

# Understanding the Evolution of Post-communist States

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# Introduction

- Economists have different views of the state.
- Welfare economics sees the state as welfare-maximizing and correcting market imperfections. Everybody knows this is not true, but economists usually formulate policy advice according according to welfare economics.
- Public choice sees the state as “Leviathan” using its monopoly of violence to engage in predatory activities in the interest of incumbent politicians. This negative view is much closer to reality but prescriptions rarely go beyond reducing the size of the state (smaller Leviathan). Moreover, states perform very differently across the globe (autocracies and democracies, failed states, differences in state capacity, ...) .

# Introduction

- Political economics looks at the conflicts inside the state apparatus between individual political agents (executive, elected representatives, the judicial apparatus, higher and lower levels of government). Neither naïve nor pessimistic, political economics gives tools to recommend institutional changes that may deliver improvements along certain dimensions (growth, redistribution, representation, equality, efficiency, fairness, justice,...)

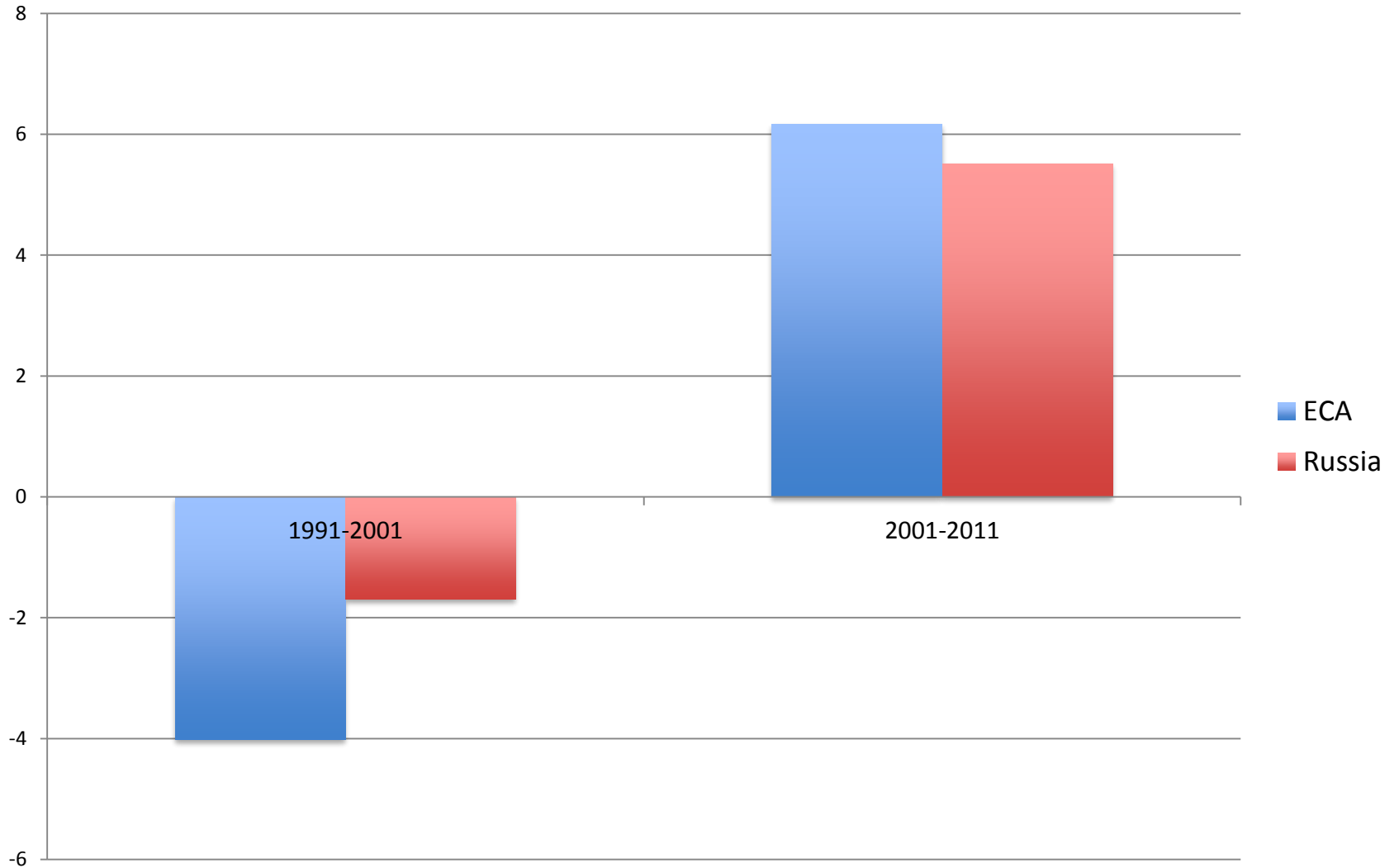
# Introduction

- The evolution of post-communist states poses a particular challenge for political economists.
- Certain patterns have emerged since the collapse of communism and the transition to the market economy.
- Observers have noticed bad institutions, usually associated with bad economic performance.
- I will focus on the evolution in Central and Eastern Europe.

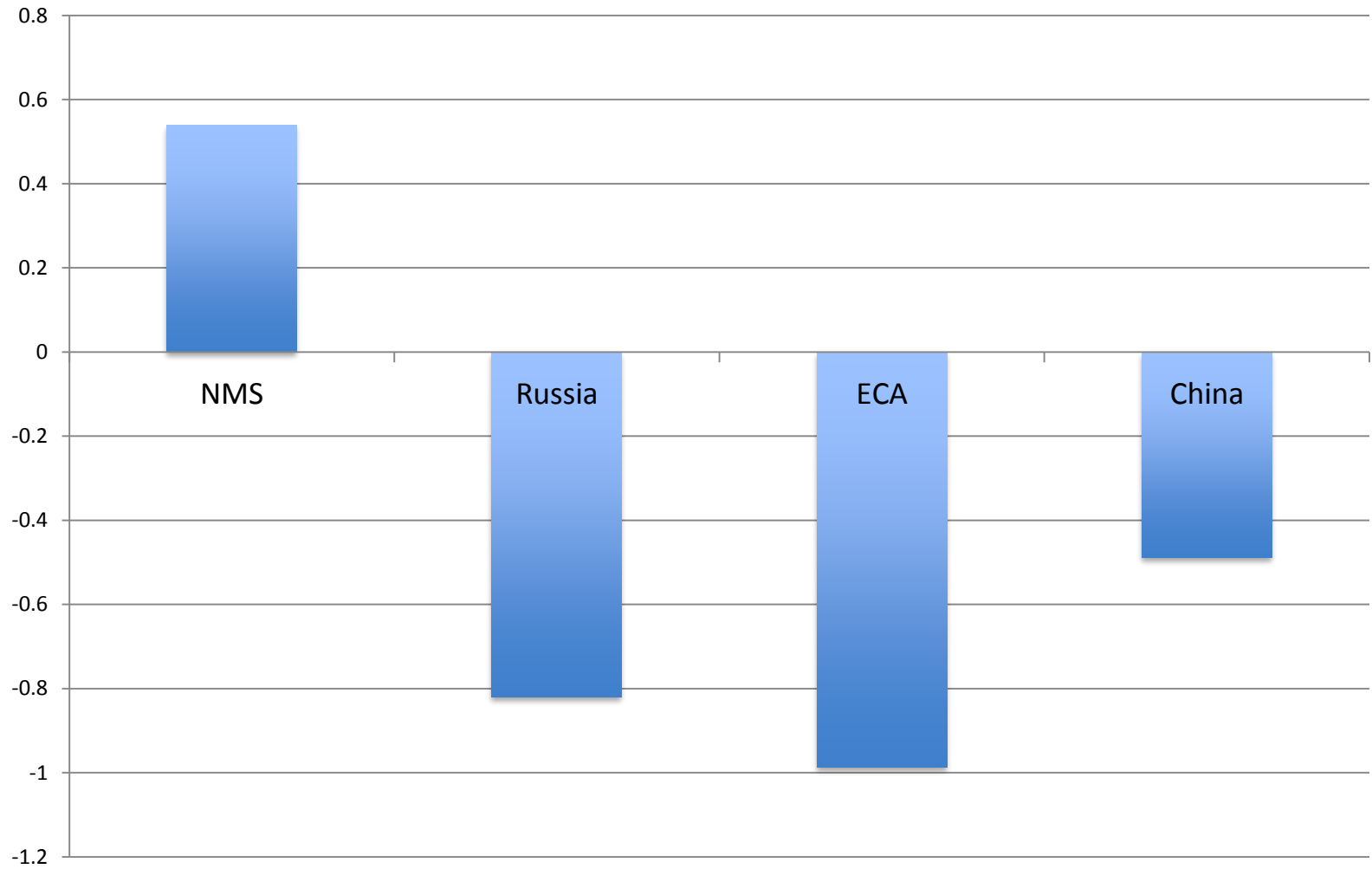
# Facts about transition 25 years later

- Eastern Europe and Central Asia (ECA: Former Soviet Union countries apart from the Baltics) have had bad performance in the 90s and significant improvement the last decade, mostly due to natural resource exports. With some exceptions (Georgia, Kyrgyzstan), their economic and political institutions have evolved in a negative way.

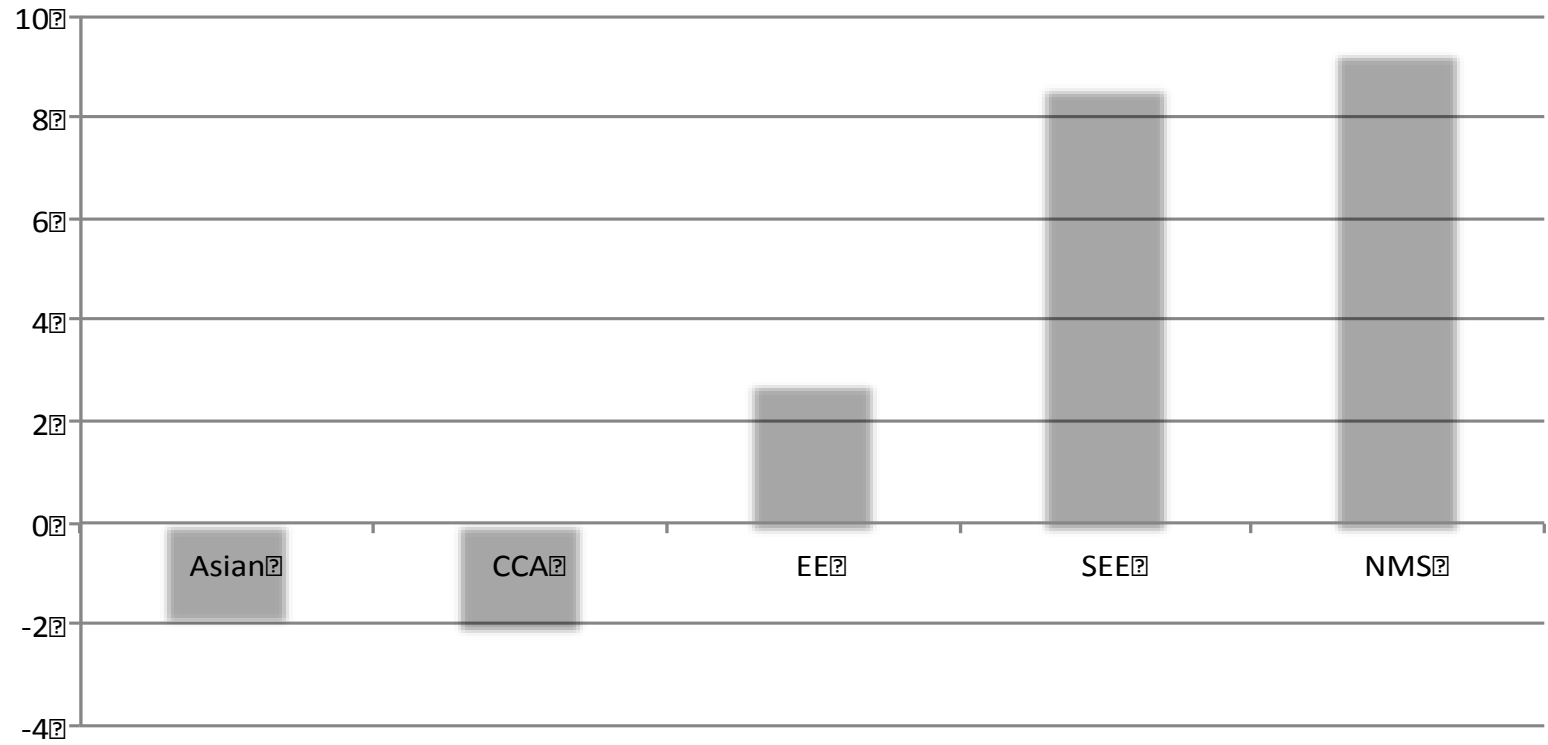
# Average Annual Growth of GDP per capita (in \$2005)



## WB Rule of Law 2012



# Polity3 score 2012





# Introduction

- Moreover, even in New Member States, institutions are far from perfect.
- Former communist countries are for example notoriously badly ranked in terms of corruption.
- Moreover, clear tendencies towards autocracy have been observed in Hungary and Poland, and may be brewing in other countries.

119	Belarus
119	Mozambique
119	Sierra Leone
119	Vietnam
124	Mauritania
126	Azerbaijan
126	Kazakhstan
126	Nepal
126	Pakistan
136	Iran
136	Kyrgyzstan
136	Lebanon
136	Nigeria
136	Russia
142	Uganda
142	Ukraine
145	Bangladesh
152	Congo Republic
152	Tajikistan
154	Democratic Republic of the Congo
156	Zimbabwe
166	Libya
166	Uzbekistan
169	Turkmenistan
170	Iraq
171	South Sudan
172	Afghanistan

Transparency International  
Corruption Perception  
Index ranking 2015

26	Estonia
26	France
39	Lithuania
39	Slovenia
43	Korea (South)
43	Latvia
47	Costa Rica
47	Hungary
47	Mauritius
50	Georgia
50	Malaysia
53	Czech Republic
54	Slovakia
94	Armenia
94	Colombia
94	Egypt
100	China
107	Indonesia
110	Albania
115	Guatemala
115	Mali
119	Belarus

# Introduction

- The surprises of transition led to lots of research to understand the output fall in Eastern Europe, and also the difference between New Member States and Former Soviet Union. **Much stronger and longer output contraction in the latter explained by difference in the quality of institutions.**
- **Accession to European Union played an important role in anchoring institutions in Central Europe and New Member States.**

# Introduction

- Why bad institutions arose outside accession countries was never really explained. In Roland (2014), I emphasized the role of democracy, and differences in civil society and values and beliefs on democratization (more on this later), but this is too partial. **Central to understanding transition history should be understanding the evolution of the communist state.**

# Introduction

- I want to take a longer historical perspective on the evolution of former socialist economies in Eastern Europe, not focusing on particular policies but on the long run processes that have been at work.
- I want to see transition in Central and Eastern Europe less as a process of reform and more as a process of **disintegration of the communist state apparatus**.
- This new interpretation of transition has important implications.

# The erosion of the communist state apparatus in Eastern Europe.

- Under socialism, **communist party concentrated all political AND economic power** in its hands. In the long run, this proved a toxic mix for communist Soviet leadership.
- The burden of managing an economy with no real balanced central plans and more economic complexity (more goods differentiation, more input complexity, more economic links, ...), without using the market as central resource allocation mechanism, led to economic stagnation and **gradual erosion of communist power** (Roland, 1989, 1990).

# The erosion of the communist state apparatus in Eastern Europe.

- Central planning necessitated that orders be obeyed, at least not challenged, but a strong authority of the center could not be sustained in the long run.
- Legitimacy requires sense that Center is in control: has sufficient coordination capacity as well as power to execute its threats of punishment.
- In reality, plans were never balanced. In the early years of planning, what mattered mostly was priority coordination of steel, coal and heavy industry. Campaign-style management, ideological enthusiasm, terror and Stakhanovism made things work.
- As things became more complex, mobilization was replaced by cynicism, in a situation of chronic shortages, **enterprise managers realized that their bargaining power was relatively strong towards the center.**



# The erosion of the communist state apparatus in Eastern Europe.

- Stronger assertion of bargaining power of managers meant simultaneously **erosion of authority of central planners.**
- Central authority had been eroding at different speeds in different countries.
- In countries where it had been eroding faster (Hungary, Poland, Yugoslavia, USSR under Gorbachev), this was interpreted as partial reform towards the market economy, but it was primarily an increase in the bargaining power of managers towards the center.

# The erosion of the communist state

- **Step 1:** elimination of mandatory planning replaced by some form of non-binding plan;
- **Step 2:** increase in decision-making autonomy of managers, in particular on prices and wages;
- **Step 3:** privatization of assets to managers, be it via spontaneous privatization, MBOs, mass privatization,...
- Under the communist state, there was also gradual reduction of power of state apparatus versus civil society and economic sphere, bargaining over extent of rents achievable outside the state apparatus. Monopoly power of communist nomenklatura elite yet unchallenged.

# Transition processes

- In Central and Eastern Europe, transition started with **political overthrow of elite in power** after threshold of weakness of communist state had been reached.
- A lot of the transition literature ignored the recent past, focusing too narrowly on comparison between transition strategies and policies, not taking into account the initial conditions created by the communist state.

# Transition processes

- In Eastern Europe, collapse of communism from the top led to **competition between different networks to grab pieces of power** of the defunct communist state for their private benefits.
- Two types of strategies:
  - Grab directly power positions to enrich oneself (corruption, predatory behavior, asset-stripping)
  - Use connections in state apparatus (government + administration) to grab assets (privatization, tenders, fines,...) and economic power

# Example of privatization

- Privatization was the biggest opportunity to use influence activities to influence allocation of assets:
  - Political **influence** to establish **privatization policies** that maximized the rents for those receiving control over assets (via free distribution of the assets for example), usually insiders but also would-be oligarchs with connections;
  - **Influence** the administrative process via corruption to divert **outcomes** in one's favor

# Privatization and political power-grabbing

- Reciprocal consolidation of economic and political power.
- Use the market power received from **privatization policies** or **regulatory capture** *or* any other influence activity to increase not only one's wealth, but one's influence inside the state apparatus, which made it easier to further enrich oneself.

# Examples

- Ukraine, a perfect example of competition between various oligarchic networks: Akhmetov, Pinchuk, Kolomoisky, Firtash, Timoshenko, Poroshenko,... Privatizations in the Kuchma area nearly all rigged towards oligarchic interests. Power shifts between different groups of oligarchs
- Russia: massive wealth transfers under mass privatization and “loans for shares” scheme; shift in power of oligarchs under Eltsin and under Putin.
- Generalization of corporate raiding.

# Examples

- Czech Republic and Slovakia: Nomenklatura benefiting from privatization (along with adventurers) and corruption in judiciary and government administration to cover up economic predatory behavior.
- Poland: siphoning of bank assets by former Nomenklatura insiders. Role of Foreign Trade Centers.



# Competition between networks

- Competition between different networks (Nomenklatura **insiders**, **outsiders** looking for fast enrichment, networks from **former secret police**, **criminal networks** taking advantage of collapse of communist state) implies lawlessness, collaboration with organized crime, use of power positions within portions of the state (political, judicial, administrative positions, positions in SOEs and state-owned banks), threats and use of violence.
- Competition leads to conflicts and deal-making in the shadow of the law.

# Newly emerging state structures

- Bad institutions directly a consequence of the collapse of the communist state and of competition among former Nomenklatura networks to grab pieces of power. No internal incentive to introduce rule of law.
- The implosion of communism explains the organization of the state: prevalence of influence networks and clans, generalized corruption and use of direct or indirect power positions for enrichment and siphoning away of resources.
- **Kleptocratic state** where **state power is used like an ATM machine**. Much more severe than the soft budget constraint phenomenon.

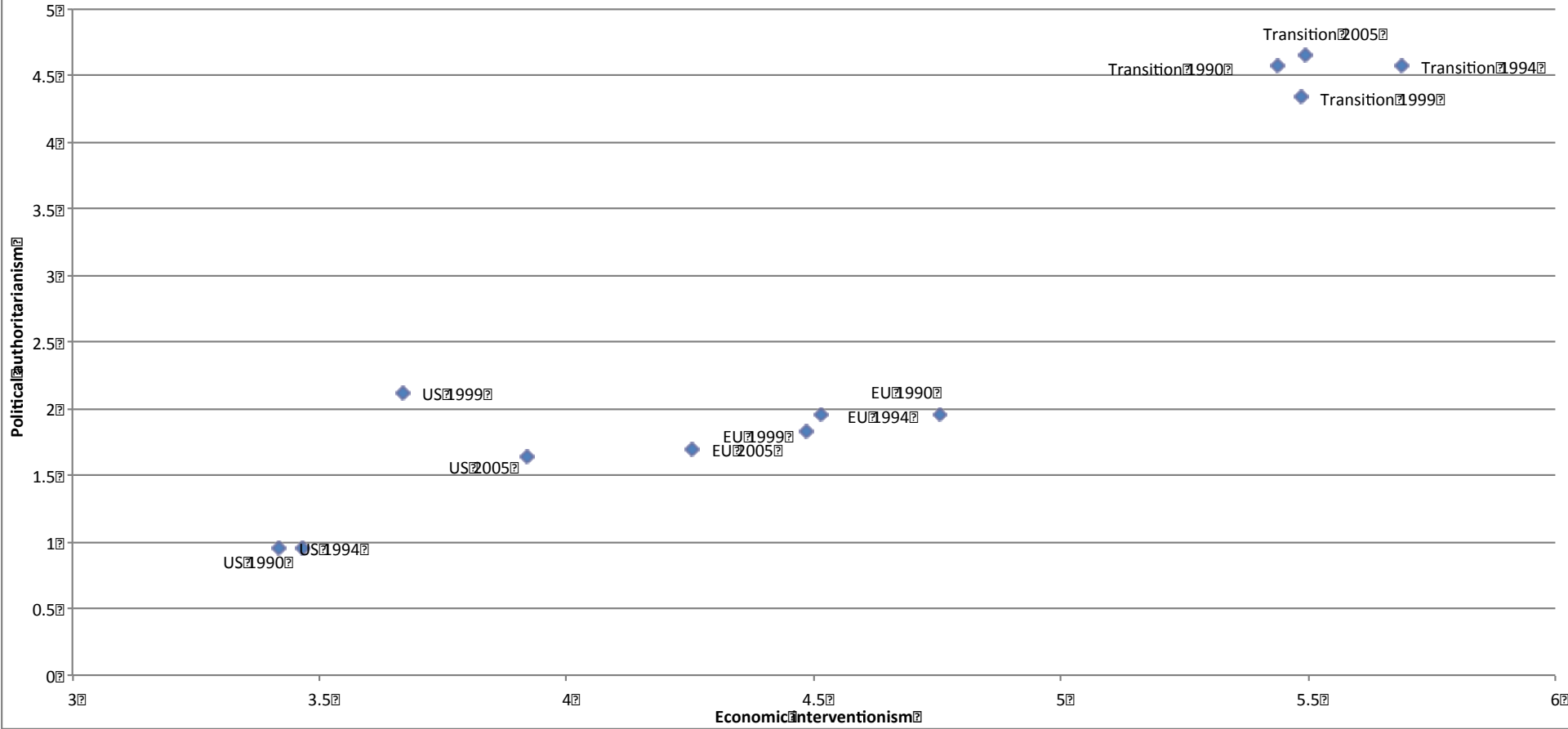
# Countervailing effects? 1. Civil society

- Low level of civil society development leaves this transformation of the state unchecked, as population that is victim of exactions of the kleptocratic state remains relatively passive and fatalistic.
- Higher level of civil society development (see Bruszt et al. 2012) can, however, act as countervailing power. Countries like Poland, Czechoslovakia, Estonia had higher level and stronger maturity of dissident activity, which affected initial political institutions: lower concentration of power in the hands of the executive, more separation of powers and more inclusive institutions.

# Countervailing effects? 2. Culture.

- Reaction against kleptocratic state is not only about level of activity of civil society, it is also about culture and values inside society.
- In former transition countries, even among New Member States, values are more authoritarian and in favor of government intervention. They are also more nationalistic and more favorable of discrimination of women, homosexuals, ethnic minorities, foreigners. These values have not changed much since transition.

# Inertia in Economic and Political Values



# Countervailing effects ? 3. EU accession.

- EU accession provided an external check on the formation of kleptocratic states. Incentives to enter the European Union dampened kleptocratic behavior compared to non accession members.
- This effect was stronger before entry than afterwards. EU is not good at punishing its own members. Autocratic drift in Hungary left virtually unchecked.
- EU still provides institutional support. Example: fight against corruption in Romania.

# The unstable alliance between liberal democrats and extreme-right nationalists.

- Nowhere else than in Central and Eastern Europe have we seen an alliance between liberal democrats and extreme right nationalists.
- They were united by opposition to Soviet occupation but have radically different views of the world. Extreme right nationalists care much less about democracy. They hesitate between alliance with Russia or reluctant integration in the EU.
- This alliance born of collapse of communism cannot last forever. Something has to give.

# Some implications of this reconceptualization of transition.

- **Implication 1:** Despite not introducing “the right institutions”, the state apparatus inside post-communist countries has been deeply transformed **from communist absolute power monopoly to kleptocratic turfs** of various stability shared by various networks.
- **Implication 2:** Reforming post-communist state with failed institutions is of a different nature than reforming communist state under democratic and market transition. Transition’s main challenge was reforming the economy, current challenge is ousting corrupt vested interests. **Requires deeper and long term transformation.** It is possible as seen from examples of Georgia and Baltic states. Ukraine is going in the right direction albeit too slowly.



# Some policy lessons on reforming the post-communist state

- Civil society activism is important.
  - Ukraine: level of mobilization post-Maidan is amazing.
  - Role of youth is important: amazing mobilization in Ukraine, Russia, Romania, Slovakia.
  - Big difference between current youth and those who were young in 1989 (now 40-50 years old)
  - Cynicism and passivity of population breed corrupt politicians (difference between Italian North and South)

# Some policy lessons on reforming the post-communist state

- Key to have executive (president, government) fully devoted to anti-corruption reforms ... and free from corruption influence. Credibility of executive against corruption needs to be signaled by VERY strong and comprehensive anti-corruption policy. Half-measures not credible.
  - Example of half-measures: increasing wages of government employees without removing corrupt agents; executive not taking responsibility for failures in other branches of government, letting corrupt politicians control anti-corruption agencies...

# Some policy lessons on reforming the post-communist state

- Anti-corruption effort requires strong support in the legislature. Legislature can either support or block anti-corruption efforts.
  - Romania: legislation to decriminalize corruption below \$47000. Half a million people went on the street.
  - Ukraine: Proposal not to allow NABU to investigate cases already terminated by other agencies. Protests ongoing.

# Some policy lessons on reforming the post-communist state

- Difficulty of fighting corruption when government administration and judicial system are corrupt. Importance of anti-corruption agency with strong powers and resources (Example of Hong Kong, Singapore, Georgia, Romania, Ukraine).
- Transparency in all domains (information must leak from everywhere ... except national security)
- Digitalization of government creates transparency in the long run, cuts the middleman and corruption. Georgia, Ukraine
- Large deregulation is a very important first step. Reregulation will come later.

# Some policy lessons on reforming the post-communist state

- Decentralization of government is generally a good thing. Spreading political power leads to
  - more experimentation,
  - more learning (education of new generation of politicians),
  - spreads risk of taking over of power by corrupt forces
- Cities are forces of progress, are less politicized and need sufficient autonomy.

# Some policy lessons on reforming the post-communist state

- Role of external pressure from European Union and international organizations (not just about budgets and repayment of IMF loans) can be critical.
- External link can play the role of a commitment device and of a useful internal “nudge”.
- External pressure can be counterproductive if incompetent advice on reforms. Commitments must be defined in dialogue. It is not about finding a compromise, but finding the best ways to reform.

# Some policy lessons on reforming the post-communist state

- Consolidation of democracy:
  - Formation of stable political parties
  - Fair elections and stable rules of the game
  - Separation of powers
  - Respect of freedom of press and association and human rights.
- Separation of powers may sometimes lead to slower decision processes but more inclusivity creates more irreversibility and stability.
- Apart from intrinsic desirability of democracy, democracy is best system to prevent (reduce) expropriation of capital (capital levy problem)

# Conclusion.

- Transition outcomes in Central and Eastern Europe better understood by dynamics of state erosion rather than by particular policies. Reforming post-communist kleptocratic states very different challenge from transition.
- Long march to correct post-communist legacy and become “normal” countries, with possible setbacks.