political environment, the failure of the Soviet-era elite to appropriate a large proportion of Estonian assets, and a strong desire on the part of the ethnic Estonian population to avoid the sort of concentration of power that was developing in Russia, all led Estonian politicians to instead look to the parliamentary systems of western Europe as the source of inspiration for institutional design (Ostrow, 2000). Indeed, the Estonian case demonstrates the importance of elite calculations in the context of a dispersion of economic and organizational resources. This dispersion engendered a competitive political environment and paved the way for the emergence of a parliamentary system. Old regime elites were denied access to economic and power

resources, while parliamentary institutional mechanisms were created to prevent the dominance of any single group (Easter, 1997).

8.1.3 Conclusion

In contrast to most other Soviet republics, the relatively favourable initial conditions and dispersed structure of the Estonian economy at the end of the Soviet period, along with higher levels of popular activism, facilitated greater political competition between dispersed elites, higher levels of public scrutiny, and a weaker nexus between business and state than was evident in, for example, Russia and Belarus. This economic and political diversity would ultimately result in greater state autonomy for the Estonian state, leaving politicians and officials to undertake comprehensive reforms in a more technocratic and less overtly political manner. Although some weaknesses were evident at this early stage – in particular the status of ethnic Russians – the nature of the Estonian ‘exit’ from the Soviet Union laid firm foundations for the development of an open-access social order thereafter. The next section identifies the leading export sectors that have tied Estonia to the international economy since independence.

8.2 General features of economic structure in Estonia

8.2.1 Leading sectors and Estonia’s position in the international economy

After the collapse of the Soviet Union and its vast, inter-linked and centrally planned production network, in which exports from Estonia to non-USSR states were very limited, the Estonian economy quickly shifted towards an export-oriented model of growth based on a diverse mix of export products (Lumiste, Pefferly and Purju, 2008).¹⁶⁶ This has involved a shift in both the direction of trade (i.e. in the composition of its

¹⁶⁶ As is common in small, open economies, the trade turnover (imports plus exports) regularly exceeds GDP. In 2006, Estonia’s trade turnover was 138 percent of GDP (Statistical Office of Estonia, 2008), compared with 109 percent in Latvia, 129 percent in Lithuania, 399 percent in Hong Kong, and 462 percent in Singapore (World Bank Development Indicators, 2008).

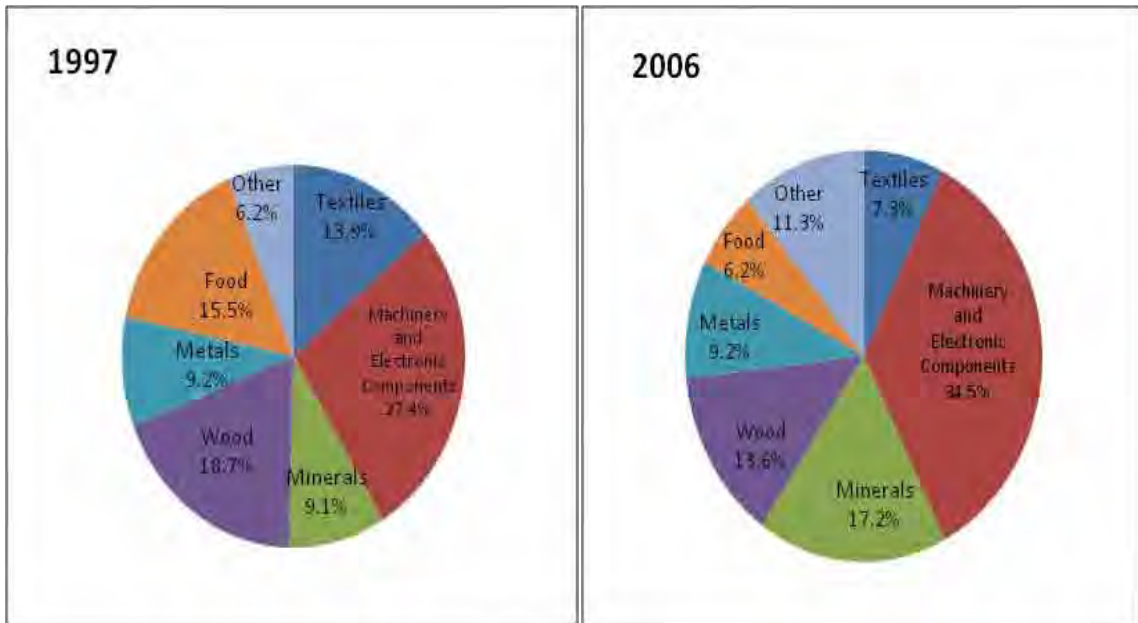
trading partners) and in the product structure of trade (i.e. the types of goods that are imported and exported).¹⁶⁷ As was argued in the previous section, this shift took place against the backdrop of perhaps the most favourable of initial conditions from within the former Soviet Union (FSU). However, notwithstanding these favourable initial conditions, the rapid restructuring of the Estonian economy was impressive in its scope. While traditional industries remained, such as wood and wood products, food processing and textiles, they have declined in relative terms as exports of machinery, electronic components, and mineral fuels have expanded rapidly (Figure 8.2).¹⁶⁸ This has resulted in a diverse export profile where no single sector appears overwhelmingly dominant, although the machinery sector has increased its share of total exports. In addition, the general level of technological sophistication of Estonia's exports is high compared to other countries within the region.¹⁶⁹ However, while the share of capital- and knowledge-intensive industries has increased in Estonian exports, there remain a relatively high proportion of industries that are natural resource- and labour-intensive (Figure 8.3). This absence of an overwhelmingly dominant export sector, and the presence instead of a diverse mix of sectors characterised by a generally high level of technological sophistication, have all contributed to the relatively smooth trajectory of Estonian politics as it has moved from a limited-access order under Soviet rule to an open-access order since independence.

¹⁶⁷ For example, Russia's share of Estonian exports diminished from 17 percent in 1995, to only 6 percent in 2006. By contrast, Finland, Sweden and Germany accounted for 44 percent of Estonia exports in 1995, a share which remained roughly stable with a figure of 43 percent in 2006. The biggest increase came in exports to Latvia and Lithuania which increased from 12 percent of total exports in 1995 to 17 percent in 2006. China also grew in importance as an export market, increasing its share of Estonian exports from next to zero in 1995 to nearly 5 percent in 2006 (Statistical Office of Estonia, 2008).

¹⁶⁸ As will be discussed later, the increase in the share of mineral fuels is based primarily on transit trade, rather than through any increase in domestic production.

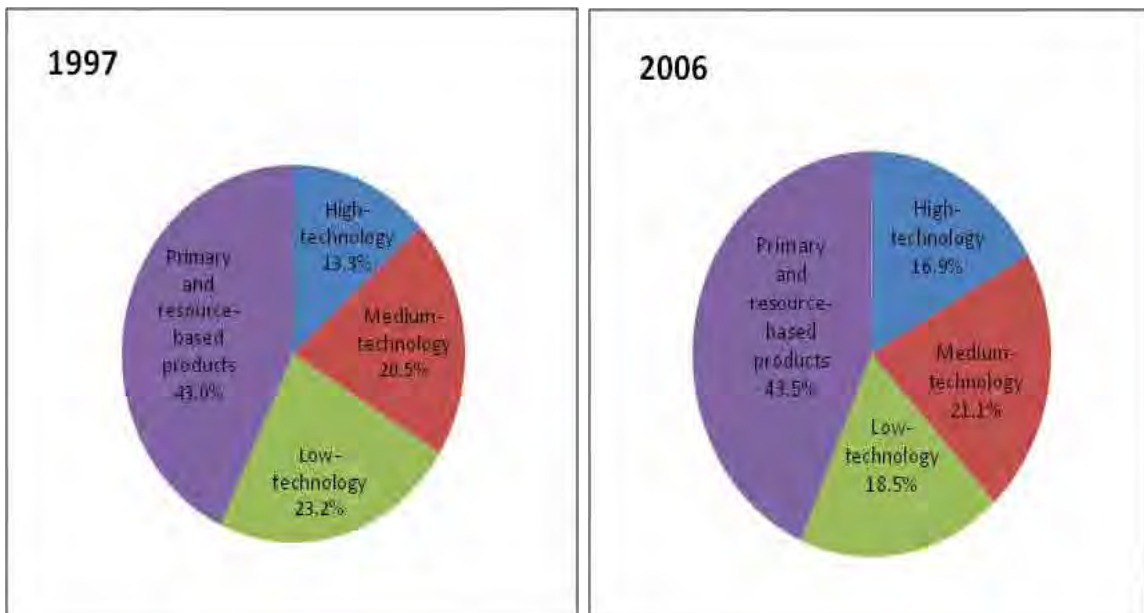
¹⁶⁹ The data presented in chapter 3 describes these tendencies. According to the Krugman Specialization Index, Estonia has one of the most diverse export profiles within the region. In 1997, it had a score of 0.20, and by 2006, had become even more dispersed, registering a score of 0.16. The technological intensity of Estonian exports (as measured by the proportion of medium- and high-technology goods in total manufactured exports) increased from 33.8 percent in 1997 to 38 percent in 2006. The composite Technological Development and Diversity Index (TDDI) displayed a corresponding increase from 0.57 to 0.61 over the same period of time.

Figure 8.2 Structure of Estonian exports, 1997 and 2006 (percent of total exports)¹⁷⁰



Source: United Nations, Comtrade Database (2008); author's calculations.

Figure 8.3 Technology intensity of Estonian exports, 1997 and 2006 (percent of total exports)



Source: United Nations, Comtrade Database (2008); author's calculations.

¹⁷⁰ These charts are based on 2-digit level data (United Nations Comtrade, 2008) that describe product-type rather than technology intensity.

8.2.2 Sectoral characteristics

Because of the diversity of Estonia's export profile, it is difficult to identify any general characteristics that are shared by all of the leading export sectors. It is, however, possible to disaggregate the export profile into three main sectors: natural resources; light manufacturing; and machinery and electronic component production. The oil shale industry, metallurgical sector, and to a lesser extent, the wood and forestry industry, are similar to other natural resource sectors in the extent to which they are characterised by high levels of capital intensity and economies of scale, as well as by high asset specificity and low levels of production flexibility. Such characteristics tend to result in specialized infrastructure, management and labour, and often raise the barriers to entry for other organizations (Shafer, 1994, p.22-24). The high cost of sector-specific investments in capital, infrastructure and labour also tend to ensure that barriers to exit are also high. As was evident in the case of Russia, such factors also tend to result in monopolistic or oligopolistic market structures as well as close links with the state. Together, the wood and other natural resource export sectors accounted for approximately 40 percent of total exports by 2006.

The food and textile industries are traditional Estonian activities that have continued to occupy an important part in the overall export profile. In 1997, the two industries accounted for just under 30 percent of total exports, although by 2006 this share had diminished to around 14 percent. Both the food and textile sectors are part of what can be broadly described as light industrial sectors. Light industrial sectors exhibit almost the opposite characteristics to the natural resource sector (Shafer, 1994, pp.106-107). Generally speaking, capital intensity tends to be low with labour tending to account for the bulk of production costs, while the prevalence of small firms also indicates limited economies of scale (Glyn, 2006; Dahlman, 2008). Because of low capital requirements, asset specificity tends to be low and production flexibility tends to be high. As a result, barriers to entry are often low: fixed capital costs are low; economies of scale are unimportant; production is often divisible; skill requirements tend to be low; technology is often standardized and easily available; and infrastructure requirements are

unspecialized. Low barriers to entry ensure competitive market structures and relatively low profit margins. Strong competition – both domestically and internationally - ensures that neither firms nor states possess the capacity to control the market; instead, firms can only conform to it. Together, these factors reduce the incentive for light industrial firms to pressure the state, as well as their capacity to do so.

The third group of export industries is dominated by machinery and electrical component production. This group comprises a technologically diverse range of manufacturing activities with differing sectoral characteristics. In Estonia, these include high-technology activities, such as the manufacture of light industrial products (described in Chapter Three as HT1 products), and the automotive and engineering subgroups of medium-technology production (MT 1 and MT3).

HT1 activities include the manufacture of electronic equipment such as computers, computer components, audio-visual equipment and office equipment. Many of these products are labour-intensive in the final assembly stage, and their high value-to-weight ratios make it economical to locate this stage of production in low wage areas. The role of multinational corporations (MNCs) and integrated international production networks (IPNs) are of crucial importance as the different stages of production can be distributed across countries to capitalize on differences in labour costs (Lall, 2000). In Estonia, the share of HT1 activities in total exports is relatively high: in 1997 they accounted for 11.3 percent of total exports, and by 2006 had increased to 15.9 percent. Estonian exports of these products tend to focus on the final, labour-intensive assembly stage and not in the higher value-added earlier stages, such as R&D, or earlier, high-tech production of components for assembly (Runiewicz, 2005; from interviews). Generally speaking, the emphasis on labour means that such industries display relatively low levels of capital-intensity and economies of scale, and relatively high levels of asset specificity and production flexibility. Consequently, barriers to entry are lower, leading to higher levels of intra-sectoral competition and greater constraints on the capacity of firms to engage in collective action aimed at the state.

MT1 and MT3 activities, which in 2006 accounted for 16.1 percent of exports, tend to be very linkage-intensive, and require significant inter-firm interaction. The automotive and engineering sectors emphasize product design and development and require a higher standard of human capital. Many have mass assembly or production plants and extensive supplier networks, both domestic and foreign (small and medium enterprises are often important in these sectors). Barriers to entry tend to be higher due to economies of scale and moderate to high capital intensity. Production flexibility and asset specificity are also lower. However, these sectors do not display the same degree of market concentration as natural resource sectors due to the importance of dispersed supplier networks. Thus, levels of competition can vary, and the potential for sectorally organized collective action lies somewhere between primary- and resource-based activities and high-technology activities.

8.2.3 International trends in Estonian export activities

The diversity of Estonia's export profile again hinders any attempt at discerning common international trends in those activities that are of considerable importance to the Estonian economy. Nevertheless, it is possible to make several very basic observations. The first set of international trends relates to the natural resource sector. This sector is, to a large degree, governed by the same pressures as the other natural resource sectors described in Chapter Six. Thus, while global or even regional economic growth is strong, the demand for natural resource products tends to grow. In Estonia, the robust economic growth across the global economy up until 2007 exerted a positive effect on the price of mineral exports, and to a lesser extent, on the price of wood and forest products, the unit price of which has tended to rise in recent years (Ukrainski and Varblane, 2005).¹⁷¹ Second, developments in the light industrial and manufacturing sectors have been shaped by a number of key global trends that have affected production in these sectors across the entire international economy (Dahlman, 2008, p.46). These

¹⁷¹ Although this is, to some degree, explained by the increasing level of technological intensity within the Estonian wood and forestry sector. The higher value-added activities within this sector (e.g., furniture, sawnwood, etc) have increased their share of wood and forest sector exports at the expense of lower value-added activities (e.g., industrial roundwood).

trends are described below and include: increasing speed in the creation and dissemination of knowledge; trade liberalization, globalization; and the increased role of multinational corporations (MNCs) and international production and distribution networks (IPNs).

In terms of *Knowledge creation and dissemination*, advances in science, combined with the information revolution (itself a product of these advances), have driven an acceleration in the creation and dissemination of knowledge that has, in turn, compressed the time between basic scientific discovery and commercial application, particularly in the electronic products industries (Dahlman, 2008, p.33). The increased importance of new technology can be observed through the increasing variety of goods and services produced, and is further reflected in the increasing importance of manufactured products and services in trade.¹⁷²

Since the General Agreement on Trade and Tariffs (GATT) there has been a trend towards increasing *trade liberalization* among most countries, with average tariff levels falling across the world (UNCTAD, 2006). In addition, non-tariff barriers have fallen. There is also a movement towards greater openness in trade in services, including not only financial and business services, but also education. Many services areas that were once considered non-tradable have now become tradable to the extent that they can be digitized and provided remotely, across national boundaries, through the internet (Dahlman, 2008, p.47). This tendency towards freer trade has increased the level of competition in manufacturing industries across an increasing range of domestic markets.

The two trends discussed above are part of a wider phenomenon, often described as *globalization* – the greater integration of economic and social activity around the world (see, for example, Wolf, 2004; Bhagwati, 2004, Stiglitz, 2006). The reduction in communication and transportation costs combined with trade liberalization has resulted in

¹⁷² Globally, the share of manufactured products in trade has increased from 58 per cent in 1965 to 65 per cent in 1980, 73 per cent in 1990 and 74 per cent in 2006 (World Bank, 2008). This is partly because the demand for manufactured products is more income-elastic than for primary commodities.

a dramatic increase in international trade.¹⁷³ Moreover, as the previously inward oriented economies of China, India, and the socialist bloc increased their participation in the international trading system, the net effect has been that the global labour force has effectively doubled (Freeman, 2006; Glyn, 2006).¹⁷⁴

One of the key drivers of globalization is the increased role of MNCs that form part of wider IPNs. It is estimated that the value added by MNCs in their home countries, plus that in foreign affiliates, represents 27 per cent of global GDP (UNCTAD, 2005). However, the influence of MNCs is greater than this. They affect a much larger share of GDP if one takes into account backward and forward linkages, as well as their role in demonstrating new technologies and putting pressure on domestic firms to upgrade production processes. Although there is no accurate estimate, probably more than half of the remaining trade is done through supply chains controlled by multinationals as part of vertical chains or through distribution chains (Dahlman, 2008, p.51). MNCs also often operate as independent global agents. Rather than responding to the needs of any country, even their original home country, their objective is often to operate globally in the best way to increase returns to their investors, whoever they are and wherever they may be. Consequently, competition among developing economies to attract FDI, or to become integrated within global supply chains controlled by MNCs, is fierce.

8.2.4 Conclusion

This section has identified those export sectors that tie Estonia to the international economy: natural resources, light industry, and machinery and electrical component production. The general organizational features of these sectors were described, followed

¹⁷³ The ratio of imports and exports to global GDP has increased from 38 percent in 1990 to 55 percent in 2005 (World Bank Development Indicators, 2008).

¹⁷⁴ This has important implications for labour intensive industries, whether in developed or developing countries, as the expanding supply of labour exerts downward pressure on wages. This doubling of the global labour force has increased the marginal productivity of capital (Glyn, 2006). As a result, that share of value added that is going to capital has increased, while that which is going to labour has decreased. The principal beneficiaries of this globalization and rebalancing of relative wages are the multinational corporations (MNCs) which are the most effective agents at intermediating and taking advantage of differences in global factor prices.

by a brief overview of the main recent international trends evident in these industries. The fact that the share of manufacturing and light industry in total exports has increased in recent years suggests that Estonia has coped reasonably well with changing international conditions. Indeed, Estonia has enjoyed far more success in developing a diverse transnational economy than any of the other cases examined in detail in this study, even compared to Romania, which although it has made considerable progress, was much slower in attracting significant levels of FDI. This has been due to a combination of the favourable initial conditions described in the first section, rapid macroeconomic stabilization, energetic economic reform, a competitive exchange rate, and relatively high levels of investment, both from abroad and domestically. The next section first describes how these factors have helped anchor Estonia within the wider international economy. This is followed by an outline of the market structures of Estonia's leading export sectors.

8.3 Main economic developments and market structure of leading export sectors

8.3.1 Main economic developments since independence

The political consensus that emerged from the independence struggle identified the need for fast and substantial economic reform (Laar, 2002, 2007; Lumiste, Pefferly, and Purju, 2008). However, the hyperinflation that occurred in the rouble zone during and after the collapse of the Soviet Union destroyed household savings, limiting the resources available for economic restructuring and effective privatization. Consequently, currency reform and the adoption of a national currency were central to economic reform. Additionally, access to foreign capital was considered the means to compensating for the dearth of capital that was a feature of the Estonian economy at this point. This stands in stark contrast to the experiences of the other cases in this study, where foreign capital was, at least initially, viewed with suspicion and was thus limited in scope. Both currency reform and access to foreign capital were part of a wider process of ensuring macroeconomic stabilization and integrating Estonia within the wider international economy, specifically the European economy. Currency reform, and the policies required

to achieve this, would help achieve wider macroeconomic stabilization and credibility, thus attracting more foreign capital. This in turn would inject greater competition into the Estonian economy and help boost the level of investment, thus generating rapid economic restructuring and a more diverse economic system.

A new currency and monetary reform represented the spine of economic reform (Laar 2002, 2007). Estonia introduced the fully convertible kroon (Crown) in June 1992, fixing the exchange rate to the German Deutschemark (DEM), and later the Euro (in 1999), through a currency board arrangement (from interviews).¹⁷⁵ The exchange rate between the kroon and the DEM was set at the level of the previously prevailing exchange rate between the rouble and the DEM.¹⁷⁶ This fixed exchange rate ensured that Estonia would experience no nominal appreciation or depreciation with its main trading partners. Consequently, the kroon conferred a high level of competitiveness for Estonian firms vis-à-vis its trading partners for over 18 years.¹⁷⁷ As well as boosting the competitiveness of Estonian firms and making Estonia an attractive destination for foreign investment, the fixed exchange rate based on a currency board also had the effect of depoliticizing monetary policy and limiting the role of the Estonian state in the economy.

Monetary reform and the constitutionally enforced limits on public spending helped ensure macroeconomic stabilization and laid the foundation for the privatization process and the rapid opening up to foreign investment (Rybczynski, 1997; Lainela and

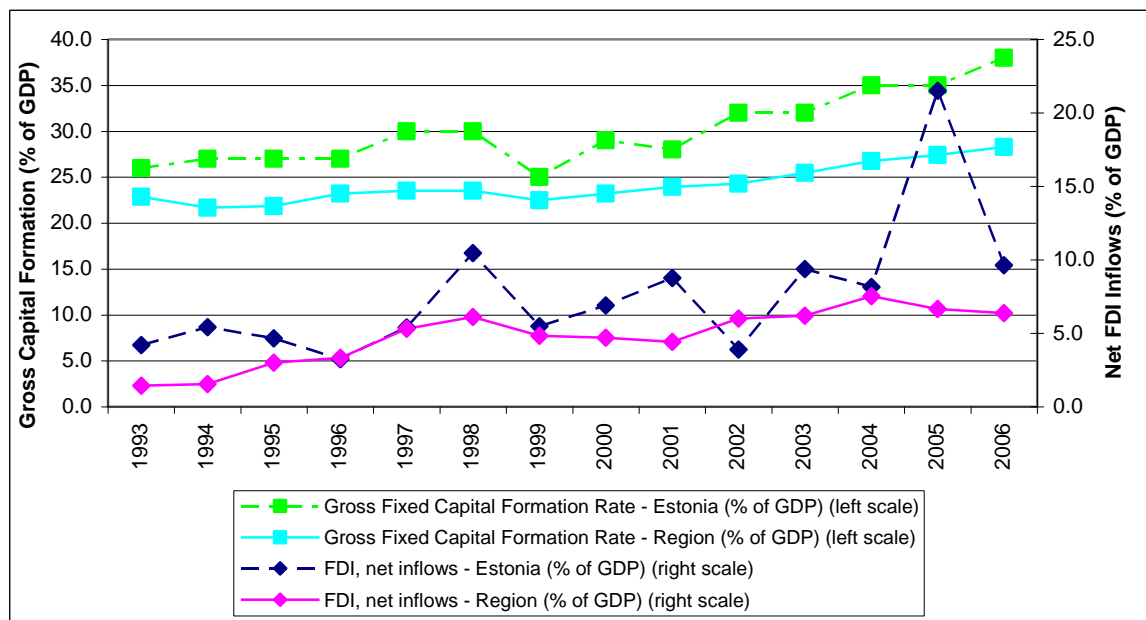
¹⁷⁵ In this respect, the prompt return of gold reserves from the United Kingdom that had been held since the Soviet invasion helped give Estonia a head start over most other newly independent republics.

¹⁷⁶ The exchange rate between the kroon and the DEM at the time of the currency reform was set at the level of the exchange rate between the rouble and the DEM determined in inter-bank auctions. Due to the scarcity of currencies offered and the abundance of the rouble, the rouble rate was undervalued and that, in turn, determined the Estonian price and wage level after the currency reform. The average wage was \$41 or 60 DEM, two times lower than in Poland and three times lower than in Czechoslovakia at that time. The similar level in Russia had mandated the initial low wage level, which was at the time the key trading partner of Estonia. In comparison with productivity, the wage and price levels were very low in Estonia. The applied exchange rate made Estonia's imports more expensive and favoured exports of goods and services. Such conditions were favourable for attracting foreign capital.

¹⁷⁷ Although this was eroded by domestic wage inflation that surpassed its trading partners, thus resulting in a real appreciation of the kroon. However, over the course of the 1990s and early 2000s, the competitive kroon acted as an effective subsidy to Estonian firms. This further insulated the Estonian state from pressures from business, as all firms enjoyed a competitive advantage relative to competing firms based in the economies of trading partners.

Sutela, 1997; Laar, 2002, 2007), thus facilitating energetic structural change in the Estonian economy. The privatization process of companies was organized by the Estonian Privatization Enterprise, founded in 1992, and was followed by the Estonian Privatization Agency, which was founded in 1994 and operated until 2000 (Terk, 2000). This process employed some elements of the Treuhand scheme used for East German enterprises, and mandated that sales were not to be made without the restructuring of companies. Companies were sold through open tenders with the primary aim of securing core owners. Minor shares were sold for vouchers. International tenders were the primary means of selling larger companies (Frydman, Rapaczynski, Earle *et al*, 1993; Pelikan, 1997). Unlike Russia, there was no reservation of shares for employees and employers, thus further limiting the potential for the socialist managerial elite to transfer ownership of assets to themselves (Easter, 1997). This performed the dual function of placing assets in the hands of agents that were serious about economic restructuring while also weakening the socialist managerial elite. Both prevented the concentration of economic resources within the hands of a small group of owners.

Figure 8.4 Gross capital formation rates (percent of GDP) and annual net inflows of FDI (percent of GDP) in Estonia compared to an un-weighted regional average, 1993 to 2006



Source: Gross capital formation statistics from EBRD (2008); FDI data are taken from UNCTAD (2009); author's calculations.

The privatization process was fast and effective with the private sector playing a crucial role in generating economic wealth by the mid-1990s (Purju, 1999, pp.199-235). According to official estimates, the private sector was generating some 70 per cent of GDP in 1996, one of the highest levels in the region at that stage (EBRD, 1999). Access to capital also improved in the aftermath to the banking crisis of 1998-99 (from interviews). As well as being a source of cheap, but relatively skilled labour, foreign investment was also encouraged by investor-friendly rules, such as the provision allowing foreign companies to buy land rather than simply lease it (Runiewicz, 2003). These incentives meant that levels of FDI were always comparatively high: the stock of FDI had reached nearly \$2 billion by 2000 (EBRD, 2001, p.8), with cumulative FDI inflows per capita among the highest in the region by 2006 (UNCTAD, 2008; see Chapter Three). The main effects of Estonia's rapid privatization process in which the interests of 'insiders' were largely disregarded, and in which openness to foreign capital was a core element, was a dispersion of ownership within the economy, supported by rapid structural transformation as a result of investment rates that were high relative to the rest of the region (Fig. 7.4), with FDI, on average, accounting for 20 percent of capital formation between 1994 and 2006 (Lumiste, Pefferly, and Purju, 2008, p.13).¹⁷⁸ The main determinants of FDI in Estonia included potential market growth, financial stability, exchange rate competitiveness, and political stability (Varblane, 2001; Roolaht, 2006; Vissak, 2006).¹⁷⁹ As was the case in Romania, prospective membership of the European Union (EU) also played an important role in the harmonization of Estonia's institutional framework with its main trading partners (Hanson, 2007a). This helped reduce transaction costs and make Estonia even more attractive as a destination for foreign capital.

¹⁷⁸ This compares favourably to the investment rates of many of the fast-growing East Asian economies. For example, between 1994 and 2003, the average proportion of GDP devoted to gross capital formation was 28.8 percent in Hong Kong, 21.9 percent in Indonesia, 32.1 percent in South Korea, 29.9 percent in Singapore, 22.1 percent in Taiwan, and 29.5 percent in Vietnam. Data are taken from World Bank Development Indicators (2008).

¹⁷⁹ The main sources of FDI in Estonia were Sweden (accounting for 39.5 percent of the total FDI stock in 2006) and Finland (26.4 percent). Data are taken from Bank of Estonia (2008) and author's calculations.

Finally, the role of external anchors was also a crucial feature of Estonia's economic development between the early 1990s and 2007 (Lumiste, Pefferly, and Purju, 2008). The concept of external anchor refers to the role of imposed conditions that are used to mandate certain requirements that reflect the values, objectives and aims of a socio-economic alliance and that also frame the economic policy of that country. These imposed conditions are primarily related to the development of the institutions within the country in question. For Estonia, rapid integration with international institutions was viewed as essential given the small size of the country (Laar, 2002, 2007). Consequently, any attempt to preserve any semblance of sovereignty within the wider international economy was abandoned. The three main external anchors through which Estonia tied itself to the international economy were the EU, the World Trade Organization (WTO), and the regional Scandinavian economy.¹⁸⁰ The Estonian state actively encouraged the absorption of the Estonian economy within these structures in order to increase their independence from Russian influence, and also to facilitate rapid economic development and structural transformation.

As was discussed with reference to Romania, in practical terms, the implementation of the formal rules and standards of the EU helped to increase the competitiveness of Estonian companies by improving market access to the EU and other markets, while at the same time making Estonia a more attractive destination for EU investors (Pettai and Zielonka, 2003; Vilpisauskas, 2003; Vachudova, 2005; Roolah, 2006; Vissak, 2006; Coricelli, 2007; Hanson, 2007a). Similarly, attaining WTO membership (achieved in 1999) entailed the adoption of a range of new laws related to the removal of technical barriers to trade. Moreover, doing so prepared Estonia for the process of EU integration. Finally, although the anchor of the regional Scandinavian economy did not require the same degree of conformity to formal rules, it did require the close vertical integration of Estonian companies within regional clusters of production.¹⁸¹ As well as injecting more competition into the Estonian economy through the exposure of

¹⁸⁰ The accession of Finland and Sweden to the EU in 1995 played an important role in motivating Estonia to seek membership.

¹⁸¹ The region accounts for over 70 percent of FDI and over 40 percent of trade with Estonia (Estonian Statistical Office, 2008).

Estonian enterprises to harsh international standards, this process also ensured that Estonia moved quickly towards attaining a high level of institutional convergence with its main trading partners.

Overall, the three main features of Estonian economic development described here – macroeconomic stabilization, rapid privatization based on openness to foreign investment, and the use of external anchors to raise the performance of Estonian enterprises – all helped Estonia achieve a high rate of economic growth, attain institutional convergence with its main trading partners, and ensure a high degree of competition within the Estonian economy. However, it is crucial to note that the decision-making process that led to these policies being adopted in the first place was largely insulated from powerful business interests (from interviews). This autonomous policy formulation process was shaped by the dispersion of business interests in Estonia, even in the early post-independence period. This point is expanded upon later on. Before this, the next section identifies the market structures of the most important Estonian export sectors.

8.3.2 Market structure of leading export sectors

Successful macroeconomic stabilization, rapid institutional reforms, high levels of investment, fast and open privatization, and an initial production structure that emphasized light industrial activities all helped facilitate the rapid diversification of Estonia's export economy. The previous section of this chapter described how this affected the distribution of production across sectors. This section describes the market structure within Estonia's leading export sectors. It is argued that all of Estonia's leading export sectors, with the exception of the oil extraction industry, exhibit extremely competitive market structures, with no monopolistic or oligopolistic markets. This is a tendency that is reflected in the Estonian economy as a whole (Table 8.4). Since 1997, small enterprises (i.e. less than 9 employees) increased their share of total employment from 16.4 percent in 1997 to 21.9 percent in 2006. Indeed, if small and medium enterprises (SMEs) are defined as enterprises that employ less than 250 employees, the

overall share of employment of SMEs has increased from an already high level of 73.4 percent in 1997, to an even higher level of 77.5 percent in 2006. The presence of such a large number of SMEs is consistent with what one would expect given the prevalence of a wide array of light manufacturing activities (see the previous section). The remainder of this section describes the most salient features of market structure within each of Estonia's leading export sectors.

Table 8.4 Number of enterprises and size by employment in Estonian economy (at end of year), 1997 and 2006

Size of enterprise by No. Of employees	1997				2006			
	No. of enterprises	% of enterprises	No. of employees	% of employees	No. of enterprises	% of enterprises	No. of employees	% of employees
1-9	20357	73.7	65885	16.4	39330	82.8	99491	21.9
10-19	3492	12.6	45630	11.3	4120	8.7	56051	12.3
20-49	2359	8.5	69439	17.2	2556	5.4	74501	16.4
50-99	858	3.1	56748	14.1	821	1.7	53739	11.8
100-249	399	1.4	57636	14.3	486	1.0	68972	15.2
250 and more	162	0.6	107275	26.6	177	0.4	102377	22.5
Total	27627	100	402613	100	47490	100	455131	100

Source: Estonian Statistical Office (2008); author's calculations.

Energy: Oil and gas exports from Estonia accounted for 4.6 percent of Estonia's exports in 1997 (out of a share of 9.1 percent of total exports by minerals – see figure 8.2). By 2006, this share had increased dramatically to 15 percent of total exports (from a share of 17.2 percent of total exports by minerals).¹⁸² This statistical leap is not, however, due to the discovery of oil deposits. Instead, a change in the reporting procedures at Estonia's statistical office in 2004 signalled the inclusion of goods that crossed Estonia as transit that were previously omitted (Estonian Statistical Office, 2006, p.10). As in Belarus, transit trade – primarily oil, oil products and gas from Russia through Estonia to Western Europe – has played an important role in Estonia's economy.¹⁸³ Some estimates suggested that the absorption of profits from Russian oil exports accounted for up to 20

¹⁸² For a more detailed summary of the oil-shale industry in Estonia, see Parkman (2008).

¹⁸³ Although Lithuania also supplies refined oil products from the Mazeikiai refinery and Finland supplies oil that is re-exported.

percent of Estonia's GDP (see, for example, Bronshtein, 1999; Purju, Dedegkajeva, and Soosaar, 2003).¹⁸⁴ Thus, no domestic producers of exportable oil are present in Estonia. Electricity current powered by Estonia's oil-shale deposits near the north-east city of Narva constitute the only other source of energy exports from Estonia. Here, oil-shale extraction is, as in many other natural industries, concentrated in only one enterprise, the state-owned Eesti Põlevkivi (Estonian Statistical Office, 2008). Similarly, power generation at thermal power plants is monopolized by Eesti Energia (Estonian Energy). However, while Eesti Energia accounts for nearly all of Estonia's domestic electricity consumption, its share of total exports declined to almost zero by 2006. This decline in the share of exports in the oil-shale and electricity sectors indicates that although they are characterised by monopoly, their relative weight in the Estonian export profile is quite limited.

Table 8.5 Number of enterprises and size by employment in forestry and logging sector in Estonia, 2000 and 2006¹⁸⁵

Size of enterprise by No. Of employees	2000				2006			
	No. of enterprises	% of enterprises	No. of employees	% of employees	No. of enterprises	% of enterprises	No. of employees	% of employees
1-9	378	82.7	1248	38.9	444	88.4	1152	33.3
10-19	48	10.5	647	20.2	39	7.8	503	14.5
20-49	26	5.7	748	23.3	16	3.2	446	12.9
50-99	1	0.2	77	2.4	1	0.2	92	2.7
100-249	4	0.9	485	15.1	1	0.2	246	7.1
250 and more	0	0.0	0	0.0	1	0.2	1019	29.5
Total	457	100	3205	100	502	100	3458	100

Source: Estonian Statistical Office (2008); author's calculations.

¹⁸⁴ But this has changed since 2007 and the breakdown in relations with Russia.

¹⁸⁵ Due to changes in statistical reporting procedures in 2000, data for 1997 are not available at a sufficiently disaggregated level to permit meaningful comparison with more recent data. Consequently, data for 2000 and 2006 are presented to give an indication of change over time in production concentration across each sector under discussion in this section.

Table 8.6 Number of enterprises and size by employment in wood processing and manufacturing sector in Estonia, 2000 and 2006

Size of enterprise by No. Of employees	2000				2006			
	No. of enterprises	% of enterprises	No. of employees	% of employees	No. of enterprises	% of enterprises	No. of employees	% of employees
1-9	421	57.3	1566	11.1	744	68.2	2573	13.5
10-19	130	17.7	1847	13.1	140	12.8	1984	10.4
20-49	121	16.5	3670	26.0	131	12.0	3859	20.2
50-99	40	5.4	2711	19.2	42	3.8	2773	14.5
100-249	19	2.6	2566	18.2	25	2.3	3416	17.9
250 and more	4	0.5	1770	12.5	9	0.8	4525	23.7
Total	735	100	14130	100	1091	100	19130	100

Source: Estonian Statistical Office (2008); author's calculations.

Forestry and wood processing: The other natural resource-based sector of significance in the Estonian economy is related to products derived from: (a) the forestry and logging industry; and (b) the wood processing and manufacturing industry. Together they constitute one of Estonia's more significant export industries, accounting for nearly 14 per cent of total exports in 2006. The forestry industry has a long tradition. Of Estonia's total land area, 47 per cent consists of forest (2 million hectares), which represents the highest wood supply per capita in Europe. These sectors underwent a rapid restructuring process in the early 1990s and privatization was completed by 2000. Foreign investment has played a major role in this transformation process, with foreign owners prominent at in both sub-sectors. For example, the Finnish-Swedish enterprise Stora-Enso, an integrated forest products company, acquired the largest forestry group in Estonia, AS Sylvester (from interviews). Elsewhere, Larvik Cell, a Norwegian company, created a cellulose plant in Kunda, on the northern coast. Moreover, the presence of strong foreign investors did not reduce competition within the forestry and wood processing sectors; both sub-sectors display a high level of dispersion in terms of the number of enterprises and the distribution of employees between these enterprises (Tables 8.5 and 8.6). In the forestry and logging sub-sector, well over 80 percent of enterprises employ less than 9 employees. In the processing and manufacturing sub-sector, nearly 70 percent of enterprises employ less than 9 workers. Indeed, in the wood processing and manufacturing sector, there are 9 large enterprises that employ over 250.

Consequently, the market structure in the forestry and wood processing sector has continued to be extremely competitive.

Light industry - the textile and food processing sectors: Outside the natural resource sector, competition remains high. In the two sectors that are traditional mainstays of Estonia production – the textile and food processing industries – a high degree of dispersion is again evident. In both cases the dominance of small firms (i.e., less than 250 employees) is marginally less obvious than in the forestry and wood processing industries. Whereas only around a quarter of employment is accounted for by large (i.e., greater than 250 employees) enterprises in the forestry and wood processing sectors, large enterprises account for just less than 50 percent of total employment in both the food processing and textiles sector. Again, foreign investors play a prominent role. Prominent companies such as Saku Brewery (Baltic Beverage Holding AB of Sweden) and A. Le Coq (Olvi Oyj of Finland), for example, are owned by foreign companies. Indeed, net sales of enterprises that involve foreign capital constitute nearly 80 percent of the total sales of the sector (Enterprise Estonia, 2008). While this domination by foreign enterprises has resulted in a slightly higher tendency towards concentration than the highly dispersed forestry and wood sector, for example, the market structures remain highly competitive. In both the food processing sector and the textiles sector, there are nearly 20 companies accounting for only approximately 40 percent of sectoral employment (Tables 8.7 and 8.8), with a large number of small and medium enterprises making up the remaining 60 percent of employment.

Table 8.7 Number of enterprises and size by employment in food processing sector in Estonia, 2000 and 2006

Size of enterprise by No. Of employees	2000				2006			
	No. of enterprises	% of enterprises	No. of employees	% of employees	No. of enterprises	% of enterprises	No. of employees	% of employees
1-9	232	48.4	942	4.7	150	38.8	648	3.8
10-19	76	15.9	1076	5.3	80	20.7	1103	6.4
20-49	84	17.5	2479	12.3	79	20.4	2407	14.1
50-99	38	7.9	2382	11.8	33	8.5	2135	12.5
100-249	29	6.1	4302	21.3	26	6.7	3600	21.0
250 and more	20	4.2	9025	44.7	19	4.9	7216	42.2
Total	479	100.0	20206	100.0	387	100	17109	100.0

Source: Estonian Statistical Office (2008); author's calculations.

Table 8.8 Number of enterprises and size by employment in textiles sector in Estonia, 2000 and 2006

Size of enterprise by No. Of employees	2000				2006			
	No. of enterprises	% of enterprises	No. of employees	% of employees	No. of enterprises	% of enterprises	No. of employees	% of employees
1-9	265	46.3	1111	4.9	340	55.6	1188	6.0
10-19	110	19.2	1510	6.7	83	13.6	1156	5.9
20-49	117	20.5	3672	16.3	107	17.5	2959	15.0
50-99	46	8.0	3145	14.0	39	6.4	2322	11.8
100-249	14	2.4	2221	9.9	25	4.1	3229	16.4
250 and more	20	3.5	10829	48.2	18	2.9	8876	45.0
Total	572	100	22488	100	612	100	19730	100

Source: Estonian Statistical Office (2008); author's calculations.

Electrical components: The electronic manufacturing industry is perhaps the most dynamic sector within the Estonian economy (from interviews). As is the case elsewhere in the Estonian economy, high levels of foreign investment and integration within regional production networks has facilitated the rapid development of a range of production capacities, with production gradually shifting from labour-intensive activities in the mid-1990s to higher value-added operations more recently as real wage costs have risen. In 2000, the electronics industry consisted of 286 registered companies, increasing to 345 in 2006 (Table 8.9). The largest of these is Elcoteq Tallinn, a subsidiary of the Finnish company, Elcoteq, employing around 2000 people in 2006. Other prominent companies include OU JOT Eesti, a subsidiary of the Finnish company JOT Automation

OY, and one of the most innovative and productive companies in the Estonian economy (from interviews). The presence of such powerful foreign competitors has not deterred smaller Estonian firms from entering the market, however. Nearly 50 percent of all employment exists in firms with less than 250 employees. Indeed, the level of competition even among large (over 250 employees) firms is considerable, with 9 companies of this size present in 2006. These competitive market structures appear to be strengthening, with the number of firms, both large and small increasing over time.

Table 8.9 Number of enterprises and size by employment in electronic manufacturing sector in Estonia, 2000 and 2006

Size of enterprise by No. Of employees	2000				2006			
	No. of enterprises	% of enterprises	No. of employees	% of employees	No. of enterprises	% of enterprises	No. of employees	% of employees
1-9	187	65.4	526	4.8	236	68.4	640	4.4
10-19	39	13.6	576	5.2	23	6.7	305	2.1
20-49	26	9.1	953	8.6	36	10.4	1152	7.9
50-99	19	6.6	1476	13.4	17	4.9	1243	8.6
100-249	9	3.1	1669	15.1	24	7.0	3609	24.9
250 and more	6	2.1	5821	52.8	9	2.6	7564	52.1
Total	286	100	11021	100	345	100	14513	100

Source: Estonian Statistical Office (2008); author's calculations.

Table 8.10 Number of enterprises and size by employment in machinery sector in Estonia, 2006

Size of enterprise by No. Of employees	2000				2006			
	No. of enterprises	% of enterprises	No. of employees	% of employees	No. of enterprises	% of enterprises	No. of employees	% of employees
1-9	183	59.4	674	7.5	132	52.0	337	3.7
10-19	41	13.3	572	6.3	38	15.0	537	6.0
20-49	42	13.6	1309	14.5	41	16.1	1248	13.9
50-99	22	7.1	1537	17.1	24	9.4	1681	18.7
100-249	15	4.9	2352	26.1	15	5.9	2982	33.2
250 and more	5	1.6	2567	28.5	4	1.6	2204	24.5
Total	308	100	9011	100	254	100	8989	100

Source: Estonian Statistical Office (2008); author's calculations.

Machinery: The machinery sector is also characterised by a very competitive market structure. Between 2000 and 2006 there has been a degree of consolidation within this sector, with the number of enterprises decreasing from 308 to 254 (Table 8.10). Moreover, the proportion of employment accounted for by enterprises that employ more than 100 people has increased from 54.6 percent to 59.7 percent. This, however, is to be expected in what is a relatively capital-intensive industry. Furthermore, despite this marginal tendency towards concentration in this industry, there remains a high degree of competition. For example, there are 19 enterprises within the group of companies with over 100 employees. Small companies (less than 100 employees) still account for 42.3 percent of total employment. Again, integration within international production networks has been a defining feature of the machinery sector in Estonia. For instance, a considerable proportion of activity in this sector is directed at producing goods for the transport vehicles and parts industry. Over half of turnover in this sector is derived from subcontracting for larger European (particularly Scandinavian) companies (Enterprise Estonia, 2008). Thus, domestic research and development in this sector has tended to be low as companies undertook activities for foreign partners. However, integration within these networks has begun to increase the transfer of knowledge and technology, gradually increasing the technological sophistication of indigenous production (from interviews).

8.3.3 Conclusion

This section has described the most important features of Estonian economic development since independence. Macroeconomic stabilization based on the credibility of a competitive kroon, rapid privatization based on openness to foreign investment, and the use of external anchors to raise the performance of Estonian enterprises have all facilitated the attainment of robust growth, institutional convergence with its main trading partners, and, perhaps most importantly in the context of social order development, the existence of competitive market structures in all of the main industrial sectors of the economy. This resulted in further restructuring due to the absence of collusive capacity. The next section discusses the implications of this for the capacity of firms to engage in collective action. As will be discussed in the following section, this dispersion of

production and competitive markets caused Estonian firms to relate to the state in a manner that is quite distinct from business-state relations in most other post-socialist societies, particularly those observed in Belarus, Romania and Russia that were discussed in the previous two chapters. With no dominant sector, and strong competition within sectors, business has been unable to exert undue influence over state policy. Instead, business-state relations are based on constructive dialogue with the state able to formulate policy in an autonomous manner.

8.4 Capacity for collective action in Estonia¹⁸⁶

The data presented above indicate a high dispersion of employment and production within and across Estonia's leading export sectors. According to the conceptual framework outlined in Chapter Two, this should lead to greater state autonomy as competition within and across sectors reduces the capacity of sectors to 'capture' the state, while also reducing the incentive of the state to rely too heavily on revenues from a few disproportionately powerful sectors. Under such conditions, robust competition should ensure that business-state relations are more open and transparent, facilitating the development of an open-access social order. Chapter Two identified four main arenas in which business might compete with other social forces to attempt to influence state policy: business associations; groups located within civil society; political parties; or through direct access to state structures. This section assesses the capacity for collective action of Estonian businesses relative to other social forces in these four arenas.

8.4.1 Business associations

Organizations representing business in Estonia can be classified into two types: sectorally defined business associations (BAs) that represent the interests of enterprises

¹⁸⁶ This section is based primarily on research undertaken in Tartu and Tallinn between the 18th and 30th August, 2008. This involved a series of interviews with representatives from political parties and business associations, as well as interviews with prominent experts in the areas under examination in this study. A full list of interviewees is contained within the bibliography.

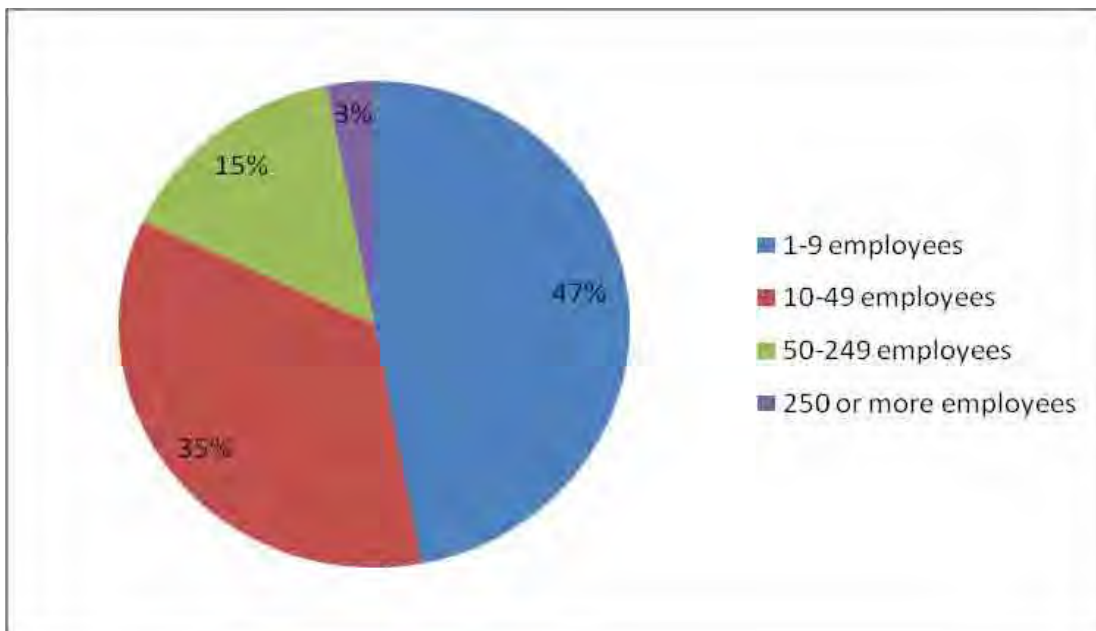
according to their industry; and broader umbrella organizations that encompass a broader range of industrial interests.

Each industry in Estonia has at least some form of capacity to represent the interests of its constituents. For example, the Federation of the Estonian Engineering Industry represents over 100 enterprises from within the machinery sector, while the Association of the Estonian Food Industry is an umbrella organization that unites companies from within the food industry. However, the high degree of dispersion present in nearly all major industries presents problems for associations aspiring to present the interests of each industry in a cohesive manner. A case in point is the Estonian Forest Industries Association (EFIA). It is the largest and most influential industry association in the forestry and wood products sector and is chiefly composed of wood purchasing companies and sawmills (EFIA, 2008). Other associations are left to represent the other sub-sectors from within the forestry sector (such as logging, manufacturing, etc). The EFIA itself is composed of 56 members of varying sizes and interests, something that often makes it difficult to “define a common interest” among its members (from interviews). Furthermore, within most sectorally arranged business associations, a divide exists between larger, foreign-owned enterprises and smaller, indigenous companies (from interviews). With each of these enterprises competing with other companies *within* the sector rather than acting collectively *against* other sectors, the capacity for collective action is quite limited. Consequently, sectorally organized BAs do not tend to perform the function of pressure groups due to the difficulty in forming a collective interest. Instead, BAs are often active in engaging in marketing activities (both domestically and abroad), technical preparation for EU integration, organizing training, and in providing and disseminating information, both upwards towards state, and downwards from the state to smaller businesses (from interviews).

By far the largest and most prominent of the Estonian umbrella BAs is the Estonian Chamber of Commerce and Industry (ECCI). It is composed of over 3600 companies, and is not restricted to industrial interests, with the commercial sector (e.g., wholesale and retail trading), construction, banking, transport and other services all

represented (ECCI, 2008). Originally founded in 1925, it was re-established in 1989. The ECCI has the largest organization of all Estonian BAs, with its role, according to Sim Raie, the Director General, being “to develop entrepreneurship in Estonia through participation in the designing of economic policy, as well as through the provision of business services” (from interviews). However, the ECCI does not act as a pressure group or attempt to influence the broader policy making process. Rather, it acts as an intermediary between state and business, playing an active role in ensuring that companies are familiar with changes in the regulations that are relevant to its members. Indeed, like the sectorally organized BAs, its role is essentially that of providing technical information to its members and promoting their activities to the wider international business community. According to Raie, the large and sectorally dispersed composition of its membership prevents the ECCI from asserting a “collective policy stance” on most issues. Consequently, it tends to concentrate its efforts on ensuring that regulations and laws passed in the legislature are simple and transparent, ensuring that the overall business environment is conducive to economic activity.

Figure 8.5 Distribution of member companies from within the Estonian Chamber of Commerce and Industry by their size (number of employees), 2007



Source: Estonian Chamber of Commerce and Industry (2008).

8.4.2 *Civil society*

Since the restoration of independence, Estonia's non-governmental organizations have undergone considerable change, with a number of specialized non-profit organizations emerging to play an important role in articulating the interests of groups that are perhaps not represented by political parties or business associations. By the end of 2002, there were 17,285 registered NGOs and 490 foundations (see Trummal and Lagerpetz, 2001). These groups represent a range of interests, from women's issues (such as Civil Courage) to the interests of the country's ethnic minorities (e.g., the Estonian Union of National Minorities). However, while the level of civic activism is high relative to countries such as Russia and Belarus, the extent of popular participation in NGOs is constrained by funding problems, a widespread view that civic initiatives will not solve the country's social and economic problems, and the more region-specific phenomenon of a distrust of voluntary activities because of the Soviet practice of enforcing 'voluntary' activity among its citizens (Uhlin, 2005). According to a 2001 study by CIVICUS and the Open Estonia Foundation, these factors have led to over half of all registered NGOs being unable to enjoy active membership bases, with nearly half of those that do reporting membership bases of less than 30 people (Trummal and Lagerpetz, 2001). Consequently, the organizational and institutional capacity of NGOs in Estonia is quite limited.

There are, however, some signs of progress. First, the Network of Estonian Nonprofit Organizations (NENO), an umbrella group for NGOs, have worked with Parliament to define complementary roles for the public and non-profit sectors and to outline mechanisms for the development of a more active civil society (from interviews). This has had some success, with NGOs expressing increasing confidence that their interests are absorbed into the policy-making process (from interviews). Second, the Bronze Soldier affair of 2007 had the inadvertent effect of mobilizing popular groups – both Estonian and ethnic Russian – into exerting greater pressure on the state to consider their views on cultural policy. During the episode, many non-Estonians felt that the Estonian government was failing to take their historical identity seriously, while many

Estonians felt that the actions of the Russian minority confirmed a suspicion that they constituted a ‘Trojan horse’ for Russian foreign policy (from interviews). However, while the period of popular mobilization did result in considerable tensions between the two groups, the actions of hundreds of community representatives and organizations did result in the Estonian government making preparations to draft a new seven-year cycle for the policy program that demonstrated a renewed commitment to work on ethnic relations (from interviews). Indeed, immediately after the crisis, the Tallinn city government convened a ‘civic peace forum’ that integrated the whole spectrum of views on the matter, demonstrating that local government was also responsive to increased civic activism. Therefore, while Estonian civil society is weak in some areas, it does play an important role in complementing the activities of business and political parties in integrating and articulating the interests of the Estonian population.

8.4.3 Political parties

The general development of political parties in Estonia is not the subject of this section and is covered elsewhere (e.g., Pettai and Kreuzer, 1999; Sikk, 2006; Ehin, 2007; Mikkel, 2007). What is important in the context of this study is the degree to which industrial interests are able to pressure political parties, and the extent to which the party system exhibits competitive tendencies more generally. In terms of the ability of industrial interests to ‘capture’ political parties and use them as a vehicle through which their interests are channelled into the Riigikogu, the evidence suggests that this is very low. The breadth of business interests that exist within Estonia make ‘capture’ of political parties extremely difficult; the presence of a large number of companies with diverse interests dilutes the impact of pressures exerted by business on parties. Moreover, because of the diverse economic structure the range of socio-economically defined constituencies within Estonian society is wide, forcing political parties to define themselves in very broad terms. Thus, the Reform Party casts itself as the liberal, market-friendly party, while the Centre Party is characterised as the party of social justice.¹⁸⁷

¹⁸⁷ Although the Reform Party has revealed that the natural resource company, Eesti Põlevki has been a major donor (from interviews).

Only the agrarian People's Union Party openly represents a single, narrowly defined constituency.

Evidence derived from interviews with a small, but broadly representative sample of MPs, indicates that while business interests do attempt to influence the development of party agendas, their success is limited by the sheer diversity of interests on offer. Therefore, the fiercely competitive Estonian economy acts as an obstacle to business domination of political parties. The law on party financing, passed in 1996, and the ban placed on corporate contributions to political parties applied in 2003, have further consolidated this independence from business (from interviews). While this might result in controversy regarding the intertwining of party and state structures, this is a relatively small concern.¹⁸⁸

But this has not stopped the development of a large number of political parties since 1990. Rather, the dispersed structure of the economy and the fluidity of socio-economically defined constituencies resulted in a party system that is characterised by relatively low barriers to entry and high levels of inter-party competition. This is not a unique phenomenon in the post-socialist region. Because of the fluid socio-economic situation in countries engaged in deep economic transformation, stable party systems often take time to crystallize (e.g., Kopecky, 1995; Mainwaring, 1998; Grofman *et al*, 2000). In Estonia, the party system has undergone some consolidation since independence; since 1990, the number of registered political parties has decreased from 31 to 16 in 2007 (author's calculations). During this time, parties have developed greater organizational capacity and are each associated with broadly defined ideological positions. The Reform Party, Pro Patria and Res Publica (both now merged into the Pro-Patria-Res Publica Union) occupy the centre-right pro-market, limited government position, while the Centre Party, the Social Democratic Party, and the People's Union Party are considered to be more concerned with social justice. There are also a number of parties that represent Estonia's Russian population. However, they have been unable to

¹⁸⁸ Indeed, this is to some degree a natural consequence of pressures associated with post-communism, such as the dearth of skilled professionals available to political parties, and of the small size of Estonia. See Sikk (2006).

pass the 5 percent threshold of support to achieve parliamentary representation in recent years.

Res Publica's mere existence is testament to the low barriers to entry and high level of competition within the Estonian party system (Taagepera, 2006). It emerged in 2001 as a reaction to perceived corruption within the country and quickly established itself as a major political actor. After winning power in 2003, Res Publica was, however, considered a failure in government, leading it to merge with Pro-Patria in order to survive. While this fluidity has been criticised by some (e.g., Mikkel, 2007), not least because it prevents the stabilization and consolidation of the Estonian party system, it is important in the context of this study to note the high degree of competition among political parties that has been evident since independence.

8.4.4 Direct links between state and business

Unlike the other cases in this study, there is little evidence of direct links between state and business that circumvent formal business associations. Instead, the main substance of business-state relations is funnelled through the business associations described above. This is a function of three main factors. First, the constitutional limits placed on state expenditure and borrowing reduces the incentives for business groups to approach the state directly in the hope of securing favourable terms or economic rent. Second, the high degree of competition in the Estonian economy that is described above – both between and within sectors - acts to reduce the degree to which the state can create differential access to Estonian organizations. Consequently, the relationship between business and state is one of open and accountable dialogue, with wide-ranging consultation being much more prevalent than examples of penetration by small numbers of groups (from interviews). Finally, the relatively low share of the state in the Estonian economy also reduced the scope for close state-business relations.¹⁸⁹

¹⁸⁹ According to the EBRD (2008), the private sector share in the Estonian economy has approximated 80 percent of GDP since 1999, and 75 percent since 1995. This compares favourably to the regional average (see Figure 7.6 in the previous chapter).

There have, however, been several examples of the state using this autonomy to direct economic development in an open and transparent manner with little evidence of rent creation for special interests. For instance, by 1992 the Estonian governments under Edgar Savissar and Tiit Vahi granted monopoly power for a decade to Eesti Telecom (in which it had a minority share of 25 percent). This was done in return for the comprehensive overhaul of the entire telecommunication sector. Upon the expiration of this monopoly status, more competitive market structures were put in place (Hogselius, 2007). This policy ultimately proved very successful; by the beginning of the 21st century Estonia had a world-class communications infrastructure with digital cables laid throughout the country. Furthermore, the state moved to create the conditions for greater competition within the telecommunication sector and did not abuse its position to create additional rents.

More recently, the Estonian government has come under increasing pressure to pursue an active industrial policy to stimulate the development of high-technology industries (from interviews). On one hand, this pressure is a consequence of the decline in competitiveness that is a product of strong real effective exchange-rate appreciation in recent years. It is also due to the inflows of EU Structural and Cohesion Funds since 2004 that mean that the Estonian state is, for the first time since independence, in a position to disburse significant funds to industrial lobbies. However, while the incentive for businesses to pressure the state has certainly increased, it has so far been unsuccessful due to the absence of any dominant industrial interests (from interviews). Instead, the existing industrial policy of sorts is based on very liberal assumptions, with the state being seen as responsible for providing infrastructure and attractive business conditions rather than direct funding (from interviews).

8.4.5 Conclusion

The high degree of competition that exists both between and within industrial sectors within Estonia has resulted in a low capacity for collective action among Estonian industrial interests. Business associations and the political party system are both free

from the influence of overbearing sectoral interests, leading to both sets of organizations striving to represent a broader array of economic interests. This has increased the autonomy of the Estonian state, enabling it to conduct economic policy in a technocratic manner, relatively free of industrial pressures. This has not been to the detriment of economic policy nor business; the autonomy afforded to the state has been mirrored by active measures from governments of all stances to engage business in a constant consultative process. The weakness of industrial lobbies due to the relatively dispersed Soviet Estonian economy at the onset of independence certainly helped; crucial decisions relating to institutional reform, monetary policy, integration with the international economy, and privatization were made without fierce opposition from vested interests. These decisions enabled further structural transformation and greater economic competition as time progressed, setting Estonia off down a path of virtuous development; as the economic structure of the country became more competitive, so were economic agents constrained to act to change this structure. Again, the autonomy of the state during the past two decades stands in stark contrast to the other cases studies contained in this study. The next section describes how the high level of competition within the Estonian economy, and the low capacity for collective action among industrial sectors, have both propelled Estonian politics towards becoming an open-access political order.

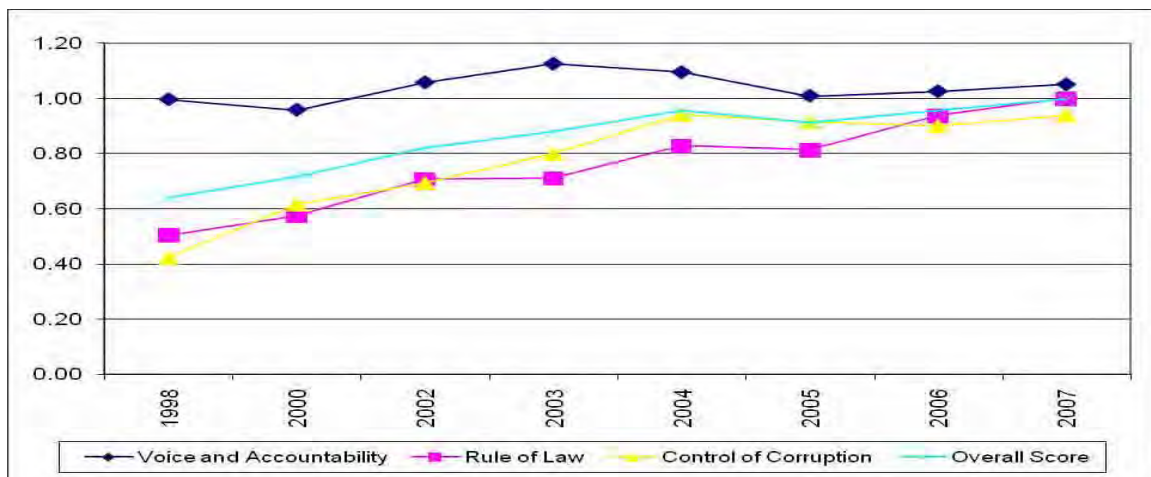
8.5 Social order type in Estonia, 1991-2007

The dispersion of structure and ownership in industry and the wider Estonian economy has ensured a high degree of economic competition, a hallmark of an open-access economy. As described in the preceding section, this has resulted in a relatively low degree of influence by industrial interests over business associations, political parties, and Estonian state structures. This has been complemented by a reasonably active and assertive civil society that has further contributed to the general pluralism that is evident in Estonian political life. In short, a wide variety of groups – from business and outside – compete for influence in Estonia. As Figure 8.6 illustrates, this has been a crucial factor in the development of an open-access political order. All three component indicators show a steady improvement since 1998, leading Estonia to possess one of the highest

overall scores in the post-socialist region by 2007 (see Chapter Three). While data are not available for the period before 1998, events during this period also suggest a rapid transformation from the closed-access socialist period (see e.g., Smith, 2001; Raun, 2002). This is consistent with the basic proposition of this study: high levels of economic competition help support and maintain an open-access political order, which in turn helps sustain further economic competition as political competition forces down the potential for discretionary rent creation and the use of differential access to economic resources as a means to maintaining closed-access orders.

Disentangling the precise cause and effect at each step of Estonia’s development is beyond the scope of this short chapter. However, it would appear reasonable to suggest that the simultaneous increase in levels of competition in both the economic and political arenas has buttressed further positive development in both areas. This suggests that there is a strong case for asserting that Estonia has enjoyed a positive form of path dependence, with each increment of competition facilitating further competition. This contrasts with the other three cases examined in greater detail in this study, where generally negative path dependencies have been evident (Belarus and Russia), or were at least evident for much of the initial post-socialist period (Romania). Each of the three component indicators are discussed below.

Figure 8.6 Components of social order development in Estonia, 1998-2007



Source: Kaufmann, D., A. Kray, and M. Mastruzzi (2008); author’s calculations.

8.5.1 Voice and Accountability

Following a two-year transitional period in which Estonia reverted to the inter-war constitution, a new constitution was approved by referendum on June 28th, 1992.¹⁹⁰ This constitution has provided the formal institutional framework through which a wide range of groups within Estonia are able to articulate their views. The dispersed economic structure described earlier in this chapter has added substance to these formal provisions and has resulted in a wide range of interests – both economic and otherwise – being able to compete for representation in the Riigikogu. The ferocity of this competition is evident through the high turnover of governments since 1992 that has taken place through regular and free elections (Sikk, 2006). The nationalism that initially dominated politics shortly after independence became less prevalent after the country had consolidated its sovereignty, except where the primacy of the Estonian language is concerned. This diversity of political forces has, despite appearing incoherent at times, resulted in an open and competitive political environment. Moreover, the dispersion of economic and political organizations in Estonia has enabled successive Estonian governments to implement policies in a relatively autonomous manner. For example, there has been a broad consensus among the major political parties, in or out of power, on, for example, liberal economic policies and European integration. The autonomy of the state to undertake reforms relatively independently of socio-economic forces can be seen as partially a function of the absence of any overwhelmingly powerful economic interests.

¹⁹⁰ This provides for a unicameral 101-seat parliament, the Riigikogu, whose members are elected directly by proportional representation. Parties need a minimum of 5 per cent of the vote to be entitled to parliamentary representation, and members may also sit as independent deputies. The constitution makes all persons equal under the law, and gives all citizens over the age of 18 the right to vote. It does, however, exclude those residents who have failed to pass a citizenship test, which includes competence in Estonian, although they are allowed to vote in local elections. Relations with Russia suffered as a result of this, as many of Estonia's Russian minority were disenfranchised. Executive power rests with the Council of Ministers, consisting of deputies from the governing party or parties. A largely ceremonial presidency was also created. However, it does possess powers that include the right to appoint the prime minister; to return legislation to parliament for reconsideration (thereby delaying its implementation); and to declare a state of emergency. The president is elected by the Riigikogu by secret ballot for a four-year term, and may serve a maximum of two consecutive terms. Moves towards introducing direct presidential elections were rejected by parliament, despite overwhelming public support for a change to the system

There remain, however, some considerable flaws in the Estonian political process. Most notably, the question of citizenship surrounding ethnic Russians has continued to blight Estonia's otherwise impressive development towards becoming an open-access order. While approximately 30 percent of the population is denied an equal voice in the political process, it is difficult to conceive of Estonian politics as being fully open, despite the impressive degree of competition that is evident throughout the different layers of Estonian society. However, because this issue is one of deep historical and cultural contention, it is to some degree independent of the relationship between economic structure and politics that is the subject of this study. Indeed, if one examines the influence of ethnic Russians on the political process more generally (i.e., outside the citizenship issue), it is clear that Russian economic organizations are just as important as Estonian organizations. The evidence derived from interviews with members of the Riigikogu, former government ministers, and business association representatives, indicates that while ethnic Russians may not enjoy the same citizenship status as Estonians, they are just as active in competing for political influence as Estonian organizations. This was particularly true before 2007, when the lucrative transit trade with Russia was largely dominated by ethnic Russian organizations (from interviews).¹⁹¹

8.5.2 Rule of law

The open and accountable political process described above has exerted a positive influence over the quality of the rule of law in Estonia. On a formal level, the supply of legislation from an autonomous parliament, the adoption of a constitution in 1992, and the rapid establishment of an independent and professional judicial system, have all provided an excellent framework through which Estonia can function effectively as a rule-based society. In addition, the process of EU integration, with the attendant absorption of the *acquis communautaire*, has added further layers to the legal framework as well as facilitating institutional convergence with Estonia's major trading partners. While

¹⁹¹ However, the rapid decline in the transit trade since 2007 will presumably reduce the influence of these ethnic Russian organizations.

the citizenship status of ethnic Russians remains problematic, the EU has argued that the rights of the Russian-speaking minority are largely observed and safeguarded.

While these formal provisions are, in general, comprehensive and meet tough European standards, the experience of other countries from within the post-socialist region (and elsewhere in the world) shows that the gap between formal provision and practical application of law is likely to be large unless a widespread demand for the application of law exists. In this respect, the diversity of organizations present in Estonian society described previously, and the competition that is prevalent between them, have helped ensure that formal provisions contained within the legal framework are largely adhered to. This is evident on two levels.

First, the implementation of the wide body of commercial laws has led to Estonia being considered as an exemplary case among post-socialist countries in protecting property rights and reducing transaction costs for business. Organizations such as the World Bank, the European Bank for Reconstruction and Development, and the Heritage Foundation have all consistently ranked Estonia highly in the years since independence on rule of law indicators.¹⁹² Second, the application of the law has been universal, affecting not only businesses and ordinary citizens, but also the central government, individual politicians, and the judiciary. For instance, the Bronze Soldier affair resulted in the Tallinn City Government successfully appealing to the Estonian constitutional court to re-examine the decision making process that led to the central government's decision to relocate war memorials. Elsewhere, Tiit Vahi, a serving prime minister at the time, was forced to resign over corruption charges in 1997, while a relative of former president Lennart Meri was investigated for allegations of human rights abuses after World War Two (from interviews). Finally, the judiciary itself has been subjected to scrutiny since 2006 when a former county judge, Ardi Suvalov, was accused of taking bribes to issue favourable verdicts.

¹⁹² These sources, among others, are used in the construction of the Rule of Law component indicators employed in this study.

While these examples are not necessarily directly traceable to a dispersed and competitive economic structure, the presence of a wide array of different social and economic interests in Estonia has ensured that there is an ample demand for the universal application of the legal framework.

8.5.3. Control of Corruption

The wide array of organizations present in Estonia that demand the universal application of rules has also had a beneficial effect on the control of corruption in the years subsequent to independence. By 2007, a survey of corruption in Estonia conducted by the Estonian Ministry of Justice reported that just 3 percent of individuals and 12 percent of businesses reported that they had paid a bribe in the previous year, with over 80 percent of respondents claiming to have never paid a bribe (Estonian Ministry of Justice, 2007, pp.22-23). Indeed, this low perceived level of corruption ranks as one of the highest in the post-socialist world and compares favourably to more mature, advanced economies (see Chapter Three). What makes this perhaps more impressive is the fact that Estonia is an extremely small country (population of just over 1.4 million) where there is a high degree of cross-circulation of business and political elites. Therefore, the fact that state officials do not tend to resort to using public office for personal gain is even more noteworthy.

There are several explanations for this success. First, the regulations and legal framework in Estonia, particularly relating to business activity, are quite simple and limited in scope, leaving little room for the exploitation of permit requirements by state officials or the issue of fines for ostensibly trivial matters. This contrasts with the other cases in this study where a plethora of minor regulations are often associated with a high level of petty corruption. Second, the small population, and concomitant cross-circulation of business and political elites can, in some cases, work in a country's favour. According to several senior politicians, the fact that elites have a high degree of familiarity with each other can cause an increase in 'social capital' without necessarily causing this to result in corruption (from interviews). While the validity of this argument is difficult to measure,

the presence of other supporting conditions might offer additional explanation. For example, Estonia has also consistently prosecuted those officials that have been caught engaging in corrupt practices. The example of Tiit Vahi was mentioned previously, but is particularly noteworthy. Elsewhere high level officials from the Ministry of Finance were removed from office in 2000 for the comparatively trivial crime of purchasing a car at a discount through the ministry and then selling it on to another official for private use at the same price (from interviews). Such acts might be considered relatively tame by Russian and Romanian standards. More recently, Villu Reiljan, a former Minister of Environment and leader of the agrarian People's Union party, was, along with other senior state officials, investigated for complicity in illegal deals carried out by the Estonian Land Board (from interviews). Finally, the presence of a diverse array of social and economic forces in Estonia are able to act as a counterweight to business and state, and play a vital role in ensuring that corrupt officials are held to account.

8.5.4 Conclusion

This section has briefly outlined the successful development of an open-access order in Estonia. In contrast to the other three cases selected for closer examination, Estonia has, throughout the entire post-socialist period, enjoyed considerable progress along the three component indicators used to measure the openness of a social order. Notwithstanding the validity of other explanations for this successful trajectory of development, it is highly likely that the dispersed and competitive structure of the Estonian economy, and the vibrant organizational base within society that this supports, have helped to shape the direction of Estonia's recent political development. As was discussed in the previous two chapters, economies that do not exhibit strong economic competition appear far less likely to develop a broad array of independent organizations that can challenge both the state and each other.

8.6 Conclusion: economic competition and the development of an open-access order in Estonia

This chapter has examined the relationship between economic structure and political development in Estonia since 1991. The first section highlighted some of the more salient economic and political legacies inherited from the Soviet period. It was argued that the relative diversity of Estonia's production profile under Soviet rule, and a strong, broadly based desire for independence, provided a firm foundation for the development of an open-access social order upon independence. The second section located Estonia within the wider international economy and described the main features of Estonia's industrial export profile since independence. The third section outlined some of the most important aspects of economic development since 1991. Macroeconomic stabilization based on the credibility of a competitive kroon, rapid privatization based on openness to foreign investment, and the use of external anchors to raise the performance of Estonian enterprises were shown to have contributed to robust economic growth, institutional convergence with its main trading partners, and, perhaps most importantly in the context of social order development, the existence of competitive market structures in all of the main industrial sectors of the economy. This resulted in further restructuring due to the absence of significant collusive capacity within the most important economic sectors. The fourth section explored the effects of economic competition on political competition within Estonia. The diversity and competition of the economy supported the development of formal institutions that represent a broad cross-section of societal forces, a relatively vibrant civil society, and a ferociously competitive business community. The final section argued that these factors have helped shape a political order in which competitive tendencies – both economic and political – are channelled in an open and transparent manner.

In the context of the theoretical framework elaborated in Chapter Two, the Estonian case vividly illustrates the importance of structural factors in explaining how a social order can develop according to open and transparent tendencies. This appears to confirm the first order hypotheses contained in conceptual framework. A high level of

economic competition was evident in Estonia from very early on in the post-socialist period, helping shape an open-access social order. Indeed, wider developments in the international economy – in particular the motivation of MNCs to exploit the opportunities for cost reduction through FDI – helped buttress and enhance the already competitive tendencies evident in the Estonian economy. This contrasts sharply with the fortunes of Belarus and Russia where developments in the international economy, along with very limited economic competition, appeared to have stymied the development of open-access social orders. Indeed, in Romania, steps along the path towards an open-access order were only taken after it opened itself up to the same forces that had helped shape Estonia's economic development. These two tendencies in turn helped provide the conditions for the emergence of a broad array of non-state organizations that competed with each other, resulting in a high degree of state autonomy in Estonia, something that has not been evident in Belarus and Russia, and only to a limited extent in Romania. In this sense, the evidence also appears to confirm the second order hypotheses that make up the conceptual framework employed throughout this study.

CONCLUDING REMARKS

9. Introduction

In the introduction to this dissertation, it was noted that structural economic variables have been underplayed in explaining political outcomes across the post-socialist region. This study has sought to remedy such an oversight by analysing the interaction between economic structure – as defined in terms of countries' merchandise export profiles – and social order development across the region. After outlining the basic building blocks of the conceptual framework in Chapter Two, a small number of simple hypotheses were laid out to test the theory that structural economic factors might be important in explaining variation in social order development in the region. The empirical analysis that followed, including both a broad cross-country statistical and historical analysis, as well as the more detailed case studies, suggested that the hypothesized relationships between the specified variables do appear to exert a significant influence over divergent patterns of social order development in the region. This short chapter offers some concluding remarks on the strengths and weaknesses of the approach adopted in this study, and highlights some of the more important implications for future social order development. It finishes with a consideration of the role of economic structure and social order type in shaping the region's ability to cope with future challenges, not least the effects of the global financial and economic slowdown that began in the summer of 2007.

9.1 Economic structure and social order development

The conceptual framework outlined in Chapter Two suggested two first-order hypotheses. First, it was hypothesized that developments in the wider international economy affect the prospects for domestic structural economic change which in turn shapes the development or otherwise of greater levels of economic competition. This study has focused on some of the broader trends that were considered of potential importance in shaping domestic economic and political behaviour. Thus, reference was made to the importance of changes in the behaviour of multinational corporations

(MNCs), shifting tendencies within international production networks (IPNs), the role of international institutions, and fluctuations in the world prices of commodities and manufactures. This short list of factors is not exhaustive; other trends and developments may also have exerted an influence over economic restructuring. For example, international capital flows were not considered outside of flows foreign direct investment (FDI). While such capital flows may have been of crucial importance in enabling or constraining economic restructuring across the region, they were not considered in this study. Service exports were not covered either. Therefore, any future research would have greater credibility if such factors were included. Again, the primary focus on merchandise trade contained within this study, specifically on the organization of export sectors, is useful for heuristic purposes and facilitates the formulation of simple hypotheses. It does, however, leave some gaps in the explanatory utility of the conceptual framework that is used here.

Notwithstanding these qualifications, the evidence does suggest that the influence of the international economy upon domestic economic developments (and, in turn, on political behaviour) is often of crucial importance. As was argued in Chapter Five, fluctuations in the price of oil had a considerable impact upon Soviet political economy, influencing the timing of reform and, to a lesser extent, the capacity of the Soviet state to implement reform. Developments in post-Soviet Russia also indicate that commodity prices, especially hydrocarbons, continue to represent perhaps the most important variable in explaining Russian political economy, largely due to the fact that those groups that control, if not necessarily own, the hydrocarbon sectors are the dominant political actors in Russia. A dependence on hydrocarbons has also indirectly supported the Belarusian economic model that sustains the dominance of the state in the Belarusian economy. Elsewhere, the importance of the global diffusion of manufacture production through MNCs and IPNs appears to have exerted a broadly positive influence over economic restructuring in Estonia and Romania, not to mention the other countries of central and east Europe. Utilizing comparative advantages in labour costs and proximity to final markets, these countries have used integration with the international economy to

upgrade the technological sophistication of their own transnational economies as well as introduce greater levels of economic competition.

The second first-order hypothesis – that higher levels of technological sophistication and competition throughout the economy causes political development along more open-access lines; in short, that there exists a ‘double balance’ between economy and polity – also appears to have been confirmed by the evidence presented throughout this dissertation. The case studies contained within this dissertation, as well as the broad overview of the relationship between economic structure and social order-type contained in Chapters Three and Four, suggests that economic structure – as specified according to a country’s export profile – is an important factor in explaining the considerable variation in social order that is evident across the sample of countries covered here. However, the simple measurement of this variable that is offered in Chapter Three conceals a number of other variables that might also be of analytical utility. For example, in order for a country to register a high score on the Technological Development and Diversity Index (TDDI), it is likely that the country in question will have also experienced considerable positive developments in areas such as macroeconomic stabilization, privatization, state-building, etc. The experience of Estonia, and Romania in the period after the late-1990s, certainly appears to support this view as important policy decisions and economic reforms enabled economic agents to increase output in new areas, thus diversifying the economic structure and increasing the level of competition within the economy. It is thus conceivable that TDDI acts only as a proxy for such variables and that they in fact are responsible for exerting a crucial influence on subsequent political outcomes.

While the argument that economic competition causes greater political competition does appear to be supported by the evidence, several issues that are raised throughout this study suggest that this is not in itself a satisfactory explanation. Most notably, the case studies illustrated the importance of legacies embodied within the existing economic structure that constrained the room for maneuver of important policy makers from the start of the post-socialist period. Such legacies can be either broadly

positive or negative. For example, the Estonian case demonstrates that an economic structure that is, at the starting point, relatively diverse increased the level of economic competition almost immediately, leaving government and state actors to formulate policies in a more autonomous manner. By contrast, the Russian case illustrates the obstacles that face political agents (such as Gaidar) who might have positive intentions vis-a-vis economic restructuring, but are nonetheless impeded by a concentrated economic structure that hinders the development of alternative political groups, the support of which would be needed to push through reforms that might be inimical to those of the dominant economic interests. It is in this respect that economic structure can be seen as exerting an influence over issues of political economy from the beginning of the post-socialist period. Indeed, given the prolonged and messy nature of the collapse of socialist economic and political structures, particularly in the former Soviet Union (although not exclusively), economic structure may have played an important role, even before the collapse of the *ancien regime*, as well placed economic and/or political actors moved to exert control over key economic areas. This was evident in, for example, both Belarus and Romania (in the 1990s), where socialist-era ‘insiders’ asserted control over the leading sectors of the economy and captured the political process.

The broadly uncausal relationship between economic structure and social order development contained within this study might also conceal a more complicated underlying process of political and economic change. The argument presented throughout this study is essentially that changes in economic structure, and the effects that this has upon wider economic competition, exert a decisive effect over the degree to which political competition is present, thereby shaping the prospects for positive or negative social order development. Of course, economic and political legacies are considered important, but only so far as they give a starting point and additional context to the subsequent narrative that follows the broadly uncausal trajectory implied by the conceptual framework. While this parsimonious model is perhaps useful as a heuristic device, its empirical plausibility is not so clear. Instead, the relationship between economic structure and social order development is no doubt far more circular or mutually constitutive than would be implied by the model contained within this study,

with social-order type itself likely to be a key factor in explaining the degree of economic restructuring. Two other factors appear to have been of more or less importance in shaping the prospects for economic restructuring in the case-studies contained in this dissertation: the rate of investment; and the nature of privatization. These two factors are considered briefly below.

First, a high rate of *investment* is clearly a pre-requisite for economic structuring. However, the sort of factors that might influence economic agents to invest or not would clearly be affected by the sort of institutional environment (i.e. social order-type) that these agents exist within. Thus, Estonia's success in restructuring its transnational economy was based on a consistently high level of investment; however, this compulsion on the part of Estonians and foreigners to invest in the economy might have been due to the initial success in implementing far-ranging institutional reforms immediately after independence. Similarly, the relatively low rate of investment in Russia since 1991 might be seen as a response to the poor institutional environment that economic agents operate within. Thus, establishing the precise direction of causation at each point of the development process is extremely difficult.

Second, the nature of the *privatization* process, and the effects that this has upon market structure and ownership within an economy, is also of crucial importance in explaining why some countries exhibit a greater degree of economic competition than others. In those countries in which privatization was either stalled, incomplete or has been subsequently reversed, economic competition has clearly suffered. Belarus, which undertook only a minimal degree of privatization in the early 1990s, has experienced only very limited economic competition since. Indeed, the Belarusian case illustrates the limitations inherent to the measure of economic competition used in this study. Despite a high degree of state ownership within the economy it still has a relatively diverse (in inter-sectoral terms) and, in some areas, technologically sophisticated, export structure. However, the domination of the economy by the state has reduced intra-sectoral competition. Furthermore, the Russian case demonstrates the importance of recognizing the role of control as well as ownership when assessing economic competition. While it is

certainly true that the natural resource sectors in Russia are, in some areas, characterized by private ownership, the role of the state has tended to ensure that even privately owned natural resource companies are constrained in the extent to which they can operate freely. This further illustrates the problem of economic structures that are dominated by only a few leading sectors; the dependence of the state on a limited source of revenue increases the incentive for it to become involved in the management of these important sectors.

The relatively short case studies contained within the study did not afford the necessary time and space to establish the precise direction of causation between these variables at different points in time; indeed, given the very nature of economic and political phenomena, it is not clear whether this is ever possible. As such, further research – probably in the form of more detailed single case-studies - would be required to make progress on this front. The study as it stands does at least offer an original and parsimonious account of social order variation across the post-socialist region; it is, however, imperfect and these flaws should be considered when drawing any conclusions from the evidence presented here.

The role of the intervening variables specified in this study – civil society, business associations, political parties, and business-state relations in general – are also of crucial importance to the credibility of the conceptual framework tested throughout this study. Again, mis-specification of the causal mechanisms linking economic structure with social order development is a potential problem. The possibility always remains that variation on the intervening variables may not in fact be shaped by economic structure, or at least not to the extent that is implied in this study. Instead, other factors might be of more utility in explaining why, for example, a broader array of political parties are able to develop in countries like Estonia, but not in Belarus and Russia. However, the fact that four different intervening variables were examined in each case study, and that all four move in the hypothesized direction outlined in Chapter Two, indicates that they are correlated at least with both the independent and dependent variables. Again, the direction and strength of the causal relationship is potentially problematic and for this reason further research – including a more in-depth analysis of a single case, as well as a

large-*n* analysis with a scope beyond the post-socialist region – would be necessary before one could conclude that the explanation offered in this study stands up against competing explanations.

9.2 Areas for future research

The brief discussion presented above has already identified some issues that would require further research, such as the need for more detailed case-studies to identify which variables are doing the analytical work at which time. However, while the model tested throughout this study does appear to be of some analytical utility when analyzing the countries of the post-socialist region, the issue of its wider applicability also remains an open question. It is possible that the trends and relationships between variables identified here are specific only to either the region, the time-frame selected for analysis, or both. While diverse economic structures and open-access politics do also appear to be correlated within advanced economies, as well as in the region under examination in this study, a cursory glance at the range of economic structures that are prevalent from around the developing world suggests that the simple relationship between economic structure and social order development does not always hold. For example, the structure of the Chinese transnational economy is relatively diverse and technologically sophisticated (see Connolly, 2008). However, the prevailing social order in China is overwhelmingly limited-access. Thus, one observes a situation where economic diversity – as measured in this study – is juxtaposed against a system characterized by low political competition. Clearly the Chinese case does not confirm the hypotheses that underpin this study. There are several reasons that may explain this important anomaly. First, the theory may simply not be universally applicable. Second, the theory may only be relevant to particular types of countries or during a specific period of time. Third, the measure of economic structure used here may be flawed. Fourth, the mechanisms linking the independent and dependent variable may take longer in some countries to produce the hypothesized relationship. It is possible that particularly rigid limited-access orders lag in the extent to which they change in response to changes in economic structure; in short, a temporally monotonic

relationship between the two variables may not always occur. Identifying which of these reasons explains the Chinese anomaly, for example, would require further research.

9.3 Economic restructuring, social order development and future challenges facing the region

This dissertation has focused on describing the main contours of economic restructuring that has taken place across the region over the past two decades, and the effects that such restructuring has had upon institutional development. As was described in Chapters Three and Four, there are distinct patterns of development across the region, with countries forming three broad clusters according to the development of their transnational production profiles, with some countries experiencing more success than others in climbing up the value-added ladder of production. As the scope for exploiting differences in labour unit costs diminishes – as is happening across the region as domestic wage inflation reduces the competitiveness of many of the economies of the region – so it will become more important for them to become more productive in their economic activities. Thus, economic restructuring and climbing up the global value-added ladder of production represents the first of what appear to be the three main challenges facing the region in the near future. The other two challenges are: (i) the ongoing (at the time of writing) *financial and economic crisis* that has afflicted the global economy since the summer of 2007; and (ii) the impending *demographic decline* that faces most countries from within the region.

All three challenges affect one another. For example, demographic pressures may reduce the availability of domestic capital for economic restructuring, in turn making the region more dependent than it already is on access to foreign capital. However, access to international capital may be more difficult for those countries with large external debt burdens. This study has so far addressed only the extent of economic restructuring across the region. The other two challenges are described briefly below. If anything, the existence of these other two challenges makes economic restructuring even more urgent; if external debt is to be repaid, or consistently rolled-over, and if pension obligations are

to be met, the countries of the region will be compelled to improve their productive capacities. Indeed, progress or otherwise in addressing these three issues should exert an important influence on further social order development; if states adopt a state-centric approach – as opposed to a market-based approach - to dealing with these challenges, the degree of economic competition may decline, perhaps then leading to a corresponding weakening of political competition.

The *financial and economic crisis* that began in 2007 has so far caused a contraction in economic activity across the whole world that is deeper and more widespread than anything since the Great Depression of the 1930s (IMF, 2009).¹⁹³ Unfortunately, there are reasons to believe that the region covered in this study is particularly vulnerable to the effects of continued distress in international capital markets and to declining levels of international trade. By the second quarter of 2009, a large number of economies from within the region displayed extreme vulnerabilities to any contraction in capital flows that might occur as a result of the financial and economic crisis.¹⁹⁴ The contraction in the volume of capital flows to this region and other emerging markets is likely to be exacerbated by the enormous volume of sovereign bond issues by advanced economies as they seek to compensate for declining private demand in their domestic economies. Indeed, by April 2009, the IMF warned that capital flows to emerging market regions might dry up completely, thus representing a ‘sudden stop’ (Calvo, 2000; IMF, 2009) Therefore, after enjoying an extended period of sustained economic growth that was, in many cases, accompanied by an accumulation of high levels of external debt built up through persistent current account deficits, the region now faces the prospect of much lower levels of economic growth as it moves towards a situation of greater macroeconomic balance. While the public sector has not generally contributed too much towards this accumulation of debt, it is likely that fiscal balances will be stretched as private sector agents struggle with the multitude of financial mismatches that threaten the economic health of many countries of the region. Indeed,

¹⁹³ Indeed, according to data from Eichengreen and O’Rourke (2009), the contraction in industrial output and world trade is more severe than at the chronologically equivalent stage of the Great Depression.

¹⁹⁴ This section is based on a summary of the financial vulnerabilities of the region outlined in Connolly (2009).

any banking crisis that might occur will also increase the contingent liabilities of domestic governments.

The downturn in trade that has accompanied the financial element to the crisis is also likely to exacerbate what are already challenging economic conditions. As was outlined in Chapter Four, and also in the case study chapters, many of the countries from within the region are open, export-oriented economies that are particularly reliant on trade with the European Union. However, the contraction in economic activity in the EU that has occurred as the global economic downturn has deepened has already caused a dramatic decline in the demand for exports from the post-socialist region. For those countries that were tightly integrated within the EU-focused manufacturing network, such as the countries of central and eastern Europe and the Baltic economies, the crisis has seen a dramatic decline in levels of trade as demand for manufactures declined. For those countries that were dependent on commodity and primary product exports, such as Russia, Ukraine, Moldova, and to a lesser extent, the Baltic states, the downturn has also resulted in a slump in demand for exports. This has resulted in a sharp decline across all commodity groups that has reduced these countries' export revenues. For manufacturers and commodity exporters alike, the downturn has savaged demand for the region's exports, leading many countries of the region into recession. If this situation persists, the susceptibility of some of the economies covered in this study to a financial crisis is likely to increase.

The financial and trade vulnerabilities of the post-socialist region to the ongoing economic downturn is likely to result in reduced economic activity as macroeconomic imbalances are evened out, and also in increased levels of public sector debt as states compensate for reduced private expenditure and, in some cases, provide the funds to bail out ailing financial systems.¹⁹⁵ Should the stock of debt across the region increase in response to the crisis, the more difficult it will be to respond effectively to the third of the challenges facing the region, that of *demographic decline*. The countries of the region

¹⁹⁵ Recent research suggests that the real value of government debt expands on average by 86 percent in countries that experience a financial crisis (Rogoff and Reinhart, 2008).

have, with few exceptions, experienced a dramatic decline in annual population growth rates since the 1980s. According to projections from the United Nations Populations Division (UNPD, 2009), the countries of the post-socialist region are currently experiencing, or will in the near future, a faster decline in population growth than any other developing region. Indeed, while the countries of developing Asia, Central Asia, Latin America, and the United States, are all projected to experience only a slowing of the population growth rate, the countries of the post-Socialist area are already experiencing *negative* population growth, with the declines being sharpest in the Baltic countries and those of south eastern Europe.

This rapid depopulation of the region will result in a sharp decline in the proportion of the population that is of working age, leaving the post-socialist region with, on average, the lowest working age proportion of the population among all developing regions, and lower than some advanced economies, such as the United States. Such pressures are likely to increase the fiscal burden of the states of the region as the demands of increasing numbers of pensioners become more pronounced, while lower numbers of people of working age will be called upon to support these pension commitments. The declining availability of labour may also result in increased wage inflation as labour markets become increasingly stretched. Coupled with the likely effects of the current financial crisis, the governments and populations of the region are likely to be burdened with high levels of debt, large future spending commitments in the form of pensions, a diminishing tax base, and potentially irresistible inflation. All of these pressures make it even more imperative that the countries of the region either begin, or continue to increase, productivity levels. Economic restructuring is a crucial component of this challenge.

Dealing with all of these pressures will be challenging enough with flexible, open and transparent political structures. However, as outlined in Chapters Three and Four, there is considerable variation in the quality of social order across the region. The type of social order, however, is likely to be of crucial importance in determining how the states of the region respond to the challenges outlined above. Primarily, the type of social order

might be expected to influence the choice made by states in focusing on state-centric solutions or market-based solutions. Where levels of economic and political competition are lower, it is probably more likely that state-centric approaches to these challenges are adopted as existing elites resist the entrance of other actors into the economic and political processes as they seek to retain their access to rents. In such circumstances, the likelihood of states overcoming the immense challenges that face them would appear to be limited. Indeed, even in those states where the type of social order is more open and competitive, the capacity to meet the challenges that lie ahead is not assured.

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LIST OF EXPERTS INTERVIEWED

In Moscow, 2-19 December 2007

Fyad Alekserov, Higher School of Economics; Professor of Economics

Martin Gilman, Moscow Higher School of Economics; Professor of Economics

Vladimir Gimpelson, Higher School of Economics; Professor of Economics

Georgii Satarov, INDEM Foundation; member of Research Council

Andrei Yakovlev, Moscow Higher School of Economics; Professor of Economics

In Tartu and Tallinn, 30 August – 19 September 2008

Agnes Aaslaid, British-Estonian Chamber of Commerce; Manager

Hannes Astok, Estonian Reform Party; member of Economic Affairs Committee

Jens Christiansen, Foreign Investors Council in Estonia; Board Member

Ulo Kaasik, Bank of Estonia; Chief Economist

Urmas Klaas, Estonian Reform Party, member of Economic Affairs Committee

Alari Purju, Tallinn Technical University; Professor of Economics

Siim Raie, Estonian Chamber of Commerce and Industry, Director General

Aivar Riisalu, Estonian Centre Party; member of Economic Affairs Committee

Taavi Roivas, Estonian Reform Party; advisor to the Prime Minister, 2005-2007

Juri Sepp, University of Tartu; Professor of Economics

Kadri Simson, Chairman of the Estonian Centre Party; member of Select Committee for the Enforcement of the Anti-Corruption Act

Erik Terk, Institute for Future Studies; Director

Uumas Varblane, University of Tartu; Professor of Economics

Taavi Veskimägi, Pro Patria and Res Publica Union Party; member of Economic Affairs Committee; Finance Minister, 2003-2005