Interest Groups in Post-Communist Countries:

A Comparative Analysis of Business and Employer Associations

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Dinissa Duvanova

The Ohio State University

Department of Political Science

Abstract

In the past 15 years, the post-communist countries of Eastern Europe and the former USSR have witnessed the emergence of a new kind of organizations—business associations. My dissertation investigates the causes of business associations' formation and their interaction with state institutions in the wake of the collapse of socialism. I explore the bottom up and top down dynamics of business association formation. My primary hypothesis is that the number and membership in business associations should depend on the actions of politicians and bureaucrats building the new patterns of sate-business relations. A number of hypotheses about business interest group formation I conduct a cross-national aggregate data analysis as well as comparative analysis of business interest representation in Russia, Ukraine, and Croatia. Such investigation is a critical step in advancing a more general understanding of the development of capitalism in the post-communist countries. This paper outlines theoretical foundations of the research, develops analytical framework to guide empirical investigation, describes methodological approach, and briefly presents some of the most significant findings.

1. Research Question

Despite the tangible benefits that interest groups may provide to their constituents, collective action required to organize such groups is difficult. Yet, in the past 15 years, many of the post-communist countries of Eastern Europe and the former USSR have witnessed a proliferation of business associations that surpassed other types of interest groups in number and strength. A new kind of organization—business associations—came into existence for the first time after decades of communism. Surprisingly, given roughly similar starting points, the post-communist countries vary on both the number of emerging groups as well as their organizational characteristics.[1] Available cross-national survey data reveals a vast divergence between levels of organizational membership in different countries of the region. The most "participatory" businesses are found in Hungary where 76.9% of them belong to associations, while in the least "participatory" country of Azerbaijan only 5.8% of businesses in the survey belonged to business associations. Such variation poses a number of empirical questions about causes of interest group formation. Why do business associations form? What kinds of firms join associations? Why some businesses in some countries join associations? Why others do not?

My research investigates the creation of business associations in the post-communist world and aims to contribute to the on-going exploration of post-communist economic transition and the evolving patterns of governance in the region. My project's dependent variable is the formal institutional framework representing the interests of business. The post-communist countries of Eastern Europe and Eurasia all have some forms of official business organizations. The extent of business interest organization, however, differs across post-communist countries and across different sectors of the economy within these

[1] The early literature on the post-communist transition tends to emphasize "Leninist legacies" as a common factor accounting for the weakness of civil society vis-à-vis the post-communist state (Barbara Geddes, 1995, A Comparative Perspective on the Leninist Legacy in Eastern Europe, *Comparative Political Studies* 28, no. 2, July: 239-74; Ken Jowitt, 1992, The Leninist Legacy, In *Eastern Europe in Revolution*, edited by Ivo Danac, 207-24. Ithaca: Cornell University Press; George Schopflin, 1994, Postcommunism: The Problems of Democratic Construction. *Daedalus* 123, no. 3: 127-41). Such perspective, however, seems to exaggerate similarities among countries of Eastern Europe. It should be acknowledged that these countries' experiences under the communist rule differed substantially. Although countries of Eastern Europe inherited different legacies from their communist past, the formal mechanisms of business-state relations followed similar patterns. An important empirical question to be investigated in the course of my research is how the diverse pre-communist and communist legacies are shaping the emerging business-state relations.

countries. This variation presents an interesting empirical puzzle and a unique opportunity to investigate the causes and consequences of interest group formation. Business representation also differs in the level of competition and conflict between the groups; the groups' connections to political parties, bureaucratic agencies, and other government institutions; the legal channels of group access to and influence on policy making, and the social and economic functions performed by groups. Although I do not attempt to go beyond the exploration of the differences in associational membership, other aspects of variation will play an important role in my research.

This research is important along two dimensions. On one hand, investigation of the causes of business associations' formation can advance a more general theory of the relationship between economic actors and state institutions. My dissertation will contribute, for example, to research on the "varieties of capitalism" and to the literature on pluralist and corporatist systems of interest group intermediation. The post-communist countries provide excellent cases for studying these topics because business-state relations are still in the process of their formation while in the developed capitalist countries such process is generally completed. On the other hand, such an investigation contributes to the on-going exploration of economic transitions and evolving patterns of governance in the post-communist countries of Eastern Europe and the former Soviet republics. Identifying the causes of group formation and divergent patterns of interest group representation in different economic sectors is a critical step in advancing a more general understanding of the development of capitalism, or of what type of capitalism will develop, in the post-communist countries.

This paper outlines theoretical foundations of the research, develops analytical framework to guide empirical investigation, describes methodological approach, and briefly presents some of the most significant findings.

2. The literature

As the liberal reforms in Eastern Europe and CIS proceeded, the two-fold assessment of interest group development emerged. On one hand, the central role of social groups in the establishment of democratic political regimes was recognized. Without civil associations that represent the interests of the diverse groups of people the tasks of democratic reforms would the undermined. On the other hand, the students of post-communist transition feared that the formation of interest groups might undermine the prospects of post-communist transformation. The major concern for the scholars representing the former approach was the supposed weakness of the post-communist voluntary associations, while those representing the latter approach predicted that strong and powerful special interests might capture the state and prevent the further democratic and economic reforms. After reviewing arguments presented by both sides, I discuss the paradoxical situation created by such contrary assessments of interest group development. I suggest that exploring the causes of business association formation can held adjudicating between these two conflicting assessments.

2.1. "Flattened Landscape" and Fragmentation

In the early stages of the political and economic reforms that swept Eastern Europe in early 1990's and shattered the remnants of the Soviet Union a few years later, the scholarly interest was directed to the problems of democratization. As the remnants of the totalitarian system crumbled, the "civil society" approach stressed the importance of the interest articulation and the civil associations operating independently of the state (Fish 1991; Pei 1994; Fish 1995; Henry 2002). Interest organizations were deemed essential for the success of post-communist transformation, but strong doubts remained about the ability of social groups to overcome many existing obstacle of association formation. The scholars questioned whether civil society comprised of strong voluntary associations would reemerge after decades of communism. Communist legacies were seen detrimental to the emergence of vibrant associational life (Geddes 1995; Jowitt 1992; Schopflin 1994). The "flattened society" argument was advanced to describe the debilitating impact of the communist-era suppression of independent civil organizations, official top-down structures replacing voluntary groups, and the resulting anti-participatory cultural attitudes.

Research on business associations have produced similar assessment of the effects of "flattened landscape" on the emerging patterns of interest representation. Based on the analysis of Polish business associations McMenamin (McMenamin 2002), for instance, argued that business associations have not emerged as super lobbies that would dominate the post-transition politics. He hypothesized that legacies of the “flattened civil society” are responsible for the marginal role of the Polish business associations. Lehmbruch (Lehmbruch 2003) have advances an argument emphasizing organizational weakness of business associations in Russia. Unlike McMenamin she proposed a more nuanced than a “flattened civil society” argument. Fragmentation of business associations, according to Lehmbruch, is the major cause of their weakness. According to this logic, the marginal role of business associations in representing and advancing the interests of their members is due to highly personalistic nature of Russian politics and markets. Research on lobbying and corruption as alternative channels of political influence provides a partial support for this argument (Campos & Giovannoni 2005). Campos and Giovannoni contend that corruption is an alternative to lobbying strategies that utilize business associations. Although their research suggests that lobbying is a more effective strategy in the transitional countries, prevalence of the personal channels of influence in the post-communist settings is likely to undermine collective action on the part of the firms. This literature suggests that in addition to the standard set of problems associated with collective actions in other parts of the world, the post-communist cases have inherited an entire host of additional impediments to the business interest group formation from their recent communist past.

2.2. “State Capture” or Market-Promoting Institutions?

An alternative approach to the study of interest groups in the post-communist countries has been to problematize the effects of interest group politics rather than the issue of interest group formation. The initial theoretical expectation was that since the task of economic transition necessarily implies economic hardship for large numbers of people, opposition to economic reforms would grow (Przeworski 1991). It was feared that strong and politically significant groups might halt reforms by throwing their support behind politicians who would satisfy the immediate economic interest in social protection and cheap consumer goods at the expense of the long-term goals of building a more efficient economic system (Brown 1991). Scholars hypothesized that market reforms would be able to proceed in the post-communist countries of Eastern Europe and Eurasia only under two conditions. Either democratic experiment (and the formation of the systems of interest representation) would be compromised and the political decision-makers insulated from the pressures emanating from the social interests (Jowitt 1992; Brown 1991), or the social groups suffering during the economic transition would need to be compensated to secure their political support for reform governments (Crawford 1995; Goldman 1994; Slay 1995).

The existing literature on economic reforms points to the influence of business groups as an important component of economic reform progress (Johnson, McMillan & Woodruff 1999). The notion of "state capture" has been widely used to describe the influence of business groups on the economic policies of the government. Contrary to the scholars advocating the "flattened civil society" argument, the "state capture" advocates argue that business interests have enormous influence on state policies in a number of post-communist countries. A frequent argument is that "oligarchs" have advanced their interests at the expense of more broadly defined social interests (Shleifer & Treisman 2000). In the Russian case, the banking sector (Johnson 2000) and the energy sector (Lane 2001) are identified as the most powerful business interest groups. The consequences of such influence are mostly seen as negative.

In the article "Winners Take All: The Politics of Partial Reform in Post-Communist Transition," Hellman (Hellman 1998) argues that the process of economic transformation fosters new politically influential actors with interests opposed to further reforms. Hellman suggests that discrepancies in the pace of different aspects of economic transition from state-controlled and market economies produces winners: enterprise managers selling products on the liberalized market, but operating within the soft-budget constraints of state-guaranteed wage funds; "red directors" with ready access to the national bank credits unenforceable in the absence of bankruptcy procedures; and large banks benefiting from the arbitrage opportunities created by high levels of inflation (see (Treisman 1998; Ganev 2001). Hellman argued that if these special interests gain access to political decision-making they will want to perpetuate the partial transition stage so they can continue to reap the benefits of their position. For Hellman, the pace of reform is a crucial factor in determining whether such "capture" can occur. Hellman believes that fast transition from planned to market economy does not lead to state capture. However, where reforms have proceeded gradually, the partial-reform equilibrium in which the "winners" of half-way transition preclude further reforms has been observed.

Hellman, Jones, and Kaufmann (2000) have pioneered a cross-national empirical research of business interests. Based on a business survey conducted in 25 transitional economies, they constructed an index of "state capture" and ranked countries according to the extent of business influence on state policies. These scholars' negative assessment of business interest influence on the state has been critiqued by subsequent research. Frye (Frye 2002b), for example, has argued that business lobbying in Russia is better characterized in terms of political exchange in which business groups supply the state with valuable economic resources in exchange for preferential treatment. The exchange argument points to the benefits politicians might derive from close connections with businesses and emphasized the supply side of the rent-seeking activities. This calls for a more balanced approach to the study of business-state relations. A more nuanced study of interest group formation can provide a new perspective on the unraveling capture versus exchange debate.

Another challenge to the "state capture: hypothesis is presented by the research on the strictly economic consequences of associational membership. Empirical research on the post-communist enterprises suggests that quite contrary to the "capture" thesis business associations are "supportive of the broad objectives of economic restructuring" (Pyle 2005). Pyle finds that Russian firms participating in business associations adopt a market-oriented behavior to a grater extent than non-member firms. Pyle hypothesized that activities and services provided by business associations affect such differences in firm's behavior. The major implication of this finding is that business interest groups in fact are market promoting rather than market-inhibiting actors in the post-communist context.

2.3. Adjudicating between Two Conflicting Assessments

As this review of the extant literature on interest groups in Eastern Europe and the former Soviet republics demonstrates, two conflicting notions of the interest group politics exist. On the one hand, proponents of the "flattened landscape" and fragmentation theses treat business interest groups as marginal players that have little influence over state policy and economic development. On the other hand, scholars operating within or responding to the "state capture" argument underscore the importance of interest groups in political and economic transition. The former researchers tend to problematize collective action, but are skeptical of businesses' abilities to overcome collective action problem. The latter group of researchers concentrates on the effects of organized interests, leaving aside the issue of how businesses overcome the problem of collective action in the first place. Consequently, business interest groups, as the dependent variable, have not become the subject of rigorous scrutiny for both approaches.

The two traditions in analyzing interest group politics in the post-communist context naturally have diametrically different assessments of the ability of economic actors to engage in collective action. While the "flattened civil society" paradigm predicts little to no collective action, the state capture argument suggest that collective action on the part of businesses not only takes place but also have important consequences for the post-communist politics and economy. The latter approach takes the solution to collective action problem for granted, which overlooks instances in which interest groups do not form. The question of *what* interests are represented in the post-communist countries, and what are not, however, has important implications for the outcomes of interest group politics. To adjudicate between these two conflicting assessments of the interest groups politics it becomes important to examine under what conditions associations form and under want conditions they do not form. This paper proposes a research strategy aimed at placing business interest group formation at the center of analysis.

3. Analytical Framework

Formation of business associations is a complex process that is likely to be influenced by a variety of factors. This work concentrates on the politico-economic aspects of interest group formation. To facilitate systematic exploration of the variation in levels of participation in business associations and associational activities an analytical framework is needed. This section develops an analytical foundation for my research on the post-communist business associations. Such framework utilizes different theoretical approaches to the collective action problem and its solutions. I develop an integrated theory that combines the bottom up and the top down dynamics of group formation as well as the interaction between the two. I start with reviewing alternative theoretical approaches to the collective action problem and its solutions developed by political economists. I argue that taken in isolation from one another, different theoretical arguments about group formation are unlikely to provide a comprehensive account of such a complex phenomena as interest group formation.

Although research on interest groups dates to the beginning of the 20th century (Bentley 1908), the work by Mancur Olson (Olson 1965) is responsible for problematizing a successful interest group action. Olson recognized that in order for a group to organize, individual actors must overcome the problem of collective action. Such a problem exists because individual rationality may and in many cases does undermine collective rationality. This creates incentives to free riding. Free riding is destructive to the organization but beneficial to an individual member. Olson detected a contradiction between individual and collective rationality in the pursuit of common, public, or collective good, that is defined as “any good such that, if any person in a group … consumes it, it cannot feasibly be withheld from the others in that group.” (Olson, p. 14) Although collectively a group might benefit from the provision of public goods, individual members responsible for contributing their resources have a strong incentive to free ride on the contributions made by others. This leads to the expectation about a gravely complicated collective action: if every member of a group does not voluntarily cooperate and contribute its share of resources, no collective action aimed at providing collective goods will be possible.

Olson’s argument has important implications for the analysis of interest group formation. Although interest groups organize to pursue some collective or individual benefits, interest organization in itself can be seen as a provision of a purely collective good it itself. The application of the assumptions of individual rationality to the issues of collective actions (including interest group formation) led political economists to a shocking conclusion: it is in the interests of an individual to abstain form the provision of collective goods unless the externally induced incentives alter her evaluation of the prospective utility or disutility of engaging in collective action. Still empirical examples of collective action and regular provision of collective goods are abundant. Such conundrum needs to be resolved to explain why we see successful collective actions while the theory predicts otherwise. The

Olsonian notion of individual incentives to free ride that undermine collective action provides foundation for the subsequent theoretical and empirical work on the subject. Scholars have concentrated on explaining under want conditions collective action becomes possible and groups are able to overcome free riding. The proposed solutions range from the spontaneous cooperation, incentive-altering institutional arrangements, social norms, and coercive authority. Such solutions can be grouped into two broad categories of "internal" and "external" solutions.

3.1. Internal solutions

Internal solutions emphasize characteristics of the group and the nature of collective good. Such solutions require no external forces that would make the latent group members to cooperate. Taylor argues that "internal" solution is one that "neither involves nor presupposes changes in the game" (Taylor 1990). Small group size (Olson 1965), close interaction among individuals, and low discount rates (Axelrod 1981) were identified as facilitating collective action. Olson emphasized group size as a crucial factor in promoting cooperation. Smaller groups facilitate information transfer necessary for sanctioning defectors. Impersonal relations, scarcity of information about individual actions, and inability to punish free riders, on the other hand, usually characterize larger groups. From the analysis of the repeated social interaction, Axelrode derives another kind of "internal" solution. For the rational individual the pay-off of cooperation is an increasing function of the probability of engaging in the same interaction in the future. When discount factor is sufficiently small, (high chance of two players meeting again) cooperation is the best possible strategy.

Explanations of the occurrence of collective action (and interest group formation) that emphasize characteristics of latent groups and the nature of their common interest are important components in the theory of collective action. Most latent groups, however, are rather large and impersonal that adds to the costs of cooperation and compliance monitoring. The kinds of common goods sought by the latent groups are often not conductive to collective action. The free riding argument would suggest that most collective action is doomed to failure. Still examples of collective action abound in the modern impersonal societies. Many examples of collective action undertaken by larger, heterogeneous, and impersonal groups suggest that group characteristics are not the only determinant of successful collective action. Thus, a number of external solutions were proposed to account for the paradoxical persistence of cooperation despite theoretical predictions about difficulties in achieving collective actions.

3.2. External solutions

The external solutions are those that alter individual inputs, pay-offs, and uncertainty. Examples include political entrepreneurs, formal and informal institutional arrangements, and social norms. External enforcement mechanisms that rely on coercive power of social institutions (norms, traditions, the state, organizations) are known as "institutional" solutions to the problem of collective action. Approach emphasizing institutional solutions has included both the formal and informal mechanisms that promote collective action.

The search for solving the collective action problems has led many authors to the recognition of the major importance of institutions as external sources of "selective incentives" and enforcement of compliance. Olson argued that in the absence of external authority, groups of large size would never achieve effective collective action. Existence of an external authority that monitors individual compliance is essential since any internal enforcement mechanism is a subject to the collective action problem. Olson argues, "just as a state cannot support itself by voluntary contributions… neither can other large organizations support themselves without providing some sanction, or some attraction distinct from the public good itself." (p. 15) Since internal mechanisms will never be sufficient in ensuring that no free riding occurs, externally imposed sanctions and rewards are necessary to ensure successful collective action, argued Olson. Existence of exogenous benefits, unrelated to immediate organizational goals, can facilitate the process of organization. Rewards and punishments alter the incentive structure of the individual members of the group making it less costly (or more rewarding) to participate in a collective action. Such selective (exclusive to the group members) incentives can be provided in the established organizations or by the application of external institutional authority (the state).

Recognition of the role of selective incentives is an important contribution made by Olson to the study of interest groups. Other scholars have studied the role of the different types of incentives available to organizations (Clark & Wilson 1961). In addition to the strictly defined material incentives, these scholars identified solidarity and purposeful incentives a group could provide for its members. In the absence of material benefits, groups can organize and hold together in order to gain the non-material benefits of contributing to socially desirable goals and expressing solidarity with other people.

Still, institutional solutions that presuppose existence of authority are paradoxical: the proposed solutions to the problem of collective action require the *preexisting* solution to the problem of collective action evolved in forming such institutions. In his discussions of institutional structures and norms Taylor makes a strong argument that the problems of collective action cannot be solved through collective means, such as institutions, social norms, and leadership, because all of these solutions are in themselves the results of successful collective actions. Put differently by Taylor, "the use of these sanctions [external stimuli] presupposes the solution to prior collective action problems."(238) Positive and negative incentives that insure compliance and, as a result, solve the collective action problem cannot occur unless collective action has resulted in the establishment of internal organizational structures capable of carrying out sanctions and providing selective benefits.

If creation of institutions is a subject to the collective action problem, one cannot use institutional argument to explain why collective action occurs in the first place. In an attempt to resolve such paradox (Hardin 1990) has argued that the emergence of power, or, institutions, capable of overcoming the problem of cooperation, may come from collectively and individually beneficial coordination, which in itself does not present the problem of collective action. Hardin proposes a theory of the emergence of power that escapes the problem of collective action. "Coordination can come about without intent, without overcoming contrary incentives. It just happens." (337)

Yet another argument accounting for the historical development of institutions has emphasized individual interests and actions of "political entrepreneurs." Exploring the role of social actors, Knight and Levi assert that collective action, directed at building institutions and organizations, is driven by *individual* incentives of those involved in building institutions and reflects their individual needs (Knight 1992; Levi 1990). In this framework institution-building, which is a basic prerequisite of the subsequent resolution of the problem of collective action is in itself a private good, and to the extent that individual (leader's) gain from building institutions outweigh the individual cost, institutions will be constructed. Individuals may engage in institution building because of the private material gains that will be available to them thought the control over the established institutions. Such theoretical framework provides a foundation for the research on the role of leadership and political entrepreneurship in interest group formation. The organizational role of political entrepreneurs and group patrons has been established by empirical research. Walker (Walker 1983) and Knok (Knok 1988) have argued that organizational leaders play a central role in group formation and success. The work on leadership and organizational capability of group leaders, however, brings us back to the characteristics of individual members and latent groups.

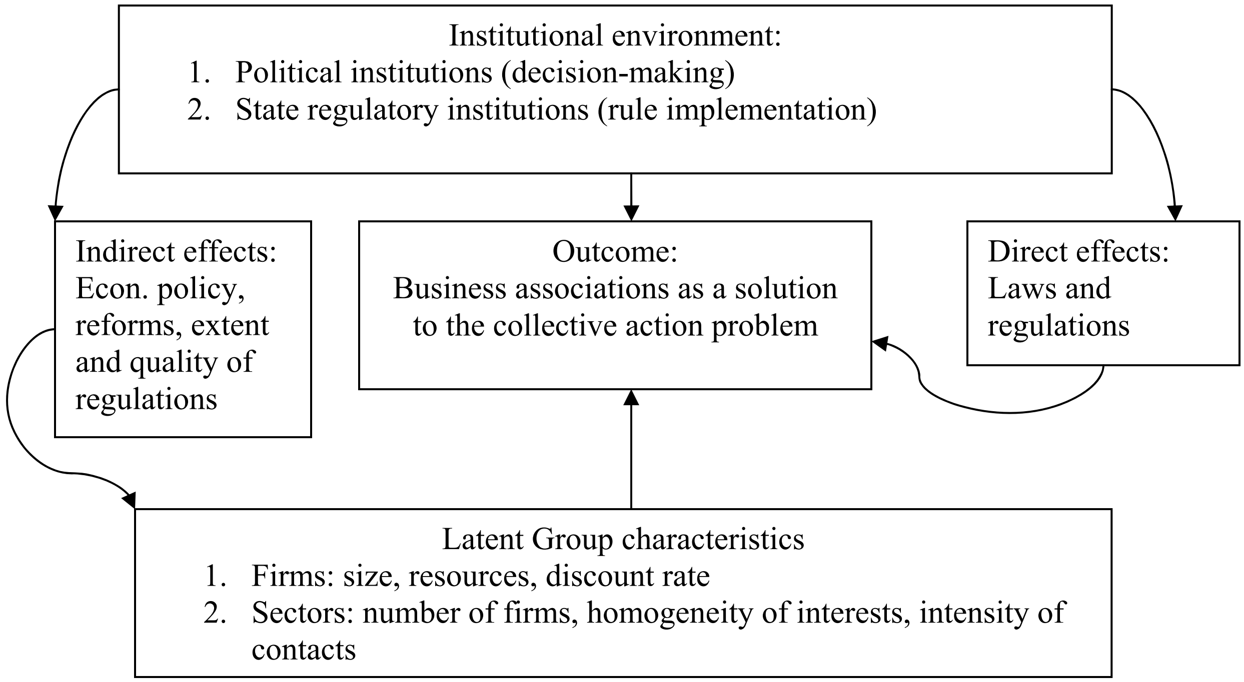
The purpose of reviewing the literature on the collective action problem and its solutions was to point to its multi-faceted nature. The "external" solutions emphasizing the top-down aspects of interest group formation cannot provide a sufficient answer. The "internal" solutions that emphasize the bottom-up dynamics are also partial and insufficient. In explaining the collective action problem solutions, it would be misleading, for instance, to concentrate on just one aspect facilitating the successful solution to the collective action problem, such as small group size. The same can be said about the establishment of institutional arrangements, norms, political entrepreneurship, as well as other way to alter individual incentives.

In providing a comprehensive account of business interest group formation both the internal and external mechanisms should be taken into account. Otherwise, one can arrive at misleading conclusions. Therefore, for researching under want conditions businesses in the post-communist countries overcome the problem of collective action and join associations I propose an analytical framework that addresses different aspects of the problem. My analytical approach integrates the bottom-up dynamics emphasizing group characteristics along with the top down approach looking at the power of political and regulatory institutions.

The first logical step in accounting for the cross-national and cross-industry variation is to consider firm characteristics, such as firm's size, ownership structure, and financial standing. Another important aspect of the bottom-up dynamics of group formation is to examine characteristics of the groups of firms in particular sectors and industries. Here, the size of the sector (number of firms), resource specificity, geographical concentration, and homogeneity of firm characteristics are of major importance. The top-down factors affecting group formation can be grouped into (1) the effects of political institutions that shape state policies towards interests groups and (2) business-state interaction, including the effects of regulatory state institutions that shape business environment. The former category includes the legislative framework for interest group formation, formal and informal channels of influence, and political parties representing business interests. The latter category includes the quality of state regulatory institutions as well as the extent of state regulation of businesses.

Although the bottom-up and top-down factors are analytically separate, in reality, the two perspectives on business association development cannot be considered in isolation. The nature of interests held by businesses is shaped by characteristics of businesses as well as the kinds of political and regulatory institutions that might shape business environment. Policies of the state, on the one hand, can directly affect activities of business associations; on the other hand, they may alter composition and interests of business community. Thus, it is not only important to consider different aspects affecting group formation, but is also necessary to account for the possible interaction effects. Figure 1 below summarizes the proposed analytical framework accounting for the factors that affect business association formation

Figure 1. Forces shaping business interest group formation



4. Standard Hypotheses

This section presents a number of hypotheses reflecting the demand (bottom-up) and the supply (top-down) sides of the business association formation puzzle. I outline my expectations about the effects of factors presented in the analytical part and concentrate on two the most puzzling aspects of business group formation – the sectoral variation and the effects of bureaucratic corruption. Other factors that are theoretically linked to the successful collective action are discussed here as important control variables to be taken into account in empirical research.

4.1. The demand side

4.1.1. The central puzzle

The central hypotheses in respect to the demand-side argument about group formation is that firms in different sectors of the economy might have differential incentive for organization. Capital mobility is an important factor that varies across industries. The standard expectation in the literature is that high asset specificity (immobility of capital across industries) should stimulate collective action. Hiscox (Hiscox

2001) suggests that factor mobility is an important variable that influences levels of group mobilization. This research will apply the same logic used by Hiscox in respect to physical and financial capital, but will look at the cross-industry variation in respect to fixed assets. Although sometimes the terms specificity and mobility of resources refer to different aspects of resource use (specificity indicates strictly technological aspects of physical capital, while mobility indicates institutional constraints), here I will use mobility as the opposite of specificity (Hiscox & Rickard 2002). Resource mobility reflects the costs of moving assets between different uses (across industries or national borders). If assets are specific to a particular industry, such costs are high; if resources are mobile, such costs are low.[2]

The standard expectation about the consequences of resource specificity is that it should promote collective action. Robert Bates (Bates 1981) argues that there exists an inverse relationship between mobility of economic assets and collective actions. This would imply that sectors with highly specific assets (high levels of fixed capital) should develop strong sector-wide associations, while mobile asset sectors should be less likely to develop business associations. If resources are not easily transferable to other use, a business is more dependent on the conditions in a particular industry. If conditions in a given industry deteriorate, business will be reluctant to move to other sectors, but instead will lobbying for protection. If assets are not industry-specific and prospects for moving assets to a different line of production are high, businesses will be interested in establishing more personalized ties with politicians and bureaucrats rather than investing resources for the protection of the sector-wide interests. As a result, fewer firms in asset mobile industries will join associations and more of them will prefer to lobby on their own. According to such logic, collective action is more rewarding in sectors with high asset specificity, entry barriers, and lower international competitiveness.

4.1.2. Additional Factors (Controls)

Additional demand-side factors that I consider as having potentially important effects on business

[2] Mobility can be affected by multiple factors. Physical capital by definition is less mobile than financial assets. Asset liquidity increases mobility across sectoral and national borders. Government regulations of entry to a particular market/industry also affect mobility. The costs of geographical relocation, acquisition of specialized expertise, licensing, and business start-up investment increase capital specificity.

association formation include firm characteristics and related sectoral differences. One can expect that the type of ownership as well as the experience under the state-controlled economy should affect participation in business organizations. Managers of enterprises formed after the collapse of central planning might have better incentives to join business associations. State-owned enterprise managers who have gained their experience under the centrally planned economy have established lasting relationships with state controlling agencies, ministries, and traditional trading partners (Huber & Worgotter 1998). The state-owned, and to some extent privatized enterprises, therefore, can do well without any associational membership. I also expect that foreign ownership should affect firms' propensity to join associations. The reason is similar to the one presented for de-novo enterprises. In addition, foreign managers might have greater cultural predisposition to join associations and greater need for publicly legitimating their businesses.

One might also expect that large firms in stable economic standing are more likely to participate in associations. The costs incurred by firms to join associations might be prohibitive to small firms and/or firm with low profitability. Since business associations usually rely on the financial, organizational, and staff capabilities of their constituent members, the availability of recourses necessary to advance the goals of organization becomes an important prerequisite of successful organization (Walker 1983; Lowery & Gray 1995). Firms in capital-abundant industries and industries generating large surpluses, therefore, have more readily available resources to support their organizations.

Sectoral characteristics that are directly related to the firm characteristics in a given industry include but are not limited to the number of competing firms, homogeneity of firms' interests, and geographic concentration. As discussed earlier in the paper, small groups with more homogenous interests and closer interactions are expected to have greater propensity for overcoming the problem of collective action involved in forming interest groups. Thus, I expect that a smaller number of firms in a given sector, their geographical concentration, and similar firm size and ownership structure should facilitate group formation.

4.2. The supply side

The existing theories of lobbying and group formation see the state institutions as the recipients of group actions. Political actors and state institutions react to the offered contributions, revealed information, or potential popular mobilization from interest groups. Recognize, however, that politicians and bureaucrats—by setting the rules of the game and regulating interest group activities—can affect the number and composition of organized interest groups. The costs of lobbying and association formation can be altered by the state through laws regulating association formation and lobbying mechanisms. In the post-communist transitions state institutions appear to be active actors shaping the number, make-up, functions, and, to a certain extent, demands of the interest groups. Here I concentrate on the impact of two kinds of institutions: 1) political intuitions that produce state policies towards business associations and provide channels of influence, and 2) the state regulatory institutions responsible for policy implementation and provision of some public goods, such as law and order, market-supporting information transfer, infrastructure, etc.

4.2.1. Primary Hypothesis

My central hypothesis addresses the effects of bureaucratic effectiveness and probity. Corruption is generally considered as a formidable obstacle to the effective functioning of emerging markets and a great impediment for businesses in transitional countries. (Miller et al. 2002; Hellman et al. 2000; Gaddy & Ickes 1999; Boyko et al. 1995) If the degree of business association membership depends on the legislative, bureaucratic, and normative environment in which firms operate, the extent of administrative corruption should have an affect on the levels of organizational membership. Corrupt officials prey on their clients. According to one argument, the easier it is to identify these potential clients, the easier it becomes for corrupt officials to extort resources. By organizing, businesses become an easier target for regulation and, as a result, extortion. Formal organizations, by the simple fact of their existence, invite bureaucratic attention and possibly extortion (McChesney 1997). This creates a vicious circle in which more and more resources are pulled out of productive use and wasted on corrupt bureaucrats. Thus, in highly corrupt systems, one might expect to find disincentives to organize. If this logic is correct, corruption should negatively affect group formation.[3]

The same prediction can be derived from the notion that corruption is a venue through which firms can influence politicians and bureaucrats. Widespread corruption allows individual firms to solve their problems by bribing public officials, thereby reducing the need for collective action (Huntington 1968; Hastad & Svensson 2005). Here corruption is a substitute for other means of problem solving (such as lobbying or self-regulation) that require firms to organize. It opens informal channels for individual firms to avoid unfavorable rules and regulations, thus rendering superfluous any collective action on the part of larger business community. Thus, one might expect that in highly corrupt systems fewer legitimate associations representing business interests will emerge.

4.2.2. Supplementary Hypotheses

Different political institutions provide dissimilar opportunities for the formal interest group organizations (Gray 1989; Taagepera 2003; Bawn & Thies 2003). Since freedom of assembly and political accountability of the government are necessary for successful interest articulation and advocacy, democratization should affect group formation. Consolidation of democratic regimes should lower the costs of organization. Democratization also provides interest groups with institutionalized mechanisms of influence such as stable political parties and independent media. One might conclude that democratization should aid the process of interest articulation and should ease the process of interest group organization. However, the effects of democratic institutions are not as straightforward as it might seem.

Studies of democratic institutions suggest that politicians' valuation of the overall well-being of society can be affected by the extent to which the general public holds them accountable (Powell 2000). One hypothesis is that political institutions weakening government's accountability and dispersing authority stimulate individual (informal) lobbying, making business associations unimportant channels of

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[3] It is important to distinguish corruption form the extent of bureaucratic regulation. Regulations might have important independent impact on group formation. According to some theorists, pervasive regulations result in counter-pressures from the business community. According to the other perspective, regulations are the result of

influence. Several factors contribute to political accountability. The type of democratic regime (presidential, semi-presidential, or parliamentary) influences the extent of accountability. Divided governments generally defuse responsibility and the fusion of power provides for clearer accountability. In addition, federalism obfuscates government accountability to the majority of the citizens by separating functions of the central and local authorities. The parliamentary system's fusion of the executive and legislative powers provides for greater accountability. Under the system of checks and balances, on the other hand, the government's responsibility can be obscured. The clarity of electoral responsibility is further masked by the semi-presidential constitutional design. In semi-presidential systems, political responsibilities are divided between legislative and presidential branches, while the control of the government is divided between the prime minister and the president. Such a system makes governmental accountability even more problematic since responsibility for policy formulation and outcomes is divided among three institutions.

In respect to the effect of party competition of interest group formation expectations are also mixed. On one hand, established party system should lower the costs of lobbying by providing institutionalized mechanisms of influence, such as stable political parties and independent media access. Democratic political regimes in this respect can be seen as more permeable for social inputs, making political participation easier for businesses. Alternatively, insofar as political parties are more concerned with attracting popular support, elected politicians might find it less attractive to provide parochial benefits to the business lobby. Furthermore, existence of a political party representing interest of business community might make associations superfluous, reducing the levels of associational membership. These alternative theoretical expectations will be take into account as contextual factors shaping the emerging systems of interest group representation in the post-communist countries.

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lobbying. To assess the separate impact of corruption on group formation, therefore, it becomes important to hold the extent of state regulations constant either through statistical techniques, or though careful case selection.

Table 1. Summary of Primary and Secondary Hypotheses

Demand-side Independent variables	effects	Supply-side Independent variables	effects
Firm size	+	Laws regulating association formation,	+/-
Ownership (private de novo, foreign)	+	Political Openness/ Democracy	+
Financial standing	+	Delegation of responsibilities	+
Fixed assets	+	Decentralization of political authority	+
Geographic concentration	+	Business party	+/-
Fewer firms per sector	+	**Corruption, ineffective bureaucracy**	-
Similarity of firm characteristics	+	Regulation	+/-

5. Preliminary results

In order to test the hypothesized effects of some of the supply- and demand-side variables on group formation I develop statistical tests that utilize the available cross-national survey data on business association formation. I use data from the European Bank for Reconstruction and Development (EBRD) and the World Bank Business Environment and Enterprise Performance Survey (BEEPS).[4] The sample of firms participating in the survey is representative of the countries' businesses in respect to sector composition, size, ownership structure, and other characteristics. A number of questions in the survey address the issues of organizational membership. The responses to the question about membership in business organizations reveal that 26.5% of business participating in the survey belonged to at least one association. Survey also reveals a vast divergence between levels of organizational membership in different countries.

To address the hypothesized effects of asset specificity I introduce dummies for secondary and tertiary sectors. For the cross-national data set, it is hard to come up with a precise measure of resource specificity. It is generally acknowledged, however, that primary industries have more fixed assets, than is the case for the tertiary industry. The same can be said about secondary versus tertiary sectors. Sectoral

[4] BEEPS is a survey of over 4000 firms in 25 transitional countries conducted in 1999-2000 that examines a wide range of interactions between firms and the state. The survey was conducted in Albania, Armenia, Azerbaijan, Belarus, Bosnia, Bulgaria, Croatia, Czech Republic, Estonia, Georgia, Hungary, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Macedonia, Moldova, Poland, Serbia and Montenegro, Romania, Russia, Slovakia, Slovenia, Ukraine, and Uzbekistan. The firms participating in the survey represent different sectors, industries, are of different size and ownership type. Based on face-to-face interviews with firm managers and owners, BEEPS was designed to generate comparative measurements in such areas as corruption, state capture, lobbying, and the quality of the business

differences however are not limited to asset specificity. They include but are not limited to the number of competing firms and homogeneity of firms' interests. It would be particularly problematic to control for such effects in a pulled cross-national analysis. Analysis other sectoral difference will be attempted in the future research investigating sectoral composition of business associations in Russia, Ukraine, and Croatia.

To measure the perceived extent of corruption I construct a scale variable (Corruption) from firms' responses on to the following question: *How often do firms like yours nowadays need to make extra, unofficial payments to public officials for any of the following?*

1) to get connected to public services; 2) to get licenses and permits; 3)to deal with taxes and tax collection; 4) to gain government contracts; 5) when dealing with customs/imports; 6) when dealing with courts; 6) to influence the contents of new laws, decrees, or regulations; 7)other (specify).

Firm's responses to these questions on 6-point scale ranging from "always" to "never" were recoded with the score of one representing the lowest level of corruption, and the score of six – the highest. Responses on seven categories were then added resulting in a 42-point scale. Constructed in such manner, the variable reflects businesses' perceptions of the extent of various forms of corruption in their immediate environment. Unlike other measures that operationalize corruption in terms of specific characteristics that might not reflect cross-national differences in the scope, kinds, and methods of corruption, this measure provides greater flexibility. The meaning and operationalization of corrupting is a highly debated topic. In this paper corruption is operationalized in terms of the perceived frequency of occurrence. An alternative way of assessing the extent of corruption involves its cost to the bribe-giving party. Corruption might seem infrequent but if its cost is high, businesses might be affected by incidences of such "expensive" corruption to much greater extent than under a widespread "cheap" corruption. To control for the cost of corruption a variable reflecting usual amounts of bribes (in terms of the share of firms' revenue) is introduced.

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environment. BEEPS data and questionnaire are available from http://www.worldbank.org/wbi/governance/wp-statecapture.htm

In order to statistically assess the hypothesized effects of asset specificity and corruption one might wish to control for other factors that affect group formation. In order to distinguish corruption from other aspects of business environment associated with rapid economic changes that accompany economic transition I incorporate a measure of unpredictability. The measure of unpredictability captures firm's responses to the question about changes in rules and regulations (the six-point scale is recoded so the higher score corresponds to greater unpredictability). Unpredictability of regulations captures unstable business environment. The expectation is that unpredictability of regulations should increase the probability of associational membership.

To capture the hypothesized effects of firm ownership structure and their experiences under state socialism a dummy variable for the de-novo firms (to distinguish from the privatized and state-owned firms) is introduced to capture such effects. I also use a dummy for foreign ownership. To address the expectation that large firms in stable economic standing are more likely to participate in associations, variables reflecting financial problems (FinProblem) and a number of employees (Employees) are introduced. I supplement the survey data with the country-level data reflective of institutional and political variables, such as the overall level of democracy and a dummy for parliamentary regimes.

Table 2. Summary statistics

Variable	Range	count		Mean	Min	Max
		0	1			
Association Member	Binary(0,1)	1415	418	…	…	…
(Democracy) $_{i}$	Score 1-7	…	…	4.5	1.5	6.5
(Parliamentary) $_{i}$	Binary (0,1)	1231	602	…	…	…
(Corruption) $_{ij}$	Score 1-48	…	…	14.02	1	42
(Employees) $_{ij}$	Categories 1-16	…	…	5.7	2	16
(Foreign) $_{ij}$	Binary (0,1)	233	1600	…	…	…
(De-novo) $_{ij}$	Binary (0,1)	728	1105	…	…	…
(Fin. Problems) $_{ij}$	Score 1-4	…	…	3.1	1	4
(Unpredictability) $_{ij}$	Score 0-5	…	…	2.4	0	5
(Secondary) $_{ij}$	Binary (0,1)	1116	717	…	…	…
(Services) $_{ij}$	Binary (0,1)	933	900	…	…	…
(Cost Corruption) $_{ij}$	Score 1-6	…	…	3.22	1	7

Since the dependent variable of the analysis is dichotomous, I use logit estimation of the following model:

$$Pr\ (Y_{ij}=1) = \beta_0 + \beta_1(Democracy)_i + \beta_2(Parliamentary)_i + \beta_3(Corruption)_{ij} + \beta_4(Employees)_{ij} + \beta_5(Foreign)_{ij} + \beta_6(De\text{-}novo)_{ij} + B_7(Fin.\ Problems)_{ij} + \beta_8(Unpredictability)_{ij} + \beta_9(Secondary)_{ij} + \beta_{10}(Services)_{ij} + \beta_{11}(Cost\ Corruption)_{ij} + e_{ij} \quad (1)$$

For i = 1, …, 25 countries and j = 1, …, 1833 firms. *P(org=1)* is the probability that a business has a membership in at least one association or lobby group. Results of different model specifications and statistical techniques are reported in Table 3. I discuss methodological issues underlying alternative model specifications in the appendix. The aim of these statistical tests is to see whether business association membership is statistically related to corruption and sectoral differences when controlling for other factors (including unobserved country-level variables) that might affect business interest group formation. The results of applying alternative statistical techniques and different model specifications suggest positive statistically and substantively significant relationship between perceived levels of corruption and firms' likelihood of being a member of business association. Also all models returned positive and statistically significant coefficients on secondary and service sector dummies. All models have significant goodness-of-fit statistics and the magnitude of regression coefficients is similar across the models, suggesting that the effects of corruption and sectoral differences are robust to different model specifications.[5]

[5] Apart from the effects of corruption and sectors, business association formation in the post-communist countries follows the patterns predicted by established theories of group formation. The effects of the institutional environment (in the logit and random-effect probit model), enterprise size, and ownership, are statistically different from zero and robust to different estimation techniques. When non-significant variables are excluded from the analysis, the remaining coefficients retain their predicted signs and statistical significance.

Table 3.

Variable	1 Logit	2 Logit	3 Dummy Variable Logit	4 Conditional Fixed Effects Logit	5 Hierarchical Random-effect Probit (varying intercept)	6 Hierarchical Random-effect MLE (varying intercept)
Intercept	-3.087(.441)***	-2.696(.392)***	-2.730(.506)***		-2.145(.289)***	-.157 (.115)
Democracy	.042(.051)	…	…	…	-.029(.050)	.013(.024)
Parliamentary	.564(.150)***	…	…	…	.530(142)***	.107(.019)
Employees	.135(.027)***	.135(.026)***	.127(.028)***	.131(.030)***	.085(.017)***	.023(.005)***
Foreign	.440(.162)**	.455(160)**	.393(.168)*	.378(.176)*	.225(.103)*	.063(.028)*
De novo	-.324(.131)*	-.312(.128)*	-.318(.135)*	-.327(.140)*	-.172(.080)*	-.050(.021)*
Fin. Problems	-.014(.060)	-.018(.059)	-.002(.062)	.090(.067)	.043(.038)	.012(.010)
Unpredictability	.042(.043)	.079(.042)	.050(.044)	.009(.047)	.011(.026)	.001(.007)
Secondary	1.005(.212)***	1.043(.209)***	1.029(.219)***	.986(.221)***	.575(119)***	.146(.030)***
Services	.884(.219)***	.964(/216)***	.915(.226)***	.852(.231)***	.496(.124)***	.125(.031)***
Corruption	.022(.009)**	.020(.009)*	.028(.010)**	.034(.010)***	.020(.006)***	.005(.002)**
Corruption Cost	-.129(.052)**	-.162(.051)***	-.140(.053)**	-.075(.056)	-.055(.031)	-.012(.008)
log likelihood	-915.098	-929.326	-888.832	-779.657	-865.646	-873.876
Cox & Snell R^2	.070	.056	.106			
χ^2/df/	138.08/11/***	109.62/9/***	210.71/32/***	81.53/9/***	119.41/11/***	94.60/11/***
σ_{u0}					.695(.103)	.147(.025)
σ_{u1}						.002(.003)
N	1833	1833	1833	1833	1833	1833

DV: P(w = 1)
Estimator: Maximum Likelihood
Significance: ^.05 (1-tail), *.05, **.01, ***.001 (2-tail)
Standard errors are in parentheses

Unlike the effects of other (control) variables the effects of corruption and sector membership are opposite to the ones predicted by standard hypotheses. My interpretation of the results is that *ceteris paribus* higher perceived levels of corruption increase firm's probabilities of joining business association. The direction of causation, however, cannot be established on the basis of presented models. The finding can be interpreted as that members of business associations on average face a greater corruption pressures. The model also does not allow to distinguish between different possible sectoral effects. Still, the results are extremely puzzling and require theoretical interpretation. For the corruption the results suggest that an interesting pattern of relations between economic agents and state structures is emerging in the post-communist context. Higher perceived levels of corruption in the transitional countries, quite surprisingly, stimulate the collective action on the part of the post-communist firms. This finding is quite unexpected given the conventional understanding of business-state relations and is incompatible with the view of corruption as a substitute for legitimate collective action. In the case of sector-specific effects, the results suggest that higher factor specificity either is unrelated to or has a negative effect on businesses' propensity to join associations. The next section summarizes my explanations of such counterintuitive findings.

6. New Explanations

6.1. Corruption

The central finding of the cross-national data analysis is that high levels of corruption are positively associated with associational membership levels. This might seem counterintuitive, but I argue that increasing bureaucratic pressure on businesses stimulate collective action to combat corruption. Unlike other theoretical frameworks that view corruption as a strategy of firms' influence on politicians and bureaucrats (Campos & Giovannoni 2003; Harstad & Svensson 2005), I propose to think of corruption as unpredictable arbitrary actions on the part of regulating agencies and other state authorities to extort resources from businesses.[6] In this framework corruption is not a firm's asset allowing for twisting the rules and regulations in their favor, but rather a firm's burden of being vulnerable to extortion on the part of regulators.

Consider this interpretation. As the extent of regulations, bureaucratic inefficiency, and the outright extortion by state officials mounts, the interests of individual businesses come under greater pressure. Corruption, in this respect, directly threatens the interests of economic actors in transition. By joining business associations, individual firms might be better able to resist corruption: organization can provide relevant information, better access to political decision-makers, and greater visibility for any misdeeds on the part of bureaucrats.[7] Thus, corruption might stimulate business organization.

This hypothesis suggests that businesses need to organize to pool resources to resist corruption

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[6] See (Svensson 2005) for the discussion of how corruption differs from other forms of influence.
[7] This perspective sees the protection from corruption as a selective benefit provided by associations to their members. Business associations therefore do not reduce instances of corruption in general but rather make their members less vulnerable to arbitrary regulations and extortions on the part of bureaucrats. Protection from corruption that business associations give to firms, thus, is a club rather than collective good. As with other club goods, protection is excludable and its net benefits are an increasing function of associational membership.

when a single firm is no longer capable of carrying the burden of high corruption. As the extent of corruption grows, more resources are to be spent "greasing" the wheels of the predatory bureaucratic machine. As corruption penetrates more and more bureaucratic agencies, and as the sums of bribes rise, pressures on business mount. By organizing in associations, firms can better protect themselves from corrupt officials. By coordinating interactions with bureaucrats and politicians, associations can provide an alternative to the direct interaction between firms and bureaucrats. This intermediate link creates safeguards to the individual firms against bureaucratic intervention and extortion. By pooling together their resources, the organized firms ban better fight corruption through either increasing public awareness or employing legal protection. The more widespread the corruption, the greater the gains derived from joining associations of such kind. Thus, at higher level of corruption, the incentives to form associations should be higher.

An alternative causal mechanism linking high levels of corruption to group formation is that business associations emerge in situations where state institutions are not fulfilling their functions of contract enforcement, property rights protection, and information provision via standards of quality and procedures. Corruption is the most vivid manifestation of institutional failure and a possible reason for why institutions fail to fulfill their functions. As more and more businesses suffer from non-enforced contracts, standards, and procedures, and from increasing insecurity, they develop alternative means to solve these problems. Such means might include various forms of monitoring and sanctioning of firms' undesirable practices, facilitating the exchange of information contributing to the establishment of reputation, and cartel-like agreements preventing the entrance of other firms that do not agree to "play by the rules." Firms no longer rely on state institutions, but form associations capable of solving their problems. The incentives and benefits of forming an association is an increasing function of state institutions' decreased ability to provide protection, enforcement, and standardization. Corruption here serves as an indicator of the degree of such failure.

6.2. Sector Differences

My preliminary finding in respect to sectoral differences suggests that firms in different sectors of the economy are unequally represented by business associations. This conclusion is also supported by my analysis of business associations in Russia. My examination of data on business associations reveals considerable variation on both the number of business associations specific to particular sector, and sectoral composition of associational membership. Industry-specific national-level associations are predominantly organized in secondary sector, while local associations unite primarily the tertiary sector. Contrary to prevailing theoretical arguments, firms in the service sector are more likely to join business associations, while firms in primary sector are least likely to join.

I hypothesize that such puzzling patters are linked to the differential effects of economic liberalization and structural changes experienced by countries in transition. I also expect to find that in some sectors of the economy politicians and bureaucrats purposefully facilitate association formation. I argue that although some variation in levels of association membership across different sectors can be traced to the supply-side factors (number of firms, contacts, discount rates), the most important effects occur in the interaction between sector characteristics and bureaucratic institutions. Most participatory firms are fond in the sectors that were underdeveloped or non-existent under state socialism (real estate, professional consulting) as well as from sectors using innovative technologies, products, and expertise. I argue that firms in these lines of business organize to develop new standards, regulate entry, and fight outdated regulatory practices. These arguments, however, require further theoretical and empirical exploration.

7. Research design

Theoretical arguments presented in the previous section call for further comparative analysis of the development of business associations across different sectors and countries in the context of post-communist economic reforms. This section summarized methodological approach to further research. My dissertation uses a variety of approaches to test hypotheses about causes of business interest group formation. By including large-N statistical analysis, comparative analyses of business association development in two countries, and in-depth case studies of business associations, my dissertation will explore association formation from different angles. I analyze data from the survey of businesses in 25 countries conducted by the World Bank in 1999 and 2002. In addition, I conduct comparative studies of associations in thee post-communist countries – Russia, Ukraine, and Croatia.[8] These countries exhibit the needed variation on a number of potentially important explanatory factors, such as the levels and success in economic transition, political contestation, development of representative political institutions, and state regulation of business associations.

To explain how the trajectories of economic reforms and quality of state regulatory institutions influence the formation of business associations I use cross-national analysis. A comparative analysis of carefully selected country case studies provides great benefits in examining the effects of political, macro-economic, and institutional environment on business association formation. Case studies of Russia, Ukraine, and Croatia will allow me to explore similarities and differences in business interest representation related to these countries' differential experience with political and economic transition, as well as the quality of state regulatory institutions. Croatia experienced early and fast economic reforms, and, after an initial setback in democratic transition, was successful in building a democratic political system. Russia, on the other hand, has been lagging in its economic transition, and after an initial period of democratization, has exhibited increasingly authoritarian traits. The major line of comparison between Ukraine and Russia is the direction of political change. In Russia, consolidation of "guided democracy" is taking place, while Ukraine is experiencing a second attempt at further democratization and reform of bureaucratic structures. Comparative analysis of these countries will examine whether these divergent trajectories of post-communist development affect the emerging patterns of business-state relations.

To test my hypotheses about sector-specific causes of group formation I intend to use comparative qualitative research. The unit of analysis for this part of the project is the sector of the economy and I plan to examine business group formation in three countries – Russia, Ukraine, and

[8] 28 interviews with public and state officials were conducted as a part of my field research in the Russian cities of Moscow, Perm, and Kaliningrad in August-September 2005. I plan to visit Ukraine in March-April, 2006.

Croatia. These countries present crucial cases for testing hypotheses about sector-specific causes of group formation: the countries have complex and diversified economies with considerable differences across sectors. Different sectors of their economies have different levels of business interest mobilization, capital, and labor mobility. If sectoral differences play a role in business association formation, such effects should be observed in Russia, Ukraine, and Croatia. Yet at the same time, the comparison would allow to examine the possible effects of drastically different legal, political, and regulatory frameworks on businesses interest organization.

Hypotheses about effects of political institutions call for the aggregate-level comparative analysis. Case studies of business associations in different post-communist countries can be conducted to assess the effect of political institutional environment on the formation of the systems of interest representation. I will compare business association representing the same sector in different countries. I propose case studies of associations representing interest of firms in specific line of business (construction is the primary candidate so far), as well as associations brining together firms from different sectors (chambers of industry and commerce).

7.3. Chapter outline

I. Theoretical chapter

Discusses the research question, lays out the theoretical framework, outlines methodology and derives hypotheses

II. The Joint Test of Group Formation Hypotheses

Based on the cross-national survey data of business elites the chapter investigates the hypothesized effects of firm characteristics, sector-specific characteristics, and institutional environment on the formation of business associations. Limitations of such analysis include the inability to assess indirect effects of institutional environment through shaping the industry- and firm-level characteristics. Another shortcoming in such a cross-national approach is that it cannot account for the over-time development of business associations, group-state interaction, and is not sensitive to the contextual variables.

III. The bottom-up approach: Firm- and Sector-Level Determinants of Association Formation

To disentangle different forces accounting for the group formation dynamics I analyze data on business association formation in different sectors of Russian economy. Comparing sector-specific characteristics allows to explore group formation over time as well as to investigate the indirect effects of state policies and regulations on the sectoral composition of business associations. A central research question to be addressed in this chapter is why, contrary to the theoretical predictions, businesses in service sector are more prone to join associations, while businesses in primary industry are least likely to join. The chapter utilizes data on sectoral composition of Russian business associations based on the survey of business associations. I supplement my analysis with qualitative data collected during structured interviews with officials representing over 20 business associations in Russia. (If I am able to obtain comparable data on business associations in different sectors of the Ukrainian and Croatian economy, I will analyze these data too.)

IV. The Top-Down Story: The Effects of Regulatory Environment on Association Formation

The central question for this part of the research is how state institutions influence the process of business association formation. A cross-national analysis is needed to address the effects of institutional arrangements. From the secondary sources I construct a cross-national dataset including information on the legal frameworks, nature of political institutions, as well as quality of bureaucratic regulations. I closely investigate the effects of corruption and regulatory environment on shaping the patterns of business interest representation. I attempt to differentiate the effects of political institutions (party system, federalism, political openness, and concentration of political authority) form the effects of regulatory state institutions. I assess my hypotheses by comparing formation of business associations representing sectoral and broadly defined business interests in three countries: Russia, Ukraine, and Croatia. I demonstrate how state policies, quality of regulatory institutions, and economic reforms in general shape the processes of business association formation.

V. Bringing it Back Together: Towards an Integrated Theory of Business-State Relations

The chapter brings together the major argument about the top-down and the bottom-up forces shaping business group formation in an attempt to create an integrated picture of the emerging patterns of business representation in the post-communist countries. I discuss the major implications of my findings to the theories of transition and business-state relations. I argue that in the post-communist courtiers different systems of business representation evolve. Differences are observable not only across countries but also across sectors of economy in a given country. Such hybrid systems are likely to have important implications for the developmental strategies of the post-communist states. They are already greatly influencing the kinds of capitalism post-communist courtiers build to replace their state-run economic structures.

8. Research Implications

The best way to conceptualize business associations is to think of them as institutions distinct from the states and the markets that have a potential to promote economic coordination, link economic and political systems, and impact patterns of distribution and the allocation of economic and political resources. The research focusing on business and employer associations as intermediary (non-state – non-market) institutions would call into question some of the underlying assumptions in scholarly accounts of the post-communist "transitions." The subfield of transitional political economy has produced a variety of theoretical frameworks. The study of transition has been dominated by discussions of the initial conditions (Jowitt 1992), speed (Sachs 1990; Przeworski 1991; Boyko 1992), sequence (Brown 1991; Bunce 1995), and constraints and challenges to the transformation rather than by investigation of the alternative end points of transition. These different theories rarely question the end point of transition and frequently rely on a tacit assumption that the post-communist economic transitions have somewhat similar, if not identical, end goals (Ericson 1992; Conway 1995). For the most part, the end point of transition — the stylized notion of capitalism — has not been problematized by those researching post-communist economic transitions. In other words, theoretically important questions about *what* capitalism is and what kind of capitalism to build in Eastern Europe[9] were replaced by the more policy-oriented question of *how* to build capitalism in Eastern Europe. As put by Roland,

> Implicit in many policy analyses on transition is the idea of a clearly defined goal, usually the analyst's pet blueprint for an ideal economic system. To be honest, however, one must acknowledge that the model of capitalism toward which transition economies should converge is not necessary clear. Existing controversies among economists on the role of government in a market economy transpose quite naturally to debates on transition. More importantly, even if there is a clear goal of transition, there is no accepted theory how to get there. (2000, p. 12)

In fact, the scholarly account of the post-communist economic transition has been dominated by the discussions of the speed, sequence, and general patterns of economic reforms. Such discussions are quite natural focal points from the perspective of both the prior study of socialist economic system and the neo-liberal economic perspective that came to dominate economic policy analysis in the late 1980s. The liberal market economy was usually seen as the ultimate alternative to the centrally-planned socialist economy (Hardt & Kaufman, eds. 1995; Crawford 1995; Crawford 2001; Sachs 1993). Such a notion is traced back to Hayek (1945) and his analysis of planned and market economies as two mutually exclusive alternatives. Free market is seen as the single most crucial element of capitalism and any attempt at circumventing market forces is perceived as a step toward socialist planning. Such an equation of capitalism with market forces — combined with the general agreement about what constituted the failure of socialist economic project — provided a foundation for most of the research projects in the subfield of the political economy of transition. The general consensus has been that the communist regimes in Eastern Europe collapsed because of the absence of markets and private property, so transition analysts naturally focused on the processes of establishing free market institutions to remedy the socialist failures. The early accounts of transition established a general consensus on the goals of transition: good economic performance and alleviation of the inefficiencies associated with the central planning. The major focus

[9] what mixture of state and private coordination will be more optimal for the post-communist courtiers, and what

was on the tasks of building functioning markets, efficient property regimes, and stable macroeconomic policies. Success in transition to capitalism was thus measured by how closely the post-communist countries approximate the ideal typical notion of a liberal market economy.

The students of the comparative capitalism strongly disagree with equating capitalism with its liberal variant. As the debates over the optimal levels of government involvement, best developmental strategies, and nature and extent of the social constraints on market economies suggest, there is not yet a clear and universally applicable model of capitalism against which the extent of transition can be measured. The body of research analyzing the differences in the organization of production, coordination, policy formation, and distribution in the advanced industrial societies points to the existence of different forms capitalism. The capitalist economic system covers such diverse types of political economies as protectionist regimes and the open market economies, laissez-faire and French-style state planning, developmental capitalism of East-Asian variants, and rent-seeking regimes of sub-Saharan Africa. Differences in these types of capitalist arrangements cannot be reduced to the degree to which capitalism is entrenched, neither can they be arranged on the continuum from the best to the worst capitalist system since the outcomes they produce are not congruent on the efficiency, stability, and distributive outcomes. If capitalism is not as uniform as transitologists have assumed it to be, then existing accounts of the economic transition have missed an important point. If Hungary and Russia are building different kinds of economic systems, how informative are the comparative accounts of the progress of economic reforms? Such factors as vulnerability to inflation, high unemployment rates, levels of regulation, and income inequalities — often used as bases of comparison — can be seen as integral parts of perhaps diverging types of the capitalist political economies these countries are building. Comparing capitalism in Azerbaijan with capitalism in Poland in this respect is not a question of the degree and the depth of the reforms, but rather an issue of comparing alternative models and variants of capitalist economic systems.

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extent of state involvement, regulation, and ownership will be more acceptable for the domestic actors

It would be misleading to characterize the study of post-communist political economies as universally embracing the neo-liberal doctrine. In fact, the evolutionary-institutionalist perspective (in Roland's terms) has challenged such dogmatism. Institutional diversity (Murrell 1992) and importance of the local knowledge (Stark 1996) in devising most appropriate strategies and methods of achieving better economic and social outcomes have been acknowledged. Several scholars have drawn attention to the fact that many economic institutions in the communist countries have perhaps been quite effective at performing crucial functions — formulating industrial policies, mobilizing resources, and coordinating developmental goals (Chang & Nolan 1995; Qian 1999). The calls for putting more emphasis on local knowledge and institutional experimentation have challenged the neo-liberal paradigm. The analyses of the second-stage or "hard" reforms have explicitly emphasized institutional diversity and alternative institution-building projects. Still, the literature gives the majority of attention to the analysis of institutions providing for the smooth operation of the markets, rather than to non-market mechanisms (Shleifer & Treisman 2000; Ickes & Ryterman 1995; Johnson, McMillan, & Woodruff 1999; Hellman et al. 2002). Corporate governance structures, development of financial institutions and capital markets, institutions facilitating information exchanges and securing property rights are examples of institutional mechanisms reinforcing the working of competitive markets. Although the largely dominant neo-liberal doctrine places heavy emphasis on the market as a single most important component of a capitalist economy, the non-market economic and social institutions are very important elements of capitalism. Prior research has shown that these non-market institutions have, to a large extent, shaped the outlook of capitalist societies, affecting the patterns of distribution, macroeconomic stability, and developmental paths available to different capitalist countries.

The literature on the varieties of capitalism, although primarily concerned with the strictly economic aspects of firm and production organization (Whitley & Kristensen 1997; Appelbaum & Schettkat 1998; Hogson 1998; Hall & Soskice 2001; Hall & Soskice 2004), points to business and employer associations as the central non-market institutions of information transfer, standard setting, industrial policy implementation, coordination, and public policy setting. Important differences between types of capitalist economies can be traced to the different structures and roles played by business interest groups and employer/producer associations in particular. The types of social-policy regimes (Esteviz-Abe, Iversen & Stokice 2001; Martin & Swank 2004), professional training systems (Culpepper 2001), patterns of economic performance (Franzese 2001), and economic policies (Thelen 2001) are believed to be affected by organizations representing business. Other researchers (Olson 1965; Stigler 1971; Grossman & Helpman 1994; McChesney 1997) linked the influence and preferences of business organizations and lobby groups to the levels of economic protection and government intervention. Business and employer associations are central to these accounts. Their patterns of organization and influence have an effect on many aspects characterizing politics and economics of different nations.

All of these theoretical accounts point to associations representing business interests as potentially important actors in directing the trajectories and producing the outcomes of socio-economic transformation. However, we know little about the emerging systems of interest group representation in post-communist countries. The dynamics of group mobilization and mechanisms of exerting influence on reforms beg further consideration. The number and strength of interest groups, their functions and relative power vis-à-vis the state and political parties, and patterns of interest aggregation and representation are widely believed to shape the outcomes of interest group politics. The task of this project is to explore the processes leading to differential the systems of business interest representation across post-communist countries.

To summarize, the theories of economic transition misrepresent the end point of reforms: capitalism has never been a uniform phenomenon. Economic, political, and social institutions that make up capitalist systems differ considerably across societies. One of the non-market institutions shaping the type of capitalist economies is business association. Business associations have different forms, functions, and methods of social and political interactions in different types of capitalist economies. Therefore, to understand the nature of capitalism, it is important to understand the roles, forms, and patterns of influence business and employer associations have. Business associations are consequential for economic coordination, work organization, welfare systems, skill acquisition and certification, and public policy formation. I contend that different systems of group representation are associated with different types of capitalism emerging in the post-communist countries. Bringing attention to the formation and development of business associations and to the causes of cross-national and cross-industry variation in the strength of business groups should change the way we think about business-state relations in the Eastern Europe and Eurasia.

Appendix

This appendix discusses methodological foundations of the statistical analysis and summarizes the results reported in Table 3. The straightforward logit model produces the following results. Controlling for the effects of other variables corruption and sector dummies are positively associated with group formation. Such effect is statistically significant at the conventional level. The goodness-of-fit test (G), as reported in the table, is significant, suggesting that model fits data better than the null model (i.e., with the constant only). The coefficient on corruption variable is positive and significantly different from zero. Expontiating the estimated corruption coefficient (exp(β_3)) I find that the odds of a firm being a member of business association are 1.023 times higher for every unit increase in the firm's response on the 42-point corruption scale. A firm that gives the highest scores for all seven corruption-related questions is 43 times more likely to be a member of business association than a firm reporting no corruption. In respect to the sector dummies, firms in service sector are 2.4 times more likely to be members of business association, while firms in secondary sector are 2.7 times more likely.

Caution however should be exercised accepting these results because of the simultaneous inclusion of the firm- and country-level variables. The within country observations of the country-level variables are not independent from each other, which violates the standard assumption underling regression techniques. As a result, the standard errors are likely to be biased. This presents a problem for the statistical analysis operating at firm level. A model specification excluding country-level (contextual) variables is less likely to commit ecological fallacy, but does not address the problem of heteroscedasticity or unequal variance. Estimates of such model are reported in column 2 resulting in a marginal change in the remaining regression coefficients and standard errors. The model fit statistics is significant, and exp(β_3) = 1.02. Pooling firm observations across 25 countries, however, assumes homogeneity among firms in different countries and is likely to suffer from specification (omitted variables) problem (as might be suggested by the lower goodness-of-fit statistics for Model 2).

An alternative way to account for the country-level characteristics that influence association formation (in addition to political variables discussed above such influences may come from differential legal frameworks, historical background, cultural attitudes, level of economic development[10] etc.) is to model unobservable country-specific effects as a part of regression equation. A customary way of accounting for such unobserved (or hard to measure) country-level effects in political science applications has been to include group dummy variables. I report the results of estimation including country dummies in Column 3. The group dummy variables models, however, are equivalent to allowing for the effects of omitted individual varying but country invariant variables to be absorbed into the intercept term of the error-correction model as in:

$$Pr\,(Y_{ij}=1) = \beta_0 + \beta_3(Corruption)_{ij} + \beta_4(Employees)_{ij} + \beta_5(Foreign)_{ij} + \beta_6(De\text{-}novo)_{ij} + B_7(Fin.\ Problems)_{ij} + \beta_8(Unpredictability)_{ij} + \beta_9(Secondary)_{ij} + \beta_{10}(Services)_{ij} + \beta_{11}(Cost\ Corruption)_{ij} + \alpha\mu_i + e_{ij} \qquad (2)$$

Where μ_i corresponds to unspecified country-specific effects and e_{ij} is a stochastic disturbance term. Here country effects are assumed as fixed parameters to be estimated. Since μ_i are not directly observable and their coefficients α are not of particular interest, a better way of estimating varying intercept models is to perform regression on the transformed variables so that observations are expressed as deviations from country mean. Such fixed-effect error correction model consumes fewer degrees of freedom and can be generated to account for a binary choice variable as in Chamberlain's (1980) conditional fixed effect logit. (Baltagi 2005) Country dummy and conditional fixed effects logit estimates are reported in Columns 3 and 4. Both models fit data better than the intercept-only models, the coefficients of interests are positive and statistically different form zero, and the marginal effect of corruption are given by exp(β_3) = 1.028 and exp(β_3) = 1.035 Note, that this fixed-effect model cannot estimate country-invariant variables since *within*-transformation wipes out any country-invariant variables.

To allow the country-level variables to be included in the model I use one-way hierarchical

[10] Olson argued that as societies become wealthier and their economic structure advances, the group's organizational level should also increase. The overall well-being of a society with higher marginal productivity creates more productive ground for redistributive politics and, thus, stimulates group formation (Olson 1982). In fact, the empirical studies suggest that more industrialized countries tend to have higher levels of group organization (Mueller & Murrell 1984; Mueller & Murrell 1986). When extending this analysis to the post-communist cases, one can expect that in countries with more advanced economic organization, diversified economies, high trade flows the resources available to invest in organizational activities and the potential gains from such activities would be higher.

random-effect estimation. Unlike fixed affect dummy variable models random coefficient hierarchical (or variance component) models treat country-level effects as random variables. Different model specifications allow for varying both the intercept and slope coefficients.[11] I estimate the random effect varying intercept model using probit estimation developed by Butler & Moffitt (1982), which is the binary-choice dependent variable counterpart for hierarchical linear MLE estimator discussed in Raudenbush & Bryk (2002) and Douglas (2004).[12] I report the random intercept and slope hierarchical MLE estimates in column 6.

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[11] I estimate variance component models of the following forms: $Y_{ij} = \alpha + \Sigma\beta_k X_{kij} + u_{oi} + e_{ij}$ for the random intercept and $Y_{ij} = \alpha + \Sigma\beta_k X_{kij} + u_{oi} + u_{1i}X_3(Corruption)_{ij} + e_{ij}$ for random intercept and slope.

[12] See Goldstein 1991 for issues involved in estimation models for discreet-response data. For an application, see Sickles & Taubman (1986) and Baltagi (2005).

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