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(Former) Informal Networks as a Reflection of Informal Institutions in East European Transitional Societies: Legacy or Opportunism?*

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Abstract: *Only recently has the influence of culture on economic development been increasingly discussed among theoretical economists. Besides observing culture through cultural traditions inherited from ancestors, current social interactions are also considered as an influential factor. Over a long period of time, the research on East European transitional societies has been focused on formal institutions. Throughout that period, informal networks, many of which originated from the previous socio-political system, have mostly strengthened their position in the society and gained power in the formal structures. They helped in building the new capitalist states and therewith had positive effects by speeding up the transition process. Yet, in medium and long term, their activities typically resulted in state capture.*

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This paper explores the persistence of tight informal and mostly inefficient formal business-government-society relations in Eastern Europe. It emphasises the influence of informal networks in the interaction of formal and informal institutions, and questions the possibility of new generations to make a turnaround in the functioning of the networks. Newly emerging social interactions are contextualised in the cultural dimensions: Power Distance and Collectivism versus Individualism. This paper argues that even when informal communities solely serve their own opportunistic purposes, the prevailing collectivist culture in the society provides tacit support to their existence and therewith delays the transformation from relation-based to rule-based governance. The empirical findings confirm the oversocialised view of the society and networks suggested by economic sociologists. Additionally, the changes in transitional institutional environment are deemed to be in line with the claims of institutional economists on durability and impact of informal institutions.

Introduction

The research on post-socialist transition revealed the gaps regarding informal institutions, i. e. culture, traditions, and norms of behaviour. Those ex post findings could explain many transitional failures and specific outcomes, reform flows in particular. Moreover, they shed a new light on the role of networks as an important and inevitable form of governance in post-socialist societies. This paper is focused on the economic sphere of the society that in Eastern Europe seems to be overly connected with the political sphere. It seeks to answer what “feeds” the existence of powerful informal networks or, in other words, what helps them growing. It explores if the in- and outgroup relations are the result of intangible heritage or raised opportunism in the new, post-transitional circumstances. The article strives to contribute to the growing debate on the role of networks, powerful elites in particular, in the transformation attempts of the Eastern European societies. Moreover, it expands the analysis to the interactions of the ordinary citizens and links it with the features of dominant national culture.

The article is structured as follows. The next section explains the methodology and the distinctive position of the researcher when dealing with this sensitive topic. Section 3 pinpoints the identified gaps between post-socialist reality and the theory available at the beginning of transition. It emphasises culture and path dependence and in that regard highlights major differences between Eastern European and Western European societies. In line with that, Section 4 confronts Western and Eastern perspective on power elites, ingroup and outgroup relations, and networks. It relies both on theoretical approach and empirical findings. The final section presents the conclusions.

Methodology

This work is based both on primary and secondary sources. By introducing the main theoretical concepts and the context of the problem explored, the literature review serves not only as an overall roadmap for the empirical analysis to follow; it also presents the major differences on the Eastern and Western perspectives on the topics relevant for this analysis. The secondary data are based on Hofstede's cultural dimensions and studies conducted for Eastern Europe, and primary data are based on interviews conducted in Croatia with business leaders mostly operating in South Eastern Europe. As it is important for the quality of data obtained for this sensitive topic, the researcher uses the position of the insider. That position is increasingly considered valuable (Banks, 1998; Chavez, 2008) and the researcher deems it to be useful in this case, because of high data confidentiality and hidden real substance as major research difficulties are faced. According to Banks (1998, p. 8) typology, the researcher is considered to be an indigenous-insider in the cases investigated in this paper. In the practice of exploring this, or related topics, a researcher needs to be an insider or to know reliable insiders just in order to start the first step, i. e. identify the network(s) as that information is not officially known.

Transitional Circumstances and Transitional Culture: Theory versus Reality

Only twenty five years ago there was no theory of transition. This deficit combined with the consequences of the removal of the old regime is named "The *Tabula Rasa* of 1989" (Elster, *et al.*, 1998, p. 25). Economists were fast to start the research on transition, but had often analysed it only as an ideological shift towards democracy and the market economy, and thereby missed the social, cultural and historical dimensions of transition (Lemke, 2001; Aligicia, 2006; Pejovich, 2008) and the geopolitical aspect including the shift of central Europe and the Baltic states towards Western Europe (Roland, 2002). The overly simplistic discussions on reform were driven by a metaphor instead of a modern theory and knowledge of Western economic institutions (Murrell, 1991a) and the same as in simpler cases, (macro) economics was not enough (Mankiw, 2006). It is also confirmed in Lavigne's (2000, p. 17, as quoted in Aligicia, 2006, p. 30) remark:

"...The *economics of transition* cannot be reduced to just *economics* (whether macro or micro), nor can it easily be merged in a single approach."

Overall, it has been proved that the ideas on the straightforward path from socialist towards capitalist system were misleading (Murrell, 1991a; Neuber, 1993; Roland, 2000; King, 2002; Županov, 2002; Mueller, 2010). Ex post analyses suggest that transitional context was much more complex than initially expected and the socialist legacy was underestimated. The Washington Consensus-like prescriptions mainly did not work, i.e. a fast and efficient switch from planned to market economy was impossible. Roland (2001, p. 30) lists transition surprises: immense output fall, continuous economic decline, insider privatisation, restructuring state-owned enterprises, increasing Mafia phenomenon, the breakup of several countries, successful economic reforms in China. Upchurch and Marinkovic (2011) emphasise further negative features in the context of “wild” or “crony” capitalism: rent-seeking, gangsterism, corruption and a burgeoning informal economy. Consequently, Roland (2001, pp. 30-31) points out:

“The experience from transition, however, has contributed to accelerate various changes of focus in the way we think about economics ... transition has forced us to think about institutions not in a static way but in a dynamic way: how momentum for reform is created, how institutions can evolve but also how momentum can be lost, and how one can get stuck in inefficient institutions.”

It is deemed highly probable that “states, existing law, and the actions of political and economic elites will promote a unique blend of property rights, governance structures, and rules of exchange in these societies” (Fligstein, 1996, p. 1079). The elites are primarily recognized as the actors of change rather than large groups of ordinary people. Moreover, the differences in the level of democratisation and the development of market economy in former planned economies are greatly considered to be influenced by the change of the elites, elite circulation or continuity of the elites (Kušić, 2009).

Culture: East-West Clash

Culture was one of the key missing links in the research of the impossibility of a straightforward change in economic, political and social arena in post-socialist societies. Only recently has culture received a greater role in the studies on economic transformation undertaken by economists¹ (Greif,

¹ O. Williamson (2000, p. 610) notes that the informal institutions, or institutions of embeddedness from his model of NIE, “are an important but underdeveloped part of the story”. The common explanation for this area remaining under-researched is the fact that due to its

1994; Pejovich, 2003; Roland, 2004; North, 2005, 2008; Aligicia, 2006; Guiso, *et al.*, 2006; Aoki, 2011; Jellema & Roland, 2011; Acemoglu & Robinson, 2012; Mokyr, 2013). Culture is defined as “customary beliefs and values that ethnic, religious and social groups transmit fairly unchanged from generation to generation” and by that definition it is focused on inherited, slow-moving components of culture and avoids possible causality issues (Guiso, *et al.*, 2006, pp. 23-25).

By finding exogenous sources of cultural variations, Tabellini (2010) explores the differences among European regions within countries based on the linkages between historical institutions, culture and finally, economic development. The culture is considered to be influenced by ongoing social interactions and tradition inherited from the ancestors. The findings show that distant history is an important determinant of current economic performance both across countries and across regions within countries. This may imply the questionable primacy of formal institutions as economic development drivers since the regions investigated had same formal institutions for several centuries, but the influential traces of early political institutions are still identified and cannot be attributed only to institutional inertia. Moreover, two sets of cultural features seem to have a positive impact on economic development: social capital and confidence in the individual. Social capital includes trust and respect, whereas confidence encompasses control in one’s life and obedience in a negative sense. These institutional features may influence economic development directly or through existing institutions. The latter influence is likely to be more efficient.

Pejovich (2003a) claims that the interaction between the Western formal institutions and informal institutions in the former socialist states was a key reason for the unsatisfying results of the institutional restructuring. The rationale behind that argument is that the harmony between the formal and informal rules will reduce the transaction costs and hence enable some resources for the production of wealth. In the opposite situation, when there is no harmony in the changes between formal and informal rules, the transaction costs will rise and that will diminish the creation of wealth in the society. Claiming that the process of CEE transition from socialism to capitalism is a cultural rather than technical issue, and emphasising the role of the informal institutions, Pejovich (2003a, p. 10) named it interaction thesis. Roland (2004) confirms that argument explaining that any endeavours to impose Western fast-moving institutions like political ones that are appropriate for the Western culture in countries with a very different histori-

nature economists left it to other social science disciplines, particularly to sociologists (Opper, 2008).

cal and cultural background will not result in same economic success. Roland (2004) distinguishes between fast-moving and slow-moving institutions, whereby fast-moving ones are political and legal institutions, and a slow-moving institution is culture. As indicated by their name, slow-moving institutions change a little at a time, while fast-moving institutions may change in a moment. Yet, slow-moving institutions have to change all the time in order to create inconsistencies with fast-moving institutions and catalyse changes (Roland, 2004, p. 117). North (2008, p. 51) stresses that despite the fact that formal economic and political rules are created to improve exchange, democracy in the political arena should not be treated as equivalent to competitive markets in the economy and concludes that this “distinction is important with respect to the efficiency of property rights”.

Two cultural dimensions Power distance (PDI) and Individualism versus Collectivism (IDV) most appropriately serve the purpose of further analysis: cultural foundations for the development of relations in the Eastern European compared to Western European societies. According to Hofstede et al (2010), it takes decades to change the prevailing culture in certain societies. Moreover, the presence of high power distance and high level of collectivism, as seen in several transitional societies, is extremely resistant to change and the estimate is that it may take even a century to change those cultural characteristics if coupled.

Power distance as a cultural dimension is explained as “the extent to which the less powerful members of institutions [family, school, community] and organizations [work places] within a country expect and accept that power is distributed unequally” (Hofstede, *et al.*, 2010, p. 61). This dimension chiefly investigates the relations of leaders and subordinates. Bosses in high PDI countries are autocrats or tend to behave paternalistically and keep their subordinates dependent on them. A great emphasis is on centralisation, formal rules and hierarchy. Privileges and status symbols for the “upper class” are highly appreciated and not questioned. On the opposite, low PDI countries are characterised by a consultative style of leadership and a real two-way communication. Decentralisation and freedom to express opinion are stimulated. Managers treat their subordinates as equals, and they interact freely. This can also be seen as a result or reflection of the relations in the society in general such as in the family, at school and in the various institutions (hospitals, public administration bodies, etc.). Privileges and status symbols are most commonly disapproved (Hofstede, *et al.*, 2010, Ch 3).

Large power distance society are characterised by status consistency, being it the desire of certain individuals for permanent status or acceptance of the masses without questioning it. Previously elaborated privileges and

continuous wealth building by people in power, same as income inequality, seem to be expected. That can be also related to nomenklatura legacy: people with unlimited power at the top of social hierarchy and ordinary citizens with egalitarian syndrome. Large power distance in intra-state relations is also disentangled as “Might prevails over right: whoever holds the power is right and good” (Hofstede et al, 2010, p. 83) or from the in- versus out-group aspect: loyalty to the incumbents was the main competence in the beginning of 1990s (Kušić, 2009, p. 610). Hofstede et al. (2010, p. 77, p. 79) add:

“Scandals involving persons in power are expected, and so is the fact that these scandals will be covered up. If something goes wrong, the blame goes to people lower down the hierarchy...

Even in the most democratic system, journalists and whistle-blowers exposing scandals have a difficult time. In less democratic systems they risk their lives...

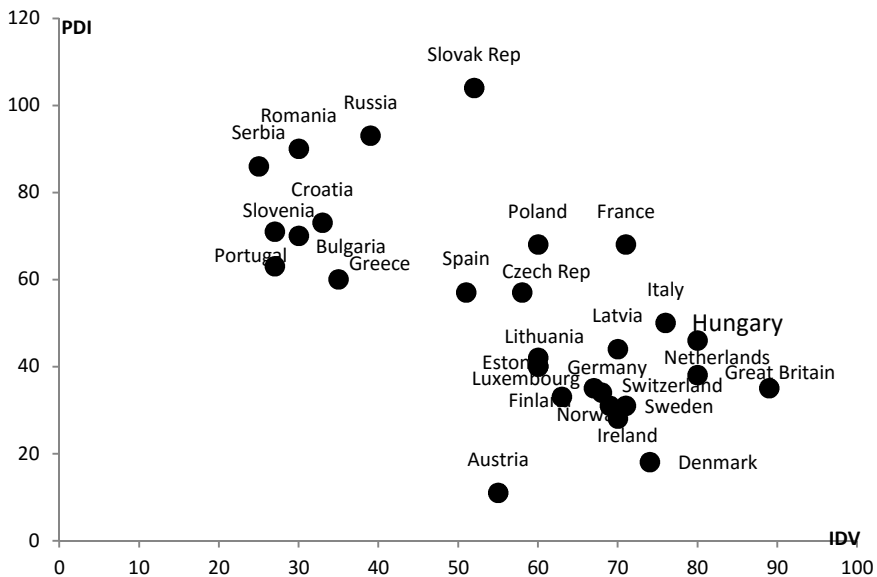
...underfed and uneducated masses make poor democrats, and the ways of government that are customary in more well-of countries are unlikely to function in poor ones.”

It seems that expectations and behaviours in large power distance societies form a vicious circle with questionable progress towards smaller power distance. As it can be seen in Figure 1, majority of the transitional countries belongs to this group: Slovakia, Russia, Romania and Serbia at the top, followed by Slovenia, Croatia, Bulgaria and Poland. Only Lithuania, Latvia, Hungary and Estonia with medium PDI score are placed between Western European PDI average and other transitional countries.

Individualist societies are primarily characterised by loose ties between people, i. e. “everyone is expected to look after him- or herself or her immediate family” (Hofstede, *et al.*, 2010, p. 92). On the opposite, in collectivist societies “people from birth onward are integrated into strong, cohesive in-groups, which throughout people’s lifetime continue to protect them in exchange for unquestioning loyalty” (Hofstede, *et al.*, 2010, p. 92). Large power distance societies are usually collectivist, whereas small power distance societies are overwhelmingly individualist (Hofstede, *et al.*, 2010, pp. 102-105). Majority of the countries in the world are collectivist, and wealthy countries are predominantly individualist (Hofstede, *et al.*, 2010, pp. 91-97). In the collectivist societies people are treated based on their group affiliation and double criteria are very common, i. e. favours and benefits for the group members and exclusion of the out-groups despite the qualities they might have. Social network serves as a primary source of information (Hofstede, *et al.*, 2010, p. 117), and that arguably results in

large-scale information asymmetries and imbalances in the society, as well as further fortification of the group divisions and structures. On the other hand, the privacy in the individualist societies is highly appreciated and consequently the pursuit of the self-interest is an overall aim, whereby the in-groups and out-groups play according to the same rules (Hofstede, *et al.*, 2010, p. 130). Among transitional economies Latvia and Hungary show the highest level of individualism, while Poland, Lithuania and Estonia are closer to a medium score on this dimension (Figure 1).

Figure 1. Culture: Inindividualism versus Collectivism and Power Distance



Source: Hofstede (2013).

As already mentioned, as a phenomenon that describes some transitional countries, large power distance is commonly intertwined with collectivism, i. e. the dependence both on in-groups and power figures is dominantly present, as well as patriarchal structures within extended family (Hofstede, *et al.*, 2010, pp. 102-105) that are expectedly reflected in other societal spheres. Among the observed European countries in the Figure 1, the Southeast European countries (Slovenia, Croatia, Romania, Bulgaria, Greece) dominate the high PDI and low IDV group; other countries in the

same group include Russia, Portugal and Slovakia. Slovakia is very close to individualist culture, yet extremely high on power distance scale.

Path Dependence and Adaptive (In)efficiency

Path dependence needs to be considered when reflecting on the complexity of the multiple pasts of transition societies². The cultural processing of information underpinning informal rules is actually a long-term source of path dependence because it gradually influences institutional change (North, 2008, p. 44). Overall, the path dependence in transition societies seen through degrees' perspective shows that the evolution of post-communist institutions is likely to be influenced by previous institutions in a variety of ways (Liebowitz & Margolis, 1995). Szelenyi and Szelenyi (1995b, p. 7) argue that the transitional change "is path-dependent, involutory, rather than revolutionary or evolutionary"

Because of the favourable initial conditions being underused, the costs of delay became an influential factor of some transition countries, South-east European in particular (Kušić, 2007). In that region, there is a great discrepancy between the importance of path dependence and historical legacies on one hand and the ways these features are treated by policy advisers on the other. It resulted in a series of adverse consequences in the last twenty years (Uvalic, 2012). Within the structuralist conceptual framework, post-communist transformation is observed as "governed by path-dependency, the deadweight of the past, continuity, and inertia – factors which are at best slowly and marginally altered by institutional innovations and rational decisions of actors" (Elster, *et al.*, 1998, p. 294). This point is reinforced by Roland's (2012) most recent claim that transition countries are more influenced by the weight of their long-run history than solely by their communist past. The historic roots of backwardness of Central and Eastern European countries are further supported by the estimate that their average GDP per capita amounted 54% of GDP per capita level of the European Core³ at the beginning of 16th century, whereas in 1820 it decreased to 47,7% and then to 41.3% in 1913 (Podkaminer, 2013, p. 1 based on Maddison, 2001).

² The term used by Elster, *et al.* (1998, Ch 2) to emphasise that post-communist societies may be seen as having at least three pasts: pre-communist and communist period, and finally, the turning point of the fall of communist system.

³ The Core consisted of 12 West European countries, including Italy but excluding Spain and Portugal whereas CEEC group of countries excluded Russia.

In the transition countries, institutional path dependence is a significant factor, and North (1992) claims that it is caused by the network externalities, economies of scope, and complementarities that exist within a given institutional matrix. He points out to the individuals and organizations with bargaining power that keep the whole system moving. Due to the non-existence of established NGOs and more because of the opportunistic behaviour of certain individuals this perpetuum in transition countries happened in a very distinctive way. It could be best labelled as free riding. In addition to lacking knowledge of the interplay between formal and informal institutions, there are also the deficits in understanding the relations between political and economic markets in transition that disable the full understanding of path dependence. Nevertheless, the path dependence may also be analysed through a logged change of the system from political capitalism to proper entrepreneurial capitalism, whereby numerous factors that contribute a political capitalism to stay in place are recognized (Županov, 2002, pp. 70-74) such as: inertia that keeps economic, political and social patterns from previous system; leadership skills from socialism that are transferred to new political leaders; inherited neotraditionalism covering clientelism, nepotism and corruption.

Following Schumpeter's ideas, Stark (2001) explains post-socialist change not as move from one system to a new one, but as "rearrangements in the patterns of how multiple orders are interwoven". This makes organizational innovation to be recombination rather than replacement. Recombination is a starting point of Stark's (2001) study of recombinant property in East European capitalism. Stark (2001, p. 480) explains that change:

"how actors in the post-socialist context are rebuilding organizations and institutions not *on the ruins* but *with the ruins* of communism as they redeploy available resources in response to their immediate practical dilemmas"

Elites, Relations and Networks: Western versus Eastern Perspective

In the communist period, a single elite existed due to the tight relations of political and economic sphere and it is rather plausible to argue that the traces of that system are still omnipresent. An extension of the previous discussion on businesspeople in transition economies being not primarily and fairly concerned with their core businesses (or doing it the unexpected way) in Nye's (2008, pp. 70-71) point:

“Any group or organization or individual with the power to make laws and guarantee the functioning of market institutions is also powerful enough to abuse those who need such protection.... this is the problem of ‘Take or Make’.”

Lemke (2001, pp. 11-12) points out that the unequal access to the channels of power and influence is also to a great extent an inherited form of the communist system and that these built-in systems in the society negatively influence social citizenship. Nee and Cao (1999, p. 801) explain the phenomenon further:

“...politics of transition reinforce the pre-existing stratification order in so far as the old communist elite succeeds in employing and deflecting institutional change to shore up vested interests”.

Elster *et al.* (1998, pp. 293-295) stress that political, managerial, and administrative elites had to a great extent monopoly over the transition process since their power from the previous system converted into strong positions within the new system. K. Mueller (2010) points to the struggles between liberal and post-communist elites as the main source of crisis and obstacles for reform implementation in the post-communist era and consequently, the historical and cultural path dependence as a defensive excuse.

Schleifer and Vishny (1999, pp. 227-253) emphasise that keeping politicians from the previous system in Russia and keeping inadequate incentives for them resulted in their predatory behaviour. In addition to that, the average of the political life expectancy of initial transition government was very short and there is a legacy of non-participatory government by the communist parties. Consequently, the citizens developed the mentality of passive “policy takers” (Neuber, 1993, p. 524; term borrowed from C. Offe). J. Williamson’s (1992) forecast in the beginning of transition was that the post-communist countries would accept the Western mainstream in terms of democracy and market economy. It would, however, take them half a century under optimal circumstances to reach the living standards of the West. Boettke *et al.* (2008, pp. 350-353) note that Russia’s informal institutions were unsupportive to privatization. Coupling those two factors resulted in majority of the richest businessmen in Russia being oligarchs whose wealth came from overtaking state assets. In contrast, in Poland having the tradition of (limited) entrepreneurship in communism, most of the wealthiest businesspeople had start-ups.

Elites

Mills (2000 (1956)) was the first one in the modern era who started talking about the elite dominance in the economic, political and military area. The findings suggest that only three-thousandths of 1 percent of the entire population. Yet, when studying European post-socialist transition societies, it becomes clear that the research on elites is at its beginning and only partly differentiated (Kušić, 2009, pp. 605-508). However, when distinguishing between reproduction of elites and circulation of elites theories, the prevalent standpoint remains that Eastern Europe is more appropriately portrayed by “reproduction” theory (Szelenyi & Szelenyi, 1995a), i. e. “the system change did not effect the personnel of the elite: those who were privileged in the past remain privileged in the present. The old communist nomenklatura is now becoming a new propertied bourgeoisie“ (Szelenyi & Szelenyi, 1995b, p. i).

When explaining the flow of the major reforms and the short term costs they cause, Rodrik (1996) took into consideration the position of the groups in power where some of them would lose their benefits both in the long and short-run. Parallel to that there is the fact that the overall long term benefits for the country would come too late for the politicians in power and that would de-stimulate them. Yet, the myopia of the politicians is not considered a satisfactory explanation for not starting the reforms with long term effects. A very common standpoint explaining the slow systemic changes in the post-communist countries points to the old elites in power, i.e. the majority of people occupying the top positions in the country before the 1990s kept their places or simply changed the previous one for another leading one⁴. There is some evidence for that view; Kornai (2000) mentions the cases of Hungary, Poland, Slovakia and Czech Republic, where more than a half of the economic elite in the mid-1990s held top position in the communist period as well; King’s (2002, p. 14) data show that almost 70% of communist political elite and half of the economic elite kept their positions in Russia and significantly less in Poland: slightly more than one fifth of the economic elite and almost 30% of the political elite. Szelenyi & Szelenyi’s (1995b) data confirm that Russia had the highest nomenklatura retention among investigated transitional countries.

Despite admitting that as an important problem, Kornai (2009, p. 296) states that the “change in elites cannot be equated with the change of system”, and recommends allowing more time for this process to be fully

⁴ Despite differences and/or changes in definitions in the studies comparing elites in the 1980s and after the fall of the Berlin Wall, the results appear to be rather similar, and the numbers invariably show a significant ratio of people staying in powerful positions.

completed bearing in mind that the requirements of the market will influence the selection in the long run (Kornai, 2008b, pp. 137-142). Quite the contrary, King (2002) considers it to be the key for the development of capitalism within the country that largely influences its economic performance. In that regard, he connects a higher prevalence of the old ruling elite with the lower FDI per capita. While checking the human capital of politicians and their adaptation to new system, Shleifer and Vishny (1999, p. 245) consider that:

“[i]t is doubtful that a Communist politician can quickly pick up the requisite skills...Many of today’s Russian politicians are Communist leftovers experiencing significant hardships in understanding what is expected of them, and fearful that in the new society they will be outsmarted by competitors. Few of these leftover politicians have transformed themselves into capitalist politicians.”

Still, Kornai (2008b, pp. 137-142) does not consider the replacement of the elite to be a necessary requirement for finishing the change of the system, although it cannot be claimed that everybody will have the full access to the opportunities. The impossibility of everybody having access to the opportunities is additionally linked with the close relations that businesspeople kept with the politicians in power both at the national and at the local level (Estrin, 2002; Županov, 2002; Kornai, 2009). The way privatization was driven helped the inherited way of managing companies to persist. The companies in transitional CEE countries usually became the ownership of insiders who were closely related with the politicians deciding on the further privatization steps and controlling the previous ones. Firms were selected for privatization based on political and economic reasons, and those were usually the firms that would be successful even if not privatized. Close relations with the incumbents enabled the new owners to follow their own goals, not necessarily enhancing the company performance, but more often misusing the company, sometimes resulting in pure “asset stripping” (Estrin, 2002). Therefore, Estrin (2002) warns that policies aimed at enterprise restructuring need to be considered as complements, not substitutes, and bearing in mind the experiences in the beginning of transition privatization itself does not suffice, effective corporate governance and hard budget constraints are of great importance.

King (2002) considers the intra-dominant class consisting of Party bureaucrats, technocrats and humanistic intellectuals to be a decisive factor in the country’s path to capitalism. During mature socialism those three groups had much higher redistributive gains than the workers. When communism in the former Soviet Union and Eastern Europe collapsed, party

bureaucrats in cooperation with managers as a fraction of technocrats decided for a complete remake and were suddenly in favour of nationalism and capitalism. This is the way “capitalism from above was initiated” (King, 2002, pp. 7-9). Along the same lines, Pejovich (2003a) argues that in the beginning of transition the old ruling elite including party leaders, businesspeople and top bureaucrats, quickly changed their façades and started officially promoting capitalism. Yet, their real mindsets were still in favour of collectivism and state-centred economy and therewith connected attitudes and behaviour. Furthermore, personal connections with the ruling elite may become substitutes for neutral formal rules and that situation results in misallocation of resources, diminishes the importance of economic efficiency and puts emphasis on bargaining power and corruption in the politicized networks (Oppen, 2008). The problems of social conflict and commitment deficit may be durable because of inefficient institutions that resist despite the changes. That kind of institutions enables vested interest groups to keep their power because winners of institutional change usually do not enforce the compensation packages for the losers, and there is no third party to do that (Roland, 2004, p. 115). In line with the described context, Rodrik (1996) points out the common tendency of political systems to keep the status quo even if it is inefficient. He considers that the reason for that is the impossibility to predict the winners and the losers from the reform, Roland (2004) and Kornai (2009) note that impossibility as one of the distinctive features of reform implementation in transition countries. Rodrik (1996) concludes his analysis by highlighting the issue of missing institutions in charge of compensating the losers from reform.

Kogut (2008) notes that Balsac’s remark on capitalist development claiming that great crime is a background of great wealth is likely to be true regarding the wealth creation in transition economies. That is in accordance with expected “transition wisdom” that considers the business creation and growth, privatisation in particular, to be a highly political issue and therefore not transparent (mildly expressed). Exploring state capture as a form of grand corruption, Hellman and Kaufmann (2001, p. 1) defined it as “the efforts of firms to shape the laws, policies, and regulations of the state to their own advantage by providing illicit private gains to public officials”. Whereas corrupt acts usually influence the way various rules are supposed to be implemented, state capture is found at the previous stage – during the process of creation of rules, laws and regulations. The influence of the interested companies on the incumbents in that early stage of the formulation of rules and laws strengthens the persistence of the vicious cycle of the capture economy. The data show that state capture is significantly lower in the countries that have pursued deep economic reforms and/or have high

levels of civil liberties (Hellman & Kaufmann, 2001), these facts make the breaking of the vicious circle even more difficult. Capture may be considered a large “tax” on non-captor firms. It is proven through sales growth data that in high capture economies captor firms grow at least twice as fast as non-captor firms. Furthermore, the security of captor firms’ property rights is five times higher than in case of other firms. The survey also shows that the usual profile of the captor firm is characterised by some surprising features: new entrant to the market willing to buy greater security from public officials in the given legal environment of a high capture economy; it is very likely to be a foreign investor working closely with local partners. The development of the high capture economy is rather expected, entrepreneurs have more incentives in capturing the state than developing their businesses in a competitive way. From the macro point of view, state capture diminishes private investments and enhances barriers for small and medium-sized enterprises, and consequently deters the fundamentals for sustainable growth (Hellman & Kaufmann, 2001).

In transition countries, several issues underpin the state capture: the creation of new rules and law occurs in a non-transparent way, almost hidden from the public; weak political parties; trade associations, NGOs and interest groups do not have significant influence on policy and lack resources and experience. That kind of environment gives an impression to the enterprises that dealing directly with state officials is the most efficient way of solving their issues in doing business. The solution might be to mobilise the losers of the capture economy – SMEs, consumers and other interest groups – and try to create an efficient collective action that can deter the pillars of the capture economy (Hellman & Kaufmann, 2001). Otherwise there is a situation depicted by Ofer (2012, p. 247):

“...the entrepreneurs and bureaucrats capitalizing on the disorganisation and weak enforcement and the disappointment of many people (and some leaders?) in the virtues of the new system.”

In the former Yugoslavia and the former Soviet Union, except for Russia to some extent, there is a disabling legacy reflected in the persistence of old elites in power regardless the strength of the political break. The old incumbents usually succeed by accepting the dominant nationalist agenda (Neuber, 1993). Pejovich (1993, based on Brown) and King (2010) argue that, contrary to the dominant opinion, nationalism is a long-lasting phenomenon in Eastern Europe, it actually never left it but was hidden or suppressed depending on the political regime. The decades of socialism and its legacy seem to be more fertile ground for nationalism, hierarchy and wel-

farism than for the capitalism implemented by any approach, Big Bang in particular. Pejovich (1993, pp. 68-74) identifies three main causes of the post-Communist nationalism in Eastern Europe. The first is the institutional instability reflected in an institutional vacuum in which Eastern European suddenly found them and interpreted it as a need to switch back to their traditional informal rules. The second is a region's philosophical heritage that made Eastern Europeans confused, and to some extent disappointed about the new institutions in place because they were expecting the best "institutional shopping" effect including capitalist benefits and socialist welfare. The third is nationalism and the regional nomenclature explaining nationalism as a cover for opportunism of ruling elite proved by fast switching façade of the former Communist leaders. According to Shirley (2010, pp. 44-45), further research is needed to examine if the politically connected enterprises are a product of poor institutions or are a part of natural state equilibrium, as recently advocated by North et al.

Croatian business and political elites appear to show very similar features and trends as previously discussed for Eastern European transition countries. Yet, there are only rare studies thoroughly exploring elite mapping in Croatia from late socialist period to recent times. Pusić (1992) observed the general managers of the most successful companies in Zagreb in 1989, and then checked their status and opinions in 1991. The 1989 the survey showed very capable managers ready to cope with large scale changes in the society and contribute to those changes with their competences, and that group of managers was considered a proper business and society elite. For instance, almost 80% of them had democratic style of leadership and it overall showed that long lasting workers' participation was appreciated and had positive effects (Pusić, 1992, p. 76). Those managers were highly educated (80% holding a Bachelor degree or more), noticed the necessity to pursue additional management education (97% of them), and claimed that there is always room for improvement of their skills and knowledge (85% of them) (Pusić, 1992, p. 82). However, the change of power in 1990 showed incumbents' unpreparedness for the new role, ambiguous vision of the country and modern democracy, same as incapability of leading transformation and stabilising institutional infrastructure. That situation contributed to the unfavourable situation for the successful managers from the previous era. Less than a third surveyed in 1991 stayed in their leading positions, another third stayed in the same company holding different positions, usually in the top management or close to it, but with questionable power. In the rest of the previously surveyed companies, same as in the other companies on the market, leading people were commonly selected basing on political criteria, and the suc-

cessful ones from the previous system did not get the opportunity to show their skills and knowledge. The later analysis for the case of Croatia showed that managers had three options for sustaining its power in the company and its position in the society (Županov, 2002, pp. 77-83 partly based on Čengić, 1995; Krištofić, *et al*, 1997): membership in the party of power, relying on their own competences, and acquiring full or partial ownership control in the company. Most of the managers decided to own to company to some extent, one fifth of them sustained their position through political involvement, while almost none of them relied solely on skills and knowledge. In general, clientelist relations between managers and politicians in power seem to be the key factor for the survival on top positions in the business sector. In the initial period that meant for the managers privileged conditions of financing of their acquisitions. Out of that situation emerged the increasing phenomenon of the privileged individuals without appropriate references (“tycoons” in Croatian) that got the opportunity to buy the companies that were undervalued for that purpose. The function of those individuals seemed to be to “drain the economic substance” from the companies by using complex transactions to pay out the money or by executing “asset stripping”. Most of the companies that failed because of the described managers’ mismanagement were usually returned to the Government Privatization fund and their recovery process was (again) at government’s cost, including the transfer payments to the former employees that became either unemployed or retired.

Interviews (Simic Banovic, 2012) with leading businesspeople involved in policy-making processes in Croatia reveal several underlying issues for doing business in Croatia. The prevailing one is that closeness with the incumbents is almost considered to be a must for running a successful business, particularly when dealing with the State. This mainly tackles the suppliers of the central state and local administration, but in a wider sense it tackles all the business subjects, as they need to comply with the laws and rules that are (too) often changed and variously interpreted. In addition, to illustrate the key success factor for winning the public tenders, the businesspeople quote the owner of one of the biggest IT companies in the SEE who reportedly keeps saying: “It’s your fault if you didn’t manage to write the public tender yourself!” meaning listing the requirements that only your company can fulfil and hence, being able to earn extra profit for the company and pay bribes to people in charge of public procurement by this illegal way of lobbying. Furthermore, to make the business environment even more difficult to work in, public criticism of the Government or local authorities by businesspeople usually coincides with a sudden tax inspection, unexpected cancellation of the contract with the State or similar “messag-

es". Another issue is that in a small society people are inherently connected and being it collectivist as well, it is rather expected that these connections will be used in both public and private sphere. If objectively analysed, some of the practices of cooperating with acquaintances and friends could be certainly considered a misuse of the position. However, in a collectivist society with high power distance there are also double criteria for ingroup and outgroup relations that are widely accepted and expected.

Networks and Communities

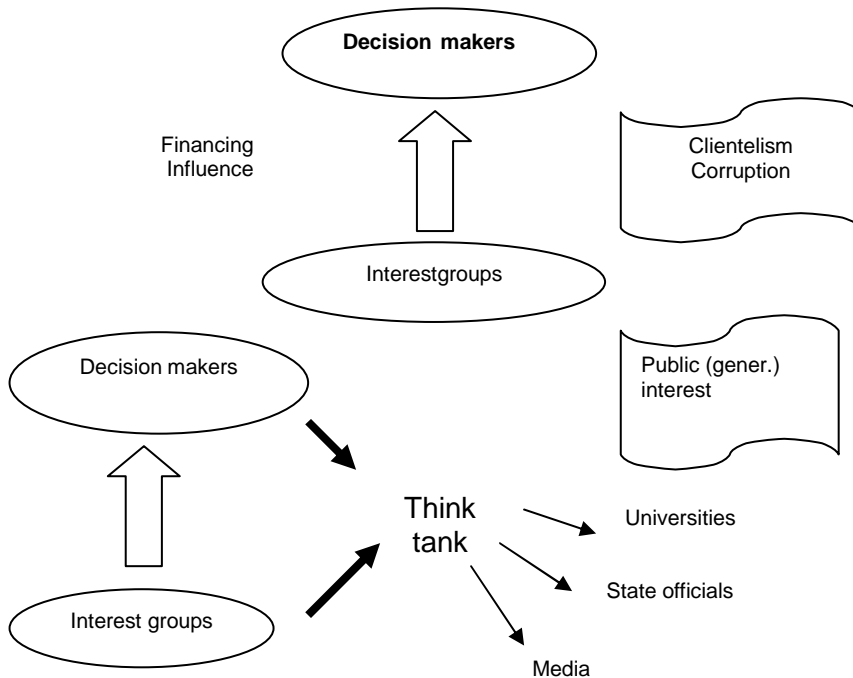
In transition countries the governance is predominantly relation-based and it is unlikely to produce an immediate switch to rule-based governance. Hence, their transition may also be observed as a transformation from relation-based towards rule-based (Dixit, 2004). The relation-based governance shows diminishing relative efficacy with the increase of economic transactions. This process may also be observed through the growth of less developed economies. Nevertheless, even the most advanced countries are not strictly rule-based; most economies contain both forms of governance. Following Rodrik's work, Dixit (2004) points out to the importance of not only state institutions, but also to context-specific social arrangements. The context-specific approach is based on the existing governance institutions and their interactions and is focused on modifying them. When comparing various policy contexts, Dixit (2004) stresses that the governance issue is the crucial factor for less developed and post-socialist economies. Networks and communities seem to emerge and/or persist as an alternative mode of governance. Treisman (2012) points to the persistence of clan networks as an obstacle to democracy.

Further theoretical reasoning for the investigation of networks can be found in the works of economic sociologists. While developing the idea of the economic actions as socially situated or embedded, Granovetter and Swedberg (2001, pp. 11-14) emphasise networks of relationships rather than atomized actors. A network is explained as "regular set of contacts or social connections among individuals or groups". In the light of post-communist transition, Aligicia (2006) notes that networks of cooperation from the communism period can easily become corruption networks in the new system, and vice versa, former opposition networks can become entrepreneurial and proactive in a positive manner.

Further analysis (Delic, *et al.*, 2011) of the political decision making processes indicates that, contrary to the situation in developed countries, think tanks in transition countries are still investing significant efforts in their positioning in the political decision-making process that is supposed

to be an open type (Figure 2). Yet, reality usually shows its closeness and that is considered to be one of the main reasons for the economic and political mistakes. Research shows that, similar to other Eastern European transition societies, think tank organisations in Croatia are insufficiently recognizable and their inputs for the policy process are either not used at all, or used only to a small extent. Despite EU recommendations for the greater role of civil society organisations, the practice of cooperation between think tanks and ministries and other public administration bodies seems to be non-existent or developing too slowly. The data from the Croatian Parliament show that most of the laws are passed in the emergency procedure that does not ensure the time for expert advice and consultation with independent organisations. Furthermore, members of the Parliament commonly follow only the guidelines of their own party and that results in the voting to be the reflection of the opinion of the party in power.

Figure 2. Political decision-making process: closed type versus open type



Source: Delic *et al.* (2011, pp. 5-6, based on Schneider (2002).

The case study (Šimić Banović, 2015) of an appropriately designed Croatian reform initiative that was officially supported by all the domestic and international stakeholders and appeared to have all key success factors applied depicts the reasons of its failure. Overall, it showed that business-government-society relations rooted in persistent informal rules mostly act as (informal) networks and communities, being at the same time also covered up by a false consensus among stakeholders. Government used it as a pre-election tool and personal interests stopped it from further implementation despite the support of international community. Underlying disabling factors included: inappropriate mindset, passivity and lack of political will at all levels including overprotected civil servants whereby state acts as a “nanny” for its employees; non-existing awareness of consultation processes; and low absorption capacity in the public administration characterised by numerous “bottlenecks” and insufficient institutional memory. Consequently, the immature and inefficient social dialogue and missing accountability of public officials on one side was coupled with deeply rooted efficient personal ties on the other and private gains were mostly achieved. Another complementary finding from the other set of interviews (Šimić Banović, 2012) is that some interviewees were only willing to honestly comment on their ingroup and outgroup relations and inclinations when the tape recorder was off. This was mainly related to their willingness to employ, cooperate with or support in their endeavours people of different ethnic origin (when talking about regional business) or people from the counties or communities other than their own. When the tape recorder was on, those interviewees typically repeated politically correct slogans and opinions.

Strong networks based on reputation and trust may be very valuable in the beginning of transition when formal institutions are still not functioning. It is common that networks in those time periods take the role of formal organisational structures. Although this substitution can have positive effects at the initial stage in terms of speeding up the transition process, in the medium- and long-term it usually results in clientelism and corruption that are essential obstacles in the process of building an effective state structure (Rose-Ackerman, 1999, pp. 317-322). Easter (1996, pp. 552-554) claims that mainstream literature used to overemphasise macrolevel causes in order to explain state-building outcomes, and thereby the structure of international environment was considered to be a decisive factor. It implied that hostility of international environment would increase the likelihood of building a strong state, same as the national obstacles to industrial development that would provoke the process of state building. Easter (1996) is a proponent of analysis of a state as a micro-level unit, and more precisely

Levi's "bringing people back into the state" stream. While analysing post-revolutionary Soviet Russia Easter (1996, p. 557) notes that state-building efforts often happen "in contexts marked by the breakdown of long-established and widely accepted political roles" and that is when "personalistic relations can provide the basis for new institutional forms". Observing the development from the 1920s until the 1980s, Easter (1996) notes that during Gorbachev's reforms the informal networks diminished the capacities of the state to implement reforms in the periphery, which makes it the opposite situation from the one six decades earlier. The similarity can be found in post-communist Russia in the 1990s, when again the centre-regional power struggles emerge and this period is characterised by a reactivation of previous social networks and the increased power of nomenclature members. Hence, throughout the decades and probably centuries as well "a better understanding of the ways in which informal, micro-level social structures influence formal, macro-level institutional forms" seems to be essential (Easter, 1996, p. 578).

Considering that interactions among people may be structured by markets, states, families, communities and other institutions, Bowles and Gintis (1999) question widely accepted expectation of the demise of community due to values and drivers of the modernised world. They consider communities as modern governance structures, notice not only the survival of communities, but also the advancement of certain communities and expect them to be increasingly important in the future nexus of governance structures. They consider that the reasons for the changes in communities are not likely to be found in the survival of certain values from the previous times, but in the adaptive capacity of communities to provide solutions to the problems that people face in the society. Communities seem to be able to solve various modes of "antisocial" behaviour like free-riding and at the same time underpin activities that are consistent with prosocial norms like honesty and altruism. Contrary to the common perception that norms and values in the community are derived from the legacy of a tradition and various inertial issues in certain populations, Bowles and Gintis (1999, pp. 207-209) claim that they are rather a result of the contemporary structure of community-specific social interactions. They strongly connect the existence of contemporary communities with their capability of solving contemporary issues by underpinning prosocial norms and behaviours. Their rationale in opposing the prevailing view on the communities being inertially built on the intentional indoctrination or inherited values is based on several reasons: heterogeneity of the groups regarding important norms; likelihood of the failure of intentional indoctrination like the one in the former SSSR; fast changes in value orientation showing the constant checks of relevance

of norms for contemporary issues to be addressed. Bowles and Gintis (1999) suppose that combination of community and other governance structures addressing coordination problems in certain population will lead to its growth and success in many aspects.

“Communities, like markets and states, are environments in which cultural traits develop and change. Cultural environments may be distinguished by the way that they favour the copying and hence evolution of distinct cultural traits.” (Bowles & Gintis, 1999, p. 213)

Conclusions

The transformation from planned to market economies in Europe brought intense and unforeseeable changes. There was a large discrepancy in the perceived potential of transitional outputs on one side and theoretical foundations for that large-scale change on the other. Transition was supposed to be a historical “window of opportunity”, but appropriate theoretical tools for managing it were unavailable and the advised practical tools appeared to be inappropriate. That arguably made the role of the agents of change even more important and the enhanced reliance on them. Yet, the transition outputs that emerged were mostly negative. That led to refocus of theoretical considerations. First, more emphasis has been put on the interaction of Western formal and Eastern informal institutions. Second, the idea on path dependent groups and organisational norms attracted more interest, as well as embedded networks account obtained more acceptance. Third, complementary to the previous point, despite the switch of the system majority of the same people stayed in power and that fact partly raised the question of scrutinizing their abilities. Finally, the progress of the trajectory from relation-based to rule-based governance, same as from closed policy making to open policy making model, appeared to be very questionable.

Transaction costs in the process of transition emerge from the collision between formal capitalist institutions and predominant culture in those countries. Furthermore, the intercultural differences produce various levels of transaction costs of transition. The size of the conflict of formal rules and culture increases the transaction costs of transition. The final results depend to a large extent on the ways leaders cope with factors affecting the transaction costs of transition. Still, delays and inefficiency of institutional changes seem to be at least partly caused by lacking commitment of the hidden or unknown stakeholders. This further leads to the issue of importance of informal networks that appear to be much stronger than expected at the beginning of transition. Moreover, revolutionary changes did

not influence the composition of elites, i. e. reproduction remained the dominant trend and it is reflected at most levels of the society.

Prevailing culture in transitional societies could be described as “Plus ça change, plus c'est la même chose”. This saying best reflects the situation in South-Eastern European countries and Russia. These countries are characterized by high power distance and low individualism and that combination of cultural dimensions builds a very resistant “glue”. It implies that both horizontal and vertical transfer of culture won't result in any significant changes, i. e. current social interactions and switch of generations are not likely to shake up the system with long-term effects. Path dependent, embedded connections are found between people at all levels. Elite mapping suggests a high rate of pre-transition leaders remaining at the top of social hierarchy in transitional societies, with Russia being the “top performer” in that regard. Ordinary people also rely on the organisational forms that work for them rather than prescribed, rule-based ones and this attitude is transferred when they move in the social hierarchy (and that happens rarely). Previously elaborated privileges and continuous wealth building by people in power are tacitly supported, and various cases in post-socialist societies indicate that that behaviour is supported even if misused. This again can be explained by dominant cultural characteristics that include tolerance for opportunism, scandals, and even criminal activities.

To underline, both formal and informal networks in transitional societies cannot be explained by dichotomies like good or bad guys, new or old ones, just legacy or pure opportunism. It is certain that a single elite before 1990s has converted into a system of “cosy” relations between political and economic elite. In addition, networks and communities are omnipresent and more influential than superficially assessed. They are rather efficient, in a way supplemental, mode of governance and certainly have stronger effect than newly introduced formal institutions. That confirms the oversocialized view of the society. And prevailing national culture presents crucial leverage for the expansion of embedded ingroup and outgroup relations.

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