

FROM THE POLITICS OF ECONOMIC REFORM TO THE FUNCTIONING OF POLITICAL ECONOMIES

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Abstract: For most of the 1990s, many analysts focused their attention on determining the circumstances under which a particular set of economic policies could be implemented in a post-communist state. Although that research agenda led to important breakthroughs regarding the importance of “first-round winners” in post-communist states and the short-run compatibility of democratization and marketization, it was nonetheless based on an anemic conception of political economy: the politics of (a narrow type of) economic reform. In the last decade, the field has moved beyond that limiting focus by asking broader questions about how post-communist political and economic systems operate in practice: Who has what resources? What constraints do they face? How do they get things done in that context? In doing so, analysts have come to emphasize the centrality of informal networks for the functioning of both politics and economics in many post-communist countries. This article uses insights from that evolution of thought to suggest a framework for further investigation of post-communist political economies that focuses on the fate of “first-round winners.”

The Politics of Economic Reform

In the wake of the crumbling of the Soviet bloc, and even while the dissolution was still underway, a large number of observers, advisors, and participants argued about the best way to achieve marketization in post-communist countries.¹ The most influential argument at the time, although not unchallenged, held that democracy needed to be circumvented or postponed so that economic reform could be carried out. Based on the experience of Latin America, analysts feared that populations would resent the short-term impoverishment reforms were expected to induce and so would vote reformers out of office before they had a chance to complete their work.² It would be best, scholars and policymakers argued, to insulate the reformers from political pressure so that they could implement policies that would eventually benefit everyone in society. Later, once the foundations of a market had been laid, politics could be opened, allowing entrepreneurs and consumers to press for further marketization as part of a virtuous cycle of political and economic liberalization. In the near term, however, politically protected technocrats should lead the way.

This approach incorporated two conceptual problems that still infiltrate discussions of political economy in many settings, especially regarding developing countries. First, the phrase “reform” (and “reformers”) was a loaded and limited term. Although it sounds broad enough to include any attempt to improve economic performance, in this setting it referred to a particular set of changes, meant to create a particular brand of market economy through price and trade liberalization, monetary stabilization, and widespread privatization. Anyone who opposed or wanted to modify that particular set of policies was labeled “anti-reform,” which made it difficult to understand the complexities of actual post-communist political economies (which are discussed further in the next section).

Second, these reforms came to be seen as ends in themselves. Countries were scored in terms of how marketized their economies had become (this remained true even after the understanding of marketization was broadened to include such “second-generation” institutional reforms as banking regulations, effective courts, and stock-market regulators). The implication was that economic reform was its own reward. In reality, however, marketization differs from democratization on that score: the

¹ An earlier version of this article was posted on the political blog “The Monkey Cage” (<http://www.themonkeycage.org>), for which the author is grateful.

² Stephen Haggard and Robert R. Kaufman, eds. 1992. *The Politics of Economic Adjustment*. Princeton, NJ: Princeton University Press; John Williamson, ed. 1994. *The Political Economy of Policy Reform*. Washington, DC: Institute for International Economics; Adam Przeworski. 1991. *Democracy and the Market*. Cambridge: Cambridge University Press. (Note that Przeworski objects to the political tactics he thinks would be necessary to carry out rapid market reforms.)

freedoms of democracy—such as free expression and the right to organize—are intrinsically valuable whether or not they produce ideal policy outcomes; in contrast, the freedoms of a market—such as the right to own a business (or lose it) and to make a profit (or fail to)—are supposed to create a better-performing economy.³ Treating them as ends in themselves distracted from their effects on total outputs, factor productivity, or other measures of economic development, to say nothing of their broader impacts on society.⁴

While neither of those critiques was fully incorporated into the study of post-communist political economies, the field did take a major step forward regarding the relationship between marketization and democratization. It turned out that, at least in the post-communist setting, marketization did not seem to engender negative political reactions that needed to be suppressed. In fact, countries in this region seemed either to build markets and democracies at the same time or not to build either one. Several scholars offered explanations for this unexpected finding, and most are at least broadly compatible with each other, although they may weight causal factors differently.

One important line of work showed that the European Union had both the desire and the material resources to encourage both processes, at least in nearby countries, which were, in fact, the ones that democratized and marketized.⁵ Another argument focused on the importance of the first, or “founding,” elections after the fall of the old regime: in the post-communist setting, parties that supported democracy also tended to support markets, so where they won the first elections, both sets of reforms were introduced; where they lost, neither was.⁶ A third possibility was that the

³ Milton Friedman, among others, argues that these freedoms, too, are intrinsically valuable, but that is not how marketization is advertised to developing countries. See Milton Friedman. 1962. *Capitalism and Freedom*. Chicago: University of Chicago Press.

⁴ For more on this issue in the context of the agrarian sector, see Andrew Barnes. 2005. “Reform Is Not Its Own Reward: Thinking about Success in Post-Communist Agrarian Transformations.” In Hilary Appel, ed., *Evaluating Success and Failure in Post-Communist Reform*. Claremont, CA: Claremont McKenna College, 21-46. It is also important to note that scholars did search for positive correlations between economic liberalization and economic performance, but even in the 1990s the results were mixed, and since 2000, oil prices and other factors have been much stronger determinants of economic outcomes. See, for example, Mitchell A. Orenstein. 2009. “What Happened in East European (Political) Economies?” *East European Politics and Societies*. 23:4 (Fall): 479-490; Jan Fidrmuc. 2003. “Economic Reform, Democracy, and Growth during Post-Communist Transition.” *European Journal of Political Economy*. 19:3 (September): 583-604.

⁵ Milada Vachudova. 2005. *Europe Undivided*. Oxford: Oxford University Press.

⁶ Valerie Bunce. 1998. “Regional Differences in Democratization.” *Post-Soviet Affairs* 14:3 (July-September): 187-211; M. Steven Fish. 1998. “The Determinants of Economic Reforms in the Post-Communist World.” *East European Politics and Societies* 12:1 (December): 31-78; M. Steven Fish. 1998. “Democratization’s requisites.” *Post-Soviet Affairs* 14:3 (July-September): 212-247; Herbert Kitschelt. 1992. “The Formation of Party Systems in East

alternation of parties in power inherent in democracy meant that ineffective policies were abandoned over the course of time, helping to create relatively well-functioning markets.⁷

The most influential argument, however, held that, in contrast to the expectations of the early 1990s, market reforms do not generate powerful forces for further liberalization, but rather create powerful vested interests in “partially reformed” economies. These *first-round winners* enjoy the benefits of buying state-subsidized oil and selling it on world markets, opening banks that can funnel money from state coffers to private accounts, building ownership groups that can defend their own property while taking it from others, and so on.⁸ In more democratic countries, these economic actors or their patrons can be driven from power by the masses, allowing marketization to continue; in less democratic ones, their advantaged positions are all but permanent—winners take all.⁹

The Political Economy of Post-Communism

Even that considerable step forward, however, still left scholars characterizing post-Soviet political economies in terms of the obstacles to and facilitators of (a certain brand of) economic reform. It was only in the last several years that this focus began to change significantly. A central theme of many recent writings is the importance of informal networks and practices for getting things done in post-Soviet political economies.¹⁰

Central Europe.” *Politics and Society* 20:1 (March): 7-50.

⁷ Mitchell Orenstein. 2001. *Out of the Red*. Ann Arbor, MI: University of Michigan Press.

⁸ The so-called “oligarchs” in Russia embodied this concept, but it should be broadened to include all those who captured property or access to revenue streams in the first few years of economic liberalization and who stood to lose some of that wealth if the political context changed.

⁹ The most famous example of this argument is Joel S. Hellman. 1998. “Winners Take All.” *World Politics* 50:2 (January): 203-234, but see also Richard Ericson. 2000. “Is Russia in Transition to a Market Economy?” *Post-Soviet Affairs* 16:1 (January-March): 18-25; Stephen Holmes. 1997. “What Russia Teaches Us Now.” *The American Prospect* No. 33 (July-August): 30-39; Michael McFaul. 1998. “Russia’s ‘Privatized’ State as an Impediment to Democratic Consolidation.” *Security Dialogue* 29:2&3 (June & September): 191-199 & 315-332; Konstantin Sonin. 2003. “Why the Rich May Favor Poor Protection of Property Rights.” *Journal of Comparative Economics* 31:4 (December): 715-731; Katherine Verdery. 1996. *What Was Socialism, and What Comes Next?* Princeton, NJ: Princeton University Press.

¹⁰ For example, see John A. Gould. 2011. *The Politics of Privatization*. Boulder, CO: Lynne Rienner; Henry E. Hale. “Explaining Machine Politics in Russia’s Regions.” *Post-Soviet Affairs* 19:3 (July-September): 228-263; Henry E. Hale. 2006. *Why Not Parties in Russia?* Cambridge: Cambridge University Press; Henry E. Hale. 2011. “Formal Constitutions in Informal Politics.” *World Politics* 63:4 (October): 581-617; Vadim Kononenko and Arkady Moshes. 2011. *Russia as a Network State*. New York: Palgrave MacMillan; Alena V. Ledeneva. 2006. *How Russia Really Works*. Ithaca, NY: Cornell University Press; Scott Radnitz. 2010. *Weapons of the Wealthy*. Ithaca, NY: Cornell University Press; Gulnaz Sharafutdinova. 2010. *Political Consequences of Crony Capitalism inside Russia*. Notre Dame, IN: University

Although the authors do not always phrase it this way, the key players in these networks typically include the first-round winners mentioned in the preceding section. At one level, therefore, these studies are able to show, in greater detail than before, how first-round winners block further progress toward a more systematically marketized economy: they establish informal ways of getting things done (with or without nefarious intent). It is then harder to displace those patterns of behavior than it would have been to set up formal rules in the first place, even if formal rules would be more efficient.¹¹

Perhaps more important, a focus on informal networks and practices allows us to ask how those systems might continue to evolve. That is, it helps us see that they are *not*, in fact, stagnant systems that are caught in partial-reform equilibria in which winners take all. Instead, we can ask what happens to the first-round winners who run these networks, under what circumstances it can happen, and what the consequences might be.

In order to investigate those questions, there are four issues scholars need to consider. First, they need to specify who the first-round winners are. A number of studies focus on political leaders and ask when they are removed from office. This is clearly important, but in keeping with the conception of post-communist political economies just discussed, it may also be useful to track the *economic* elites who first emerged after the fall of the old regimes. These are the first-round winners as originally conceived, and they have the economic wealth that allows them to support the informal networks that are so important in these countries. They may depend in important ways on political figures (patrons), but the patrons also depend on them, and this was particularly true in the systems that emerged from the first round of political and economic reforms in many post-communist countries.

Whatever definition of first-round winners is used, scholars need to envision the full range of fates that can befall them. The most common expectation in the 1990s was that they would be able to capture the state in order to maintain their positions, but this need not always be the case. In

of Notre Dame Press. For earlier works that are compatible with these, see David Woodruff. 1999. *Money Unmade*. Ithaca, NY: Cornell University Press; Juliet Johnson. 2000. *A Fistful of Rubles*. Ithaca, NY: Cornell University Press; Vadim Volkov. 2002. *Violent Entrepreneurs*. Ithaca, NY: Cornell University Press; Andrew Barnes. 2006. *Owning Russia*. Ithaca, NY: Cornell University Press.

¹¹ This is why it may be a pipe dream to think that full marketization will happen when first-round winners hand these functions back to the state. The state will not only have to develop the capacity to provide these services, but it will also have to disrupt existing patterns of behavior, which may be much more difficult. It is also important to note that informal practices not only *fill* gaps (which could be considered a positive in some circumstances); they may also *take advantage* of gaps (e.g., making use of weak courts or poor monitoring of shareholder registries to take property from rivals).

some instances, states may escape their initial capture and come to dominate the first-round winners. This might be particularly likely when a new government comes to power. In other cases, economic and political elites may simply move to a more equal footing, engaging more in an exchange of resources than in a relationship of dominance by one side or the other.¹²

Less emphasized in much of the literature is the fact that first-round winners in some countries might be dislodged by *other* economic actors—first-round “losers.” As noted in the previous section, Hellman and others expected these losers to be the masses, who were unemployed or impoverished and who recognized that additional marketization would help improve their lot (and undermine the illegitimate gains of the first-round winners). In countries without much in the way of open politics, however, the most likely challengers to first-round winners might be those near-elites who believe they did not get a big enough slice of the pie the first time around. More importantly, they *did* acquire enough assets and develop enough of their own networks to be an important threat to those at the top of the system.

A third question for analysts of post-communist countries is: Under what conditions these changes in first-round winners’ positions might occur. One possibility is a shock to the system. Many scholars emphasize, for example, the importance of elections and the uncertainty they can produce, regardless of their final outcome. (The president is usually the key patron in these networks, so presidential elections can be the most destabilizing, but similar effects may arise surrounding gubernatorial or legislative elections.) One way elections can destabilize the system is through the jockeying for position and the hedging of bets that take place as the election approaches. Another is through the activities of international non-governmental organizations and domestic advocacy groups during the campaign and the voting process.¹³ In some settings, their activity might also be facilitated by second-tier elites.

Another type of shock that might weaken or dislodge first-round winners is economic. The financial crash in Russia in 1998, for example, brought down some of the major banks of the era and handed advantages to product-based economic groups, particularly those in the energy sector. The collapse of a major export market, such as cotton or metals, could likewise undermine economic actors who had once seemed invincible.

¹² Timothy Frye has argued that this is a better description of the post-communist experience in general than the image of “state capture” ever was. See Timothy Frye. 2002. “Capture or Exchange?” *Europe-Asia Studies* 54:7 (November): 1017-1036.

¹³ In addition to the authors already mentioned, see Steven Levitsky and Lucan A. Way. 2010. *Competitive Authoritarianism*. Cambridge: Cambridge University Press; Valerie J. Bunce and Sharon L. Wolchik. 2011. *Defeating Authoritarian Leaders in Postcommunist Countries*. Cambridge: Cambridge University Press; as well as other works on the color revolutions.

It is also important, however, to point out a longer-term process that may weaken first-round winners and strengthen their rivals, a process that only becomes visible when we focus more on “post-communist property redistribution” than on “post-communist privatization.” The latter term emphasizes the formal policies transferring property from state to private hands. While those were undoubtedly important, the transfers that took place outside of those policies, as well as the myriad conflicts between private actors—that is, the broader process of property redistribution—raged for more than twenty years and offered another mechanism by which the original victors in post-communist political economies might be weakened or brought down.¹⁴ That is, first-round losers may continually peck away at the empires of the first-round winners, slowly replacing them by taking their property one piece at a time.¹⁵

That brings us to a final question, which is what happens after first-round winners are displaced, weakened, or subordinated. In some cases, those changes may clear the way for further democratization, economic development, or both. This is typically the hope when an old elite is toppled. Often, however, the second-round winners behave much like their first-round counterparts, and their ascension simply means a transformation of authoritarianism and continued stagnation. And in other cases, the country may descend further into chaos, as the new elite is unable to govern even as effectively as their rightly maligned predecessors.

The field of post-communist political economy has thus moved from studying the political requisites of marketization to studying how resources are deployed in post-communist countries. Doing so, scholars have produced several new studies of lasting value and pointed the way toward new questions, as well. This re-conceptualization should continue to deepen our understanding of post-communist systems and also produce findings that are relevant across regions.

¹⁴ See Barnes. *Owning Russia*.

¹⁵ Note that such a shift would not require either a plan or coordination among second-tier elites.

