

Economic Transformation and Comparative Politics

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The hardest part of the transformation, in fact, will not be the economics at all, but the politics.

Jeffrey Sachs, 1993:3

Over the last fifteen years the transformation of command economies has held great attraction for scholars of comparative politics. The opportunity to explore the impact of democratic politics, interest groups, and the European Union (EU) on the creation of market economies in real time has attracted leading lights in economics and political science who previously plied their talents elsewhere.¹ The mix of scholars with deep regional knowledge and experts from other fields has helped to make the study of the postcommunist world particularly compelling.

This essay highlights how research on the transformation of command economies has contributed to the broader literature in comparative politics. It begins by depicting the great variation in economic reform across countries over the last fifteen years. From an (arguably) similar starting point in the late 1980s, countries in the region range from EU members with robust market economies to highly statist closed economies today. It then examines how regime-type, interest groups, the quality of governance, and the EU have influenced economic reform. Research to date suggests that democracy has been far less of an obstacle than was previously thought; that groups gaining during the reform process

¹ Among political scientists, Raymond Duch, John E. Jackson, James Gibson, Stephen Holmes, David Laitin, Juan Linz, Alfred Stepan, and among economists, Gerard Roland, Andrei Shleifer, Jeffrey Sachs and Joseph Stiglitz have made important contributions to academic debate on the transformation of command economies.

may not support for further reforms; that the EU can serve as a motor of economic reform, and that capable institutions, particularly states, are critical for building markets. These insights have become rather broadly accepted, however, I argue that these arguments are often lacking in microfoundations. As is often the case in comparative politics, middle-range theories are vulnerable to attack from below because they provide multiple causal paths for interpretation. In discussing each of these explanations, I try to identify ways to tighten the casual links between these middle-range factors and economic reform.

Identifying the causal link between the middle-range arguments and the outcomes at hand is important because democracy, capable states, and economic reform are highly correlated by some measures. In addition, satisfying explanations should account for the process by which outcomes are achieved rather than just for the outcomes themselves. To date, the literature on postcommunist economic reform has been better at the latter than the former. Moreover, a number of scholars have expressed concerns that these middle-range factors and economic reform may spring from the same source. Thus, many questions remain about causal relationships in the study of transition economies. This problem of weak microfoundations is far from unique to the postcommunist world and is a common shortcoming in the middle-range theories that dominate comparative politics.

Having taken on middle-range theories for lacking microfoundations, this essay then reviews arguments that criticize middle-range theories from a different direction: a lack of causal depth. Kitschelt (2003) has raised this methodological/ontological issue most prominently by arguing that good explanations should not only draw tight causal links based on human agency; they also should also identify more temporally distant

causal factors to reduce the likelihood of tautology or banality. To this end, a number of scholars have put forward explanations for variation in economic reform in the postcommunist world that focus on deeper historical causes, including the timing and nature of state-building, the timing and nature of mass literacy, the role of geography and norm-diffusion, as well as the legacy of communist institutions. At their best, these explanations not only identify historical factors that are correlated with contemporary economic outcomes, they also trace some mechanisms by which these historical effects have been transmitted over time. This attention to causal mechanisms offers an advance over much work in historical institutionalism. I conclude by briefly presenting my attempt to integrate temporally proximate and distant factors into an explanation for reform outcomes in the region. My argument focuses on the impact of executive partisanship, democratic institutions, and the relation of the communist party to national sovereignty prior to 1989.

This review essay does not include all important works on economic transformation. Far too much work has been written over the past fifteen years to shoehorn into a brief review.² It also does not make a case for a single method, concept, or approach as is often done in review essays. Instead it aims to clarify points of contention, identify shortcomings in the literature that merit greater attention, and to demonstrate how the transformation of command economies raises issues of general concern for students of comparative politics.

Economic Transformation

² For excellent overviews see Djankov and Murrell (2002) and Campos and Corricelli (2002). This review essay focuses on economic reform and the creation of markets rather than on economic performance, such as economic growth and inflation rates.

Economic transformation begins with the command economy. While no two command economies were identical (just as no two market economies are identical), they did share common features. The state owned property and directed its use. Planners rather than markets set prices for most goods. Firms experienced soft rather than hard budget constraints. That is, managers were constrained more by resource shortages than by competitive pressures from the market (Kornai 1992). For all its perversities, the command economy was an equilibrium (Ericson 1992). Planners, managers, workers and consumers responded rationally to the incentives provided by the command economy and each participant had no incentive to deviate from their strategy. Being in equilibrium, command economies were not subject to changes at the margins. They were, in Schroeder's (1979) apt phrase, "trapped on a treadmill of reform." Command economies have proven largely impervious to endogenous reform, although China and Vietnam are currently proving exceptions to this rule. The institutional innovations that underpin China's and Vietnam's ability to "grow out of the plan" are discussed later in the chapter (Naughton 1995; Qian 2003; Malesky 2005).

The 27 countries of the former Soviet Union (FSU) and Eastern Europe fit most easily into the category of economies in transition and have the advantage of a roughly common institutional starting point. China, Mongolia, and Vietnam are often included in the literature as well. When comparing the three Asian economies in transition with their counterparts in the FSU and Eastern Europe, it is important to bear in mind the differences between these two groups. China and Vietnam began their transformations at much lower levels of income and retain strong one-party autocratic rule, albeit with varying degrees of competition at lower levels of government. In addition, the number

of goods included in the central economic plan was far less in China and Vietnam than in the command economies of the FSU and Eastern Europe (Naughton 1996). There is robust debate about the merits of drawing lessons from Asian economies in transition and applying them in the FSU and Eastern Europe, but comparisons across these groups may be quite fruitful for some questions (Qian 2003).³

In examining progress in the creation of market economies over the last fifteen years, one is struck by the great strides made by a number of countries, particularly given the region's hostile initial conditions, the scope of transformation, and the volatility of global markets in the 1990s. The European Bank for Reconstruction and Development (EBRD) rates progress in eight different types of economic reform on a scale where 1 equals little change from the command economy and 4.3 equals a standard equivalent to that of a developed market economy. The types of reform include large privatization, small privatization, trade liberalization, price liberalization, corporate governance reform, bank reform, securities market reform, and competition policy reform. The highest reform scores recognize the institutional variety of modern capitalist economies and do not necessarily indicate convergence on an ideal type. For the most part the scores set benchmark levels of performance found in developed market economies.

Insert Table 1 here

Column 1 in Table 1 depicts the unweighted average EBRD reform scores across all eight dimensions in the year 2004 and reveals the considerable progress that many countries have made over the last fifteen years. Poland, the Czech Republic, Hungary,

³ Among others see Sachs and Woo (1992), and Mau (1999) who are skeptical of such comparisons, while Naughton (1995) Stiglitz (2000) and Roland (2000) are more supportive. One difficulty in integrating studies of the two sets of countries is a lack of comparable data.

Slovakia, Estonia, and Latvia have made great strides toward developing institutional frameworks that resemble developed market economies. Other countries, like Albania, Armenia, Bulgaria, Romania, Russia, and Ukraine have struggled to introduce extensive economic reforms in some areas, but have made considerable progress in others. A final group of countries, Belarus, Uzbekistan, and Turkmenistan have shed some elements of the command economy, but retain extensive regulation, high levels of protection, and large state sectors.

The postcommunist cases remind us that reforms are multidimensional. Countries often conduct several different types of reforms simultaneously. Different types of economic reform have generally been highly correlated in the region, but variation in the rate of progress across different dimensions of economic reform is also prevalent. For example, the last three columns of Table 1 provide data on the reform scores for three types of reform in 2004. Column 2 indicates that most countries have significantly opened their economies to foreign trade, while Columns 3 and 4 indicate that they have made less progress in privatizing industry or improving corporate governance.⁴

The impact of variation on the rate of progress across different types of economic reform has sparked debate. Some scholars have argued that economic reforms are largely complementary, that is, progress in one type of economic reform begets progress in other types of economic reform (Fischer et al. 1996). For example, liberalizing trade makes it easier to liberalize domestic prices. Others have argued that variations in speed across different types of economic reform create opportunities for politicians to build coalitions of early winners from reform to support further liberalization later in the transformation

⁴ Countries have made more progress in small privatization and domestic price liberalization than in other areas of reform, such as bank reform, securities market reform, and competition policy.

(Roland 2000). This implies that variation in progress across different types of reforms may be associated with more successful reform efforts. Still others argue that variation in the progress of different types of economic reforms allows economic actors gaining from one type of economic reform to block further progress in other types of economic reform (Murphy, Shleifer and Vishny 1992; Hellman 1998). The impact of the interaction of different types of economic reform likely depends on the specific reforms in question and more research is needed along these lines. However, even in a preliminary form this debate has helped push forward the literature on the politics of economic reform by forcing scholars to consider in more detail how different types of economic reforms may influence each other.

Over time variation tells an equally interesting story. Some countries, like Poland, conducted extensive economic reforms start of the transformation and maintained a highly liberal economy throughout the postcommunist era. In contrast, Belarus has followed a much more gradual path of economic reform over the last fifteen years. Russia's economic reform experience is punctuated more by fits and starts. After an initial period of liberalization, Russia experienced a reversal of economic reform in 1998. Following this setback, Russia has struggled to create a greater role for markets.

Insert Figure 1 here

Middle-Range Theories and Economic Reform: Regime Type

Accounting for this variation in economic reform across countries and over time has been a central task for political scientists and economists. Most authors have emphasized middle-range theories that focus on the impact of regime-type, the power of interest groups, the quality of governance institutions, and the lure of the EU. Each of

these arguments has generated important insights, but they often are built on shaky microfoundations.

Guided by the conventional wisdom on the politics of economic reform emerging from studies of Latin America, initial analyses focused on regime type as a potential explanation for economic reform (Lipton and Sachs 1990; Przeworski 1991; Williamson 1994). This view emphasized that economic reforms produced concentrated costs on specific groups in the short-run and dispersed benefits for society in the long-run. Rulers seeking to liberalize their economies should therefore promote economic reform as rapidly as possible across a broad range of policies and insulate themselves from the inevitable populist backlash as reforms took hold. The main political challenge of economic transformation was to create institutions that would allow reform-oriented politicians to stay in power through the “valley of tears” until the economy began to rebound to their political benefit (Przeworski 1991). Countries with executives most vulnerable to popular pressure, typically via elections, should experience the least progress in economic reform.⁵

The emerging conventional wisdom from the postcommunist world, however, challenges this argument. There is evidence that the level of democracy is positively associated with the level of economic reforms in the postcommunist world. A number of works have reported high bi-variate correlations between the level of democracy measured by Freedom House and the level of economic reform as measured by the EBRD’s Index of economic reform (Hellman 1998; EBRD 1999). Regression analysis

⁵ Scholars rarely went so far as to argue that autocracies were better at conducting economic reform, but many scholars favored institutions that provided insulation from popular protest and expressed skepticism that political and economic liberalization could be mutually supportive.

reveals that the positive association between democracy and economic reform remains significant after introducing controls for membership in the former Soviet Union, executive partisanship, and initial levels of wealth.⁶

Despite the currency that the “democracy promotes economic reform” view has attained in recent years, it is not time to pop the champagne just yet because the microfoundations of the argument remain largely unspecified.⁷ Democracy may affect economic liberalization in many ways and the casual path has yet to be identified. Some argue that democracy heightens accountability by giving electoral power to the losers from economic reform and thereby prevents powerful groups from hijacking the state (Hellman 1998). According to this view, accountable rulers with short tenures are less prone to capture as economic agents get fewer returns for building personalistic ties to particular rulers. However, on equilibrium, political turnover need not be associated with economic reform. The threat of losing office should deter both accountable incumbents from granting and interest groups from seeking particularistic benefits in the first place. Because the threat of turnover should be sufficient to reduce rent-seeking, the empirical observation of high government turnover and extensive economic reform is not especially informative.⁸

⁶ Time-series cross-section analyses of economic reform in the postcommunist should be conducted with care given the relatively short-time frame, and the prospect of endogeneity bias and measurement error, but nonetheless provide considerable insight.

⁷ It should be noted that democracy is far less correlated with increases in economic than with the level of economic reform. The correlation between the level of democracy in the year of the largest increase in economic reform and the size of the increase in economic reform is .26, a relationship that falls short of statistical significance ($p = .21$). Many countries made their largest increases in economic reform early in the transformation at fairly low levels of democracy.

⁸ Economic reform may be driving the level of democracy rather than vice versa (Fish 2005).

A slightly different argument suggests that democratic states have more dispersed power, e.g., more veto points, and are therefore less prone to state capture. This may be true, but it also offers little insight into why reforms are introduced in the first place. Analyses from other regions indicate that dispersed power makes it more difficult for governments to overcome the collective action and distributional problems of introducing economic reforms, even as it may complicate the maintenance of economic reforms in later stages (Haggard 1990; Haggard and Kaufman 1995; Roubini and Sachs 1989).⁹ Without some reference to the partisan preferences of the main agents of interest it is difficult to know why democratic institutions on their own are conducive to the introduction of economic reform.

Democracy may promote economic reform through the electoral cycle. There is some evidence that trade liberalization is more likely to be introduced in the year immediately following elections and is less likely to be introduced immediately before elections (Frye and Mansfield 2004). Others have found evidence of electoral cycles across different policy domains in Russia (Treisman and Gimpelson 2001), but these arguments have not been tested on a broader range of policies across countries.

Cross-national evidence suggests that free media characteristic of democratic rule may be central to economic reform (Adsera, Boix and Payne 2002). Using detailed receipts and videos of bribes between officials in Peru, McMillan and Zoido (2004) argue that because the size of bribes paid to the media were far larger than those paid to elected officials and bureaucrats the media are a lynchpin in efforts to reduce corruption. Within

⁹ Haggard and Kaufman (1995) argue that concentrated political power makes it easier to introduce economic reform, but may make it more difficult to consolidate economic reforms once they have been introduced.

Russia, regions with greater freedom of the press experience better economic performance (Yanovskiy et al. 2001). Perhaps, democracy works through the freedom of the press, but this argument has not been tested across the postcommunist world. More broadly, the institutions of democracy may be complements rather than substitutes and promote economic liberalization only when all are present. That is, the effects of electoral pressure, dispersed power, and free media may each be necessary to promote economic reform. If this is the case, then all the pieces of democracy must be in place for it to have its desired effect on economic reform.

Two contextual factors may also make democracy more conducive to economic reform in the postcommunist world than elsewhere. Democracy may be highly correlated with economic reform in the postcommunist world because organized labor is so weak.¹⁰ In Latin America where labor has traditionally been better organized and more closely tied to political parties, the relationship between democracy and economic reform has been more tenuous. In the Latin American cases, the losers from economic reforms appear to have had greater (if far from great) success in using the institutions of democracy to block economic reforms than have their compatriots in the postcommunist world. Thus, the relationship between democracy and economic reform in the region may depend on the general impotence of organized labor.

In addition, the dispersion of power typically associated with democracy may be more likely to promote economic reform in the postcommunist world than in other settings. Given a status quo of highly centralized political power and an extremely statist economy at the start of the transformation, the likelihood is high that new groups

¹⁰ Many scholars have noted the surprising weakness of organized labor in the postcommunist world. Crowley (2004) provides a nice review of this literature.

entering the political sphere have more liberal economic preferences than incumbents. Thus, on balance the dispersal of power from statist incumbents is likely to increase the leverage of groups with more market-oriented preferences over policy in a postcommunist setting. Using data from 1990-1998, one study finds that democratic governments had open economies regardless of the concentration of political power, but that non-democratic governments with dispersed political power also had highly open economies. Only autocracies with concentrated political power retained very high levels of trade protection (Frye and Mansfield 2003).

In sum, it is not clear precisely how the level of democracy influences economic reform. Identifying the causal impact of regime-type on economic reforms is important because democracy is also correlated with the presence of liberal governments, accession to the European Union, and certain historical factors as well. Here scholars of economies in transition are in the same boat as students of the democratic peace (Rosato 2002). There appears to be a correlation between the level of democracy and an outcome of interest, but the causal path is still subject to debate. More research into the process by which democracy is associated with economic is needed. In addition, there is a possibility that both democracy and economic reform are both driven by deeper structural factors. It seems premature to embrace the emerging (and normatively pleasing) consensus that democracy and economic reform necessarily go hand in hand in the postcommunist world.

Interest Groups: Good Winners, Bad Winners, and Economic Reform

Scholars have also examined the role of interest groups in economic transformation in the cases at hand. In other regions of the world, interest groups have

figured prominently in explanations of economic reform in a rather straightforward fashion. Groups gaining from economic reforms received tangible benefits and pushed economic reform forward, while the losers from economic reform had to be compensated or repressed for economic liberalization to proceed (Garrett 1998; Haggard 1990). Summing up the standard view, Rodrik (1996: 29) argues that “reforms become sustainable when they generate winners with a stake in their continuation.” Generating political support for economic reform was especially important in the postcommunist world given that the expected beneficiaries of economic reform – firms in the private sector – barely existed in many countries at the start of the transition. This concern helped to provide an intellectual justification for rapid economic reform.¹¹ Many argued that privatization would benefit enterprise insiders, primarily company managers, who would then provide a constituency for further economic reform (Shleifer and Vishny 1998: 11).

Yet, evidence from the postcommunist cases suggests a more nuanced view of the behavior of economic winners is appropriate. One of the biggest surprises from the literature on economic transformation is that some groups gaining from economic reform may have incentives to block further liberalization. Most prominently, Hellman (1998) argues that some economic reforms have delivered concentrated benefits to specific interest groups who are then well placed to block further reform. For example, easing restrictions on foreign trade before domestic prices are fully liberalized allows exporters to buy goods at subsidized state prices, sell them abroad at world market prices, and pocket the difference. Similarly, rapid privatization of industrial assets prior to the creation of institutions to protect property rights allows enterprise insiders to strip assets

¹¹ Eyal et al. (1998) captured this problem in the aptly titled *Making Capitalism Without Capitalists*.

for their personal benefit. Many argue that the winners from so-called “partial reforms” have been a potent brake on the continuation of reforms.

Scholars have long recognized that groups with privileged positions in the economy can subvert the process of economic reform, but Hellman (1998) advances this notion by recognizing that the reform process itself may generate benefits to groups who then have a stake in stalling reforms. This insight, which builds off earlier work by Murphy, Shleifer, and Vishny (1992), identifies groups gaining from the transition economy as a primary obstacle to further economic reform.¹²

Others have picked up on this argument. Sonin (2003) develops a formal model that suggests that company managers grown wealthy from privatization prefer to keep the rule of law weak because they are especially well placed to use private means to protect their property, including bribing government officials and hiring a private security firm. Hoff and Stiglitz (2004) argue that managers who take control of their enterprise through privatization face collective action and coordination problems that blunt their incentives to lobby for further institutional reform. As a group managers stand to benefit from improvements in the rule of law, but because institutional reform has distributional consequences there is no guarantee that managers will coordinate on a strategy that improves their individual lot. Indeed, managers with access to rents may prefer to delay the establishment of the rule of law until the resource is depleted.

This view has gained considerable credence, but more research on the topic is needed, particularly outside of Russia (Ganev 2001). Big winners from early rounds of economic reform are certainly the most visible opponents of further economic reform, but

¹² Schamis (1999) makes a similar argument for Latin America.

it is not clear that they have been the most powerful barriers to progress. In Russia, the financial crash of August 1998 dramatically weakened the political power of oligarch-controlled banks, but the last seven years have seen only slow progress in cleaning up the sector. If the oligarch banks were the biggest obstacles to reform in this sector, we might have expected more rapid progress after their decline.¹³

Similarly, if the early winners from economic reform were sufficiently powerful to capture the state, we might have expected more reversals in economic reform as early winners roll back reforms that cut against their interests. Yet reversals of economic reform have been rare and have tended to occur at low rather than high levels of economic reform. Moreover, some countries appear to have escaped the “partial reform equilibrium,” an outcome that would seem unlikely given the political power of the early winners (Malesky 2005).¹⁴ Despite these concerns, there is evidence that some groups grown wealthy off the transition economy have obstructed further reforms.

Good Winners

Not all winners, however, are bad winners. Some groups have grown rich from distortions in the reform process itself, but others have benefited from expanded opportunities to trade and have been allies in support of further economic reform. Jackson, Klich, and Poznanska (2005) find that districts in Poland that created more new private firms early in the transformation experienced higher vote shares for market-oriented parties in national elections in 1993 and 1997. This study advances the debate

¹³ Of course, tycoons in other sectors of the economic retain considerable influence on policy.

¹⁴ Guriev and Rachinsky (2005) find that on average oligarchic-controlled firms in Russia obtained higher rates of profit, but it is difficult to determine whether this stronger performance is linked to characteristics of the firms or the owners’ greater political power.

by tracking the entry and exit of new private firms over time and by demonstrating precisely how the presence of many new private firms compel parties to favor policies that expand the market. Similarly, Fidrmuc (2000) and Tucker (2006) find that regions within countries of East Central Europe with more groups gaining from economic reform show greater support for liberal parties at the ballot box. Frye (2004) finds that managers of new private firms were especially likely to vote for pro-reform parties in parliamentary elections in Russia in 1999.

These results suggests that the reform process itself can change the balance of power among groups gaining and losing from reform in ways that are difficult to capture in a static analysis. Reforms that create robust new private sectors can generate their own constituencies in support of further liberalization, while reforms that deliver concentrated benefits to strategically placed interest groups may stall further reform. his suggests the merits of a more dynamic approach to the politics and economics of transformation than is often found in the literature.¹⁵ In addition, these results call for a more subtle treatment of the political behavior of winners from economic reform. It would be helpful to determine the conditions under which different types of winners emerge as constituencies in support of or against further economic reform.

¹⁵ These results portray the new private sector in a new light. Rather than being seen as marginal political actors, this view suggests that it is the small firms in the new private sector who have little lobbying power on their own but can be a force at the ballot box that are a central constituency for promoting institutional reform and democracy. This distinction is reminiscent of the oft-cited discrepancy between good bourgeoisie merchants and the bad bourgeoisie landed capitalists in Barrington Moore's *The Social Origins of Dictatorship and Democracy*. It is their limited ability to strip assets and obtain rents that gives the new private firms a stake in furthering reform and democracy.

Perhaps more important, these results indicate that when studying political and economic change it is useful to think in terms of intertemporal contracts (Deirmeier et al. 1997). Politicians and groups gaining from economic reform face a problem of credible commitment. Incumbent politicians choose policies in hopes that the beneficiaries will then provide political support. However, having received their benefits, winners may not deliver the promised political support. Indeed, having grown wealthy off the transition economy, early winners may be well-placed to withhold their political support in hopes of getting a better bargain.

The problem of intertemporal change becomes more severe when we realize that public officials may also violate their end of the bargain. Having delivered selective benefits in exchange for political support, state agents may then be in a position to revoke those benefits. President Putin's campaign against several oligarchs who backed his presidential campaign in 2000 illustrates this dynamic quite well. This recognition alerts analysts to the problem of time inconsistency in conducting economic reform and raises a host of interesting questions for future research. Why does privatization "stick" in some cases, but not others? Does the fairness of privatization help make property rights secure? Are privatization deals with foreign firms easier or harder to overturn? Why do politicians who come to power respect the privatization decisions of their predecessors in some cases, but not others? Having received control over the enterprise, how do managers come to believe that state officials will respect their property rights?

This problem is far from unique to transition economies and is present to a greater or lesser extent in all instances of political and economic exchange. Identifying the political and social conditions that facilitate exchange between incumbent politicians and

economic winners should be high on the agenda for scholars of economic transformation and comparative politics as well. In this case, the economics of transformation has highlighted a central problem of credible commitment inherent in distributional politics that is often swept under the rug.

Governance, the Role of the State and Economic Reform

Governance and the role of the state in the economy is a third long-standing concern in comparative politics that has been central to economic transformation (Offe 1991; Grzymala-Busse and Jones-Luong 2002). Early studies emphasized scaling back the Leviathan of the communist state, but scholars soon realized that an enfeebled state did little to promote economic reform (Sachs 1994; Holmes 1996). One lesson of the postcommunist transformation is the importance of capable states for building markets.

It is often stated that advocates of rapid economic liberalization ignored the reform of state institutions, but it is more accurate to note that they believed that construction of state institutions first required a stable macroeconomic environment. And they were likely right as institution building under macroeconomic instability is a dubious proposition.¹⁶ However, it is also true that most observers were caught off guard by the rapidity of the decline of the state, the rise of the informal economy, and the great speed needed to develop the basic institutions of a market economy (Roland 2000).

Debates about the nature and capacity of state institutions to govern markets have been central to work on postcommunist transformation. Three issues merit clarification. There is a widely held view postcommunist states have collapsed, but in most cases states

¹⁶ One study finds that institutions have a stronger impact on economic growth after the first few years of transformation indicating that institutions grow in importance after macroeconomic conditions have stabilized (Campos and Corricelli 2002).

in the region retain greater capacity to tax and spend than other lower and middle-income countries. Table 2 presents data from the World Bank on state tax revenue as percentage of GDP and state spending as a percentage of GDP for the year 1995 for a range of countries. On average, most postcommunist states are large relative to the size of their economies and retain considerable ability to tax.

Table 2 here

There is also a widespread belief that postcommunist states have needed to cut spending, particularly social spending, to “free up” the market. But states with the most robust market economies have also tended to have high social spending. The lagged value of health spending per capita is positively correlated with the mean economic reform score as calculated by the EBRD (.55) (World Bank 2002; EBRD 2003).

China and Vietnam serve as outliers on this score. They have small states without generous transfer payments, but have conducted considerable economic liberalization. China is particularly interesting in this respect. Total government fiscal revenue in 1978 was about 40 percent of GDP, but by 1996 this figure had fallen to just 17 percent (Qian 2003: 320). This ratio has changed not because of drastic cuts in spending. Indeed, government revenue has doubled in this period. The decline in this figure is largely due to rapid economic growth which has led to a five-fold increase in the denominator.

Finally, governance in the postcommunist world is widely thought to have been abysmal over the last decade, but several studies find that it has generally been similar to that of other middle-income countries. Murrell (2003: 1) measures governance using World Bank indicators for 1990-1997 and finds that “institutional quality is roughly as expected given per capita income.” Treisman (2003) uses Transparency International

Indices to measure governance and reaches the same conclusion. Single country studies produce similar findings. Despite the notorious reputation that Russia has gained for being the poster child of postcommunist lawlessness, Hendley et al. (2001) present survey evidence which suggests that legal institutions in Russia are not atypical.¹⁷

Part of the debate is due to measurement problems. In the last decade, scholars have developed a range of innovative instruments to study governance and corruption, including surveys and case studies. However, as Anton Chekhov notes, “when many remedies for a disease exist, it means that the disease has not been cured.”¹⁸ This difficulty of assessing the quality of governance should not be underestimated.¹⁹

Blueprints and Local Knowledge

There is a consensus that “good institutions” are important, but how countries obtain them is a subject of debate. At a broad level, two camps have emerged on the sources of good institutions and the postcommunist cases have been central to this discussion. The blueprint school emphasizes that we know which institutions work and there is no need to “re-discover America” as the Russian folk saying goes. The basic institutions of capitalism are well understood and can be exported with minor adaptation to local conditions. The transfer of existing institutions may spare countries the costly trials and errors that accompanied the creation of markets elsewhere. This view advocates borrowing institutions of corporate governance, bank legislation, and bankruptcy where

¹⁷ By other benchmarks we might have expected governance in the region to be higher than its current level. Many authors trace the capable bureaucracies of the East Asian tigers to low levels of inequality and a highly educated workforce -- factors that also present early in the postcommunist cases (Rodrik 2000).

¹⁸ Chekhov was a medical doctor so he knows of what he speaks. This quote is from *The Cherry Orchard*.

¹⁹ Case studies of state institutions over time within a single country have been rare and case studies of state institutions across countries have been even less common. See Johnson 2000; Meaney 1995; Easter 2003.

international best practices are more or less well known (Kaufmann 2005).²⁰ The blueprint argument is often associated with “shock therapy” economic reform (although it need not be), because it allows for the rapid introduction of new institutions.

It is easy to caricature the blueprint school as Washington-based bureaucrats trampling on local norms to force cookie cutter solutions on experienced local public officials who have little choice but to follow instructions. But the view is somewhat more subtle and has evolved over time. Adherents to this school emphasize general principles in the design of good institutions rather than the direct transplantation of laws. The principles of transparency and accountability are treated as paramount and there is some recognition that different institutions may be available to solve governance problems.

Supporters of this view point to the influence of the European Union on economies in transition. By some accounts, the adoption of EU regulatory norms improved the quality of governance and reduced corruption in some transition economies (Mattli and Ploemper 2003; Kaufmann 2005; Vachudova 2005). Why should countries experiment with new approaches when they can borrow off-the shelf regulatory institutions and adapt them to local market conditions?

Others have suggested that local knowledge is the building block of successful institutions (Berkowitz et al. 2003; Rodrik 2000). This view is skeptical that “best-practice” institutions may be imported from other settings, in part because institutions are highly complementary. Strong institutions emerge through the ingenuity of political and economic entrepreneurs who rely on deep knowledge of local conditions (McDermott 2002). Here institutions are specific to particular contexts and emerge from path-

²⁰ Of course, these questions are still vigorously debated by academics even as they remain broadly accepted by policy advisors (Easterly 2003).

dependent processes that use trial and error. This view is often associated with gradual approaches to economic liberalization, (although it need not be) as it emphasizes experiments that may take time to evaluate.

Whether blueprints or local knowledge are relatively more important for the development of institutions, however, neglects an important insight of transformation economics – the political conditions that underpin the choice of institutions are critical. For example, Qian (1998; 2003) attributes part of China’s success to the creation of “transitional institutions” that are politically feasible and efficiency-enhancing, even if they fall short of the type of first-best solutions advocated by the blueprint school.²¹ These institutions protect rents obtained by the politically influential, while expanding opportunities for others. The institution of dual-track pricing allowed firms to produce for the plan at one price, but sell their above-plan output at market prices. Prices were “liberalized at the margin while inframarginal plan prices and quotas were maintained.” Similarly, the creation of township and village enterprises (TVEs) that combined state and private ownership and ensured the local and central government a stable flow of revenue while allowing shareholders in the TVE to retain revenues above those pledged to the plan. These institutions stand at odds with the blueprint school’s emphasis on broad-based price liberalization and clearly defined property rights.

In addition, the development of anonymous banking violates the blueprint school’s emphasis on transparency, but has helped constrain the Chinese government in the absence of the rule of law. Anonymous banking limits information available to the

²¹ One standard approach to policy analysis is to identify economically efficient policy and then identify how politics has muddied a beautiful design. An alternative is to begin with the politically efficient policy and then identify how to adapt economic policy to bolster efficiency.

government and makes predation against specific depositors more difficult. The government accepts the arrangement in part because it gains from the revenue held in banks through its controls on interest rates and capital flows (Qian 2003: 306). Thus, anonymous banking helps to decrease the capacity of the state to intervene arbitrarily in the market and thereby bolsters credible commitment. These transitional institutions work because they are well-suited to China's political conditions and not because they are "best practice" institutions appropriate for mature market economies.

Shleifer and Treisman (2000) take a similar tack. They argue that privatization and tax reforms in Russia were designed to protect the rents of powerful groups, while also trying to increase efficiency at the margins. According to this argument, by substituting state treasury bonds for seignorage, the Russian government preserved the rents of the politically powerful banking sector, but reduced the social costs generated by large budget deficits that had been financed by inflation. They argue that given the politically feasible political set of options, rulers should seek to introduce reforms that improve economic efficiency at the margins. Some have expressed concern that such an approach rewards rent-seekers too generously, while defenders treat these compromises as essential costs to pay of promoting economic reform in less than ideal conditions (Stiglitz 2000; Zhuravskaya 2006).

In sum, economic transformation in the postcommunist world has reinforced the importance of institutions and governance for a market economy.²² However, the effectiveness of institutions is determined in part by incentives facing political and

²² It is probably no surprise that the eminent scholar of institutions Douglass North won his Nobel Prize in 1994 as the economic transformation was underway in the former Soviet Union and Eastern Europe.

economic agents. More research is needed to identify more precisely why politicians supply efficiency enhancing institutions and why powerful political actors demand them.

The European Union

The transformation of command economies in Eurasia, China, and Vietnam is taking place on the fringes of economic powerhouses that have undoubtedly shaped economic transformations from command economies. Most prominently, the European Union has played a powerful role in economic transformation. Eight transition economies in Eurasia joined the EU in 2004 and three more are on the doorstep. Membership in the EU provides considerable economic benefits for new member countries, and popular support for membership has been rather high. The EU has loomed large in analyses of economic reform. Roland (2000) argues that accession countries in Eastern Europe engaged in a “tournament of reform” with potential members pushing each other to enter the EU first. The power of competition and the fear of being excluded helped to spur economic reform in countries on the EU’s eastern border. Vachudova (2005) argues that the possibility of accession allowed the EU to assert “passive leverage” on economic reform in East Central Europe from 1990-1994. As negotiations for membership began in earnest in the mid-1990s, the EU then exerted “active leverage” by pressing for specific economic reforms that were consistent with the *acquis communautaire*. In her view, the EU provided credible commitments that economic reforms would not be reversed and empowered domestic interest groups with pro-reform preferences.

While existing arguments about the impact of the EU have made headway, the micro-logic of these arguments can be more clearly specified. There is little doubt that the potential gains to expansion were high. On the supply-side, EU members sought

expansion in hopes of maintaining stability on their borders, creating more security property rights for their investments, and regulating the flow of labor from the East. On the demand side, potential members had their eyes set on EU transfer payments, high paying jobs in member countries, and expanded export opportunities.²³ Pointing to the benefits of membership as an explanation risks the danger of functionalism. Many beneficial agreements fail to occur for a variety of reasons, particularly where distributional consequences are involved. Moreover, if the benefits of membership alone were decisive, all countries would have sought to join the EU, but governments across the region expressed varying degrees of support for accession.²⁴

An additional concern in studies of the impact of the EU on economic reform is the direction of causation. Has the pull of EU membership been more powerful than the push from the economies in transition? In other words, to what extent is economic reform due to EU conditionality or to policies that countries would have pursued anyway given their partisan preferences? There was considerable debate about the merits of expansion within the EU until at least the mid-1990s (Mattli and Ploemper 2002: 551). Moreover, there was vigorous debate about which countries in the postcommunist world would qualify as potential members. One could argue that it was only after the countries of Eastern Europe made considerable progress in economic and political reform that the EU began to push expansion more aggressively. Alternatively, one could argue that the prospect of EU accession motivated economic reform even as the EU was lukewarm

²³ Some of these goals could have been met with policy instruments short of EU membership, such as bilateral trade agreements, free trade zones, and immigration policy.

²⁴ Norm-based accounts for EU membership also have difficulty accounting for variation in the strategies adopted by potential accession states. See Shimmelfenning (2001)

about expansion. The direction of causality between EU membership and domestic reforms likely runs both ways which makes analysis of this process a challenge.

Ploemper, Schneider, and Troeger (forthcoming) address this issue using a selection model to account for the possibility that countries do not apply to the EU at random.

They find that the level of democracy and market reforms influence the decision to apply to the EU, with EU conditionality playing a much larger role in promoting economic reform after a country applies for membership.

In reflecting on the impact of the EU, it may be helpful to consider some counterfactuals. Would the pull of Europe's powerful economies have been sufficient to encourage economic reform, even without the EU? What if economic reform early in the 1990s in East-Central Europe went awry? Would the EU have been as supportive of enlargement? These questions cannot be answered beyond a reasonable doubt, but they point to a number of ways in which the causal logic of how the EU shaped economic reform in the region can be clarified.

Part II. Middle Range Theories and Causal Depth

The types of middle-range theories presented above have made considerable headway, but are vulnerable on two fronts. First, they often lack microfoundations that offer concrete accounts of how and why policy outcomes vary across country. Existing studies have been better at drawing correlations between middle-range factors, like regime type and state institutions, than in accounting for why these factors have the effect that they do. More attention is needed to theoretical accounts and empirical investigations that account for the decisions made by powerful economic and political agents.

In addition, a number of scholars have argued that these types of middle-range theories have tended to lack causal depth. That is, they may primarily be the reflection of deeper historical processes that are the underlying creators of market economies. Kitschelt (2003: 16) makes this case most eloquently by urging scholars to navigate between “an uncompromising structuralism that has a penchant toward excessively deep explanations without human action, on the one hand, and purely conjunctural theories that favor only the shallowest, most proximate of intertemporal social mechanisms, on the other.” In specific reference to the cases at hand he notes: “causal analysis in the comparative study of post-communist politics should not be so shallow as to blur the distinction between *explanans* and *explanandum*, but it should also not be so deep as to evaporate any causal mechanism that could operate through human action, identified by preferences, skills, and expectations.” With this line of argument in mind, a number of scholars have thought to push back the causal chain to find structurally deeper causes of reform outcomes in the postcommunist world.

These accounts do not always seek to account for economic reform outcomes, but they do aim to identify the structural factors that in turn shape attempts to build market economies. For example, Kitschelt and Malesky (2000) critique institutional accounts of economic reform in the region for their neglect of the likely endogeneity of institutions themselves. They note that “the independent effect of institutions may be quite modest in many instances and vastly overshadowed by the power configurations that antedate the choice of institutions.”²⁵ In a related argument Kitschelt (2003) suggests that the timing

²⁵ More specifically, they trace the constitutional choice of presidential and parliamentary institutions in the postcommunist world to the extent of inter-war political mobilization, the timing of state formation, and geography. In turn, the impact of presidential and parliamentary regimes on economic reform is small and

of state-formation and the type of communist rule, whether it was bureaucratic administrative, national accommodative, or patrimonial, shapes the prospects for both democracy and economic reform. For example, the patrimonial communism and late state formation that marked most of the former Soviet Union gave incentives and resources to outgoing communist leaders to establish political institutions inhospitable to democracy and to pursue gradual economic reforms that reflected the interests of their constituencies. In contrast, countries like Poland and Hungary that experienced national accommodative communism entered the 1990s with more robust state institutions and human capital better suited to building a market economy and democratic political institutions. In these accounts, it is the nature of state-building and the legacy of communist rule that generates institutions and human capital that travel temporally to influence the prospects for economic and political reform in the contemporary period.

Similarly, Kopstein and Reilly (2000) argue that geographic proximity to market-oriented democracies in Europe and Japan drove both the creation of democratic institutions and the extent of economic reform by spreading norms of appropriate elite behavior. They argue that “geographic proximity to the West has exercised a positive influence on the transformation of communist states.” To provide a more causal account, the authors argue that geography shapes political and economic outcomes through two types of diffusion effects: neighbor effects, in which states are influenced by their neighbors and openness effects in which states vary in their receptiveness to the “flow of ideas and the willingness and capacity of the ruling regime to allow interaction with

contingent on pre-existing structural conditions. Powerful presidencies may promote economic reform in highly clientist autocratic regimes, but have more limited effects when structural conditions are not conducive to clientelism or the regime is democratic.

surrounding states and to accept the influence of communication, transportation, and technology that has the potential to transform attitudes and behavior” (Kopstein and Reilly 2000: 36). The causal story here of how these diffusion effects influence economic reform is not very clear, but the larger point is well made that both economic and political reform may both be driven by geography.

Darden and Grzymala-Busse (2006) trace the outcome of the first postcommunist elections, which Fish (1998) argues is a critical determinant of economic reform, to the timing of mass literacy and the content of the national curriculum.²⁶ They argue that the substance of educational training at the timing of mass literacy shaped values and attitudes in subsequent generations in ways that map onto policy preferences in the postcommunist period. They write: “What brought about the communist exit from power? We argue that the ultimate roots lie in pre-communist nationalism, fomented and fostered by mass nationalist schooling. The exit itself was the culmination of decades of nursed nationalist grievances, invidious comparisons, and carefully fostered hostility to the communist project as a foreign and inferior imposition.” In a multivariate cross-section analysis, they find that the timing of mass literacy achieved via a curriculum infused with nationalist content is highly correlated with seat share of non-communist factions in the first postcommunist election. One can then make the case that countries with early mass literacy under nationalist schooling were especially good candidates for the creation of democratic governments and market economies. This argument has the

²⁶ This of course does not rule out the possibility that institutional legacies have a direct impact on economic reform. Just as political scientists have noted that the institutional legacy of the command economy shapes the prospect for democracy, economists have pointed to initial conditions and institutional legacies as important to economic outcomes (DeMelo, Denizer and Gelb 1996).

great strength of providing a means (nationalist education) by which a temporally distant factor (the timing of mass literacy) can influence a contemporary outcome (the results of the first free and fair election).

These works offer greater causal depth than has traditionally been found in the literature. They also offer the opportunity for generating instrumental variables that may help resolve some endogeneity problems. Moreover, unlike arguments that simply seek to correlate institutional or structural features of the past -- years under communism or previous experience with a market economy -- with contemporary outcomes, these works also try to identify the means by which temporally distant factor travel over time to influence current policy choices. These accounts, understandably, are better at identifying variations in the structural conditions that promote economic reform than at accounting for the process of economic reform once it is under way, but they do provide a needed temporal dimension to the literature.

In my own work, I try to integrate more temporally proximate and distant factors in two steps. I begin by exploring how executive partisanship interacts with democracy and the nature of political opposition before examining why countries vary in their executive partisanship.²⁷ I argue that despite the homogenizing pressures of the global economy, the partisanship of the executive influences the extent of economic reform.²⁸

²⁷ Others have argued that the partisan balance of political power shapes economic reform. In cross-sectional analysis of economic reform from 1991-1995, Fish (1998) finds that the seat share of the ex-communist party in the first free election is a good predictor of the level of economic reform. Aslund (2002) as well emphasizes the importance of elite partisanship for economic reform.

²⁸ Liberal executives with few ties to the state or party apparatus may prefer economic strategies that rely on the market because they have little control over state officials installed by the previous regime. Traditional ex-communist executives whose base of support lies in the state and party apparatus and in

Executive partisanship does not, however, exert a straightforward impact on economic reform. It interacts with the extent of political polarization and democracy to shape economic reform.²⁹ When political polarization is low, that is, governments face little opposition across the partisan divide in parliament, executives are able to implement their preferred policies. Liberal governments facing weak opposition from traditional ex-communist parties pursue extensive reform as in Poland, Hungary, and Estonia, while traditional ex-communist executives facing weak opposition from liberal parties pursue minimal and gradual economic reforms, as in Uzbekistan, Belarus, and Azerbaijan.

However, opposition within parliament across the liberal/traditional ex-communist divide heightens the possibility of policy reversals should the incumbent government fall. Politically polarized countries – those with a rough balance of power between liberal and traditional ex-communist factions, like Russia, Bulgaria, and Romania – face greater policy uncertainty. This polarization induced uncertainty over future policy reduces the expected return on investment made by economic agents. With less investment and hence less tax revenue to buy political support, incumbents in a polarized environment grant more specific benefits to powerful interest groups that slow reforms in order to stay in power. The effects of this type of political polarization between liberal and traditional ex-communist factions are heightened in a democracy because political competition increases the likelihood of a change in government.

social groups threatened by economic reform may, in some cases, be skeptical of economic liberalization which may weaken their constituents.

²⁹ Here political polarization is measured by the percentage of seats held by the largest liberal (traditional ex-communist) party when a traditional ex-communist (liberal) controls the executive.

To establish the microfoundations of the argument, I use data from a 1999 survey of about 4000 company managers in 20 countries conducted by the World Bank and the EBRD. Based on a multi-level statistical model, I find that businesspeople in polarized political systems perceive policy as less predictable and invest at lower rates. The point here is to try to establish the path (political uncertainty) by which a middle range variable (political polarization) influences an outcome (economic reform).

I then argue that the partisan balance of political power between liberal and traditional ex-communist factions in the postcommunist world is driven by more causally deep factors. More specifically, I trace the extent of political polarization to the timing of national identity and the position of the local communist party within the communist bloc. In some countries, like Belarus, Uzbekistan, and Azerbaijan, the creation of a national identity came late and occurred only after the installation of communist power. In these settings, local communist leaders faced weak nationalist oppositions in the postcommunist period and could rely on existing institutions to install themselves as the “defender of the nation” to stay in power. Here polarization has generally been low as traditional ex-communist leaders have largely retained their political dominance.

In other countries, like Poland, Estonia, and Hungary, national identity was created before the installation of communist power, and the local communist party played a subordinate role in the communist bloc. Here the local communist party faced a strong nationalist opposition and had little credibility with the mass public. In these countries

traditional ex-communist party leaders quickly gave way to liberal parties who dominated the political spectrum, and again political polarization has been low.³⁰

In a third group of countries, including Russia, Albania, and Romania, the creation of a national identity predated communist power, but the communist party played a relatively autonomous role within the communist bloc. This allowed communist successor parties after 1989 to credibly claim to have made policy without being subservient to a “foreign” power. In these cases the leaders of the communist party had greater credibility and could claim credit for some of the achievements of the communist period, while downplaying the worst features of the period of communist rule. These themes played well with some sectors of society, but not with others and led to a pattern of polarized politics between a liberal and traditional ex-communist camp.

This two-pronged strategy seeks to trace the causal chain back in time to give the argument greater causal depth, but also to provide microfoundations that link middle range factors to economic outcomes. This is far from the only strategy to explore relationships between institutional legacies and economic reform. One alternative is to make comparisons across countries with different institutions. One might gain leverage on institutional legacies by comparing economic reforms in Vietnam, China, Uzbekistan and Kyrgyzstan (Qian 2003; Malesky 2005). All are poor, agrarian, non-democracies, but the Asian cases began reform with different institutional legacies.³¹ Another useful

³⁰ In accordance with much of the secondary literature, I treat the ex-communist parties of Poland, Hungary, Slovenia, and Lithuania as market-oriented parties (Ishiyama 1997; Grzymala-Busse 2002).

³¹ The comparison is complicated by differences in the type of authoritarian rule as Uzbekistan and Kyrgyzstan are characterized by much personalistic form of autocracy as compared to strong party rule in China and Vietnam, but may be fruitful nonetheless.

comparison may pair Vietnam and Moldova, both of which are poor and agrarian, but the latter is surprisingly democratic (Way 2003).³²

Finally, scholars may take advantage of case studies of theoretical outliers. For example, Ukraine and Belarus have been far less successful in conducting economic reform than their structural conditions would lead one to expect. Each began the transformation with relatively wealthy and well educated populations located in close proximity to Europe, but have had considerable difficulty introducing market institutions. Similarly, Bulgaria's economic transformation has been far more difficult than its relatively robust democracy would suggest. Moreover, Slovakia's economic reform scores are higher under the populist Meciar than one would expect. Indeed, Slovakia's EBRD reform scores in the 1990s are almost identical to those of the Czech Republic despite the former's less promising initial conditions and more populist government.

Conclusion and Areas of Future Research

In sum, the postcommunist cases have made important contributions to substantive debates on the creation of market economies. Studies from the last fifteen years have indicated that that democracy does not inhibit economic reform and the oft-stated tensions between democratization and economic reform have been exaggerated. In addition, the literature from the postcommunist world has developed more subtle understandings of interest group politics than is commonly found in the literature on the politics of economic reform. In contrast to expectations, groups gaining from economic reform may have incentives to block rather than advance economic liberalization. The

³² Another approach is to focus on the regional level within countries that have experienced different institutional legacies. Here the frequent shifting of state borders in the past is an advantage.

cases at hand have also found that the EU has been a key element of support for economic reform in some countries, but not others. Finally, the cases remind us that capable states are critical for economic liberalization.

Yet, as in comparative politics more generally, scholars have considerable room to build on these substantive insights by providing sturdier microfoundations and deeper causal chains for these arguments. Precisely how does democracy promote economic reform? When does exchange between political and economic agents stick? Under what conditions can international organizations influence policy? When do politicians support the creation of stronger state institutions? And when do private interests demand them? Answers to these questions will help draw tighter links between middle-range theories and economic reform outcomes.

In addition, there is a need for deeper arguments that trace causality back in time to ensure that the impact of middle range theories on economic reform in the region is not solely a reflection of causally prior factors. Understanding how pre-communist and communist era legacies shape institutional choices and policy outcomes in the postcommunist period has spawned a productive research agenda (Pop-Eleches 2006).

This chapter has argued that economic transformation has produced a number of empirical and theoretical insights that have challenged existing literature and contributed to areas of interest for scholars of comparative politics. Based on the logic that empirical surprises have largely shaped the research agenda in the field, it is perhaps unwise to recommend areas for future research. With this caveat, I point to three additional areas of potential interest.

Cross-Regional Comparisons

Przeworski's *Democracy and the Market* set the stage for broad comparative research on economic transformation in Latin America and the postcommunist world, but few works have drawn explicit comparisons between the two regions. This is unfortunate. While such comparisons raise many difficulties, interesting puzzles remain unexplored. Why does economic liberalization appear to lead to strong economic performance in the postcommunist world, but not in Latin America (Aslund, Boone, and Johnson 1996; Remmer 2002)? Why is policy switching among rulers so much more prevalent in Latin America than in the post-communist world (Stokes 2001)? Why does democracy appear to have been more supportive of economic reform in the postcommunist world than in Latin America? More broadly, studies that place economic transformation in cross-regional and global perspective are one area of future research.

Institutional Legacies

Another area for future research is to assess the impact of the institutional legacy of communist rule on economic and political transformation over time. Does the institutional legacy have a sharp impact on democracy and economic outcomes early in the transformation, but declining influence over time? If so, we might expect countries with different institutional legacies to more closely resemble each other over time. Or, is the legacy subject to increasing returns? If so, we might expect the countries of the former Soviet Union to look less like the countries of Eastern Europe in the future. In some respects this research agenda is akin to Acemoglu, Johnson, and Robinson's (2003) argument that colonial legacies established in the 19th century continue to separate the developed from the developing world in the last half of the 20th century. This may help

contribute to larger debates in the field about the impact of institutional legacies on economic and political outcomes.

Social Institutions and Market Economies

Scholars have paid great attention to how formal state institutions have shaped economic reform, but efforts to study the impact social institutions on markets have been less prominent (Bruszt and Stark 1998; McDermott 2002; Ganev 2001). This is unfortunate as market economies rely on a complex mix of social institutions (networks, business associations, reputation mechanisms) as well as state institutions (courts, bureaucracies, legislatures). Several authors have examined the impact of “violent entrepreneurs” -- mafia-like organizations that provide protection in the place of a weak state, but other more benign types of social institutions have largely been left unanalyzed (Varese 2001; Volkov 2002). Do business organizations impede or promote economic reform? Why do state bodies govern some sectors, while social institutions dominate in others? Under what conditions do social networks inhibit and advance markets? The mixture of state and social institutions in protecting property rights, generating norms of behavior, and influencing the transactions costs of exchange merits more attention.

Scholars of comparative politics are only beginning to tap the potential of countries undergoing transformation from a command economy and communist party rule. Indeed, the transformation of command economies, like the rise of the European Union and the spectacular growth of East Asia, will likely occupy the attention of political scientists and economists alike for years to come. This essay has focused on a handful of themes of general importance for comparative politics, but this far from exhausts the potential of economic transformation for the field.

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Table 1. Economic Reform, 2004

| | Average Reform Score 8 Policies | Trade Liberalization | Large Privatization | Corporate Governance |
|-------------------------|--|---------------------------------|--------------------------------|---------------------------------|
| | 1 | 2 | 3 | 4 |
| Albania | 3.00 | 4.3 | 3.0 | 2.0 |
| Armenia | 3.06 | 4.3 | 3.3 | 2.3 |
| Azerbaijan | 2.71 | 3.7 | 2.0 | 2.3 |
| Belarus | 1.88 | 2.3 | 1.0 | 1.0 |
| Bulgaria | 3.41 | 4.3 | 4.0 | 2.7 |
| Croatia | 3.49 | 4.3 | 3.3 | 3.0 |
| Czech Rep. | 3.78 | 4.3 | 4.0 | 3.0 |
| Estonia | 3.78 | 4.3 | 4.0 | 3.3 |
| FYR Macedonia | 3.08 | 4.3 | 3.3 | 2.3 |
| Georgia | 3.04 | 4.3 | 3.3 | 2.0 |
| Hungary | 3.86 | 4.3 | 4.0 | 3.3 |
| Kazakhstan | 2.95 | 3.3 | 3.0 | 2.0 |
| Kyrgyzstan | 3.08 | 4.3 | 3.7 | 2.0 |
| Latvia | 3.63 | 4.3 | 3.7 | 3.0 |
| Lithuania | 3.62 | 4.3 | 3.7 | 3.0 |
| Moldova | 2.89 | 4.3 | 3.7 | 1.7 |
| Poland | 3.69 | 4.3 | 3.3 | 3.3 |
| Romania | 3.16 | 4.3 | 3.7 | 2.0 |
| Russia | 2.99 | 3.3 | 3.3 | 3.3 |
| Slovakia | 3.70 | 4.3 | 4.0 | 3.3 |
| Slovenia | 3.41 | 4.3 | 3.0 | 3.0 |
| Tajikistan | 2.43 | 3.3 | 2.3 | 1.7 |
| Turkmenistan | 1.34 | 1.0 | 1.0 | 1.0 |
| Ukraine | 2.86 | 3.0 | 3.0 | 2.0 |
| Uzbekistan | 2.15 | 1.7 | 2.7 | 1.7 |
| Sample Mean | 2.40 | 3.79 | 3.14 | 2.38 |
| (std. Deviation) | (.76) | (.92) | (.83) | (.71) |

Source: EBRD

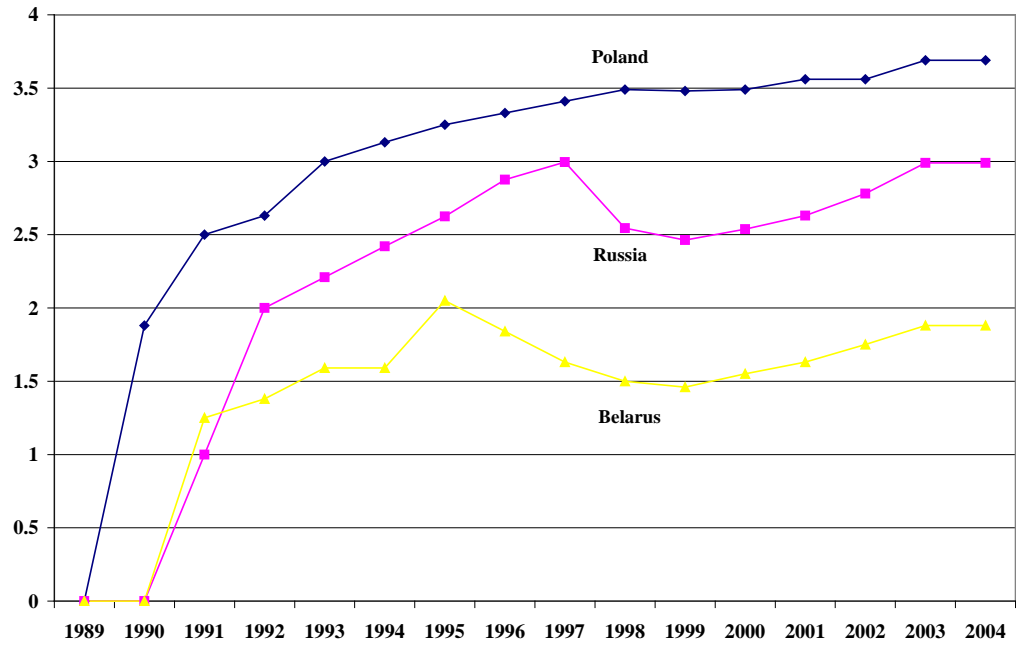
Table 2. Tax Collection and State Spending in Latin America and the Postcommunist World in 1995

| | Tax Revenue % GDP | Expenditures % GDP |
|--|------------------------------|-------------------------------|
| Argentina | 13 | 14 |
| Bolivia | 11 | 21 |
| Brazil (1994) | 20 | 34 |
| Mexico | 13 | 16 |
| Latin America Caribbean Average | 8 | 7 |
| | | |
| Albania | 17 | 31 |
| Bulgaria | 36 | 42 |
| Estonia | 36 | 31 |
| Europe/Central Asia average | 23 | 31 |
| | | |
| All middle income average | 12 | 15 |

Source: World Bank Development Indicators, 2005

Figure 1

**Average Economic Reform Score
1989-2004**



Source: EBRD