

## Approaches to institution building

Political scientists have long sought to understand how relations between economic and political elites affect the development of institutions. This question gained particular salience as the financial crisis of 2007–2009 gripped the global economy. The deregulation of banks, their ability to own such large parts of the US economy and securitize credit markets, and their political access were frequently blamed for the inadequate regulatory institutions that were largely responsible for the economic crisis.

The post-socialist countries offer an opportunity to examine the parallel development of a whole region in perhaps the closest approximation of a social science laboratory. All the post-socialist countries were affected by insider attempts to preserve the status quo of the early 1990s in the context of states undermined by the collapse of state socialism. Yet, after more than two decades, sharp differences in institutional development are apparent even in neighboring countries. Some states continue to be vulnerable to the demands of narrow societal groups, while others are able to pursue institutional reforms that broadly promote economic development.

The general expectation is that networks among businesspeople and linkages between the state and the economy will be an obstacle to the development of well-functioning institutions. Paradoxically, the cases examined in this book show that the causal linkage between networks and institutional development is more complex. The cases in this book show that, when networks of business ownership and personnel are broad, larger coalitions were driven to imbue institutions with the power to regulate the market.

The introduction to this study presented an initial comparison of the three core cases explored in this book: Bulgaria, Romania, and Poland. In Poland, strong networks emerged among a group of crony entrepreneurs allied with the Social Democratic Party and a competing faction supported by the anti-communist opposition, Solidarity. The left faction prospered when the SLD was in power and frequently suffered when Solidarity won elections. Those

affiliated with Solidarity also took advantage of political protection. Because political competition was sharp, parties depended on political financing from firms, and thus had an interest in their prosperity. Many firms took advantage of preferential access to privatizations to acquire shares in other firms. Thus, ownership networks among firms became increasingly broad over time. Also as a result of sharp political competition, individuals shifted from positions within the state to jobs in private but politically allied firms. These shifts often happened after elections, with the result that personnel networks also became very broad over time. Both types of networks tightly linked political parties to firms and firms among themselves. The economy consequently became heavily politicized. Because of these broad networks, large cross-sectoral coalitions negotiated over the content of new market institutions. Yet, despite these strong network ties between parties and firms, institutions that were broadly distributive emerged.

This outcome was not a given, as shown in the divergent paths taken by other countries in the region, including the two other case studies of this book: Bulgaria and Romania. Bulgarian political parties effectively became the clients of powerful businesspeople. In this context, businesspeople had no interest in creating pacts with politicians. Networks among firms and members of the state bureaucracy, as well as those between businesspeople and politicians, were much less broad and offered fewer points of contact. As a result, businesspeople did not have the same network assets to negotiate broadly distributive institutions with a view to the long term. Instead, small groups of businesspeople hijacked institutional development for their own purposes. Romania followed a third path, because the nature of its transition created a political party that was asymmetrically powerful. Firms developed under the patronage of the dominant Social Democratic Party. In order to limit extraction, some businesspeople entered the political arena with personal parties. This further undermined business cohesion, and firms did not develop collective bodies to articulate demands. Businesspeople also figured heavily on party lists as part of a broad system of clientelistic exchanges that traded financial support for the protection of business interests (Protsyk and Matichescu 2011). Unsurprisingly, the resulting institutions favored selective advantage – that is, they were narrowly distributive.

The comparison of Poland, Romania, and Bulgaria frames a puzzle: given the generally negative and corrupting role ascribed to networks, how can we explain their positive role in the process of institutional development in some contexts? My argument is that the structure of networks and the level of uncertainty within which these networks operate shape the incentives of elites to act collectively and make broad demands for market-supporting institutions. Networks emerge to fill the space left by incomplete institutions. Broad networks link cross-sectoral coalitions and facilitate collective action. The effect of uncertainty on collective action depends on the type of network present. Under high levels of uncertainty, if networks are broad, cooperation emerges because

information flows and reputation undermine defection from agreements between politicians and businesspeople. Networks also support credible commitments. Under high levels of uncertainty and narrow networks, business elites prey on the state because parties are weakened by high levels of competition and cannot credibly commit to agreements with business. Narrow networks make defections hard to detect, and uncertainty lowers the value of politicians' promises. Under low levels of uncertainty and narrow networks, dominant political elites that do not face the threat of alternation exploit atomized firms. Under low levels of uncertainty and broad networks, dominant political elites enter into collusive relations with firms.

Hence, I argue that the broad incorporation of interest groups is critical to the successful design and implementation of economic policy and market-supporting regulations that are broadly distributive. Strong and broad networks are not anathema to institution building. To the contrary, in the conditions of widespread uncertainty present after political and economic transitions they are necessary for the development of functional institutions.

I examine the trajectories of institutional development by exploring the progression of countries in four areas of policy making that have very direct distributional consequences: competition law, the regulation of banking, the regulation of financial transactions, and the rule of law. These institutions have sweeping distributional consequences for firms.

To understand the extensive bleeding together of economic and political elites that is so prominent in the cases at hand as part of an explanation of the emergence of broadly distributive institutions requires a revision of some views in the literature. To begin, I propose that little leverage is gained in conceptualizing the emergence of institutions through the notion of a unitary and bounded state. Accounts based on a unitary view also fail to deal with the genesis of state power – the authority that comes from being separated from societal influences and yet connected to societal actors in a way that envisions political elites building institutions together with economic elites that meet the needs of both groups and generate long-term stable social equilibria. This is the elusive embedded autonomy described by Evans (1995).

As discussed in the previous chapter, early studies of reform in post-socialist countries suffered from an inability to adequately explain the emergence of capacious and autonomous states in contexts in which reform did not make it quickly through the “valley of transition” – the difficult early period when reforms were extremely painful and required determined leaders while democracy heightened the incentives for them to deviate from the necessary policies to increase short-term welfare (Przeworski 1991) – but instead passed through a long process of negotiation and experimentation. As many countries faltered in the valley, Hellman (1998) has argued that the initial “winners” – those who used arbitrage opportunities present when reforms such as price liberalization were only partially complete to amass vast wealth and power – would hijack the policy agenda, preventing further reform in order to protect their interests.

The implicit conclusion of Hellman was that only fast shock therapy resembling reforms would allow countries to build markets and grow instead of becoming mired in a state of partial reform. By extension, as actors are joined by increasingly broad networks of ties, states should become hostage to a greater number of demands. Consequently, we should expect those states with broader economic networks to be less autonomous and make less progress on institutional reform than those narrowly connected to the economy.

Quite surprisingly, the puzzle of eastern European state building is that this does not describe the progress of reform across the region. Across the post-socialist world, different trajectories of institution building emerged that deviated from the predictions of the early reform literature.

The empirical record shows that countries with broad networks of inter-firm ties and ties connecting political and economic elites have been able to collaborate toward broadly distributive institutions. Those that did not have these networks have not been able to do so. Put another way, networks do the opposite of what the institutional argument suggests. Instead of binding reformers, when networks are far-reaching they can align the interests of a broader group of actors and allow them to work in concert. Networks thus structure the demand making of societal actors. When broad, they also shield states and political actors from narrow interests. The use of networks must be channeled in productive directions, however. This is more likely to happen when a second factor is present: uncertainty.

Two literatures are useful in understanding the link between networks and uncertainty, which are at the center of my argument. The body of research that has grown out of the research agenda on the “varieties of capitalism” (VoC) approach offers a way to understand how the variety of economic institutions that has emerged across post-socialist Europe over the last two decades can be internally stable and coherent (Hall and Soskice 2001). The VoC framework argues that the early institutional preferences of firms create spillover effects that lead to the selection of other complementary institutions. Thus, VoC provides a model for how firms put forward demands for institutions. More importantly, VoC helps understand how these demands can lead to the development of sets of complementary institutions that constitute internally coherent and stable models of economic activity. These can deviate sharply from the liberal model of capitalism. Thus, each of the state types described in this chapter and the institutions associated with them reflect the preferences of dominant firms and the extent to which they can collaborate across network ties. I use this notion of *complementarity* as a way of explaining the persistence of varieties of post-socialist capitalism that have developed out of the preferences of firms and are based on various network structures that link the polity and economy.

A second literature, commonly known as the “developmental state” approach, has sought to identify how the east Asian states, in particular, were able to pursue economic development by aligning coalitions of actors such as

business leaders, unions, and bureaucrats behind the goal of rapid upgrading and innovation. The principal contribution of this literature to my argument is the concept of *embeddedness*: the extent to which political actors are able to enlist economic actors in the process of building institutions to govern the market. I focus on embeddedness because it has a role in generating institutional reform that serves the interests of both political and economic actors, but I also develop the notion to show that there can be different faces to embeddedness. Early work emphasized the positive role of embeddedness in allowing information flow. Later scholars also focused on the extent to which single or multiple factions of elites were linked through embedded ties.

Together, insights from these literatures help explain how demand making from firms in collaboration with political actors has generated a variety of trajectories of institutional development. I extend both concepts, focusing on information flows for collaboration but also introducing competition.<sup>1</sup> Thus, while building on the conceptual tools offered by VoC and developmental state scholarship, I add a novel focus on political party competition as a factor that shapes the interests of firms and the way in which embedded ties are used. The rest of this chapter examines the most important contributions of the two literatures, which provide useful tools and a foundation for the typology and argument advanced in this study.

## EXTENDING THE VARIETIES OF CAPITALISM

The process of economic reform is one of devising new institutions that frame economic activity and drive economic actors toward broadly distributive institutions. Ideally, these institutions allow firms to pursue profits and politicians to be re-elected while promoting economic growth and development. The basic challenge is to develop institutions that will govern markets so as to support the wealth-enhancing and innovative activities of firms. Not all firms are well served by the same institutions, however, and not all market economies follow the same systemic logic. This point has been well established with the development of a broad research agenda on the varieties of capitalism. The central message of the literature that focuses on VoC in the advanced industrial societies is that different countries develop distinctive institutions that generate strong complementary effects to support economic activity.

The VoC literature proposes two main variants: the coordinated market economies (CMEs) of continental western Europe and the liberal market economies (LMEs) of, for example, the United Kingdom, the United States, and

<sup>1</sup> The developmental state literature neglects to consider competition because it is concerned largely with non-democratic contexts.

Australia. In the former, firms depend “more heavily on non-market modes of coordination” such as relational contracting, the use of inter-firm networks, and collaborative instead of competitive relationships with other firms (Hall and Soskice 2001: 8–9, 33–6). In liberal market economies, by contrast, firms coordinate on the basis of competition. The CME/LME framework of the varieties of capitalism project has opened up research on the complexity and variation both between and within these clusters.

The extension of this agenda to contexts in which institutions are still in a developmental phase requires some adaptation. In the post-socialist countries, where market institutions developed to replace pre-existing state socialist institutions, similar institutional complementarities have developed. These support forms of market-based activity that are radically different from either the CME or LME types, however. The main distinction is the extent to which economic activity and actors are politicized and rely on networks that differ from those present in CMEs.

Efforts to expand the VoC framework have been undertaken by numerous scholars. While Feldmann (2006) argues that the two VoC types can be applied to post-socialist countries, most authors find that these types cannot be directly transported. Nölke and Vliegenthart (2009) argue that the post-socialist countries represent a fundamentally different type of capitalism with a heavy transnational component and suggest a third variant: the dependent market economy (DME), in which transnational corporations are the core coordination mechanism. Bohle and Greskovits (2007) also highlight the difference between post-socialist capitalism and the two variants present in advanced industrial societies. They argue, however, that not one but several different variants of post-socialist capitalism have emerged out of the common legacy of state socialism, classifying states by how much they have imposed constraints on private economic activity.

These authors underscore the extent to which firms in post-socialist countries are collectively trying to solve a very different set of problems from those present in the advanced industrial economies, such as much higher levels of uncertainty, a lack of indigenous capital, poorly developed institutions, and lower state capacity. It follows that firms in post-socialist countries address these problems using strategies other than those identified in CMEs and LMEs. Bohle and Greskovits in particular draw attention to the role of the state in light of the influence of transnational actors. Yet the fundamental point of the VoC literature is that different variants of capitalism persist because of the strong institutional complementarities they generate. The DME and the variants identified by Bohle and Greskovits label the distinct qualities of post-socialist capitalism but do not identify the nature of the complementarity of arrangements that underpins it. One such arrangement is the configuration of the relationship between the polity and the economy. In my view, this is the foundation of each distinct form of post-socialist capitalism.

How these forms develop is explained in the VoC literature. The process by which countries embark on different paths occurs at two levels according to the framework developed by Hall and Soskice. On the ground, firms seek to create institutions that increase their chances of survival. Once firms choose a particular set of institutions, a macro-social evolutionary logic drives the development of complementary institutions. In the CMEs, for example, Hall and Soskice's argument is that, if the prevailing labor practice is to sign long-term contracts with skilled laborers to ensure the availability of skills, then it is also highly likely that firms will rely on extensive education and training schemes and develop systems for sharing technology with other firms as a remedy for the lack of labor mobility. The benefits of institutions increase as other complementary institutions develop around them. By this mechanism, the initial preferences of firms start countries on an institutional path.

Hall and Soskice's evolutionary vision of the development of economic institutions is useful in explaining the different variants of post-socialist capitalism that have emerged. In the post-socialist countries, early moves toward network-based forms of coordination drove countries toward the establishment of matching institutions in other areas that frame economic activity. For example, if business finds new clients primarily via networks, it is likely that it will also borrow by using preferential access to banks. Over time an insider network logic takes hold in the whole economy, because a hybrid mix of institutions would generate costs and confusion rather than the synergies to be found with complementary institutional forms.

Discovering which institutions will generate the best results for a given group of firms and a particular context is not a simple problem, however. Hall and Soskice (2001) focus on the preferences of firms and to some extent the formation of coalitions of firms. They pay relatively little attention to the interaction of firms with political actors. Yet it is precisely this interaction – the ability of firms to create coalitions and negotiate acceptable solutions with state leaders – that is crucial in the developing world and emerging markets, where the state is often predatory or suffers from insufficient capacity to achieve its goals alone. Further, state leaders can have the wrong motivations or bad information, be under the influence of powerful but narrow lobbies, or even simply harbor bad ideas – all with disastrous effects. Leaders can also pursue their own short-term interests by choosing to serve the preferences of economic allies. All these dynamics were at work at times in the economic and political transformation from state socialism, which involved the readaptation of old institutions and the construction of new institutions to regulate the emerging economies.

Differences between countries persist because the majority of firms in one country might oppose, for example, the elimination of selective benefits that come with the development of a competition-enforcing authority or the protection of minority shareholders (Black, Kraakman, and Tarassova 2000: 1753; Hoff and Stiglitz 2002: 38). These firms might fear the unexpected

consequences that accompany a move away from the status quo. Influential firms in some countries might prefer weak shareholder protections and be willing to sacrifice the ability to raise funds in capital markets. Similarly, some firms may prefer a more developed system of banking, credit, and the institutions that accompany developed lending markets, while others will prefer to source credit from within networks.

Later chapters show how firms in the post-socialist countries have settled on different levels of what can be called “selective advantages.” Countries across the post-socialist region vary widely in the development of key areas of market regulation, such as banking, financial, and competition law, and the regulation of political finance by firms. The variance of interest here is the extent to which institutions are designed to distribute benefits broadly or narrowly. Over time, as a result of foreign pressure and changing internal economic conditions, key institutions of market regulation may creep toward and ultimately converge on Western norms, such as those established in the EBRD’s transition indicators of progress on institutional development. There are many long and tortuous roads to that end point, however. Countries take different paths toward that destination, and it is much too soon to argue for a convergence of institutional types.

Thus, when adapted to the market conditions of countries in the developing world, the conceptual tools of the VoC literature allow us to understand how trajectories of institutional development persist over time despite the pressure of international economic integration. Networks provide the social foundation through which an array of complementary alternative market practices form the basis of national economic models that deviate from competitive markets.

#### CONSIDERING MULTIPLE FORMS OF EMBEDDEDNESS

Throughout the post-socialist reform period businesspeople sought to influence politicians so that new institutions would benefit their existing or nascent ventures, while politicians sought to secure financial support from businesspeople. In other words, economy and polity were both in the process of developing different forms of embeddedness (Evans 1995; Polanyi 2001). The concept of embeddedness was applied by Evans to explain why some states in the developing world were able to promote growth while others failed. “Embeddedness” signifies the extent to which networks connect the state to the economy. According to Evans, when these two spheres are too closely connected, opportunities for collusion are easily within reach. At the other extreme, when they are too distant, opportunities for entrepreneurs and policy makers to coordinate and communicate are not available, and critical signals and information are lost. Policy makers and businesspeople both fail to understand the goals and priorities of their counterparts. At the ideal balance point for embeddedness, political and economic actors are connected but the state is able to remain autonomous – gathering key information but nevertheless able to make difficult and often unpopular decisions without being too influenced by

the demands of narrow business interests. When this balance is struck, business can receive vital support from the state while also facing incentives that make firms innovate, becoming more productive and competitive.

Evans offers an important foundation for thinking about how state–economy ties are both critical for and able to derail developmental policy. Where Evans’s approach and the developmental state literature fall short is in failing to make clear why political elites would want to pursue developmentally oriented policy as opposed to short-run self-dealing. In the developmental state literature, we are told that states able to achieve the miraculous outcomes associated with east Asian development had a special blend of embeddedness and autonomy.

Later studies questioned the benign nature of embeddedness and its sufficiency to explain good economic governance. Kang (2002), for example, instead focused on the importance of a situation he labels “mutual hostages.” In this circumstance, instead of a state mediating to bring about good outcomes, Kang sees two social networks of elites that counter each other’s power. The conflict between them promotes good governance by limiting the power of each to engage in excessive self-dealing. When the economic and political elites are unified, on the other hand, excessive self-dealing undermines governance. Kang’s approach avoids ascribing to the state the almost magical qualities of the developmental state to coordinate economic development, and takes a much more cynical view of the east Asian “miracle.” This approach is not sufficient to explain good governance in democracies, however, where there are always at least two separate groups of political elites but very different outcomes obtain across countries.

For both Evans and Kang, good developmental outcomes result from network ties, albeit through different mechanisms: information sharing versus mutual monitoring. In both, the problem of development is essentially a type of coordination problem facing elites. I build on these ideas toward a hybrid position, viewing the problem of development under incomplete institutions as a coordination problem in which multiple elites must collaborate to realize the greater gains to be had after institutional reform.<sup>2</sup> To collaborate requires that they overcome pervasive information, monitoring, and commitment problems.

Such coordination under incomplete institutions is facilitated by networks. According to Beckert (2007a), Polanyi’s original notion of embeddedness was precisely one of the glue that allows market actors to operate in stable worlds that are calculable. Polanyi identified three key coordination problems that are exacerbated by uncertainty (Beckert 2007a; Beckert 2007b). First, the problem of *value* refers to the difficulty with which individuals are able to form notions

<sup>2</sup> This is akin to Doner’s (2009) idea that elites in developmental states were able to coordinate around levels of investment or upgrading that individuals would not pursue alone.

of value of items offered on the market. Value is socially and, more importantly in the present context, politically created. The second coordination problem is that of *competition*. Markets are based on competitive pressures, but profit emerges only when markets are imperfect. Hence, market actors try to create conditions that protect them from pure price competition. Incumbents try to retain their position by using existing regulation, while market actors who are disadvantaged attempt to challenge incumbents (Weber 1978 [1922] and Fligstein 2001, both cited by Beckert 2007a). The state plays a central role here by setting out the rules of the game. Third, *cooperation* problems arise from the fact that not all actors have the same access to information about factors such as “price, product quality and the possible opportunism of exchange partners” (Beckert 2007a: 14). Embeddedness provides a solution to all three problems. Even for Beckert, however, embeddedness is a “mysterious substance which provides... stability in market exchange” (Beckert 2007a: 11).

This book adopts a view of embeddedness as just such a solution to the coordination problems of value, competition, and cooperation that business-people and politicians are trying to solve, and unpacks its mysterious mechanisms. As the coming chapters show, it was precisely these problems that plagued economic actors and led them to form different types of bonds with political elites. Each group articulated a series of demands to their counterparts wherein their common aim was to make the future more legible. As I will show later, certain network structures facilitate that task while also leading to the development of broadly distributive institutions, while others result in narrowly distributive institutions. The structure of networks also can allow economic and political elites to act as constraints on one another. For both reasons, the developmental state literature set an agenda for studying ties between political and economic elites. The rest of this book builds on this foundation to understand the relationship between individuals, the social structure within which they act, and the development of institutions.

#### HOW UNCERTAINTY LEADS TO INSTITUTIONAL DEVELOPMENT

Two groups of elites have been identified as key actors in the process of state building in contemporary new democracies: business leaders and politicians. Together they operate in emerging markets – sites of high economic volatility where opportunities for economic growth are immense but the institutional framework is incomplete. Since the 1960s emerging markets have been a subject of fervent conversation among social scientists, investors, politicians, and development experts, at times because emerging markets were a source of surging growth, at others because they were sites of financial volatility, desperation, and social unrest. But what does it mean to be an emerging market? Economists tend to think of such markets as places where opportunity and uncertainty are high because political and economic institutions are not yet present or well established but economic dynamism and innovation are present.

At the same time, we tend to think of emerging markets as places where social networks fill the gap left by missing institutions, generating other types of uncertainty, such as poor information flow.

Both these circumstances are present simultaneously: markets are based on social structures as well as institutions and impersonal signals (Fligstein 2001). It is the interaction of these in a variety of forms, each with a different political foundation, that determines the extent to which uncertainty and networks are relevant. Hence, family capitalism (Morck and Yeung 2004; Fogel 2006) is different from business group or alliance capitalism (Gerlach 1992; Kang 2002) and institutional capitalism (Black 1992; Hawley and Williams 1997). These capitalisms differ because their institutions vary according to the cultural and political context in which they are embedded (Granovetter 1985). Each of these forms of capitalism presents a different relational solution to the challenge that businesspeople in emerging markets face: how to minimize uncertainty in order to generate profits.

Two decades have now passed since the largest political and economic transformation in recent history swept across nearly half the globe and affected every country lying between East Germany, North Korea, and Vietnam. What this massive transformation did, at the most basic level, was to introduce uncertainty into economies that were previously planned and governed by one party. This was accomplished by expanding the base of stakeholders in the economy and the polity and making them compete.

The ability to reduce uncertainty underlies the paradox investigated in this book. After all, the presumed purpose of introducing elections and markets into previously one-party systems and planned economies is precisely to introduce uncertainty into contexts in which everything was rather certain. But uncertainty can be paralyzing, as actors unable to form expectations about the future will refrain from taking any action at all. Unable to calculate the likelihood of outcomes, economic actors prefer to keep assets buried in the proverbial backyard.

What is the optimal point between too much uncertainty and too much certainty? Should elites coordinate closely and exchange information in the process of development, as the east Asian developmental model suggested? Or does close elite coordination generate bad growth rates and political corruption, as African, Latin American, and indeed the post-socialist cases suggest? In other words, is it true that social networks generate institutions that are narrowly focused and redistribute to narrow coalitions? Current scholarship presents a confusing picture. On the one hand, networks are seen as inefficient except under special circumstances when their impact is limited by elite competition (Kang 2002), acute international competition (Doner, Ritchie, and Slater 2005), or special bureaucratic capacity (Evans 1995), which is extremely difficult to reproduce. Under these conditions, it is argued that networks can be harnessed toward productive ends (Evans 1995; Chibber 2003). Other research, however, finds that even overt corruption does not correlate with

lower levels of investment when the environment is predictable and business-people have clear expectations about the outcome of their illicit exchanges (Edgardo Campos, Lien, and Pradhan 1999). In other words, we do not yet have a clear understanding of the boundary conditions under which networks and uncertainty can lead elites toward collaborative and broadly productive outcomes.

My position is that broad networks reduce uncertainty and thus render the future more readable for economic and political agents. The former use networks to facilitate business and exchange information about the changing nature of the economy. The latter use networks to obtain information about the preferences of economic actors and to secure political finance. When these networks are broad, the intense uncertainty of a period of simultaneous and rapid institutional and economic development is reduced for a large number of actors with heterogeneous interests. Thus, networks become conduits for implementing broad preferences rather than narrow ones. Moreover, if political competition is high in combination with networks, it acts as an offsetting force by both limiting the amount of time that politicians have at the helm and making them more sensitive to the preferences of societal actors, thereby raising the incentives for cooperation.

Comparison across the post-socialist region shows that various patterns of influence expression and interest aggregation have emerged. These patterns do not correspond to economic factors such as GDP growth, suggesting that there are multiple paths and political models of functioning markets in the region. Close examination of the interactions of business and political actors since 1989 in three case studies reveals that broad networks play a crucial role in the emergence of broadly distributive institutions, however.

#### HOW NETWORKS AFFECT INSTITUTIONAL DEVELOPMENT

Granovetter's (1973) theory of weak ties provides the basis for my argument about the value of broad networks. Research spearheaded by Granovetter on the spread of new ideas finds that social systems lacking weak ties will be "fragmented and incoherent" (Granovetter 1983: 202). The effect of this fragmentation is that new ideas spread slowly and individuals are exposed to homogeneous views likely to be held by their friends. Because networks of strong ties are likely to link actors with similar outlooks, such social systems will be deprived of diversity of thought by the failure to "bridge" to other groups with dissonant outlooks.

According to Granovetter, "[A]cquaintances, as compared to close friends, are more prone to move in different circles than oneself. Those to whom one is closest are likely to have the greatest overlap in contact with those one already knows, so that the information to which they are privy is likely to be much the same as that which one already has" (Granovetter 1983: 205). A dangerous consequence of such tight and closed networks is the unchallenged persistence

of poor information, bad ideas, or inappropriate strategies, because the lack of exposure to outside information reinforces the status quo even if external circumstances have changed. Thus, particularly when network members' weak ties act as bridges to other groups, they are crucial conduits of information. This is especially relevant in situations when actors are engaged in "searches" for information (Stigler 1961).

Search theory, commonly applied to labor and producer markets, can equally well apply to markets for influence and information in politics. In all these contexts, actors are reliant on information in order to obtain better outcomes for themselves. For example, individuals who maintain weak ties tend to have greater success in job searches (Granovetter 1995) and obtain higher wages (Montgomery 1992). Similarly, maintaining "acquaintance relationships confers an informational advantage for individual lobbyists" as a result of the same weak tie mechanism (Carpenter, Esterling, and Lazer 1998: 439). Granovetter points out that weak ties also generate macro-social benefits, for example by increasing the efficiency of job placements. Stigler argues that lowering the costs of information search lowers price variability and increases efficiency in the target market.

Thus, when networks are broader and link diverse groups, actors (whether people or firms) will be exposed to new ideas, more information, and greater diversity. Such broad networks of weak ties therefore benefit from the challenges that come from encounters between dissimilar actors. If one accepts that heterogeneity and conflict strengthen social systems by subjecting plans and ideas to constant trial as well as causing new ideas to spread widely, then diversity is performance-enhancing. In fact, this is a central premise of explanations for the performance of complex adaptive systems – that is, systems of multiple interconnected agents capable of learning from experience (Axelrod and Cohen 1999; Miller and Page 2007). Broad networks of such ties, therefore, are crucial for the successful design of institutions.

I focus on the breadth of network ties as a key feature of networks because it determines the extent to which networks can act as the conduits of diversity. Networks themselves are arrays of relations between a set of actors that form a structure. These structures can vary in how dense they are, because some actors have many more ties than others. They can be more hierarchical if they have a distinct center around which other actors are organized, or they can be disjointed, with many isolated actors. These and many other properties of networks can be observed and measured to obtain an understanding of the possibilities that different actors have. In other words, networks create a structure of possibility for the actors in them. They also relationally structure the identities of actors in them; much as in a high school clique, we are defined by those to whom we are connected. Those who are connected to many can potentially use their network to mobilize others much more effectively than those who are connected to only a few. They can also control and funnel information more effectively. As a result, networks with such actors may be

more efficient at passing news, though also more vulnerable to disruption if the single central actor is removed.

The basic idea of network analysis is that systematic patterns of relations among actors reveal the structure of a system. Networks are defined as lasting relations that generate expectations of reciprocity or provision of some sort (Granovetter 1985). A central consideration of network analysis is how relationships among multiple actors jointly affect individual network members' behavior. In other words, networks capture the structure of opportunity and reciprocity, and can both empower and constrain members.

Networks do not simply present a map of existing social structures, moreover. When we move to a temporal conception of networks, network approaches are able to capture both structure and agency. Kilduff and Krackhardt (1994), quoting Cialdini (1989), present a clear illustration of this mechanism with Baron de Rothschild, who signaled his close link to a would-be borrower by walking across the floor of the stock exchange arm in arm with him. Observers of the display of friendship upgraded their evaluation of the creditworthiness of the baron's apparent friend and would-be borrower. Thus, by observing the same network over time, we can observe the effect that structure has on individual choice within a network.

As in the example of Baron Rothschild, networks can both empower and restrict an individual's ability to act, as the individual is defined by his or her ties. Networks by definition have non-linear effects, as information spreads relationally. The difficulty and the value of network approaches both lie in the relational and recursive nature of network ties. Much as in an iterated game, players update their strategies on the basis of observed and expected behavior alike. As such, neither is a fixed point; their actions mutually affect the choices that the other will make. Taking again the cases at hand, ties between individuals and between organizations structure political outcomes. In the process of building capitalism, politicians and firms both anticipate and adapt to the actions that their counterparts take. Thus, to say that firms adapt their strategies to the policy choices that politicians make would be to tell less than half the story, as politicians are already incorporating both the anticipated and the observed actions of firms in their behavior.

Similarly, firms have considered the reactions of politicians in the earlier moves that led to politicians' current choices. The mutually constructed nature of institutional choice results from this process of anticipation and reaction. Of course, information is imperfect and consequences are often unintended, making the process of institutional design a meandering journey of experimentation and selection. As the chapters that follow show, politicians formulated and altered their strategies to develop firms as a source of political resources that they needed in order to win elections. In parallel, firms forged relations with the political sphere in ways that reflected both their strategic opportunities at any given time and the effects of earlier political decisions that had a constitutive impact on them as political actors.

This relational perspective has the advantage of drawing attention to the internal configurations and external connections of interest groups. By including network features as an independent variable, this book takes networks seriously as part of the political process. In particular, it seeks to understand how networks affect institutional function and development.

What, then, is the relationship between networks and institutions? Institutions provide a set of rules that govern political and economic life. Networks provide a social structure to supplement incomplete rules and indeterminate institutional outcomes. Institutions determine who has the authority to make decisions and who can benefit from and dispose of material goods. Networks enable their members to influence decisions, and sometimes the nature of the institutions themselves.

For this reason, the period during which institutions are being chosen has been of particular interest to social scientists; during such times the participants in the process of institutional development cannot know fully the effects of the institutions they are choosing. Nevertheless, they often have strong beliefs about their likely distributional consequences. Hence, they jockey for individual advantage, form coalitions, strike bargains, share information, and engage in open conflict to arrive at their desired outcome.

Ties between businesspeople and politicians are one place where networks and institutional development meet. Newspaper headlines resonate in the popular imagination when they refer to visible or alleged ties between the economy and the polity. The political goals of businesspeople affect elections, shape legislation, and impact the institutional landscape. Businesspeople lobby, make private deals with politicians, create organizations, and sometimes use violence.

Precisely in the middle ground when institutions are not yet fully developed, social groups – networks of individuals – fill in the gaps, influencing the process by which institutions are built through formal and informal means. I therefore focus on the network that we imagine as the most powerful in contemporary democratic polities: the community of businesspeople and their ties to the political sphere. How does the network that we imagine as most powerful affect a nation's ability to make economic policy and guide economic development? The answer lies, I argue, in understanding the various ties between the economy and the polity.

My argument is not to be mistaken for the “grease the wheels” argument, which states that corruption arises as a solution to the problem of inefficient bureaucracy (Leys 1965). Corruption is generally acknowledged to be inefficient (Mèon and Weill 2010) and harmful to development (Aidt 2009). Nevertheless, some authors argue that corruption can be used to address inefficiencies, such as the extra time needed to deal with a slow or inept bureaucracy (Lui 1985). Others have argued that extra payments related to corruption may attract talent to bureaucratic work in contexts where low government pay would otherwise have the opposite effect (Leys 1965). These

arguments suggest that corruption constitutes a second best solution by allowing business to operate in contexts that would otherwise present major obstacles to private sector activity and in which the development of functional institutions is not a viable alternative. By contrast, the argument being made here is not about corrupt payments or “wheel greasing” to obtain certain outcomes, such as queue jumping. Instead, it focuses on collaborative agreements, which may involve electoral support to parties from business in exchange for influence in shaping institutions and affecting legislation, regulation, or other policy-related decisions.

The business owners discussed in this volume used existing networks, reconfigured old ties, and built new coalitions in order to achieve their goals. One of these goals was to influence the basic content of rules, laws, and regulations that were being designed as part of long-term reform projects with potentially huge rewards for the first set of incumbents. Because one key focus of this study is the large business owner, this is also an account of the impact of “who owns what” on institutional development. Ownership is one of the core forms of economic power defined by institutions such as contracting and the rules of property rights. Ownership is therefore a form of politics. And yet we have only just begun to understand how the structure of ownership influences the conduct of politics. Thus, ownership structure is one of the key starting points of the argument. Whenever one firm buys a stake in another firm or one individual owns two firms, ownership creates networks of firms. These ownership networks interact with and reinforce personal and personnel networks. “Who owns what” links with “who knows whom” to create a structure through which some individuals and organizations wield much more influence than others. Therefore, in addition to ownership networks, I examine elite career networks. Both these networks influence the creation and function of social institutions; they are a core part of the construction of markets and the consolidation of state power over them.

#### ARGUMENT

The post-socialist countries provide an opportunity to explore and trace the process of contemporary institution building because, by the time of transition, these states had lost the capacity to extract resources, control their assets, and effectively issue commands and sanctions. As other scholars have argued, late socialism was a time of state weakness and breakdown (Ganev 2001; Grzymała-Busse and Jones-Luong 2002; Volkov 2002; Ganev 2007). In the early 1990s new democratic governments had weak state structures, as evidenced by the tunneling of resources out of state-owned firms and frequent business-related violence. Actors in control of the state had to create a new framework and rebuild capacity if they had any hope of carrying out political and economic reforms.

What enabled them to do so? Two elements are central in the answer advanced by this book, as shown in Table 1.1. First, the *breadth of networks* among members – whether they are broad or narrow – is a key resource that determines how firms behave when calculating and pursuing their interests. The ties of any one individual constrain or enable their opportunities for action. By extension, as discussed in Chapters 3 and 4, the identities of actors are also relevant. Some firms, such as financial institutions, maintain more ties, on average, than industrial firms by virtue of their sector. Thus, the prominence of financial institutions in a given country will shape the network structure. And, as Chapter 4 shows, the structure of firm ownership and control networks affects the incentives of elites to engage in collective action.

A second critical feature shaping the macro-trajectories of countries is the *level of uncertainty* actors face when calculating the future. The nature of political competition generates a key form of uncertainty. It has been argued that political alternation and divided government generate suboptimal behavior because sets of actors with opposing goals make policy decisions that often reverse course on decisions made earlier (Persson and Tabellini 2000; Frye 2010). For example, US states with divided governments have larger fiscal deficits (Alt and Lowry 1994; Poterba 1994). Similarly, the alternation of governments is linked to higher deficits (Rumi 2009). Frequent alternation has detrimental effects on the quality of policy because longer time horizons allow office holders to plan and execute better policy decisions (Rumi 2009). This may indeed be the case in well-institutionalized contexts. The same time-horizon-limiting features that lead politicians to make poor spending decisions, however, or react slowly to budget crises can also force them to concentrate on the present and collaborate with other societal actors. Scholars have found, for example, that frequent government alternation in the post-communist area correlates with lower levels of influence peddling (Horowitz, Hoff, and Milanovic 2009), and, when constructive lobbying is possible, alternation is a substitute for rather than a complement to corruption (Campos and Giovannoni 2008). I find that uncertainty, and especially political uncertainty, promotes collective action between party and business elites by disciplining politicians, who must deliver on their promises to business or risk punishment in the next election cycle.

High uncertainty means that societal actors do not know who will be in power next and thus cannot assess the value of their social networks. They also find it difficult to predict policy changes that may come with the next government. These changes could range from policies such as tax and labor policy to the awarding of public contracts. Uncertainty may come from high levels of political competition in an unsettled party system, such as in Bulgaria, which has seen the regular entrance of new parties. It may also come from high levels of competition in a polarized party system. This does not necessarily mean that the same parties will alternate. For example, in Poland failure at the elections

has frequently meant organizational death for Polish political parties. While the party labels changed, however, the parliamentarians themselves largely reappeared under a new organizational guise. Shabad and Slomczynski (2002) document the emergence of career politicians in Poland, showing that an increasing proportion of the candidates for office have competed in prior elections (Shabad and Slomczynski 2002: 342). Career politicians thus preserve the value of ties between business leaders and political actors even if old party organizations are replaced by new ones.

This is contrasted with low uncertainty, in which it is much easier to identify the dominant political force because the levels of political competition are lower. For example, in Romania not only was there a dominant party<sup>3</sup> but the recruitment of political elites was highly centralized (Gherghina, Chiru, and Casal Bértoa 2011). According to Chiru and Gherghina (2012: 511), for more than two decades major Romanian parties (they examine five) have displayed an “uninterrupted oligarchic inertia,” in which parties have highly centralized leadership selection and removal procedures with low party membership and little member involvement.

The view that uncertainty drives elites toward better policy making is echoed by other post-communism scholars. For example, Grzymała-Busse (2007) finds that high levels of competition limit corrupt behavior by political parties. When opposition parties offer a viable alternative, parties resist opportunities for private gain and instead move forward with reform agendas such as institution building and privatization. Similarly, O’Dwyer (2006) finds that high levels of competition reduce opportunistic moves by political parties to expand the size of the state bureaucracy. And Horowitz, Hoff, and Milanovic (2009: 118) find that more government turnover is associated with higher levels of the development of the rule of law.

In both the case studies and the quantitative analysis that follow, political uncertainty is the key form of uncertainty that affects political and economic actors. Political uncertainty specifically is generated by the difficulty of predicting alternation across the dominant left–right (post-communist/anti-communist) cleavage. This corresponds to what Horowitz, Hoff, and

<sup>3</sup> I classify Romania as a country dominated by one party, the PSD, and this may raise questions with some readers. My research covers the period 1989 to 2005. During this time the PSD was in government from 1990 to 1996 and again from 2000 to 2004. The country was governed by a broad opposition coalition from 1996 to 2000 that was largely ineffectual and plagued by internal conflicts. Although it came to power as the result of a protest vote against the PSD in 1996, voters were so dissatisfied in 2000 that they returned the PSD to power. This dominance allowed the PSD to shape networks and attract the support of business allies as no other party could. I thus think it is reasonable to talk of one-party dominance during this period. The situation changed afterwards, but this does not affect the argument here, which is focused on the first fifteen years during which the distinct trajectories of each country developed. For most of the period from 1990 to 2005 party competition was mostly between two blocs, the left-leaning PSD and the right-leaning opposition (Fesnic and Armeanu 2010).

Milanovic (2009) refer to as “ideological turnover.” This is differentiated from leadership turnovers: a shift in the majority coalition of political parties that does not necessarily imply a shift across the ideological divide. I choose the term “ideological turnover” because it better captures what firms are actually concerned with: that another ideological option to which a firm has no access will come to power. Firm–party networks are often a legacy of the pre-1989 period, and the contacts of business owners often run to a broad group of either post-communist or anti-communist political elites (McMenamin and Schoenman 2007). As also becomes clear in the case studies, ideological turnover matters because the ideological divide is a key factor shaping the personal networks linking economic and political elites.

Ideological turnover is, thus, closer to the argument being made here than regular government turnover. The purpose here is to capture the extent to which changes in party personnel in positions of power limit a firm’s ability to extract rents and favors. Despite the emergence of a new coalition, when a government turnover is not also an ideological turnover, the same actors have often been reshuffled into a new leadership coalition.

Without an ideological turnover, the networks of firms to power holders might not be disrupted because leadership turnovers can be the equivalent of rearranging “the thrones of heaven, or the deck chairs on the Titanic, as the case may be” (Horowitz, Hoff, and Milanovic 2009: 110). In fact, they find that ideological turnovers have a slightly stronger effect on the development of the rule of law than leadership turnovers, reasoning that the latter may allow for more continuity of corrupt contacts (Horowitz, Hoff, and Milanovic 2009: 121). Thus, for my argument, ideological turnovers are clearly more relevant.

One question to be answered is how ties between parties and business can be maintained in competitive democracies. Why do citizens not mobilize to disrupt the alliance between business and political parties, withdrawing their votes from parties that are seen as self-serving and serving the interests of business allies rather than those of voters? Kopecky (2006) notes that political parties have traditionally been studied and classified by their connection with societal actors and the representative function they performed. Thus, an earlier literature on parties compared them on the basis of patterns of representation (worker’s party, peasant party, religious party) and organizational form (cadre party, mass party, catch-all party). This approach to political parties reflected an era when the key function of parties was to represent societal actors.

In the post-communist context, however, political parties have ceased to function primarily as representative actors. In fact, the decline of the party–society linkage across Europe is well documented in the literature (Katz *et al.* 1992; Mair and van Biezen 2001; Kopecky 2006; van Biezen and Kopecky 2007; Dalton 2008; Whiteley 2011; van Biezen, Mair, and Poguntke 2012). Evidence of this in the post-communist world is seen in the comparatively low

levels of popular party identification, strikingly high levels of electoral volatility – the net change in the popular vote across consecutive elections (Lewis 2002; Birch 2003; Bielasia 2005; Sikk 2005), low levels of party membership, declining voter turnout, and weak links between parties and collateral organizations (Dalton and Wattenberg 2000; Bielasia 2002; van Biezen 2003; van Biezen and Kopecky 2007).

Numerous reasons are cited in the literature to explain this lack of embeddedness in post-communist civil society. Some have argued that the legacy of repression and forced political mobilization under communism has left post-communist citizens reluctant to become involved with political organizations and skeptical of the political realm (Kitschelt 1992; van Biezen and Kopecky 2007). Alternatively, in what is known as the “tabula rasa” approach, citizens are seen as blank slates shifting from party to party as they try to make sense of a confusing landscape of new political organizations, learn about political participation, and understand their own interests in an unfamiliar and complex economic system (Kitschelt 1992; Sztompka 1992; Sztompka 1993). In addition, economic interest did little to create stable alliances to parties during the transition, as voters were faced with an array of mainstream parties proposing pro-market economic programs imposed by international economic pressure (Brada 1996; Kochanowicz 1997; Ost 2006). Parties in some countries, such as Poland, also leaned toward making broad appeals to voters instead of narrowly targeting socio-economic groupings, thus undermining the sense that a particular party speaks to a specific group (Szczerbiak 1999).

What is clear from this debate is that the attachment of voters to parties in the post-communist world is remarkably unstable. On the supply side, voters are faced with the frequent entrance of new parties and movements wooing voters (Tavits 2008). On the demand side, voters are shifting alliances from party to party, although not necessarily to new entrants (Sikk 2005). Nevertheless, voter volatility has continued to rise well into the second decade of transformation after multiple elections, by which time we would expect voter preferences to have settled (Innes 2002). While Tavits (2005) argues that party systems are slowly moving toward stability, on the basis of a decreasing trend in volatility after an average eleven years of democratic transition, Epperly (2011: 2) finds that “the passage of time is not consistently associated with decreasing levels of volatility,” based on a data set covering a longer period. Regardless of who is correct, both support the view that the voter–party linkage is too weak to interrupt exchanges between interest groups and politicians.

This is not to say that some parties have not made progress in developing connections to constituents. In fact, some differences can be observed in the extent to which programmatic parties have emerged and created ties to societal groups across the post-communist world. The difference, however, is between modest progress in countries such as Poland and Hungary and the poor record

of parties in most other countries in post-communist Europe. Moreover, as Innes argues, the impression of stabilization in countries such as Poland and Hungary given by “rational choice” approaches to the study of parties in post-communism is misconstrued. Even in these countries, where there has been a noticeable shift toward programmatic competition among parties, party systems remain “peculiarly vulnerable” (Innes 2002: 101). In this context of region-wide weak ties to societal constituencies, it does not make sense to view post-communist parties as an outgrowth of societal interest groups (van Biezen and Kopecky 2007). Because this linkage is absent, we also should not expect party–society ties to perform the usual function of disciplining parties in their behavior. In other words, the role traditionally assigned to civil society in a democracy is undermined (Katz and Mair 1995; Scarrow 1996; Dalton and Wattenberg 2000; Bartolini and Mair 2001; Detterbeck 2005). As a result of the absent society–party linkage, parties are driven to form other bonds in the direction of the state (Kopecky 2006; Meyer-Sahling 2006; van Biezen and Kopecky 2007). As Kopecky (2006) explains, in post-communist eastern Europe “political parties are weakly anchored in society while at the same time they have strongly penetrated the state.” Consequently, in analyzing parties, these authors argue for a shift of attention from the party–society linkage to the party–state one. They point out that political parties and the state are linked through a series of channels: the flow of campaign finance funds from the state to parties is the most visible. Patronage resources such as appointments in the state bureaucracy and state-owned or partially privatized firms also flow from the state to political parties, however. Control of these resources through the appointment of party personnel to the boards of firms is another key manner in which the state–party linkage is reinforced. Building on a paper by Kopecky (2006), van Biezen and Kopecky (2007) propose that the nature of the party–state linkage can be assessed on three key dimensions: the public funding of parties, the public regulation of parties, and party rent seeking. These three dimensions reveal some of the substance of the linkage between party and state. The public funding of parties is an indicator of the dependence of parties on the state for financial resources. Public funding is widespread in the region. Szczerbiak finds that it clearly favors “insiders” and has been increasing in amount in Poland since the establishment of state financing in 1993 (Szczerbiak 2006).

The public regulation of parties is seen as a reflection of the increasing perception that parties are a necessity and that their role must be defined and specified in the law and, increasingly, directly in the constitution. Van Biezen (2004) argues that this has transformed parties from voluntary associations emanating from society to a kind of “public utility” to be regulated and managed by the state. The constitutionalization of parties is an extreme form of the institutionalization of parties (van Biezen and Kopecky 2007).

Finally, party rent seeking is an indicator of the extent to which parties dominate and have penetrated the state. Of the three dimensions, this is perhaps

the most commonly associated with post-communism and the widespread political corruption that has been a central part of post-communist political development.

Kopeccky finds that public financing is widespread, public regulation of parties is extensive throughout the region, and party rent seeking is also common. Meyer-Sahling (2006), in fact, shows that attempts by governing parties in Hungary to penetrate the state and politically staff the bureaucracy, commonly referred to as politicization of the state, have increased over time and are not just a feature of early post-communism.

The above dynamics support a focus on the interaction of economic actors and politicians. I thus propose that uncertainty and network structure together define potential future costs for individuals or firms calculating the payoffs of strategic behavior. In other words, the availability of networks and the level of political competition determine the ability of businesspeople and politicians to calculate the probable shape of the future and make decisions about collaboration. As uncertainty rises, businesspeople have a harder time predicting who will lead the next government. Thus, uncertainty shortens time horizons. It does not mean, however, that parties know they won't be in power again (it is only post hoc that we know this). In an attempt to increase their chances at the polls, parties turn to business for support. Under broad networks, politicians and businesspeople are able to forge deals because monitoring, information flows, and credible commitments are facilitated and parties have the credibility needed to raise broad support. Defecting on deals under broad networks will undermine the future ability of parties to turn to business. Networks offer informational, binding, or commitment opportunities. They determine the balance of relations between polity and economy, and influence the ability of individuals to calculate likely future scenarios. The breadth of networks among economic actors (firms and their proxies) and between business and political elites thus affects the predictability of the future. Broad networks allow information to flow and provide a structure of mutual credible commitments, but they also include more and heterogeneous actors. The resulting deals are likely to represent broader demands. Narrow networks have the opposite effect.

The combinations of network structure and uncertainty and the resulting state type are summarized in Table 1.1. I present below the characteristics of the resulting trajectories of institutional development.

TABLE 1.1 *The effect of networks and uncertainty on the state*

		Uncertainty	
		Low	High
Network structure	Narrow	<i>Patronage</i>	<i>Captured</i>
	Broad	<i>Embedded corporatist</i>	<i>Concertation</i>

- (1) When networks are broad and uncertainty is high. In this context, political and economic elites are engaged in a process of concertation, and the state broadly functions as a coordinating body by channeling information, mediating among interests, and potentiating network ties. In these contexts, *concertation* states develop mutually beneficial institutional solutions for competing factions over the long term.
- (2) When networks are narrow and uncertainty is low. In this context, political elites dominate economic elites. The resulting *patronage* states award selective benefits to allies on a case-by-case basis.
- (3) When networks are narrow and uncertainty is high. In this context, economic elites dominate political elites. This combination of features gives rise to *captured* states, which are colonized by and helpless in the face of strong societal actors.
- (4) When networks are broad and uncertainty is low. This combination describes an *embedded corporatist* state in which groups of well-established political elites do not face the disciplining effects of uncertainty and they co-opt business through broad networks. Although this type is logically possible, the combination of low uncertainty and broad networks does not appear among the cases covered here and is unlikely in contexts with competitive elections.<sup>4</sup>

The different dynamics that took hold between business, parties, and the state are brought to life in the statements of business leaders and officials. A Polish businessperson described the relationship as one driven by “*wspólny interes*,” mutual interests: “Mutual interests are the basis of interaction with parties and the state. It is not about the general interest but self-interest so it would be difficult to say that politicians are on the side of business or anyone else. They each solve their own problems.” Business leaders also spoke of this relationship as a collaborative one, however, looking to the state as a partner “with which you can do something together.” This combination of self-interest and partnership defined the Polish dynamic, and contrasts sharply with the other two cases.

Noting the influence of narrow interests, a Romanian business leader said, “The biggest challenge for Romanian big business today is the bureaucracy, but not just the bureaucracy but the input of special interests into this bureaucracy. And the relations and sweet deals that come out of it.” These relations developed in the context of top-down party–business relationships in which parties held the upper hand; as another business leader pointed out, “The idea of party leaders running around to gather money is wrong. There is more money available in the grey and black economy than can be spent.” And, as

<sup>4</sup> This combination, in fact, most closely describes the case of South Korea, as discussed by Kang (2002). Kang calls the tightly linked political and economic elites in South Korea “mutual hostages” because of the stalemate that exists between them.

will be discussed later in this book, numerous interviewees noted the absence of any coherent business community.

In Bulgaria, the opposite dynamic took hold. Remarking on the inability of the state to govern business and the consequent explosion of corruption, an official said, “There were too many sharks in too small a lake, which the state cannot cope with.” Describing the power and reach of business over the state as an unofficial lobby, another official observed, “The lobby that these business groups own involves not only senior people but also lower levels of the state.”

## CONCLUSION

This chapter has advanced an argument that is distinct from much of the literature on the political economy of institutional development. Existing scholarship focuses on the extent of democratization and popular opposition, the speed of reform, and the role of legacies. I take a different view: that institutional development is essentially a collective dilemma facing political and economic elites. To this end, the developmental state and varieties of capitalism literatures both offer insights into the way that these two sets of elites view economic institutions and the process by which these two groups can work toward socially beneficial outcomes. I draw on both lines of scholarship to construct a theory that also incorporates the untreated variables of networks and political uncertainty. Bringing political competition over economic resources to the fore, I extend and develop both literatures to contexts that are democratic but not in the advanced industrialized world. The result is a theory that conceptualizes the moves of political and economic elites and their success in realizing mutually beneficial outcomes.