

INTEREST GROUPS IN POST-COMMUNIST COUNTRIES: A COMPARATIVE  
ANALYSIS OF BUSINESS AND EMPLOYER ASSOCIATIONS

DISSERTATION

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## ABSTRACT

In the past 15 years, the post-communist countries have attempted to rebuild state society relations. Central to this process has been the formation of business associations. Despite roughly similar starting points, the post-communist countries vary dramatically in the number and type of business associations. This variation poses a number of empirical questions. Why do business associations form? What kinds of firms join associations? What roles do business associations play in the creation of capitalism? Existing literature often treats business associations as marginal players, but my dissertation demonstrates that they are important organizations that have a profound effect on the political and economic life of post-communist countries. Moreover, while scholars have examined the behavior and influence of interest groups, the actual *causes* of group formation (or non-formation) remain underdeveloped. My dissertation examines the creation of business associations and their subsequent development across countries and economic sectors.

Based on a cross-national survey of firms in 25 countries as well as a comparative analysis of business interest representation in Russia, Ukraine, Croatia, and Kazakhstan, I find that low-level bureaucratic corruption and excessive state regulations facilitate the formation of business associations. This might seem counterintuitive, but I argue that

increasing bureaucratic pressure on businesses stimulates collective action to combat corruption. Another empirical finding is that firms in different sectors of the economy are unequally represented by business associations. Contrary to prevailing theoretical arguments, firms in the service sector are most likely to join business associations, while firms in mining and heavy industry are least likely to join. This finding is consistent with my argument because firms in the service sector are more vulnerable to invasive regulations. My analysis suggests that the nature of state regulatory institutions and policies affects business association formation. When corruption and regulations by bureaucrats are rampant, businesses have greater incentives to join associations that provide legitimate means to counter bureaucratic pressure. Thus, business associations arise as a defensive mechanism to protect business against corruption and extensive regulation.

This contributes to the debates about the sources of civil society organizations suggesting, ironically, that petty corruption may strengthen business associations – a crucial element of civil society. In addition, my 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 roots of the formation of business interests is a critical step in advancing a more general understanding of the development of capitalism in the post-communist countries.

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## CHAPTER 1

### INTRODUCTION

In the past 15 years, the post-communist countries of Eastern Europe and the former USSR have witnessed the emergence and development of new systems of interest group representation. For the first time, after decades of communism, a new kind of organization—business associations—came into existence. Despite their substantial membership and developed organizational structure, post-communist business associations are often treated as marginal players that have little influence over state policy and economic development.<sup>1</sup> Moreover, while scholars have examined the behavior and influence of interest groups, the actual causes of group formation (or non-formation) remain underdeveloped. However, if associations are so unimportant in serving the interests of business community, it is unclear why firms across the post-communist world join them and why the number and membership in these associations grow. Contrary to the prevailing perception, this study demonstrates that business associations are performing functions vital to their constituents—functions, that have

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<sup>1</sup> But see Thomas F. Remington (2004). Analyzing activities of one Russian business association, Remington writes: “The RUIE [Russian Union of Industrialists and Employers] is the single most powerful organized interest group in Russia” (p. 153). Another work echoes Remington’s assessment of business interests: “... interest groups with more independent resources and greater power (especially economic interest groups) have succeeded in their pressure to create more institutionalized policy networks with an important influence on behalf of non-state actors” (Fink-Hafner & Krasovec, 2005, p. 414). Still such assessments are rather infrequent and the majority of scholars report weakness and disorganization of the post-communist employers.

remained below the radar of the transition research. They protect firms from the predatory state behavior.

Based on a cross-national survey of firms in 25 countries as well as a comparative analysis of business interest representation in Russia, Ukraine, Croatia, and Kazakhstan I find that low-level bureaucratic corruption and excessive state regulations facilitate the formation of business associations. This might seem counterintuitive, but I argue that increasing bureaucratic pressure on businesses stimulates collective action to combat corruption. Another empirical finding of this dissertation is that firms in different sectors of the economy are unequally represented by business associations. Contrary to prevailing theoretical arguments, firms in the service sector are most likely to join business associations, while firms in mining and heavy industry are least likely to join. This finding is consistent with my central argument because firms in the service sector are more vulnerable to invasive regulations. My analysis suggests that the nature of state regulatory institutions affects business association formation. When corruption and regulations by bureaucrats are rampant, businesses have greater incentives to join associations that provide legitimate means to counter bureaucratic pressure. This contributes to debates about the sources of civil society organization suggesting, ironically, that petty corruption may strengthen business associations – a crucial element of civil society. Thus, unlike a large body of literature on business-state interaction that sees interest groups as making claims on the state and seeking protection from the market forces, I argue that business associations are defense mechanisms to protect businesses against the state. This dissertation also investigates the role of formal institutions in shaping the aggregation of economic interests. Comparative analysis of business



representation in the voluntary and compulsory membership systems offers little support to the institutional perspective but suggests a greater role of agency in shaping the institutions. Between these empirical and theoretical contributions, this study of the formation of business organizations becomes an important piece of research advancing a more general understanding of the development of capitalism and civil society in the post-communist countries.

## **1. 1 DEFINING THE SUBJECT**

Interest groups are an important element of the political system. According to the liberal intellectual tradition, they link society to political decision-makers; they express the demands of distinct social groups and make relevant information available to political actors; and they organize citizens to solve urgent problems requiring coordination and interaction with state institutions. Interest groups are also essential players in the sphere of economics; their activities shape the nature and extent of state regulatory and distributive policies. Interest groups are such an essential part of political and economic systems, but how do they form and evolve, and what roles do they play in times of fundamental political and economic transformation?

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; Hodgson, 1998; Hall & Soskice, 2001, 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 to employer/producer associations in particular. Theoretical and empirical studies point to associations representing business interests as potentially important actors in directing the trajectories and producing the outcomes of socio-economic transformation.<sup>2</sup> 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 similarities and differences in the systems of business interest representation across post-communist countries. In this dissertation, I establish and test hypotheses accounting for the divergent patterns of business interest group formation and development in post-communist Eastern Europe and Eurasia.

This dissertation investigates the causes of business associations' formation and their interaction with state institutions in the wake of the collapse of state socialism.<sup>3</sup> It

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<sup>2</sup> The studies of the political economy of the East Asian newly industrialized countries point to organized industrial interests as one of the central components of the East Asia's developmental success (Johnson, 1982; Lim, 1983; Wade, 1990; Morley, 1998).

<sup>3</sup> It is important to emphasize that the objects of this research are formal associations of businesses rather than business interest groups broadly conceived. By concentrating on formal associations, I evade the fundamental problem facing any study of interest groups – the question of what a social interest is and what constitutes an interest group. If one follows an established notion that "...an interest arises from the conjunction between some private value held by a political actor – public officials or groups thereof as well as private sector operatives – and some authoritative action or proposed action by government" (Salisbury, 1991, p.12), not all civic associations are interest groups. Based on the two elements of such a definition of interests – private values and governmental authority to grant or deny acquisition of such a value – civic organizations that do not lobby the government are not interest groups. I find such exclusion of groups that have overcome the problem of collective action and formed organizations unjustified. Contrary to the lobbying literature, this dissertation concentrates on the organization of business communities rather than

advances a theory of the relationship between economic actors and state institutions and contributes to the on-going exploration of post-communist economic transition and the evolving patterns of governance in the region. The primary empirical focus of this dissertation is to explore variation in the development of business associations across countries and across sectors of their economy. Surprisingly, given roughly similar starting points,<sup>4</sup> the post-communist countries vary on both the number of emerging business groups as well as their organizational characteristics. Why some businesses in some sectors of the economy in some countries form associations has not been the subject of rigorous scrutiny in the field of post-communist comparative research. My dissertation places business interest groups at the center of analysis.

Despite the evidence of substantial membership and developed organizational structure, post-communist business associations are often treated as marginal players that have little influence over state policy and economic development (Peregudov & Semenenko, 1996; Kubicek, 1996; Fortescue, 1997; Rutland, 2001; McMenamin, 2002; Lehbruch, 2003). This dissertation demonstrates that business associations are important organizations that have profound effects on the political economies of the post-communist countries. Bringing attention to the formation and development of business

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the actual granting of private benefits by the government. My approach excludes formally unorganized or individual demands and activities, does not necessarily require attempts to influence or lobby, and when such attempts are present, does not specify the channels of influence.

<sup>4</sup> 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 (Geddes, 1995; Jowitt, 1992; Schopflin, 1994). Such a perspective, however, seems to exaggerate similarities among countries of Eastern Europe. It should be acknowledged that these countries’ experiences under 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.

associations and to the causes of cross-country variation in the strength of business groups should change the way we think about business-state relations in Eastern Europe and Eurasia. Understanding how business associations affect the emerging capitalist economies and the relationship between the business sector and the post-communist state will inform policy-making in the areas of economic development assistance, regional cooperation, and civil society development.

## **1. 2 WHY SHOULD WE CARE?**

This research is important along the following dimensions. On one hand, investigating the causes of lobbying and business associations' formation can advance general theory of the relationship between economic actors and state institutions. My dissertation will contribute, for example, to research on the "varieties of capitalism", which examines how different countries organize relations between business and the state. In addition, my 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 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.

The development of civil society in post-communist settings and the emergence of groups representing the interests of the entrepreneurial sector in particular present a natural laboratory for testing existing theories of group formation. The investigation of the causes of business associations' formation in the new capitalist economies provides

an opportunity to trace the developments of a very important component of civil society—business and industrial organized interests. The study of business associations in post-communist countries can bring to light previously unexplored aspects of such research. Post-communist countries provide excellent cases for studying this topic because business-state relations are still in the process of their formation; while in the developed capitalist countries, such a process is generally completed. The emerging systems of interest representation in post-communist countries present an opportunity for developing and testing new theories about the causes and effects of group formation.

The task of this dissertation goes beyond “presenting new wine in old theoretical and conceptual bottles” (Kubicek, 2000, p. 296). It indicates a promising area of research: the connection between developments within the economic domain of civil society and the nature of state bureaucratic structures. Such research inevitably touches upon the central problems of political economy. Namely, how state authority shapes the workings of markets by changing the incentive structures of market agents? How do these agents interact with the state in pursuit of their economic gains? As Polanyi (1957) suggested, economic and political spheres of society cannot be analyzed as separate entities. The markets are embedded into the net of social and political institutions regulating their workings. Business associations comprise an important component of such a net. Investigation into the formation of business associations speaks to the issues of social “embeddedness” of the economic sphere.

This project underscores the importance of the state bureaucratic institutions and speaks to the on-going debate about effects of good governance. Other than its importance for the theory of interest group formation, the relationship between the state

and economy, and issues of governance, the question of business association formation has significant ramifications for the study of post-communism. Understanding why post-communist countries differ in the ways social groups organize is an important element in solving the overall puzzle of success and failure in political and economic transformation.

Testing the alternative theories of group organization also contributes to the debate about state capture, influence, and exchange. Although this debate is typically waged about the *consequences* of group politics, rather than *causes*—which are the focus of this research—the intersection of the two perspectives will paint a clearer picture of the issue at hand. Much of the research on capture, lobbying, and influence is motivated by the question of under what conditions do interest group politics produce positive results in economic performance, accountability, fairness, and efficiency, and under what conditions do groups' interactions with the state lead to the opposite effects? The more specific questions are under what conditions does the group interaction with the state produce the effects associated with state capture and under what conditions does such interaction result in a more benign relationship? Why, in some countries, do strong business interests coincide with vigorous reforms and economic growth; while in others, they coexist with poor economic performance and stagnant reforms?

Research on the causes of group formation cannot directly answer these questions. However, knowing why groups form and how such formation is affected by state institutions can indicate the possible effects of interest groups. If, for instance, business interest group formation is motivated by the desire to compensate for the failure of state institutions to provide collective goods necessary for improving efficiency and growth, one might expect the positive effects of group formation—institution-building resulting

in improved business climate, efficiency and growth. If, on the other hand, business groups form as venues of rent-seeking and the major activity of the emerging associations is to interact with and influence politicians and bureaucrats, some negative consequences can be expected. It should be noted that the above statements do not imply that the effects of group formation can be deduced from the causes of their emergence. What I have in mind is that the possible effects of group formation can be *expected* if we understand the reasons why groups form. In no way does this mean that unintended consequences cannot occur or that the functions, aims, and activities performed by business associations cannot change over time. Understanding the consequences of group formation would require thorough research, which can be aided by knowledge about factors affecting group formation.

Although proposed research into the causes of group formation speaks to many aspects of the study of politics, the scope of the project and the number of questions it can answer should not be overstated. By addressing the question of business association formation, this research contributes to the study of interest groups in general and to their relations with state institutions. However, it should be recognized that business associations are not the only, and probably not the most typical, kind of interest groups operating in the grey zone between the state, the family, and the market. Thus, some findings, although suggestive of the patterns of group formation in other social spheres, cannot be directly extended to other types of civil associations. Still, this research touches upon the crucial aspects of state-society relations—interaction between economic elites and the state. This is an essential component of a larger picture of state-society relations in the post-communist transformation.

## **1. 3 INTEREST GROUPS IN THE STUDY OF POST-COMMUNISM**

### **1. 3.1 Interest Groups in the Study of Transition**

In the early stages of the political and economic reforms that swept Eastern Europe in the early 1990s and shattered the remnants of the Soviet Union a few years later, scholarly interest was redirected to the problems of democratic and economic transitions. As liberal reforms in Eastern Europe and CIS proceeded, a two-fold assessment of interest group development emerged. On the one hand, proponents of the “flattened landscape” 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 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 further democratic and economic reforms. The former researchers tended to problematize collective action and were skeptical of businesses’ abilities to overcome collective action problems. The latter group of researchers concentrated on the effects of organized interests, leaving aside the issue of how businesses overcome the problem of collective action in the first place. Consequently, formally organized business interest groups, as the dependent variable, have not become the subject of rigorous scrutiny for either approach. 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 help adjudicating between these two conflicting assessments.

### **1. 3. 2 “Flattened Landscape” and Fragmentation**

As the remnants of the totalitarian system crumbled, the “civil society” approach stressed the importance of the interest articulation and of civil associations operating independently of the state (Fish, 1991, 1995; Pei, 1994; 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 the collective action problem exacerbated by historical legacies. Yet, at the same time, the central role of social groups in the establishment of democratic political regimes was recognized. Without independence from the state, the activities of organizations representing the interests of diverse groups of people would undermine the tasks of democratic reforms. This approach, heavily motivated by the Tocqueville belief in democracy from below, could not transcend its ideological focus on civil activism and organizational pluralism. It assumed that civil associations have the intrinsic ability to promote democracy. Such an assumption, however, was never rigorously tested. Instead, scholars questioned whether a civil society comprised of strong voluntary associations would reemerge after decades of communism. Communist legacies were seen as 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 has produced similar assessment of the effects of “flattened landscape” on emerging patterns of interest representation. Based on the analysis of Polish business associations, McMnamin (2002), for instance, argued that business associations have not emerged as super lobbies that would dominate post-transition politics. He hypothesized that legacies of the “flattened civil society” are responsible for the marginal role of the Polish business associations. Lehbruch (2003) has advanced an argument emphasizing the organizational weakness of business associations in Russia. Unlike McMnamin, she proposed a more nuanced than a “flattened civil society” argument. Fragmentation of business associations, according to Lehbruch, 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 partial support for this argument (Campos & Giovannoni, 2005). Campos and Giovannoni contend that corruption is an alternative to lobbying strategies that occur through organized groups. Although their research suggests that lobbying is a more effective strategy in transitional countries, the prevalence of personal channels of influence in 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, post-communist cases have inherited an entire host of additional impediments to the business interest group formation from their recent communist past.

### **1. 3. 3 “State Capture” or Market-Promoting Institutions?**

An alternative approach to the study of interest groups in post-communist countries has been to problematize the effects of interest group politics rather than the issue of interest group formation. The students of post-communist transition feared that the formation of interest groups might undermine the prospects of post-communist transformation. 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 the democratic experiment (and with it 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 grim prognosis about incompatibility between the tasks of democratization and market reforms collapsed in just a few short years (Bunce, 1995; Fish, 2001). Contrary to initial expectations, in the regimes most isolated from social pressures, leadership failed to achieve good economic performance and radically transform their

problem-ridden economies. The focus of attention in the studies of transition shifted to the issues of interaction between the private and public sectors.

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.

Hellman (1998) argues that the process of economic transformation itself 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 the 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. The state capture argument, although insightful, is rather indiscriminant of differential impact organized interests might have on the policy-making process. It assumes an anti-market orientation on the part of special interests and disregards possible anti-regulatory market-promoting initiatives by strong economic actors.

The negative assessment of business interest influence on the state has been critiqued by subsequent research. 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 emphasizes the supply side of the rent-seeking activities. This calls for a more balanced approach to the study of business-state relations.

In addition, recent research by Pyle (2006b) suggests that, quite contrary to the “capture” thesis, business associations are “supportive of the broad objectives of

economic restructuring.” Pyle finds that Russian firms participating in business associations adopt a market-oriented behavior to a greater 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. A similar argument is presented by Recanatini and Ryterman (2001).

Although the state capture argument and its critiques do not directly address the interest groups’ politics (the argument operates at the firm level, rather than the group level), it is relevant to the study of business interest groups. The capture thesis raises a number of theoretical issues pertaining to the role of business organization in the politics of economic reforms. For example, whether the state capture is related to the levels of group organization? However, while examining the importance of interest group politics, this literature is silent in respect to the actual *causes* of group formation (or non-formation). Examining the formation of business interest groups as a dependent variable, however, is a necessary step in describing business-state relations. Unlike many influential works on business interests in the post-communist context, this work does not address the question of the socio-economic consequences of interest group politics, but rather examines the causes of group development. The study of interest group formation can provide a new perspective on the unraveling capture versus exchange debate.

### **1. 3. 4 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 assessments have been advanced. 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 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 suggests that collective action on the part of businesses not only takes place but also has important consequences for a post-communist political economy. The latter approach takes the solution to the collective action problem for granted, which overlooks instances in which interest groups do not form. The question of *what* interests are represented in post-communist countries and which are not, however, has important implications for the outcomes of political conflict. To adjudicate between these two conflicting assessments of interest groups politics, it becomes important to examine under what conditions associations form and under what conditions they do not form. This paper proposes a research strategy aimed at placing business interest group formation at the center of analysis. This research also differs from existing literature by examining the formation rather than the behavior of business interest groups.

#### **1. 4 SUMMARY OF THE MAIN ARGUMENTS**

This dissertation explores the development of business associations in post-communist countries. Because of the wide scope of such an exploration, strong theoretical guidelines are needed to frame the research. I identify relevant theoretical arguments that account for the formation of interest groups in general and business associations in particular to provide a roadmap for the empirical exploration. Although a number of theories provide compelling arguments for explaining interest group formation, none seems to explain fully the development of post-communist business associations. By integrating elements of different approaches and incorporating relevant features of the post-communist transitional politics and economics, I construct an alternative theoretical foundation for thinking about business associations' development in Eastern Europe and Eurasia.

My framework offers an integrated approach to the question of business association development. As I pondered over the stories of formation and evolution of dozens of small and large, local and sectoral, resource-abundant and well-established, and fledgling or disintegrating associations, I realized that there was not a single answer to the question of why they emerge. Neither could I find a single reason for why firms join business associations. I found that the process of establishing an entrepreneurs' league, employers' union, or business association is far from automatic. It is a complicated task to bring together enterprises or individual businessmen who see each other as competitors. There is no single reason to account for success or failure. Rather, there are complex and mutually dependent reasons leading to the formation of business



associations and decisions to join them. Four central points summarize the answers I discovered.

1. Associations form as a reaction to unfavorable business environments. Although this general statement should come as no surprise to those familiar with the classical theories of group formation,<sup>5</sup> I qualify this point by referring to the specific type of environmental disturbances that affect formation of post-communist business associations—bureaucratic corruption. Unlike their counterparts in the lobbying and influence literature, most post-communist business interests organize not to change regulating legislation but to protect their members from corruption. This argument implies that associations respond to, rather than create, bureaucratic corruption.

2. Associations form and succeed in attracting members when organizational entrepreneurs are able to offer potent selective benefits to prospective members. Possible selective benefits are limited in the post-communist context. The post-communist take on the theory of selective incentives is that the most potent selective incentives promoting associational development are those that help firms protect themselves from predatory bureaucrats. Surprisingly, not many associations lobby for lower taxes or less intervention. Most of the post-communist business associations, however, provide particularistic benefits associated with lowering the cost of doing business.

3. Associations form unevenly across different economic sectors. Economic theories that emphasize capital concentration and mobility provide only partial explanation for this uneven mobilization of economic interests. I find that because of the rapidly changing economic structures, some post-communist countries contain conclaves

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<sup>5</sup> Here I refer to Truman (1951) and Olson (1982).

of under-regulated and under-coordinated business activity. Post-communist enterprises often lack non-market institutions of information transfer, quality control, and standard setting and enforcement. Enterprises operating in such sectors form associations to compensate for the failing or withdrawing state in the absence of alternative institutional coordination mechanisms. This suggests that associations evolve as regulatory substitutes to the state.

4. In few post communist countries compulsory business associations are created by the state while the majority of the post-communist business associations are voluntary-membership organizations. The state-enforced compulsory membership structures are the sure solution to the collective action problem of the part of businesses. Still I find that participation in the corporatist-stile compulsory organizations does not substitute for the membership in voluntary groups. Voluntary organizations of businesses form and attract sizable membership even in the countries that have adopted the compulsory membership institutional structures of business representation. This calls into question institution-centered theories that suggest self-perpetuation of the existing institutional frameworks.

Prior research (Whitley & Kristensen, 1997; Appelbaum & Schettkat, 1998; Hodgson, 1998; Hall & Soskice, 2001, 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 (Estevez-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 the 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 systems of business interest representation across post-communist countries.

Business associations are the central non-market institutions that shape the type of capitalist economies. 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. 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.

## **1. 5 ROADMAP**

Because of the multifaceted nature of the empirical issue at hand, this dissertation is organized around distinct groups of theoretical propositions and empirical tests. The next chapter identifies the relevant theoretical themes, lays out the theoretical framework, and outlines the methodology and research design. It proposes an integrated approach to the study of business associations' formation that incorporates supply and demand-side components and develops hypotheses operating at multiple levels of analysis. I dedicate one chapter to the analysis of the firm- and sector-level factors affecting group formation. Such supply-side factors account for the bottom-up dynamics of business interest articulation and include firm size, type of ownership, financial standing, resource specificity, and concentration of production. Then, I introduce additional variables reflecting the institutional environment and regulatory regimes in which firms operate as the supply-side factors in the association development. I concentrate on bureaucratic controls and regulations, as well as on the opportunities and limitations presented by the configuration of political institutions in the post-communist countries.

I employ the “nested analysis” research strategy (Lieberman, 2005) that operates at different levels of analysis and calls for the use of multiple methods. To disentangle

different forces accounting for the group formation dynamics, I analyze quantitative data on business association formation in different sectors of Russian economy. My quantitative research informs my qualitative analysis of data collected during structured interviews with officials representing business associations in three countries that had differential experiences with economic reforms.

The kinds of empirical evidence I use to assess theoretical arguments accounting for the business interest group formation across countries and sectors of the economy include cross-national survey data of business, national surveys of associations, and qualitative data on the formation of business associations in Russia, Croatia, Ukraine, and Kazakhstan. In the course of my field research, I have collected original data on the number of business associations, their estimated membership, sectoral representation, as well as over 80 hours of structured interview and oral history records describing the development of 20 Russian, 16 Ukrainian, and 5 Croatian business associations. Such data has not been available from existing sources and presents a valuable addition to the scholarship. Although I did not conduct a field research in Kazakhstan, I was able to acquire qualitative data on the development of Kazakh business associations through the internet sources, newspapers, and my connections in this country. Available data allows testing many hypotheses operating at firm-, sector-, and national levels. Qualitative data allows investigating the over-time development of business associations, which adds a temporal dimension to my arguments. I draw extensively on the qualitative evidence and illustrate plausibility of my arguments on the multiple examples of the formation, development, and activities of business associations in three post-communist countries.

Chapter 3 investigates firm- and sector- level characteristics affecting group formation. A central research question to be addressed in this chapter is why, contrary to the theoretical predictions, businesses in the service sector are more prone to join associations, while businesses in primary industries are least likely to join. I argue that sectoral differences in business interest representation are best explained by the dissimilar experiences of enterprises in different lines of business during economic transition.

Chapter 4 investigates the supply-side arguments about the effects of business environment on association formation. The central question for this part of the research is how state regulatory institutions and macro-economic conditions influence the process of business association formation. Chapter 4 presents a cross-national quantitative analysis. It utilizes cross-national survey data and aggregate data on the legal frameworks, the nature of political institutions, and the quality of bureaucratic regulations. I model the choice of business participation in associations as a strategic interaction between the state, business associations, and firms. One of the most interesting implications of the model asserts that businesses are more likely to join associations in the environment of pervasive bureaucratic corruption. I argue that business associations arise as defensive mechanisms against bureaucratic pressures on businesses. The positive empirical relationship between corruption and associational membership detected by the survey and aggregate data analysis supports this argument about the effects of bureaucratic corruption on patterns of business interest representation. I statistically differentiate the effects of corruption from the effects of firm- and sectoral characteristics, political institutions, and macroeconomic conditions.

Chapter 5 subjects the defensive organization argument to further empirical tests focusing on the qualitative evidence of associational activities. I describe business representation systems of Ukraine and Kazakhstan and comparatively analyze functions and activities of business associations. I present case studies of 10 business associations in four post-communist countries: Russia, Ukraine, Kazakhstan, and Croatia. My analysis suggests that despite these countries' different political and economic environments, strategies and activities adopted by business associations are similar. In all four countries business associations attempt to reduce the costs of doing business by providing selective benefits to their members or attaining a collective good of reduced regulatory pressures.

Chapter 6 turns to the issue of compulsory membership. Although the majority of the post-communist countries have adopted the pluralist framework for interest representation that relied on voluntary membership, some countries created compulsory-membership business associations. Interestingly, despite historical institutional legacies, underlying legal frameworks, and official support for compulsory business representative organizations, most of the compulsory systems have eroded throughout the 1990s to incorporate many elements of competition and voluntarism. Voluntary business associations developed alongside the compulsory membership institutions undermining their legitimacy and shading doubts on the state-sponsored methods of overcoming the free rider problem. Chapter 6 investigates the development of voluntary organizations in such compulsory-membership systems. I extend the formal model first introduced in Chapter 4 to the analysis of compulsory membership associations and analyze the development of business representation in Croatia as a representative case of the compulsory-membership model.

Although this dissertation investigates the *causes* of business interest group formation, the *effects* of the interest group politics on the trajectories of the economic and political development of post-communist countries remain to be an attractive empirical and theoretical topic motivating any investigation of why groups form. The concluding Chapter 7 summarizes theoretical and empirical contributions of this dissertation and discusses the consequences of the emergent systems of business interest representation on the democratic and economic development of post-communist countries. 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. It reviews the evidence of the important role of business associations in the post-communist politics. I discuss the major implications of my findings to the theories of transition and business-state relations.



## **CHAPTER 2**

### **ANALYTICAL FRAMEWORK:**

#### **THE BOTTOM-UP AND THE TOP-DOWN DYNAMICS**

This chapter outlines theoretical motivation and builds an analytical framework to guide my research on business associations' development in the post-communist countries of Eastern Europe and Eurasia. It starts with a review of alternative approaches to the issue of group formation. 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. I then develop an integrated analytical framework to guide my empirical research, outline central hypotheses, and discuss methodological and case selection issues. I propose an integrated framework that explains the formation of business associations in terms of the interplay between institutional environment, regulatory regimes, and firms' interests shaped by conditions in particular industries.

#### **2. 1 EXISTING THEORIES OF INTEREST GROUPS' FORMATION: WHAT DO WE KNOW AND WHY IT IS NOT ENOUGH?**

Established theories of interest group politics provide powerful insights into post-communist group formation. In this section, I review various explanations of interest

group formation proposed in the literature on interest groups that mainly developed in the western context. In the past, extension of interest group theories to the study of non-western cases has proven to be a fruitful strategy (For examples of the application of U.S.-based interest group theories to non-U.S. cases, see Al-Otaibi, 2002; Freire & Baum, 2003; Maier & Knaap, 2002; Pratt, 1993; Shadlen, 2002; Simmons, 2002; Tien, 1989; and Jordan & Richardson, 1987).

Three theoretical traditions in the analysis of group formation offer alternative theoretical perspectives. Change in the socio-economic environment is the driving force behind the modernization theory of group formation. Another tradition addresses group formation as the solution to an instance of the collective action problem. Characteristics of latent groups are the major explanatory elements in this framework. The third framework concentrates on the industrial structure as the main reason behind interest organization in the economic sphere. In the following pages, I review the arguments advanced by these alternative theories and discuss their shortcomings. I present these theoretical traditions in the chronological order of their emergence. I suggest that these theoretical traditions, although providing powerful insights into the question of interest group formation, are deficient because each offers only a partial view. Later in the chapter, I propose an alternative framework that builds on the existing literature but develops an integrated theory that includes the micro-, meso- and macro-level factors accounting for the interest groups' formation.

### **2. 1. 1 Modernization Theory**

One of the earliest accounts of interest group development—Truman’s theory of social disturbances—views social dislocation as the major catalyst in the emergence of civic associations.<sup>1</sup> Truman (1951) observed that the surge in the emergence of various organized civil groups in the United States coincided with the most rapid and profound socio-economic change associated with modernization. Truman hypothesized that modernization was the major facilitator of organizational formation. As the existing patterns of resource flows were disrupted by profound changes in industrial organization caused by economic innovations, the groups of people directly affected by such disruptions organized to protect their interests and to place demands on the regulatory and distributive functions of the state.<sup>2</sup> According to this logic, periods of rapid social changes—modernization being the primary example—should be accompanied by a surge in associational formation. In fact, the empirical studies of interest groups’ formation in industrialized countries have provided evidence that more industrialized countries tend to be characterized by higher levels of formal group organization (Mueller & Murrell, 1984, 1986).

Although the social disturbances hypothesis was developed mainly to account for the periods of rapid economic development and the parallel changes in the social

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<sup>1</sup> Truman’s theory of group formation is based on an assumption that, at any given point in time, social structures exhibit static equilibrium. One might question this assumption. However, the defensive organization argument can be reformulated even if one rejects the structuralism of Truman’s theory.

<sup>2</sup> Peltzman (1976) and Becker (1983) have extended this analysis by suggesting that group organization can be a response to the organized opposition. These authors argued that as a group with an opposing interest organizes and extracts resources from the non-organized group, the latter will feel increased pressure for organization as the marginal costs of being unorganized increase with the increased organizational power of the opposing group. According to this logic, the organization can be a response not only to the direct disturbances emanating from changing economic structures, but also to the indirect influence mitigated by increasing organization on the part of other social groups.

structures, Truman's theory can easily be extended to the analysis of the post-communist transition. Although experiencing stagnant or even negative growth in the early 1990s, the countries of Eastern Europe and the former USSR underwent political liberalization, state withdrawal from its central position in the national economies, and the emergence of "haves" and "have-nots" in formerly egalitarian societies. If Truman's thesis about social and economic disturbances as the major source of associational formation is correct, the post-communist transition should stimulate the emergence of civil associations.

A different take on the same idea that macro-economic factors shape interest articulation has been advanced. Olson in his *Rise and Decline of Nations* (1982) has pointed to the empirical connection between periods of rapid economic development during modernization and major developments in the formation of interest organizations. Olson argued that—among other things—as societies become wealthier and their economic structure advances, the group's organizational level should also increase. The reason is that the overall well-being of a society with higher marginal productivity creates more productive ground for redistributive politics and thus stimulates group formation. Most small groups are better off when investing valuable resources into the struggle over a share of the collective pie. The larger that pie is—the more productive and wealthy the society becomes—the more groups can benefit by entering the redistributive struggle. The overall levels of economic development therefore, should have a positive effect on groups' propensity to organize.

The disturbance thesis and the development theory are two variants of the argument that traces group formation to the socio-economic change (development) broadly conceived. These explanations differ in their specification of causal mechanisms

through which macro-economic environment influences group formation. While the disturbance thesis emphasizes the external threat as the catalyst of group organization, the development thesis stresses opportunities as the major requirements for group formation. Although these two arguments might seem to provide explanation for business group formation in post-communist countries, their emphasis on socio-economic structure overlooks individual dynamics and ignores the role of agency and institutional effects. The arguments also find little empirical support in post-communist cases that exhibit greater divergence in the levels of group formation within the same income groups and at similar states of economic transition.

### **2. 1. 2 Individual Rationality and Collective Action**

Although research on interest groups dates to the beginning of the 20<sup>th</sup> century (Bentley 1908), work by Mancur 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.<sup>3</sup> 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 public goods. Although, collectively, a group might benefit from the provision of public goods, individual members 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

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<sup>3</sup> This individual-centered argument is ignored in Olson's 1982 book.

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, an interest organization in itself can be seen as a provision of a purely collective good. 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 from 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 the regular provision of collective goods are abundant. Such a conundrum needs to be resolved to explain why we see successful collective actions while the theory predicts otherwise. Scholars have concentrated on explaining under what conditions collective action becomes possible and when groups are able to overcome free riding. The proposed solutions range from the spontaneous cooperation, incentive-altering institutional arrangements and social norms to coercive authority. Such solutions can be grouped into two broad categories of "internal" and "external" solutions.

### *Internal Solutions*

Internal solutions emphasize characteristics of the group and the nature of collective good. Such solutions require no external forces that would make latent group members cooperate. Taylor (1990) argues that an "internal" solution is one that "neither involves nor presupposes changes in the game." 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 the 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 analysis of the repeated social interaction, Axelrod 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 (a 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 increases the costs of cooperation and compliance monitoring. The kinds of common goods sought by the latent groups are often not conducive 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.

### *External Solutions*

External solutions are those that alter individual inputs, pay-offs, and uncertainty through coercion or persuasion. Examples include formal institutions (the most potent being the state) and social norms. External enforcement mechanisms that rely on the coercive power of social institutions are also known as “institutional” solutions to the problem of collective action. The approach emphasizing institutional solutions has included both the formal and informal mechanisms that promote collective action.

The search for solutions to the collective action problem has led many authors to the recognition of the major importance of institutions as external mechanisms of compliance enforcement. Since the internal mechanisms will never be sufficient to ensure that no free riding occurs, externally imposed sanctions and rewards are necessary to ensure successful collective action (Olson 1965). Existence of exogenously enforced rewards and sanctions, unrelated to immediate organizational goals, can facilitate the process of organization. Rewards and punishments alter the incentive structure of individual members of a group, making it less costly (or more rewarding) to participate in a collective action. The coercive power of the state is seen as one of the most effective ways to solve the collective action problem. The state, as the ultimate coercive authority in the society, can enforce collective action through the use of courts, police, taxation, as well as symbolic and monetary rewards.

Recognition of the role of selective incentives is an important contribution 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 the existence of authority are paradoxical: the proposed solutions to the problem of collective action require the *pre-existing* solution to the problem of collective action involved in forming such institutions. In his discussions of institutional structures and norms, Taylor (1990) 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 the creation of institutions is subject to collective action problems, one cannot use the institutional argument to explain why collective action occurs in the first place. In an attempt to resolve such a 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 the *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 an individual leader gains from building institutions outweighs 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 through their control over the established institutions.<sup>4</sup> Such theoretical framework provides a foundation for 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 (1983) and Knoke (1988) have argued that organizational leaders play a central role in group formation and success. The work on leadership and the organizational capability of group leaders, however, brings us back to the characteristics of individual members and latent groups.

### **2. 1. 3 ECONOMIC STRUCTURES: RESOURCE SPECIFICITY AND INDUSTRIAL CONCENTRATION**

The literature on the collective action problem and its solutions has shaped the way theorists think about group formation. The third theoretical approach discussed here

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<sup>4</sup> The evidence for this argument is not particularly compelling. For an individual to derive private material gains from institution-building, she should have a very small discount factor for evaluating her future gains. This, however, is randomly the case in the uncertain world.

shares the overall premise of the collective action problem literature. It builds on the general understanding of disincentives for organization, but offers a different mechanism for the analysis of how it is solved. This third approach specifically addresses mobilization of economic interests and emphasizes the effects of the mobility/specificity of economic resources. Frieden (1991), in his analysis of Latin American economic reforms of the second half of the last century, concentrated on the politics of economic interest group influence. He argued that “economic interest groups exerted more pressure on policymakers in direct proportion to what they had to gain or lose from policy and to the ease with which they could mobilize.” Frieden advanced a compelling idea suggesting that the organizational capacity of economic interest groups is directly proportional to their asset specificity and concentration.<sup>5</sup> This argument goes back to Hirschman’s (1970) analysis of alternative responses to organizational decline. When faced with shrinking benefits, individuals have the options to withdraw (exit) or complain (voice). If “exit” is costly, which is the case when resource specificity is high, “voice” becomes the dominant strategy to secure continuing stream of benefits. Extending this to the economic sphere, businesses might be more likely to organize to voice their demands when moving to another sector or geographic location implies considerable cost.

Factor (capital) mobility is an important aspect 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 (2001) develops Frieden’s assertion that factor mobility is an important variable that influences levels of group

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<sup>5</sup> Industrial concentration plays an important role in Frieden’s analysis. However, I omit this argument here because it is closely connected to the group size argument advanced by Olson and thus falls into the collective action framework discussed in the previous section.

mobilization. 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.<sup>6</sup> High levels of investment in fixed capital suggest lower mobility since such fixed capital, as opposed to financial assets, is much harder to convert to other uses.

The standard expectation about the consequences of resource specificity is that it should promote collective action. Bates (1981) argues that there exists an inverse relationship between the mobility of economic assets and collective actions. This would imply that sectors with highly specific assets (high levels of fixed capital) should develop strong interest groups, while mobile asset sectors should be less likely to develop such groups. If resources are not easily transferable to other uses, a business is more dependent on the conditions in a particular industry. If conditions in a given industry deteriorate, businesses will be reluctant to move to other sectors and will instead lobby 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 in investing resources for the protection of sector-wide interests. As a result, fewer firms in asset mobile industries will join interest groups (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.

The resource specificity argument emphasizing industrial structures as the source of organizational strength is an intermediary between the structural development theory

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<sup>6</sup> 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.

and the individual-based collective action framework. The limitations of such approaches, similarly to Truman's framework, are in their structural, static formulation. Still, attention to sectoral differences offered by the resource specificity argument is valuable. Such perspective provides a powerful alternative to the micro logic of collective action theory as well as to the macro logic of development thesis. Although all three approaches discussed here offer valuable insights into the mechanisms of interest group development, they remain partial since they concentrate on a single aspect of group formation dynamics.

In explaining business group formation, it would be misleading to concentrate on factors pertaining to only one aspect of the problem such as macro-economic change or resource specificity. The same can be said about the establishment of institutional arrangements, norms, political entrepreneurship, as well as other arguments reviewed above. Instead of focusing on just one of such factors, an alternative theoretical framework proposed in the next section presents an integrated account of group formation that factors in individual, institutional, and sectoral dynamics. The next section outlines my framework that builds on the existing theoretical arguments. I argue that different factors influencing group formation not only have simultaneous effect, but are in an intricate interaction.

## **2. 2 AN INTEGRATED APPROACH TO THE INTEREST GROUP FORMATION**

Formation of business associations is a complex process that is likely to be influenced by a variety of factors. This work proposes an integrated theory of business group formation that concentrates on the interplay between institutional factors and firm

characteristics. This section develops an analytical foundation for my research on post-communist business associations. I propose an alternative to the existing theoretical traditions explaining group formation. Such framework distinguishes between the bottom-up and the top-down dynamics of group formation and allows for interaction between the two. The bottom-up mechanisms concentrate on the characteristics of latent groups and their intrinsic interests. The top-down mechanisms are the ones that emphasize environmental factors such as institutional structures and socio-economic milieu. Some important factors, such as selective incentives, emerge on the interaction between the top-down and the bottom-up dynamics. The resulting multi-dimensional theory of business interest group formation takes a next step in providing a comprehensive account of the emerging systems of business interest representation.

The Olsonian “internal solutions” tradition that concentrates on the size and homogeneity of latent groups and Frieden’s argument about resource specificity would exemplify the bottom-up dynamics since these pertain to the interests and demands on the part of businesses. The external solutions to the collective action problem, such as the role of the state, and economic development theory would constitute top-down arguments. In providing a comprehensive account of business interest group formation, both the top-down and the bottom-up mechanisms should be taken into account. Otherwise, one can arrive at misleading conclusions.

The first logical step in accounting for the cross-national and cross-industry variation is to consider firm characteristics such as 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, sectoral fragmentation (number of firms), resource specificity, geographical concentration, and homogeneity of firm characteristics are of major importance. In effect, the Olsonian and Frieden's arguments present two alternative explanations for the bottom-up, or the demand-side, dynamics of group formation.

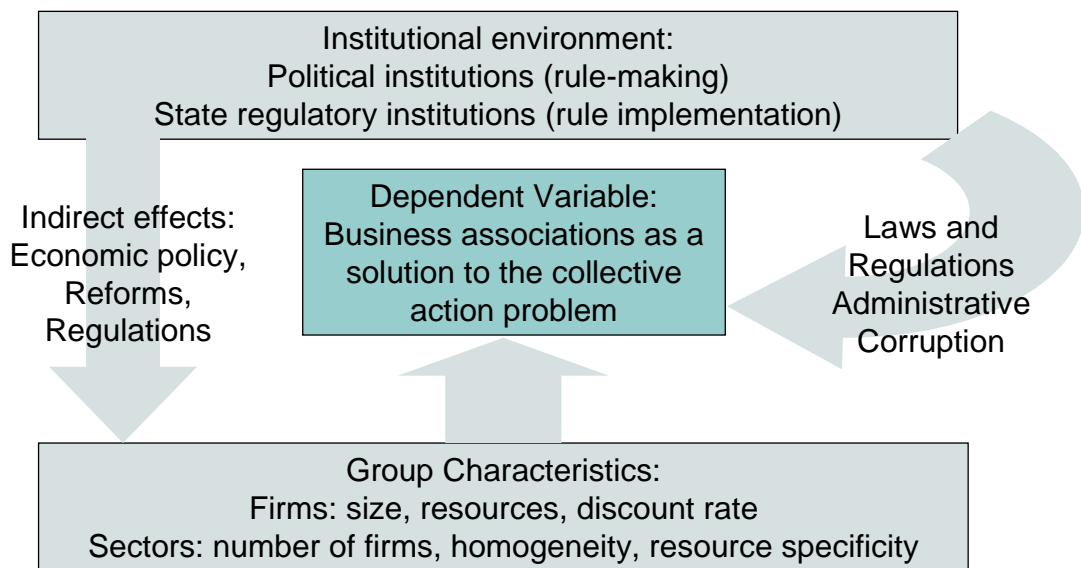
The top-down, or the supply-side, factors affecting group formation can be grouped into (1) the effects of political institutions that shape state policies towards interests groups and (2) business-state interactions—including the effects of the regulatory state institutions that shape the business environment. The former category includes the legislative framework for interest group formation and the existence of formal and informal channels of influence. The latter category includes the quality of state regulatory institutions as well as the extent of state regulation of businesses. It might or might not be an attribute of a particular stage of economic (capitalist) development. The study of interest groups cannot ignore institutional structures within which interest groups have to operate in order to achieve their goals. Although it is widely recognized that different institutional structures provide different opportunities for the formal organization of interest groups (Gray, 1989; Taagepera, 2003; Bawn & Thies, 2003), the specific relations between political institutions and interest groups are far from certain.<sup>7</sup> The effects of regulatory state institutions, on the contrary, have received extensive theoretical and empirical coverage.

Although the bottom-up and the 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 firms

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<sup>7</sup> For the review of the Americanist literature addressing the effects of political institutions on interest groups, see Tichenor & Harris (2005).

as well as the kinds of political and regulatory institutions that might shape the business environment. Policies of the state, on the one hand, can directly affect activities of business associations; on the other hand, they may alter the composition and interests of business community and through compulsory measures solve the classic free-rider problem. Simultaneity of such effects may result in the mutually reinforcing stimuli for group formation, or alternatively, in the multifaceted impediments to collective action. 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 business association formation.



**Figure 2.1:** Multi-level “nested” research design to investigate various causes of business associations’ formation



The following sections present hypotheses reflecting the demand (bottom-up) and the supply (top-down) sides of the business associations' formation puzzle. I outline my expectations about the effects of factors presented above and concentrate on the argument about the institution-shaped business environment that is central to my analysis of business association formation in post-communist countries. Other factors that are theoretically linked to successful collective action are discussed here as important control variables to be taken into account in the empirical research.

### **2. 2. 1 Demand Side Hypotheses**

The primary demand-side factors that I consider as having potentially important effects on business 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 a greater cultural predisposition to join associations and greater need for publicly legitimating their businesses.

One might also expect that large firms in good financial standing are more likely to participate in associations. The costs incurred by firms to join associations might be prohibitive to small firms and/or those with low profitability. Since business associations usually rely on the financial, organizational, and staff capabilities of their constituent members, the availability of resources 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 in 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, 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.

The central hypothesis with respect to sectoral characteristics is that firms in different sectors of the economy should have a differential incentive for organization. Capital mobility is an important factor that varies across industries. If Frieden's argument is correct, we should see asset specificity (immobility of capital across industries) be associated with more successful collective action. This would imply that sectors with highly specific assets (high levels of fixed capital) should develop strong sector-wide associations with many firms in a given sector participating. If conditions in a given

industry deteriorate, business will be reluctant to move to other sectors but, instead, will lobby 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 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.

Firm- and sector-level characteristics are important explanations for group formation; one however cannot reduce the analysis of business group formation solely to these factors. In the empirical chapters I probe their effects and evaluate their explanatory power. Still one should go beyond these explanations. While the theoretical foundations for the arguments emphasizing group- and industry-characteristics have been established, the theoretical foundation and the empirical research on the institutional side remains somewhat deficient for objective reasons. Unlike the rational choice framework that has a universalistic appeal, institutional arguments are necessarily context-specific—specific to the given institutions. The specificity of transitional economic and political institutions, for instance, precludes any direct extension of the existing institution-based arguments—such as the Schattschneider (1948) argument about the inverse relation between the strength of political parties and interest groups or the Stigler-Peltzman (Stigler, 1971; Peltzman, 1976) argument about protectionist industrial lobbies. I contend that, in the theoretical realm, institutional or supply-side arguments need further development partially due to the deficiencies of the existing arguments and partially due to the unique institutional development of the post-communist countries. First, I briefly review existing

theoretical arguments evoking institutional explanations, then I present my central argument.

### **2. 2. 2 Supply Side Hypotheses**

Existing theories of lobbying and group formation see state institutions as the recipients of group actions. Political actors and state institutions react to the offered contributions (Grossman & Helpman, 1994; Snyder, 1991; Groseclose & Snyder, 1996; Hall & Wayman, 1990; Stratmann, 1995; Wawro, 2001), revealed information (Austen-Smith & Wright, 1992), or potential popular mobilization from interest groups (Kollman, 1998; Gordon, 2001). 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.<sup>8</sup> The costs of lobbying and association formation can be altered by the state through laws regulating association formation and lobbying mechanisms. In 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 institutions 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, and infrastructure.

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<sup>8</sup> The reciprocal relations between state institutions and interest groups present a potential endogeneity problem. At the same time, in the context of the emerging systems of interest group representation, it would be safe to assume that the effects of state institutions would precede any potential impact the organized interest groups might have on political and bureaucratic structures.

Different political regimes provide dissimilar opportunities for 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. The 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.

Studies of democratic institutions suggest that the extent to which politicians are concerned with the overall well-being of society is directly linked to whether 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. This might make business associations unimportant channels of influence. Several factors contribute to political accountability. The type of democratic regime (presidential, semi-presidential, or parliamentary) and electoral rules influence the extent of accountability. Divided governments generally defuse responsibility while the fusion of power provides for clearer accountability.<sup>9</sup> 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

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<sup>9</sup> Lohmann & O'Halloran (1994) make an argument about the positive effects of decentralized political authority on the ability to lobby protectionist interests. They examine two alternative situations of the unified and divided government in the US and argue that: "divided governments may be associated with higher levels of protection."

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.

<b>Demand-side Independent variables</b>		<b>Supply-side Independent variables</b>	
Firm size	+	Laws regulating association	+/-
Ownership (private de novo, foreign)	+	formation Political	+
Financial standing	+	Openness/Democracy	+
Fixed assets	+	Decentralization of political authority	+
Concentration (firms per sector)	-	Corruption, ineffective bureaucracy	+/-
		Business-inhibiting regulations	

**Table 2.1:** Summary of hypotheses.

## 2. 3 RESEARCH METHODOLOGY

Theoretical arguments presented in the previous section call for a comparative analysis of the development of business associations across different sectors and countries in the context of post-communist economic reforms. This section outlines the methodological approach to my empirical research and the case selection issues. The research question at hand, as well as the hypotheses I formulate, dictates the choice of research methods. In applying research methods and selecting comparative cases, I follow the “nested analysis” research strategy advocated by Lieberman (2005). Since testable implications of my theoretical arguments operate at different units of analysis (firms, sectors, and countries), I employ various quantitative and qualitative techniques

when analyzing different sources of data. Results of my quantitative analysis guide the selection of comparative cases for the in-depth process-tracing qualitative research.

### **2. 3. 1 Methods and Levels of Analysis**

This dissertation uses multi-level data. I analyze data from a cross-national survey of businesses in 25 countries conducted by the World Bank in 1999 and 2002, survey data on Russian business associations, as well as qualitative data based on structured interview and oral history records describing the development of associations in four post-communist countries: Russia, Ukraine, Croatia, and Kazakhstan. By including large-N statistical analysis, comparative analyses of systems of business representation in four countries, and in-depth case studies of business associations, my dissertation explores association formation from different angles. The major advantage of employing a multi-method research strategy is the ability to tease out hypotheses pertaining to various units of analysis and thus operating at different levels. Considering multiple units of analysis (firms, sectors, and countries) allows for cross-checking the validity of inference.

The theoretical framework outlined in this chapter requires the use of multiple methods. Some implications refer to characteristics of firms, some to the characteristics of economic sectors, and still others operate at the macro level. When dealing with firms' decisions to join associations, the unit of analysis should be firms. When characteristics of groups of firms, such as fragmentation and interest concentration, are of primary concern, the unit of analysis is an economic sector. Macro-level implications require the cross-national comparison.

To test hypotheses operating at the firm level, I use quantitative analysis of the cross-national business survey data that provides two snapshots on associational membership across post-communist countries. I utilize data on 25 post-communist countries and introduce appropriate controls for sample heterogeneity. The primary reason for pooling survey data from 25 post-communist countries is that, despite increasingly divergent patterns of the post-communist development, they share many common pre-existing traits. Considering data on associational membership in all 25 post-communist countries allows for investigating the effect of regulatory regime and macroeconomic variables.

To test my hypotheses about sector-specific causes of group formation, I concentrate on the analysis of cross-sectoral differences in the extent of business associations' formation in Russia. Available quantitative data on the number and size of business association across 15 sectors of Russian economy is the basis for the comparative quantitative research. In addition to the quantitative analysis of sectoral variation in Russia, case studies of business association in Ukraine, Croatia, and Kazakhstan illustrate interest aggregation dynamics in different sectors.

Hypotheses about the effects of political institutions call for national-level comparative analysis. I analyze aggregate cross-national data and qualitatively compare systems of business representation emerging in Russia, Ukraine, Croatia, and Kazakhstan. I present descriptive analysis of these countries' business organizations and background conditions in Chapters 3, 5, and 6. Such descriptive analysis allows exploring similarities and differences in business interest representation related to these countries' differential experience with political and economic transition as well as the regulatory



regimes. I structure the presentation of country cases around the most representative associations, as well as associations bringing together firms from different sectors (Chambers of Industry and Commerce).

I select association cases based on the information learned from the statistical analysis of survey and aggregate data. The profiles of associations operating in different economic sectors in four post-communist countries add a temporal dimension absent from the cross-national and cross-sectoral analysis. Content analysis of programs, statements, and other documents produced by associations over time reveals an evolution in the aims, priorities, and strategies adopted by their leadership. Studying the evolution of functions and priorities facilitates investigation of the impact of important factors such as economic reforms and the changing political climate.

### **2. 3. 2 Country Cases**

Russia, Ukraine, Croatia, and Kazakhstan belong to different geographical and geo-political camps and had different experiences after the collapse of communism. Croatia experienced early and fast economic reforms, and, after an initial setback in democratic transition, was successful in building a democratic political system.<sup>10</sup> 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. Although

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<sup>10</sup> As a successor state to Yugoslavia, Croatia's early years of transition were tainted by war, ethnic violence, and exclusion. Xenophobic politics and restrictions on political expression marked the rule of its first president Franjo Tuđman. In effect, the Freedom House ranked Croatia partially free (score 4) throughout the 1990s. After his death in 1999, the power was peacefully transferred to the resident Stjepan Mesić, and the post-2000 politics are dominated by competition between nationalistic and liberal parties.

exhibiting strong similarities to Russia, Ukraine differs dramatically from its eastern neighbor as it recently made a drastic turn towards a more democratic political system. In Russia, consolidation of a “guided democracy” (Brown, 2001) is taking place, while Ukraine is experiencing a second wave of democratization and reform of bureaucratic structures. Kazakhstan serves as a representative case of stagnant political reforms coinciding with the moderate but steady economic performance. Although all of the selected countries have experienced periods of undemocratic rule, Kazakhstan has emerged as the most authoritarian of the four, adding an important political variation. Comparative analysis of these countries examines whether these divergent trajectories of post-communist development affect the emerging patterns of business-state relations. The comparison allows for examining the possible effects of different legal, political, and regulatory frameworks on businesses interest organization. Table 2 presents summary indicators for these four countries.

Indicator	Russia			Ukraine		
	1991	2000	2006	1991	2000	2006
Freedom House ranking	PF	NF	NF	PF	PF	F
Political Rights (FH)	3	5	6	3	4	3
Civil Liberties (FH)	3	5	5	3	4	2
Capture Index (Hellman)	...	32	...	...	32	...
Regulatory Quality	...	-.3	...	...	-.62	...
Corruption (CPI Rank)	...	82	121	...	87	99
Corruption (CPI Score)	...	2.1	2.5	...	1.5	2.8
GNI/Capita (\$) 2005	...	1,785	2,130	...	634	780
Indicator	Croatia			Kazakhstan		
	1991	2000	2006	1991	2000	2006
Freedom House ranking	PF	F	F	PF	NF	NF
Political Rights (FH)	3	2	2	5	6	6
Civil Liberties (FH)	4	3	2	4	5	5
Capture Index (Hellman)	...	27	...	...	12	...
Regulatory Quality	...	.19	...	...	-.74	...
Corruption (CPI Rank)	...	51	69	...	65	111
Corruption (CPI Score)	...	3.1	3.4	...	3.0	2.6
GNI/Capita (\$) 2005	...	4,206	4,540	...	1,310	1,780

**Table 2.2:** Country cases: Summary Indicators.<sup>11</sup>

I start my empirical research with the investigation of the creation of business associations in the Russian Federation, a country that has a mixed record in implementing economic and political reforms. Russia is a crucial case for investigating the post-communist patterns of interest group representation, nature of business-state relations, and the evolving capitalist economy. The country certainly does not follow the neo-

<sup>11</sup> Sources: Freedom House Country Rankings, <http://www.freedomhouse.org> (Free (F) ranging from 1 to 2.5; Partly free (PF) from 3 to 4.5; Not free (NF) from 5 to 7); Transparency International Corruption Perception Index (CPI), <http://www.transparency.org> reports the countries rank order with 1 being the most corrupt and 10 being the least corrupt; Hellman et al. 2002 (Index is based on the proportion of surveyed firms that report being directly affected by private payments made to public officials); Regulatory Quality (Kaufmann et al. 2003) index is measured in units ranging from -2.5 to 2.5, with higher values corresponding to better governance outcomes.

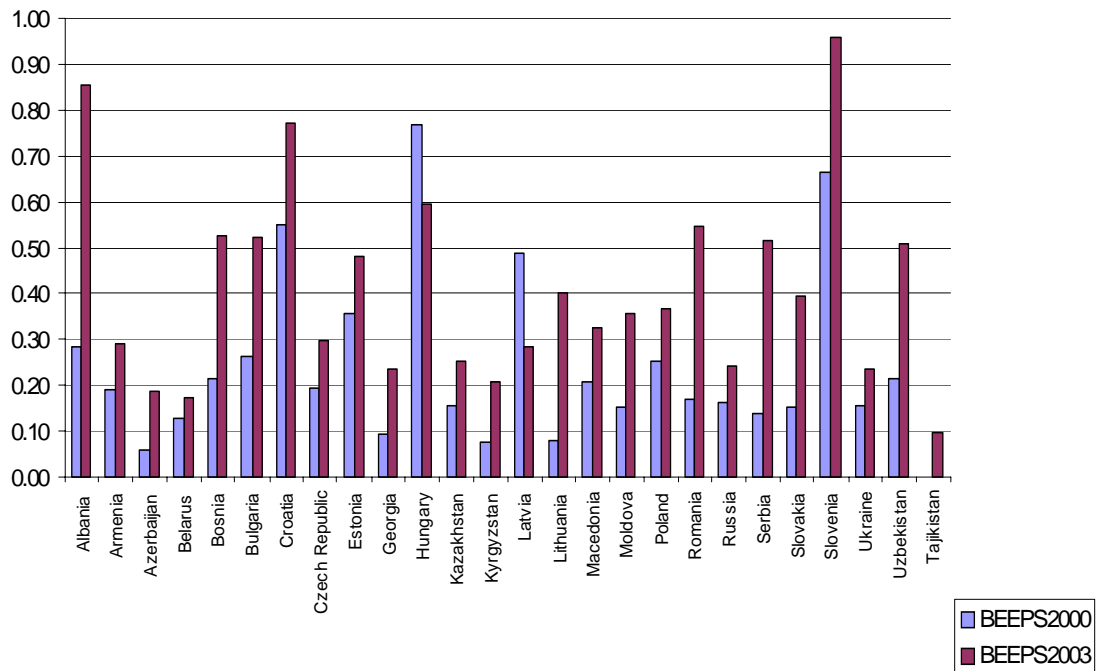
liberal economic blueprint; nor does it hold on to the soviet-era economic and political practices restricting private property. Analyzing the emerging roles of the legitimate channels of business interest representation in this post-communist country expands our understanding of the capitalist economy development. On the other hand, investigation of the emerging business associations contributes to the on-going exploration of economic transitions and evolving patterns of governance in Russia and points to the more general patterns that are shared by other post-Soviet societies.

Chapter 5 introduces Ukraine and Kazakhstan as country cases. Unlike a number of other post-communist countries (including Croatia), Russia, Ukraine, and Kazakhstan have no compulsory memberships in any of the civic or semi-official organizations uniting business.<sup>12</sup> Ukraine, unlike Russia and Kazakhstan, has less prohibitive legislation regulating the formation of social organizations. It also gives groups of citizens greater room for expression and influence. While Russia and Kazakhstan tightened state control over political parties and social organizations starting in the mid-1990s, Ukraine did not undergo a similar process. Greater levels of political competition allowed entrepreneurs to pursue alternatives to the formal association channels of influence that included political parties and individual political participation. Most crucially for my investigation is that an active political party of entrepreneurs exists in Ukraine but is absent in Russia and Kazakhstan. Does its existence affect the position of the business community vis-à-vis the state? Or, do the party and business associations

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<sup>12</sup> Russia and Ukraine are similar in other respects. Both are presidential, post-soviet, and for most of the post-communist period had comparable levels of civil liberties and political competition. Both are at similar levels of economic development (industrialization measured as a percentage of urban population is 73 and 68, respectively). What distinguishes these cases is the size and sectoral composition of the economy, GDP per capita, and organization of the state. Russia appears to be wealthier and better governed, but recently less free and responsive to input from society.

divide responsibilities by providing different services to their constituents? A comparison of Russian and Ukrainian business associations' development allows for investigating whether levels of political competition and the existence of a business party have an effect on the development of formal business associations. Specifically, it can provide an answer to the question of whether the availability of alternative means of influence (direct representation in the parliament or representation through the political party) precludes or promotes associational development.



**Figure 2.2:** Membership in business associations: Cross-national perspective.

Kazakhstan stands out as the most authoritarian of the four countries. Kazakhstan's early consolidation of the authoritarian regime distinguishing this country from Russia allows investigating the effects of non-democratic politics on the

organization of economic interests. Unlike other country cases, Kazakhstan is ranked low on the state capture index, suggesting that authoritarian regime won other the economic interests. At the same time, the regulatory capacity of the government remains low, suggesting that Kazakhstan is the most poorly governed country in the analyzed group. Whether such differences in political and regulatory environment have any affect of the formation and development of business association is an empirical question to be addressed by this research.

The overall levels of business group participation are similar in Russia, Ukraine, and Kazakhstan. These countries, as evident from Figure 2, are in the low-intermediate category in respect to business participation. Croatia, on the other hand, is an example of a highly participatory country. It also represents an alternative compulsory model in respect to the formal organization of business-state relations. It has compulsory membership in designated associations—the National Chamber of Industry, the Chamber of Crafts, and the Association of Cooperatives. This, at least on the surface, accounts for the higher levels of associational membership. In fact, of the top four most participatory countries, three have compulsory membership in the officially designated business associations. Introducing the Croatian case provides the chance to examine how such drastically different legislative framework affects the formation of business associations (compulsory and voluntary) and their interaction with the state.

### **2. 3. 3 Qualitative Data Collection**

While the quantitative data analyzed in this dissertation come from the existing sources, the qualitative data were collected first-hand. During my field research I

interviewed 53 officials representing business associations and state agencies in Russia, Ukraine, and Croatia (See Table 2.3). I also collected qualitative data on the development of business associations in Kazakhstan, although I was not able to travel to this country for personal interviews. My research visits to Russia in winter and fall 2005 resulted in 28 interviews yielding qualitative data on the development of 23 associations. I also communicated in writing with representatives of three additional associations who provided extended written answers to my questions. Majority of these were located in Moscow (20) while 3 were regional associations located in the provincial centers of Kaliningrad and Perm *oblast*'s. Five of my respondent did not represent business or employer associations, but were the state officials heavily engaged in contacts with such associations – an ex-deputy, a MP's staff member, a high-ranking official in the ministry of Economy and International Trade, and two provincial officials (one retired).

My research visit to Ukraine in March-April 2006 coincided with the parliamentary elections and resulted in personal interviews with 19 leaders of business associations and state officials. This gave me qualitative data on 16 national and regional (Kyiv city) business and employer associations. In addition I conducted interviews at the Ukrainian State Committee for Regulatory Policy and Entrepreneurship, the National Committee for Tripartite Negotiations, and independent research centers working on the problems of economic transition and civil society development. These contributed a more balanced information on the development of the system of interest representation in Ukraine.

In July and August of 2006 I interviewed representatives of 5 business associations in Croatia. One of my respondents has also been a high-rank government

official in late 1990s. During my visit to Zagreb I visited Croatian Ministry of Economy and interviewed an official presenting the head of the Office for Cooperation with NGOs. Table 3 lists associations I visited during my field trips. Although I was unable to make a research visit to Kazakhstan, I have collected extensive qualitative data on Kazakh business associations from printed sources, web pages, and e-mail correspondence. Appendix C contains the names and brief classification of Kazakh associations I identified as currently functioning in Kazakhstan. I was able to closely trace the development and activities of a number of these associations from published materials. Overall, during my field trips and scrupulous perusal of printed and internet sources I collected qualitative data on the development of over four dozen associations in these four countries.



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## RUSSIA

1. Union of Industrialists and Entrepreneurs (Employers) of Kaliningrad Oblast
2. Russian Union of Industrialists and Entrepreneurs
3. Union of Alcohol Producers “SUAR”
4. All Russian Social Organization of Small and Medium Size Business "Opora"
5. Russian Association for the Development of Small and Medium Size Entrepreneurship
6. Chamber of Commerce and Industry of Russian Federation
7. KSORR – Coordination Council of Business Associations of Russia
8. Russian Banking Association
9. Moscow Chamber of Commerce and Industry
10. Moscow International Business Association
11. Russian Franchising Association
12. Union of Ice-Cream Producers of Russia
13. Business Association of Confectionary Industry
14. Union of Manufacturers and Consumers of Packaging Products "SoiuzUpak“
15. Russian Constructors’ Union
16. Federation of Restaurant and Hotel Industry
17. Moscow Contractor's Club
18. Noncommercial Partnership "League of Trade Merchants”
19. Association of Trading Companies and Producers of Appliances and Electronics
20. Russian Association of Owners of Trade Marks
21. Guild for the Development in Audio-Video Trade
22. Russian Associations of Regional Banks “Rossiia”
23. Perm Chamber of Commerce and Industry

## UKRAINE

1. Association “New Formation”
  2. National Association for the Development of Trade and Services
  3. European Business Association
  4. Ukrainian Association of Business Incubators and Innovation Centers
  5. Ukrainian Franchising Association
  6. Ukrainian Union of Leasing Companies
  7. Civic Organization “Board of Entrepreneurs”
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Continued

**Table 2.3:** Business associations investigated through qualitative research.

Table 2.3 continued

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8. Association of Ukrainian Banks
  9. Union of Small, Medium, and Privatized Enterprises
  10. Federation of Employers
  11. Ukrainian Union of Industrialists and Entrepreneurs
  12. League of Entrepreneurs of Small and Medium Business “Left Bank”
  13. Tender Chamber
  14. Ukrainian Chamber of Commerce and Industry
  15. Construction Industry Union
  16. Association of Tobacco Companies

#### CROATIA

1. Association of Travel Agencies
2. Union of Entrepreneurs
3. Croatian Union of Cooperatives
4. Croatian Exporters’ Association
5. Croatian Chamber of Economy

#### KAZAKHSTAN

1. Kazakh Business Forum
  2. Almaty Association of Entrepreneurs
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**Table 2.3:** Business associations investigated through qualitative research.

### 3. 4 SUMMARY

Although the formation of business association is subject to a classic free-rider problem, a number of theoretical traditions offer powerful hypotheses about factors facilitating organization of interest groups, and economic interests in particular. None of the existing approaches seem to prevail on the theoretical level. Instead it appears that the formation of business associations should be facilitated by a number of factors descriptive of the latent group characteristics, economic conditions, and institutional

environment. In order to evaluate relative strength and validity of different theoretical approaches I developed an integrated analytical framework to guide this research. This framework integrates the bottom-up and the top-down approaches to group formation accounting on the one hand for group characteristics and underlying interest structure, and on the other, for the effects of macro-economic and institutional environment. A promising area of research lies at the intersection of these approaches. To empirically investigate such a multi-faceted process as formation of business organizations I employ a “nested” research design. This allows testing hypotheses that operate at different levels of analysis.

## CHAPTER 3

### **THE SUPPLY SIDE: FIRM CHARACTERISTICS AND SECTOR VARIATION IN RUSSIA**

*In times of rapid change, experience could be your worst enemy.*

Jean Paul Getty, US oil industrialist

This chapter introduces the first country case study and investigates the demand-side factors influencing the creation of business associations. Such factors include the characteristics of firms (size, ownership structure, resources) and economic sectors (concentration of capital and mobility of resources). These factors vary within each country, thus I test the impacts of such demand-side factors in one of the post-communist countries—the Russian Federation. The exploration of the formation of business associations within one post-communist country presents an opportunity to concentrate on the firm- and industry-specific factors and makes it possible to keep certain institutional, political, and macroeconomic factors constant. Without denying the importance of those latter influences on group formation, this chapter concentrates on the characteristics of the latent groups—firms and sectors of the economy—to develop an understanding of what makes businesses in certain sectors more likely to participate in

associations. Here I investigate such firm- and industry-specific factors and leave the investigation of political institutional effects to other chapters.

Russia is a crucial case for investigating the post-communist patterns of interest group representation, the nature of business-state relations, and sector-related differences as independent variables in the analysis of business association development. The reasons are the following. First, unlike some other post-communist countries (including Hungary, Slovenia, Croatia, Serbia, and Albania), at no point in its post-communist history did Russia have compulsory membership in any of the civic organizations uniting businesses and employers. Second, the nature of representative political institutions in Russia is not conducive to the vigorous associational life. For these reasons, Russia presents a crucial case for studying why businesses in certain sectors overcome the problem of collective action that in Russia might be more substantive than in other post-communist cases. Third, being a case of a moderate success in economic reform, Russia to this date retains many elements associated with a transitional economy, such as the presence of state-controlled enterprises and underdevelopment of non-state institutions of market self-regulation (Remington, 2004). This means that in Russia we are likely to find a greater diversity among firms in the extent to which they were reformed during the transition. Additionally, Russia has a large, diversified economy with considerable differences across sectors. If sectoral variation has an effect on the development of business associations, such an effect should be observable in Russia. Lastly, as a case of low associational membership levels (16% of businesses are reporting membership in 2000), Russia is a representative case for a large group of countries (17 out of 25) that in 2000

had a below 25% rate of business participation in associations.<sup>1</sup> Analyzing the emerging roles of the legitimate channels of business interest representation in this post-communist country can point to the more general patterns that are shared by other post-communist societies.

### **3. 1 DESCRIBING THE SYSTEM OF INTEREST REPRESENTATION IN RUSSIA**

Characterizing the system of business and employer associations in Russia is a hard task due to both the number of such associations and, more importantly, to the tremendous diversity in their forms, scope, interests they represent, structure of membership, and the functions and activities of these associations. Without a clear picture of how the associational landscape looks in Russia, it is hard to start investigating the issue of why businesses join associations in this country. Here I describe the patterns of development of business associations in Russia drawing mainly on qualitative evidence collected during two research visits to Russia in the winter and fall of 2005. I interviewed 31 officials representing 24 associations. I also communicated in writing with representatives of three additional associations who provided extended written answers to my questions. The majority of these were located in Moscow (23) while 4 were regional associations located in the provincial centers of Kaliningrad and Perm *oblast*'s. Additionally, five of my respondents did not represent business or employer associations but were the state officials heavily engaged in contacts with such

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<sup>1</sup> Figures are from BEEPS 2000, World Bank. According to the 2003 survey, however, Russia, with its membership level of 25%, falls in a much smaller group of 11 countries (out of 26) with membership levels below 30% of firms.

associations: an ex-deputy, a MP's staff member, a high-ranking official in the ministry of Economy and International Trade, and two provincial officials (one retired).

I also draw on the quantitative data from the national survey of business associations and data on business associations provided by the Division of Membership of the Chamber of Commerce and Industry of Russian Federation (CCI RF). The survey of business associations was conducted in 1999-2000 by the Russian Institute for Entrepreneurship and Investment (IEI). Of over 1,500 business associations existing in Russia in 1999 and contacted by the Institute, 325 have participated in the survey. This amounts to about 20% of the business associations that existed in Russia according to official records. Given the difficulty of removing the official record once an association ceases to exist and also given the large number of inactive associations, this provides a conservative but more realistic estimate of the active part of the business association sector. The survey elicited information about legal form, foundation dates, size, sectoral composition of membership, scope, and goals and activities of the participating associations.

A number of Russian business associations received attention in the media and scholarly publications. Looking at the amount of articles written on RUIE (Russian Union of Industrialists and Entrepreneurs), RPA (Russian Producers' Association), *Opora*, and CCI (Chambers of Commerce and Industry), one might get a false impression that the Russian system of interest representation is dominated by large encompassing peak associations representing the interests of business at-large. Most analysts describe these associations as well established and reputable (Remington, 2004), although not particularly influential (Peregudov & Semenenko, 1996; Kubicek, 1995; Rutland, 2001,

Fortescue, 1997). Lobbying is seen as the major purpose of such associations and rarely are associations judged as particularly successful channels of influence. Much more often we see an argument suggesting that individual enterprises are better capable of representing their interests either through informal influence or through direct participation in politics (Peregudov & Semenenko, 1996; Fortescue, 1997; Rutland, 2001; Remington, 2004).

In the following pages, I present quite a different assessment of the system of business and employer associations developed in Russia by 2005. Most of what we know about Russian industrial interests is coming from the research done early on in transition. By 2005, the composition of Russian business (in terms of ownership structure, resource availability, market position, and development opportunities) has changed dramatically, leading to the changes in the interests of business community. At the same time, the 21<sup>st</sup> century brought about a redefinition of the relationship between the business community and central state institutions (Remington, 2004, p. 155). As a result, many notions developed in early 1990s are no longer applicable. It would be erroneous to think about Russian business associations in 2005 in terms of the work done in early 1990s. As a background to the quantitative research resented in the section 3 of this chapter, I first provide a qualitative description of the system of business representation that emerged in Russia by 2005.

### **3. 1. 1 Large Number**

It has been a daunting task to estimate the number of existing business associations in Russia. Although Russian legislation strictly regulates the process of



establishing civic associations and requires all organized groups to apply for official recognition by the state authorities (to “register”), incorporation/registration registries are not particularly useful in identifying the number of business associations.<sup>2</sup> Different sources suggests that there are between 300 (Volkov) and 1500 (IEI) business associations currently functioning in Russia. Such divergent estimates reflect Russian realities. On the one hand, many of those business associations that exists on paper, in fact, have ceased to exist; on the other, a large number of local and regional associations that register with the local authorities rather than the Ministry of Justice exist bellow the radar of Moscow business activists, statisticians, and researchers.

Even by the most conservative accounts, Russia has an impressive number of associations. This is in a drastic contrast to what is suggested by scholarly accounts, mainly focusing on RUIE, Russian Business Roundtable, CCI, and the Federation of Commodity Producers (FCP) (Remington, 2004; Fortescue, 1997; Peregudov & Semenenko, 1996; Kubicek, 1995).<sup>3</sup> Such exclusive attention to the few top associations suggests that such encompassing associations bring together diverse industry and commercial interests—banks, top production companies, or energy exporters—and dominate the formal system of interest representation in Russia. Focusing attention on the

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<sup>2</sup> Business associations may register with state authorities under three legal forms: association/union, civic organization, and non-profit partnership. Other civic associations use the same legal forms to legitimize their existence. Thus, looking at the statistics on the number of civic associations in Russia, it is impossible to discern business associations form other kinds of civic associations. Looking through the Ministry of Justice registries is also unsatisfactory: it is very hard to identify a business association by its name. For example, the name “Civic Association Opora Rossii” (Russia’s Support) hardly explains that this association represents small and medium-size business.

<sup>3</sup> See brief mentioning of such associations as the Coordination Council of the Employer Organizations (CCEO), Leaseholders Union, Union of Cooperatives by (Peregudov & Semenenko, 1996), and Association of Russian Banks (ARB) (Fortescue, 1997).

top national associations exclusively has led some observers to conclude that a corporatist system is developing in Russia (Kubicek, 1995).

On the contrary, peak national associations—the mega-level associations in Cawson’s (1985) terms—are not the only type of associations existing in Russia; neither do they unite the majority of participatory firms. The most typical Russian firm that has chosen to join an association, joins a regional or sectoral association that might or might not be a part of national umbrella group. According to the IEI survey, 65% of Russian associations have fewer than 100 members, while only 9.7% of associations unite more than 1,000 members. Of the 357 business associations for which I have data, 48 have either national or international status, 24 are inter-regional, and the remaining 285 operate at the regional and local levels. IEI estimates that 49% of all surveyed associations operate on the regional and 35.6% on the local levels, while only 7.6% and 7.3% operate on the national and international levels respectively.<sup>4</sup> According to the survey, regional and local associations unite 215,423 members while national associations unite 107,383 members. It should also be taken into account that the majority of the all-Russian associations estimate their membership based on the figures reported by their regional and local branches, meaning that most of their members join regional/local organizations rather than national organizations directly.

The above figures suggest that the all-Russian high-visibility associations constitute only a small proportion of all associations existing in this country today. The majority of enterprises that join business associations become members at the regional

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<sup>4</sup> Regional and local associations are more likely to be left out of the IEI survey due to the absence of data about their existence. Thus, the reported figure is likely to underestimate the number of regional and local associations.

and local levels. Thus, the focus on the national-level pick associations appears to be unjustified. Such focus misses the majority of Russian business associations and the larger number of firms participating in them. Thus, it is important to incorporate regional and local associations into the study of the Russian system of business representation.

### **3. 1. 2 Organizational Bases and Structural Forms**

As the above discussion demonstrates, a vast number of Russian associations function at the regional and local levels. Some of these regional and local associations are integrated into the larger inter-regional groups, and some of them comprise the membership structure of the national associations. Such hierarchically (vertically) integrated structures are the central organizational principle of the national associations. Although vertical integration is widespread in Russia, and below I describe the reasons why this is the case, this is not the dominant way formal interest representation is organized in this country. A large number of associations do not belong to any of the vertical structures but are, instead, integrated in horizontal networks.

Examples of such vertical and horizontal links can be seen in the structure of the Chambers of Commerce and Industry and in the network of business associations representing small/medium size business. The CCI of Russian Federation has regional organizations in all 89 sub-national territorial units as well as in a number of localities. These sub-national (regional and local) CCIs are largely independent from the national CCI in their operations and financing. Their membership, activities, and influence vary considerably from region to region. Horizontal links are evident in the cross-membership of different business associations, such as the Russian Franchising Association,

Association for the Development of Small and Medium-Size Business, and the Russian Shareholders Association, which are associational members in one another. Similarly, RUIE is a member of CCEO and leaders of CCEO occupy important positions in RUIE.

Such a pattern of vertical and horizontal linkage is an important characteristic of the Russian system of interest representation. One author has investigated the issue of a firm's membership in multiple associations and concluded that such crosscutting membership is traceable to both the organizational weakness of associations and to the firms' desire to spread the risks and opportunities presented by multiple access points to the political decision-making (Lehmbruch, 2003). The explanation for the horizontal and vertical integration among Russian associations, however, differs from the ones provided for the firms' decisions to join multiple associations. Legal regulations have directly shaped the structure of vertical and horizontal integration.

Russian law prescribes a territorial basis for associational formation. The Ministry of Justice and the local authorities are responsible for registering associations that unite firms or individuals in a given territory. This is the process of the official registration of a civic association. In the absence of such registration, an association cannot open a bank account, collect dues, or rent an office. An association can claim a provincial (*oblast*/republic/autonomous republic) status if its founding members reside within provincial boundaries and file an incorporating charter with the provincial authorities. The status of an all-Russian association is granted to those associations that unite members representing more than a half of the 89 Russian regions. The inter-regional

associations are those that operate on the territory of more than one region<sup>5</sup> (Civic Code). It becomes clear that for an association to claim legitimacy in representing industrial or business interests at-large, the status of an all-Russian association is important. Thus, the legal framework places a pressure on top business associations to open their offices in regional centers and enlist regional members.

The legal frameworks regulating formation of associations are also responsible for a peculiar pattern of horizontal associational cross-membership: when one association becomes a member in another association while retaining its autonomy. Three different pieces of legislation (in addition to the Civil Code) prescribe legal forms for organizing business and employer associations. A business association in Russia may exist in three different legal forms: a civic organization (Law on Civic Organizations, May, 1995, amended in 1997 and 1998), an association/union (Law on State Support for Small Entrepreneurship, June, 1995, amended in 1998), or a nonprofit organization (Law on Non-Profit Organizations, November, 1996, amended in 1998 and 1999). These legal organizational forms differ in the requirements for forming an association. Firms cannot be members (only personal or associational membership is permitted) of a civic organization, and to establish such a legal entity, other civic associations usually sign on as founding entities. A union/association, on the contrary, cannot accept personal membership, but only firms or other civil associations can be members. These two, however, were the most popular legal forms under which business associations registered

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<sup>5</sup> Of 356 associations for which I have data, 5 have international status, 43 are all-Russian associations, and 24 are inter-regional. The majority of associations are organized at the regional level (159), and 125 associations operate at the local level. It is interesting to note that inter-regional associations constitute a small proportion of associations: there are fewer inter-regional than all-Russian associations.

in the mid 1990s.<sup>6</sup> Prior to 1995, the process of registering a new association was less complicated for associations whose founding members included other civic organizations. This explains why many associations have other associations as their (founding) members.

The other important characteristic that is often overlooked by analysts focusing on the largest all-Russian associations is the differential bases on which associations are formed. Contrary to the prevailing notion, a large number of business associations in Russia do not aspire to encompass diverse business interests. Unlike large peak associations that seem to (or claim to) represent business at-large, a growing number of business associations organize on sectoral, professional, or issue-specific principles. Growth of sectoral associations became most prominent in the late 1990s and early 2000s. IEI reports that 40% of Russian business associations are organized on the sectoral principles.<sup>7</sup>

Some associations are formed on the strictly professional principle. For instance, the Bar Association, the Associations of Realtors, and the Expeditors' Association represent such professionally-based groups. Other associations are not organized along

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<sup>6</sup> IEI estimates that 48% of Russian business and employer associations register as civic organizations, 30.4% as unions/associations, and 21.6% as nonprofit partnerships.

<sup>7</sup> The issue of sectoral representation in Russian business associations is a debated topic. Some authors argue that many peak associations, such as RUIE or the Federation of Commodity Producers of Russia, in fact, represent specific sectors of the economy. Hanson and Teague (1992) claim that RUIE represents the interests of defense industries, McFaul (1993) and Lohr (1993) insist that it represents declining industries, specifically auto- and machinery producers, Fortescue (1997) admits that RUIE has additionally included the financial sector. Such conclusions are usually based on the analysis of the founding members of the Union, and the industry background of leadership. Thus, depending on the time of one's analysis, it would be safe to portray RUIE as a club of red directors, financial tycoons, or private sector oligarchs. If one, however, looks at the entire range of enterprises and sectors represented by RUIE as early as 1992, it would be hard to determine the sectoral specificity of this organization. The most important factor that signifies the cross-sectoral maturation of this association is its leadership's commitment to bringing diverse business interests into its organizational base.

professional lines, but unite firms involved at different stages of the production chain of a certain product. The Association of the Ice-cream Producers, for example, unites milk-processing plants, ice-cream makers, producers of refrigerators, and distribution networks. Some cross-sectoral associations also have a much narrower focus than their general status would imply. For instance, the Association of Trademark Holders is not a sectoral organization. It unites law firms, large domestic and foreign producers, and trading companies in diverse lines of business. The Association concentrates on the issue of protecting intellectual property rights associated with trademarks. The Association for the Development of Small and Medium Business (ADSMB) unites such diverse enterprises as small retailers, sub-contractors, bakeries, taxi companies, and private dentists. Although it is not a sector-based association, it focuses on a much narrower range of issues (specific to small business) than general associations such as CCI or RUIE.

Sector- and issue-based associations, similarly to the cross-sector associations, engage in hierarchical and horizontal relations with other associations. The National Farmers Union and the ADSMB, for instance, have their regional offices in other a half of Russia's regions that allows these associations to claim national status. Sector- or issue specific-associations also join general associations organized on territorial basis. Although similar to the general associations in their organization, membership, and internal structure, sectoral associations differ substantially from those associations that are not organized on sectoral principle. A sectoral basis for organization implies different relations among the members of association, different demands on the part of the membership, and different opportunities for satisfying these demands. Thus, to

adequately describe the system of business associations in Russia, it is important to pay attention to the sector-based associations. Table 3.1 presents a typology of Russian business and employer associations in respect to their structural forms and organizational bases.

Organizational basis Structural form	General	Sectoral /Professional
National	<b>Peak Associations/Umbrella Groups</b> <i>(e.g. RUIE, CCI, FTR)</i> <b>Issue-specific National</b> <i>(CCEO, Small-Medium Business)</i>	<b>Nation-level Sectoral</b> <i>(ARB, RATEK, Realtor's Guild, Association of Confectioners)</i>
Inter-regional	<b>Umbrella organizations for regional general or issue-specific groups</b> <i>(Fareast Confederation of Businesswomen, Moscow International Business Association)</i>	
Regional	<b>General</b> <i>CCI of Perm Oblast'</i> <b>Issue-specific</b> <i>Tambov Association of Small Entrepreneurs</i>	<b>Sectoral/Professional</b> <i>Novosibirsk Developers of Scientific-Industrial Products, Pharmaceutical Association of Krivoi Rog</i>
Local	<b>General</b> <i>Union of Entrepreneurs Arhari village, Amur Oblast</i> <b>Issue-specific</b> <i>Center for Development and Protection of Small Business, Krasnodarskii Krai</i>	<b>Sectoral/Professional</b> <i>Rostov Organization of Private Taxi Owners, Kostroma Realtor's Guild</i>

**Table 3.1:** Typology of Russian business associations



### **3. 1. 3 Membership**

It logically follows from the above discussion that associations organized on differential organizational bases should also vary. Such variation is considerable in both the size of membership and the kind of firms joining associations. The membership of national peak associations is considerably different from the membership base of sectoral association organized on local level. Here I describe the major lines of distinction among members of associations operating at different levels and organized on different bases.

Members of large national associations received the strongest scrutiny in the literature. The large membership base of the national peak associations is one of the reasons why they receive most attention in the literature. The fact about RUIE mentioned by all of the researchers—and the point of pride for the association itself—is that by the time of its formation in 1992, the association had over 2,000 member firms jointly producing 65% of country's GDP. In 2006, RUIE was claiming 328,000 members (firms and individuals). Its member enterprises produce 85% of Russia's GDP. The CCI estimates its membership at 20,000 firms. Such extensive coverage has given observers a reason to see Russia as an emerging neo-corporatist model of interest representation (Kubicek, 1996).

It should be kept in mind, however, that a vast majority of enterprises counted in these figures join national umbrella associations indirectly, through their membership in regional branches or affiliated groups. Within the RUIE, there are over 100 sectoral and issue-specific associations operating both at the national and regional levels. The CCI unites 178 sectoral and issue-specific associations in addition to its 169 territorial chambers. Among CCI members, only 38 are commercial entities. The remaining

massive CCI membership is comprised of the membership of the regional chambers and member associations. An important issue in characterizing the Russian system of interest representation is to assess the degree of autonomy member associations enjoy within the corresponding umbrella associations. If umbrella groups are tightly controlling member associations, this might provide for a vertically integrated system of the neo-corporatist type.

In Russia, this seems not to be the case. Business associations frequently affiliate with multiple umbrella groups. The Association of Russian Banks (ARB), with its 543 members, and the Russian Association of Wood-Processing and Furniture Industry, with its 40 members, for instance, are members of both the CCI and RUIE. Such crosscutting membership makes it impossible for the peak associations to effectively control the activities of member associations. In addition to the reasons discussed above in relation to the organizational structures of associations, the reasons for such crosscutting membership include networking considerations. The president of the Association of Trade Companies and Producers of Consumer Electronics and Computers (Russian acronym RATEK), Mr. Pliatsevoi, stated in an interview that, as a new association, RATEK made the strategic decision to join all major associations, consultative councils, and working groups actively functioning in Moscow. This gave RATEK access to high-level state officials and informational and organizational resources and supported the association's efforts to position itself to potential members, state agencies, and competing interest groups. Paying the dues in umbrella groups was worth the benefit of making the association's position and activities known to politicians and industry participants. Once the association had established itself, Mr. Pliatsevoi told me, there was no need to

continue participating in activities organized by other associations. Thus, the association withdrew itself from activities not directly related to satisfying the demands of its members and terminated its membership in many of the groups it had initially joined. RATEK, however, retains its membership in the CCI, since, as Mr. Pliatsevoi suggested, it offers an indispensable informational advantage. This example illustrates that mutual cross-membership of Russian business and employer associations is a method of networking rather than a form of organizational dependency and hierarchy.

A largely debated aspect of associational membership is the question of who joins business associations and whose interests do associations represent.<sup>8</sup> The literature concerned with the top national associations, such as RUIE and others, does not provide a conclusive answer to the question of whose interests dominate their agendas. For the RUIE—the usual focus of most of the research—different authors point to the “red directors,” financial tycoons, and oligarchs as the dominant interest. The biggest irony of such assessments is that the interests of these different actors are antithetical. While the red directors, or the managers of state-controlled enterprises, have been the proponents of the retention of state subsidies and trade barriers, the “oligarchs” championed the reduction of export controls as well as state withdrawal from the economy. Some authors identified even the narrower interests as being dominant in RUIE, such as the heavy (McFaul, 1995) and defense (Lohr, 1993) industry or automobile and agricultural

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<sup>8</sup> In many treatments, however, these questions are seen as separate. One might argue that membership, or who joins associations, is not necessarily indicative of whose interests are represented by such an association. A rather narrow group, advancing its parochial interest at the expense of the larger membership, might hijack an association. Without denying such a possibility, I doubt that such a hijacked association would be able to retain and expand its membership over time. I make a simple assumption that if businesses join an association voluntarily and at a cost, they expect certain benefits in return. If an association does not respond to the expectations (does not represent the interest of its members), there is no reason to expect that it would be able to sustain its membership.

machinery industries (Hanson & Teague, 2005). In the early 2000s, the same organization is seen representing the interests of private sector oligarchs, specifically the energy exporters and raw material processing industries.

Analysts who try to find a clearly identified interest behind such umbrella associations as RUIE, CCI, or FCP usually overlook or downplay their multi-sectoral nature. However, an absence of a narrowly defined constituency, program of action, or interest area is an important characteristic of the nation-level peak associations. Fortescue (1997) notes the lack of a unifying element in the extremely diverse membership structure of RUIE and other umbrella groups as an important limitation for their success: “The RUIE has tried to please everybody [industrial interests, financial sector, and new private sector] and has ended up pleasing nobody” (p. 138). Although the political and economic significance of the red directors in the early and mid 1990s and private-sector oligarchs in the late 1990s to early 2000s should not be denied, it is important to stress the danger of equating the interests of these groups with those of national umbrella associations such as RUIE, CCI, FCP, and CCEO. From the early years of their existence, the leadership of these associations made consistent efforts to attract diverse business interests—the efforts were consistent with their desire to develop peak associations as legitimate channels of business representation (Primakov, 2002; Volskii, 2005).

The absence of a clearly defined, narrow constituency, however, is not a universal feature of Russian associations. The regional, sectoral, and issue-specific associations have a much smaller potential membership base and attract firms that share much in common: sectoral membership, professional orientation, ownership, scale, and specific

issue focus. In Russia, there is a great degree of variation in the development of business associations representing different sectors of the economy. Fortescue (1997) noted the fact that sectoral association, although promising a more stable ground for collective action, are absent in many sectors that used to be the strongholds of the soviet economy. Despite such absence of sectoral representation in some sectors, it would be misleading to characterize the Russian system of interest representation as lacking sectoral representation. One peculiar aspect that emerges from the analysis of quantitative data is the greater number of sectoral associations representing the service sector (personal services, trade, financial, and professional services), and the fewer associations representing mining, natural resource processing, and heavy industry. In the quantitative part of this chapter, I address this issue and propose an explanation.

The issue of individual vs. firm membership deserves some attention. As should be clear from the discussion of the legal requirements for forming an association, individual vs. firm membership is largely dictated by formal requirements imposed by the law. My interviews with representatives of business associations suggest that no distinction usually is made between individual (by firm's top manager) and firm's membership. The majority of associations have the same dues for individual and firm membership. However, many associations differentiate between full and associate membership. Full membership usually affords a member voting rights at meetings and congresses but comes at a price of higher initial and/or yearly dues. Such differentiation allows associations to attract some members that might be deterred by high amounts of required contributions.

### **3. 1. 4 Functions and activities**

Another widespread misconception about Russian business and employer associations is that their primary activity is to lobby. Although many associations are involved in lobbying, the majority of their interaction with the state institutions is better characterized by the term “representation.” Representation implies a less active stance on the part of business associations. Although not all associations lobby, virtually all of them offer services to their members (selective benefits) and potential members (private and collective benefits). Below I address lobbying and the provision of services as two major spheres of associations’ activities.

#### *Lobbying and Interest Representation*

It is often assumed that interest groups (and business associations, in particular) organize to lobby the interests of their members.<sup>9</sup> Carrying this assumption to the analysis of Russian business associations has led many authors to conclude that business associations are weak and unimportant defenders of firm’s interests. The success stories of lobbying by business associations are few. At the same time, scholars point to the ability of corporations and financial-industrial groups<sup>10</sup> to lobby their economic interests more efficiently (Peregudov & Semenenko, 1996). Some scholars have claimed that business associations and political blocks formed by them in the early 1990s (the Civic Union and the Party of Economic Freedom) represent the “political” wing of lobbying in Russia while most of the “economic” lobbying is generally done by the large

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<sup>9</sup> In fact, lobbying the government is usually included in the definition of an interest group (Salisbury, 1991).

<sup>10</sup> For the description of Russian financial-industrial groups, see Rutland (2001).

corporations and financial and industrial groups directly. The difference between these two forms is that while the former concentrates on influencing the contents of laws and uses political channels of influence, the latter is primarily concerned with extracting favors and defending the parochial interests of specific firms through informal channels (Fortescue, 1997).

Perhaps the most important accomplishment in advancing the interests of its constituency has been credited to RUIE. Peregudov and Semenenko cite the 1991 law on privatization as an important accomplishment of the RUIE's predecessor, the Scientific and Industrial Union (SIU).<sup>11</sup> The adopted privatization law allowed for the "insider" privatization scheme resulting in transferring the ownership of large state enterprises to the hands of their managers. Another victory for the red directors dominating the RUIE, according to Remington (2004) and Fortescue (1997), was the replacement of reform-minded prime-minister Chubais by centrist Chernomyrdin in 1992. The RUIE has voiced its disagreement with the government headed by prime-minister Chubais, but it is hard to establish a direct connection between the RUIE antigovernment lobbying and the replacement of Chubais. In the late 1990s, little in terms of influence has been attributed to the RUIE, and it was virtually forgotten by the media and researchers until 2000 when president Putin held a number of closed-door meetings with the association's leadership, encouraging the organization to expand its ranks and inviting it to play a larger role in Russian economic policy making. An important question is whether the lobbying history

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<sup>11</sup> SIU was organized as a USSR organization in 1987 by a the general manager of the Moscow car manufacturing plant, Arkadii Volskii. After the collapse of the USSR, the union was reorganized as RUIE and Volskii served as the president until 2005. Alexander Shohin, who has been the minister of economy and the first deputy prime minister in the mid-1990s and later occupied leading positions in the Federal Duma, replaced him.

of the RUIE is representative of the activities undertaken by other business associations. Do different types of associations have differential lobbying records?

Available quantitative data demonstrates that about 90% of associations report lobbying as one of their primary activity.<sup>12</sup> This however, may be a result of following the standardized language required for an official registration of a civic organization with the Ministry of Justice or with the local authorities. Only 20% of respondents in the open-ended interviews mentioned being involved in lobbying. When specifically asked about whether the goal of their organization is to lobby the interests of their members, most of the respondents referred to their founding documents and accepted that they lobby occasionally, but only a few could remember specific issues and organizations they have lobbied in the past. To check whether such response is prompted by negative perception of lobbying, I followed the inquiry with a question about how the lobbying is perceived by a larger public (press, the people, and politicians) in Russia. Only in two instances, did I receive a response suggesting a negative public image of lobbying.

To find out whether lobbying is an important part of activities undertaken by business associations, I asked representative of 27 business associations about their interaction with state institutions (ministries, local government, legislative, and executive authorities). Seventeen associations interact with state authorities through formally established channels such as councils, working groups, committees, and expert centers. Representatives of business associations are usually permanent members in these bodies. Some associations have actively participated in the creation of these channels of representation; some were invited by the state authorities after such bodies were created.

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<sup>12</sup> The most widely used statement of organizational goals is formulated as “the protection of members’ rights and interests.”



For business associations, participation in these consultative institutions offers a channel of representation. It allows them to have regular access to the political decision-makers and higher-level bureaucrats. The level of influence of such consultative bodies varies depending on the wishes of state institutions (individuals occupying the public office). The Entrepreneurs' Council under the Moscow City Government, for instance, lobbied for and was granted the right to veto any city bill that has an effect on the operation of business in virtually all spheres of economic activity. The consultative group under the Russian government, including representatives of RUIE, ARB, and other major nation-level associations, on the other hand, has demonstrated its inability to influence the government and is largely perceived as an approval stamp for all major government initiatives.

When asked about lobbying and interest representation, the majority of my respondents admitted that business associations are not the most effective means of lobbying. "We cannot help each of our members to solve specific issues plaguing their business. Instead, we try to influence the government by educating them about problems common to all our members," replied the president of the Association for the Development of Small and Medium Business, V. Ioffe. Leaders of other associations made similar points. They admit to lobbying, but distinguish the kinds of issues they lobby from the issues usually lobbied by corporations. "It makes little sense for an association to promote the narrow interests of few members, we lobby for our sector, and these are the legitimate concerns," stated the executive director of the Association of Ice-cream Producers in an interview.

When associations lobby, how do they do so? Besides the consultative institutions existing at the different levels of executive and legislative authorities, Russian political and administrative systems offer multiple opportunities to lobby. Fortescue (1997) and Peregudov and Semenenko (1995) describe public opinion formation as one form of lobbying activity undertaken by business associations. Although opinion formation is not directed at the political authority per se, associations' publications, conferences, statements in the press, and reports prepared by expert groups have the potential to advance the business associations' agenda. An important tool of influence is associations' expertise in evaluating the effects and consequences of proposed government policies. Many general (RUIE and CCI), issue-specific (CCEO), and sectoral (ARB, Guild for the Development of Audio-Video Trade, and others) associations have established research departments (in the case of the RUIE, an affiliated research institution) that conduct monitoring of the legislative and regulatory environment. Such departments periodically release their expert analyses and prepare special reports on the issues and events of particular concern to associations' members. Such expert analyses often make their way to the corridors of power and inform political decision makers about the current situation in a particular industry/ problem area.

Despite the country's super-presidentialism, in Russia, legislative politics is not discounted as channel for lobbying. Although all the major attempts to organize a business party have failed in Russia in early 1990s, business interest can find its way into the parliament in two ways. Some businessmen are elected to the regional and national legislatures, and the single member district system has contributed the majority of businesspeople in the Federal Duma—the lower house of Russian parliament (*Novye*

*Izvestiia*, 2003). After the 2003 elections, about a quarter of deputies in the Duma had business backgrounds. Russian legislature is also characterized by relative openness to lobbying pressures. Russia does not have a legislation that regulates lobbying and political contributions, making parliamentary lobbying a murky activity. *Novye Izvestiia* report a fee of 50,000 to 70,000 US dollars to be paid in bribes to a deputy for introducing a bill to the floor, and a 250,000 to 300,000 dollars (payable presumably to the faction leaders) for passing a bill as a federal law. (In Russia, any deputy as well as a committee may introduce a bill and the parliament must approve a bill in three readings before it may become the law.)

Government institutions at the ministerial and regional levels are also subject to lobbying. The focus here, however, is on rule implementation. Thus, lobbying bureaucrats offer a much better advantage to the individual firms seeking exemptions and special treatment that can be granted by a bureaucratic agency. The modest position of associations in respect to lobbying has been contrasted in the literature with the active lobbying by individual firms. Limited lobbying by associations, therefore, is likely to be linked to the abundant opportunities for individual lobbying presented by the Russian political and administrative institutions. Much of the influence is exerted through informal consultations and meetings that not necessarily imply bribes and financial favors (Rutland, 2001). Not all corporations, however, can get access to legislators and ministers to benefit from such informal contacts. Associations, therefore, especially those that have established themselves as serious players, are sometimes better positioned to utilize such informal contacts. Overall, different channels of influence existing in Russia offer different opportunities for business associations. Associations are effective in opinion

formation and some informal contacts, but the channels of legislative and bureaucratic lobbying hardly give advantage to associations over individual firms.

### *Member Services*

If only some associations are actively engaged in lobbying, all associations that I have qualitative data on provide various services to their members. I group such services and member-oriented activities into two categories. Some are directed specifically to the association members, and others target the associations' constituency at-large without discriminating between members and non-members. Such orientation is sometimes traceable to the nature of the services provided: some services cannot be provided to the members without benefiting non-members. In the language of the collective action literature, these are non-exclusive goods. However, some associations make strategic decisions to offer perfectly excludable goods to non-members at extra charge, to raise money. Russian legislation restricts commercial activity of business associations registered as a union or an association. At the same time, civic organizations and non-profit partnerships have the right to supplement their budgets by commercial activities, including service provisions. Such legal restrictions, together with the specific needs of constituencies, determine the types of services provided by associations.

The list of services provided by associations ranges from distributing information via publications and newsletters to developing business plans and material assistance. Table 3.2 summarizes the services offered by associations and is based on the IEI survey data. The most frequently provided services are information, legal support, and consulting. These are closely followed by marketing and investment assistance. The least

frequently mentioned are the specialized services and expositions and the targeted assistance. These services are offered by few specialized associations. The CCI, for instance, developing on the tradition of organizing international expositions during the soviet times, has specialized in this sphere of activity. A number of specialized associations known under the name of “business incubators” provide a wider range of services and assistance targeted at fledgling small businesses. Business incubators are not associations representing the interests of specific sectors/regions, but rather are the charitable institutions of civil society dedicated to the task of private sector development.

Services Provided	Frequency (%)
Informational services (via publications, web-sites, request)	100
Legal Support	100
Consulting	73
Marketing Services	65
Assistance in Attracting Investments	61
Education/Training	55
Assistance in Developing Business Plans	30
Targeted Business Assistance (Office Space, Transportation Services etc.)	6
Facilitating Search for Business Partners	5
Auditing/Accounting service	5
Specialized/Professional Services (e. g. Advertising, Receiving Patents)	1
Expositions	1

**Table 3.2:** Services provided by business associations. Source: IEI survey data.

Although Table 3.2 differentiates between such types of services as information provision, legal assistance, and training, in reality, these can be part of the same activity undertaken by a business association. The League of Trade Merchants, for instance, publishes an information bulletin that reviews recent changes in regulations affecting

retail trade. The association offers regular seminars in which legal experts familiarize participants with such changes and offer consulting on specific issues. Such activities combine informational, legal, and educational services. Most of the services listed in Table 3.2 including legal, consulting, educational, professional services, targeted business assistance, and assistance in business plan development are perfectly excludable types of goods that associations could use to discriminate between members and non-members. Expo activities, business partner search, and other services including but not limited to arbitration, quality certification, and technical standard setting are not purely excludable. If non-members were denied an access to such goods, the overall benefits to the members and non-members alike would decline.

Interviews with the leaders of business associations confirm great variety in the types of services offered to associations' members and non-members. Usually members and non-members are required to pay a fee for some services such as legal or accounting assistance. Provision of services allows associations to reduce their financial dependence on membership dues collection. About half of association leaders report dues collection as a major problem. About 60% of my respondents indicated that only 20-40% of their new members remain to be active and pay dues regularly. The usual way to encourage membership has been to develop differential fee schedules for due-paying members and non-members. By providing services that businesses find helpful to their operation and development, associations are able not only to expand their membership, but also to facilitate dues collection from the existing members.

### 3. 1. 5 Creation

Very instructive are the origins of Russian business associations. Although most of the existing associations in Russia report establishing after 1991, it would be misleading to assume that in early 1990s the Russian civic landscape was a *tabula rasa* on which new associational development took place. One should not discount institutional continuity from the soviet public entities (ministries, agencies, and trusts) and perestroika-era civic organizations. Among the 325 associations participating in IEI survey, one association traces its existence to a soviet economic organization established in 1974; 12 were formed during *perestroika*, but the most rapid growth of associations occurred in the period between 1995 and 1999 when the number of associations increased from 100 to over 300. One, however, should not interpret these figures as representative of the general trend in the business association formation since the survey does not account for attrition. Many associations formed in the early 1990s simply did not survive to participate in the survey conducted in 2000.

Besides few associations that trace their origins to the soviet public organizations (The National Chamber of Commerce and Industry,<sup>13</sup> and the National Association of International Auto Trackers, for examples), pre-1991 business associations have been created as institutions of civil society. *Perestroika* gave freedom to organize on

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<sup>13</sup> CCI is a re-created Soviet structure that presents a unique example of a rapid adaptation to the new environment. In the USSR, the Chamber was created as a counterpart to the foreign institutions of this sort and was specializing on foreign economic relations. It was the primary organization responsible for expos, accreditation of foreign trade missions, arbitration, certification, some technical standard setting, and quality evaluation. The soviet structure was reorganized as the CCI of Russian Federation by a special presidential decree of 1993. The decree established CCI as a public (non-state) association with independent financing and a wider range of functions. Expertise developed by the Chamber during the soviet time in the sphere of international trade was expanded to include domestic economy. In the mid 1990s, a system of regional Chambers was developed to extend services offered by the national chamber to the local enterprises.

professional and interest bases. Associations of cooperatives, leaseholders, entrepreneurs, and farmers were created alongside the independent trade unions. Some top national associations, such as RUIE and the Association for the Development of Small and Medium Business, are the successors to the all-Soviet associations (Scientific-Industrial Union and the Leaseholder Association correspondently).

The other element of continuity is that many associations organizationally have been created on the ruins of the all-union ministerial system. After Russia's independence in 1991, the country inherited a dual system of government institutions: the ones comprising the government and bureaucratic structures of the Russian Federation and Soviet government institutions. The latter system was dissolved and major resources and personnel were incorporated into the new Russian institutions. The ministerial bureaucrats who were left behind in this reorganization possessed important knowledge about enterprises formerly supervised by their agencies. They had developed lasting personal connections with the managers of state enterprises in the corresponding sectors. These bureaucrats usually had a background in the industry and insider knowledge about technological processes, supply chains, and other important elements of industrial relations, making them perfect organizers of business associations. Some sectoral associations, especially in the manufacturing sectors, also received logistic, organizational, and material backing from the state agencies.

Formation of regional associations deserves special mentioning. As discussed earlier, Russian legislation stipulates requirements for the national and regional statuses of business associations. As a result, the formation of many regional associations was stimulated from Moscow. In order to attain all-Russian status, associations were



interested in opening regional representations. Many regional associations were formed thanks to logistical, organizational, and sometimes financial support from the center. Others were created by local efforts and continue to exist outside any hierarchical structures. Others, however, after being created by local businesses independently of Moscow had subsequently joined national hierarchical structures. Thus, the development of many regional associations involved simultaneous efforts on the part of local organizers and the organizational work by the national-level political entrepreneurs.

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This description of the system of Russian business representation provides the background information for the analysis of the supply- and demand-side hypotheses of business association formation presented in this and the subsequent chapters. The next section turns to the supply-side hypotheses and tests them with Russian quantitative data. I will return to the Russian business associations in Chapter 5 that presents case studies of Russian, Ukrainian, Kazakhs, and Croatian associations.

## **3. 2 STATISTICAL TESTS OF THE SUPPLY-SIDE HYPOTHESES: FIRM AND SECTOR CHARACTERISTICS**

### **3. 2. 1 Hypotheses**

Here I concentrate on the characteristics of the social actors – firms and businessmen – that make some of them more likely to overcome the problem of collective action involved in forming business associations. This section re-states hypotheses first presented in Chapter 2 in respect to the bottom-up dynamics of group

development (as opposed to the top-down approach that emphasizes the effects of political institutions and legal frameworks).

The first logical step in explaining why some firms join business associations while other do not is to consider firm characteristics, such as firm's size, ownership structure, and financial standing. Another important aspect is to examine characteristics of the groups of firms in particular sectors and industries. Here, the size of the sector, its fragmentation (number of firms) and resource specificity are of major importance. 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 have established relationships with state controlling agencies, ministries, and traditional trading partners (Huber & Worgotter, 1998), and thus should be less interested in replacing them with new institutional forms. I also expect that foreign ownership should affect firms' propensity to join associations. The 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 firms with low profitability. 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 and homogeneity of their interests. As discussed in Chapter 2, 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 should facilitate group formation. Yet another characteristic—factor (capital) mobility— is an important aspect that varies across industries.<sup>14</sup> The standard expectation in the literature is that high asset specificity (immobility of capital across industries) should stimulate collective action. Resource mobility reflects the costs of moving assets between different uses (across industries or national borders). High levels of investment in fixed capital suggest lower mobility since such fixed capital, as opposed to financial assets is much harder to convert to other use. This would imply that sectors with highly specific assets (high levels of fixed capital) should develop strong interest groups, while mobile asset sectors should be less likely to develop such groups. 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 lobby for protection. As a result, more firms in asset specific industries will join interest groups (associations).

### **3. 3. 2 Data**

Quantitative data on business association membership in Russia are fragmented and scarce. The first source of data on membership in business associations is the

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<sup>14</sup> 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). 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.

European Bank for Reconstruction and Development (EBRD) and the World Bank Business Environment and Enterprise Performance Survey (BEEPS).<sup>15</sup> The sample of 525 Russian firms participating in the survey is representative of the countries' businesses in respect to sector composition, size, ownership structure, and other characteristics. Although the survey does not provide data on the number and composition of business associations, a number of questions address the issues of the surveyed firms' organizational membership. The responses to the question about membership in business organizations reveal that 16.6% of business participating in the survey belonged to at least one association.

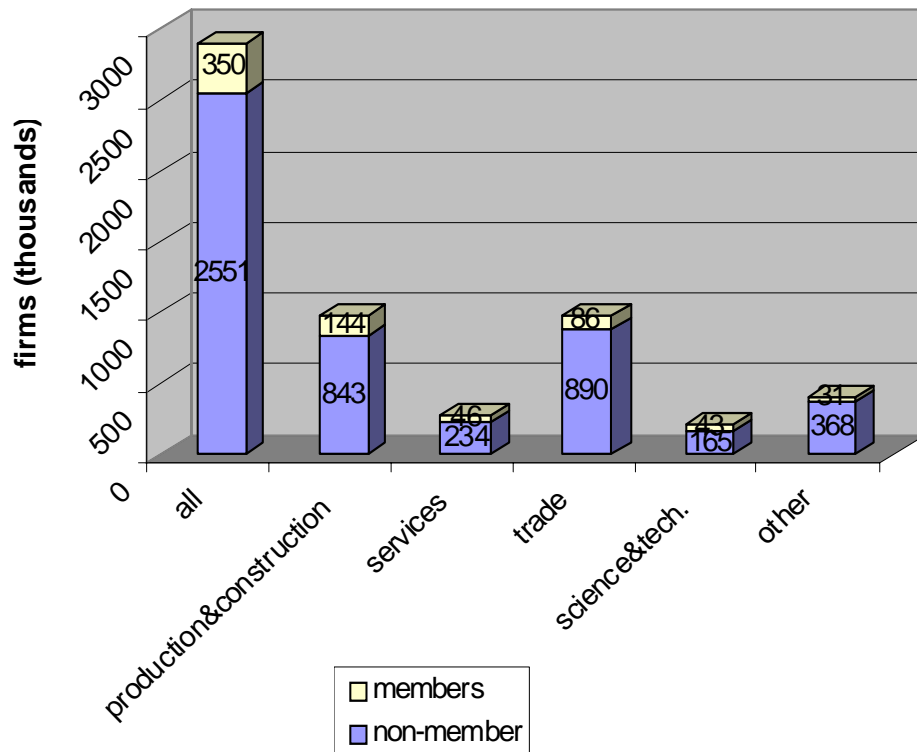
BEEPS data reveal that of the 75 state-owned firms participating in the survey, 12 or about 16% are members of at least one business association. Of the 256 de-novo firms, 15.2% (39 firms) report membership, while 19.4% (39 out of 201) privatized firms are members. Of the 10 surveyed foreign-owned firms, half are members. In the secondary sector of the economy, there is a 19.4% (39 of 201 firms) membership rate, while services enjoy a 17.8 % (35 of 197) membership rate. The rate of participation in business associations in the primary industry is the lowest; only 10.2% or 13 out of 127 surveyed firms are members.

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<sup>15</sup> BEEPS is a survey of about 4,000 firms in twenty-five 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, and are of different size and ownership type. Based on the 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 quality of business environment. BEEPS data and questionnaires are available at <http://www.worldbank.org/wbi/governance/wp-statecapture.htm>

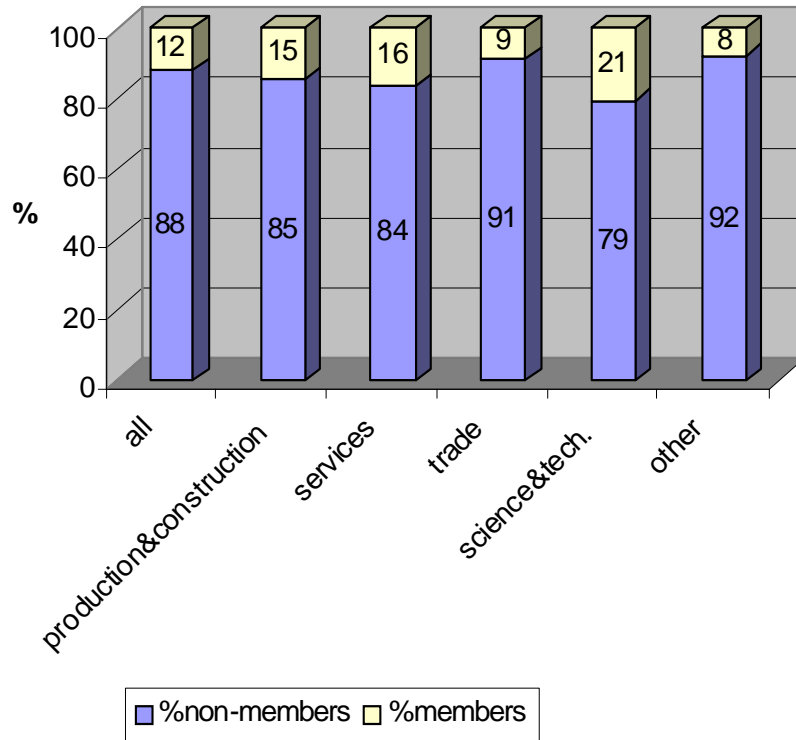
The other source of data is the survey of business associations conducted in 1999-2000 by Russian Institute of Entrepreneurship and Investment (IEI). The surveyed associations reported 401,972 firms to be their members, which amounts to 14% of all firms existed in Russian economy, according to official statistics. Note that this is close to the estimated participation level based on the BEEPS data.

While the BEEPS survey data reflects characteristics of firms that allow for distinguishing the common traits of joiners and non-joiners, the IEI survey provides data on associations themselves. The IEI data, however, do not reflect characteristics of firms-members of surveyed associations. The only information one can obtain about such firms is their number and sectoral membership. Of the total of 325 associations, 135 have reported sectoral composition of their members that allows for computing the sectoral rates of participation. Such figures, however, are rather conservative estimates because they are based on the membership in 135 associations, out of 325 participating in the survey and over 1,500 registered by the Ministry of Justice. Figure 3.1 reports the estimated levels of participation for different sectors.



**Figure 3.1:** Associational membership by sector. Source: IEI data.

It is hard to eyeball any difference based on the raw numbers of participating firms, thus Figure 3.2 below reports the same numbers expressed in the percentage of the total number of firms in a given sector. The highest levels of participation (21%) in business associations are observed among the research and educational organizations serving the industry. The lowest (9%) are observed in the retail and wholesale trade. There is little difference between levels of participation among firms in the service sector and “production” group—including firms in power generation, mining, manufacturing, and construction.

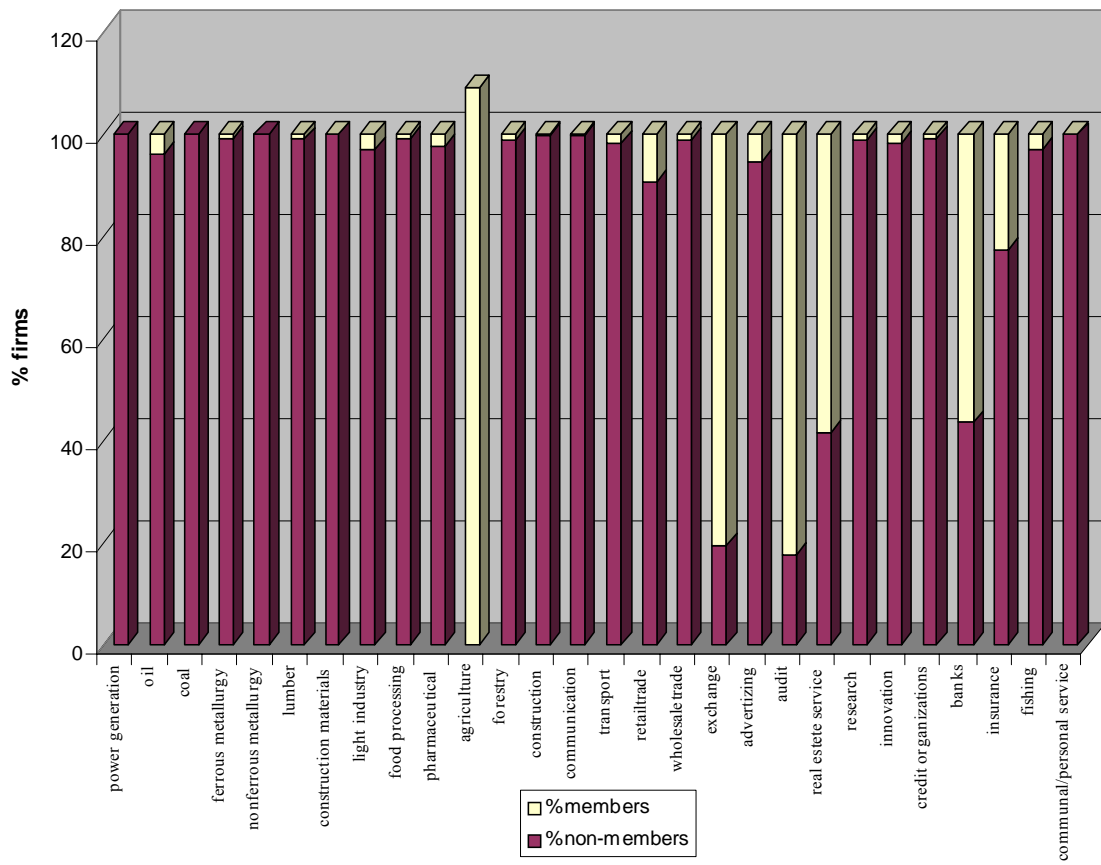


**Figure 3.2:** Estimated associational membership by sector, % firms.

These figures do not concur with the BEEPS survey data; neither can they be seen as contradictory. The categories of firms in BEEPS and IEI surveys do not overlap, making it difficult to assess the measurement validity of the two instruments. Production category in the IEI survey includes firms in agriculture, mining, and industry sectors, while BEEPS discriminates between these three sectors. The “production” category combines the most participatory (according to the BEEPS) firms in the secondary sector with the least participatory firms in primary sector, giving us no purchase on the actual sectoral differences.

A more nuanced data, reflective of the differential levels of business participation in associations, can be obtained by analyzing the size of 161 sectoral associations participating in the survey. Such associations reported 41,839 firms to be their members. Based on the reported membership in such sectoral associations, Figure 3.3 reports levels of participation in different sectors of the economy. One, however, should keep in mind that such figures are biased downwards because many firms, in addition to, or instead of being, members of sectoral associations, also participate in cross-sectoral businesses associations. Figure 3.3 reveals drastic differences across sectors in respect to association membership. The possible implication is that for firms in certain sectors, it is easier to overcome the problem of collective action involved in forming and joining voluntary associations. Differential levels of membership in sectoral associations, however, might be attributed to the fact that different industries are dominated by firms with distinct characteristics. Small, de-novo firms dominate some industries, while other lines of production are dominated by large, privatized, foreign- or state-owned firms. Still, differential levels of association membership may spring from the characteristics of industries rather than from firms themselves. Such industry-wide characteristics include factor specificity, levels of productivity and profitability, number of firms per sector. The next section puts together statistical tests to assess the effects of such factors.





**Figure 3.3:** Membership in sectoral associations. Source: IIE data.

### **3. 2. 3. Quantitative analysis**

Since the data are fragmented and of dubious measurement validity, it is difficult to decide which measurement of associational membership levels is more reliable. One might question whether the BEEPS data are representative of all economic sectors—including those with fewer firms. (For instance, the sample of 525 Russian firms does not include a single firm in the financial sector). IEI data can be questioned based on its biases to underestimate the number of existing associations and overestimate their membership. Rather than relying on one set of data, I evaluate my hypotheses against both sets of data.

First, I present statistical tests based on the IEI data. The purpose is to test hypotheses about sector-specific characteristics including sector size (in terms of the employed personnel), fragmentation (number of firms), and capital mobility operationalized as investment in fixed capital (per firm and per worker in a given sector). I also control for the level of profitability in the sectors. The analysis is based on 15 sectors for which I was able to obtain macro-economic data as well as estimates of associational membership. The dependent variable is based on (1) percentage of firms participating in associations in each of the analyzed sectors and (2) number of associations per firm in a given sector. If my expectations about the effects of factor specificity are correct, we should observe positive signs on the fixed investment variables. Negative significant signs on variable capturing the number of firms per sector would support the Olsonian argument about the difficulty of collective action in large latent groups. I also hypothesized that the size of the sector in terms of the employed

labor force and increased profitability should promote participation in business associations. Positive signs on these variables should support my hypotheses.

I performed an OLS regression analysis. Results are reported in Table 3.3. Analysis of data does not reveal a clear pattern. While the number of associations per sector seems to be affected by the levels of investment in fixed assets, the extent of participation is not. The latter, on the other hand, seems to be related to the size of the sector as well as to the number of firms. The negative sign on the number of firms supports the Olsonian idea about difficulty of collective action in large latent groups; while the positive relations between participation and physical size of the sector suggest that enterprises in larger, more important sectors are more likely to join associations. In either model, average profitability does not have an influence on the dependent variable.

Independent Variables	DV: participation (%firms members)		DV: representation (associations/ firms)	
	Constant	-2.587(8.364)	-2.846(8.553)	-.161(.292)
Firms	-.001(.000)*	-.001(000)*	.000(000)	.000(.000)
Employees	.021(.005)**	.021(.005)**	.000(000)	.000(.000)
Fixed Investment/ worker	...	.037(.417)	...	.032(.011)*
Fixed Investment/ firm	-.029(.787)	...	.065(.016)**	...
Profit/firm	-.026(.407)	-.084(.512)	.000(000)	-.005(.014)
Adj R2	.526	.526	.796	.873
N	15	15	15	15

**Table 3.3:** OLS regression results. Significance:  $\wedge$ .05 (1-tail), \*.05, \*\*.01, \*\*\*.001 (2-tail)

To evaluate the hypothesized effects of sector-level variable vis-a-vis firm-level variables, I analyzed BEEPS data. As a first approximation to address the hypothesized effects of asset specificity, I introduced dummies for secondary and tertiary sectors. It is

generally acknowledged that primary industries have higher levels of fixed assets. It is also the case that, on average, tertiary industries are less asset-specific partly because many businesses in service sector are not capital-intensive, and partly because services are *a priori* more mobile. Sectoral dummies will serve as markers of asset specificity. Sectoral differences, however, are not limited to asset specificity. They also include the number of competing firms and homogeneity of firms' interests. Sectoral dummies would not allow for distinguishing between asset specificity and other sector-specific characteristics. The major purpose of this part of the analysis, however, is to evaluate the effects of sectoral differences *vis-à-vis* firm-specific characteristics.

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 my 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 sector-level data (distinguishing between firms in agriculture, mining, power generation, manufacturing, retail trade, wholesale, personal, and business services) on the levels of investments in fixed assets, average profitability, size of sector (in terms of number of firms and employees), and volume of production. Since the dependent variable of the analysis is dichotomous, I use the logit model. Results of different model specifications are reported in Table 3.4.

Variable	1	2	3	4
Intercept	-3.226(.703)***	-3.568(1.150)**	-2.093(.571)***	-2.073(.576)***
Employees	.188(.071)**	.225 (.079)**	.208(.072)**	.201(.075)**
Foreign	1.371(.672)*	1.445(.706)*	1.442(.708)*	1.464(.712)*
Privatized	.224(.261)	.021	...	.092(.283)
Fin. Problems	-.100(.122)	...	-.102(.128)	-.105(.128)
Secondary	.734(.359)*	-.671(.666)	...	...
Services	.910(.382)*	.817(.786)	...	...
Firm per Sector	...	-.000(.000)	-.0001(.000)**	-.0001(.000)**
Employees/Sec	...	.0001(.0000)*	.000(.000)	.000(.000)
Fixed Invest.	...	...	-.327 (.786)	-.330(.810)
log likelihood	437.449	406.654	393.293	393.187
Cox & Snell R <sup>2</sup>	.039	.057	.058	.058
$\chi^2/df/$	4.163/8	14.173/8	13.822/8	10.178/8
significant	.842	.077	.087	.253
N	515	499	489	489

**Table 3.4:** Logistic regression estimation. Dependent variable: P(member = 1).

Significance:  $\wedge$ .05 (1-tail), \*.05, \*\*.01, \*\*\*.001 (2-tail).

The first model is estimated with the dummy variables accounting for the hypothesized effects of sectoral differences. In the first model, coefficients on secondary and service sectors are positive and statistically significant revealing that, *ceteris paribus*, firms in service and secondary sectors are more likely to be members of business associations. Coefficient magnitudes also suggest that firms in services are a little more likely to participate. The effects of the enterprise size and foreign ownership are positive and statistically different from zero. The overall model fit, as reported by the  $\chi^2$  statistics, however, is poor; thus, I proceed with other model specifications. After including the sector-level variables reflective of the sector size and magnitude in the second model, sectoral dummies lose their significance, suggesting that sector magnitude, rather than asset specificity, drives sectoral variations. Models 3 and 4 drop sector dummies and add

the measure of factor mobility. I find significant negative effect of only one sector-level variable—the number of firms per sector—that supports the argument about the negative effects of large group size on collective action. The magnitude of such an effect, however, is quite small. All other sector-level variables are non-significant. Across all four reported models, enterprise size and foreign ownership variables are positive, statistically significant and robust determinants of associational membership. Presented regression estimates are not conclusive: although sectoral membership dummies detect important and counter-intuitive differences in business representation across sectors, I did not find sector-level factors that would serve as strong predictors. Most importantly, BEEPS data does not support my expectation that resource specificity has an effect on associational membership.

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The statistical tests support my hypotheses about some firm-level characteristics, such as firm ownership structure and size, but found no support for the material resources argument. Foreign-owned firms and larger firms are more likely to join business associations, while firm's financial standing has no effect controlling for sector characteristics. My finding in respect to sectoral differences suggests that firms in different sectors of the economy are unequally represented by business associations. This conclusion is supported by comparing levels of business participation in different industries as well as by the results of regression analysis. My examination of data on business associations reveals considerable variation on both the number of business associations specific to particular sector and on the sectoral composition of associational membership. As suggested by BEEPS data analysis, contrary to prevailing theoretical

arguments, firms in service and secondary sectors are more likely to join business associations, while firms in the primary sector are least likely to join. Analysis of the IEI data points to sector size (number of employees) as having a positive effect on membership levels. Levels of fragmentation (number of firms per sector), however, have negative effects on levels of participation in business associations. The latter finding is supported by BEEPS and IEI data alike. Factor specificity, however, does not explain observed sectoral variation: resource specificity has no statistically significant effect on membership in BEEPS data, and its effect is not robust in the analysis of IEI data. In order to explain the observed sectoral differences in the extent to which businesses organize in associations, other factors must be considered.

I hypothesize that such puzzling patterns are linked to the differential effects of economic liberalization and structural changes experienced by firms in transition. Most participatory firms are found in sectors that were underdeveloped or non-existent under state socialism (real estate, professional consulting, commercial banking) as well as in sectors using innovative technologies, products, and expertise (communications, hotel and restaurant business). I argue that firms in these lines of business organize to develop new standards, regulate entry, and fight outdated regulatory practices. These arguments, however, are hard to quantify, and thus, require a more context-situated approach. In the next section, I present case studies of two business associations tracing the development of corresponding sectors over time. I investigate two sectors that lack factors suggested by quantitative research as having positive effects on business participation in associations. These are the crucial cases for demonstrating plausibility of my

explanation since despite the absence of fertile grounds for association formation, these sectors have established active associations with growing membership.

### **3.3 CASE STUDIES**

The highest levels of participation in business and employer associations in Russia are observed in banking, real estate, and professional services (such as advertising, consulting, and financial auditing). These lines of business started developing at the outset of economic liberalization and transition to market economy. The emergence of associations and high levels of business participation in such sectors are consistent with my hypothesis about the effects of regulatory environment, standards, and procedures—economic institutions supportive of and functioning alongside the markets. Associational development in the above-mentioned sectors, however, cannot serve as a valid test for my argument because such sectors possess other characteristics that emerge as important facilitators of business participation: small number of firms, considerable concentration of resources, large number of foreign-owned businesses, and in some instances, large firm size. To assess the plausibility of the explanation based on characteristics of regulatory environment, one should consider sectors lacking those important factors that facilitate business association formation. I examine two sectors—the audio-video trade and the retail trade. The first is a “new” sector, while the second has undergone considerable transformation in the past 15 years. A crucial piece of information lies in the circumstances surrounding the emergence of associations representing the interests of firms operating in these lines of business. In addition, an examination of the activities undertaken by business associations should be suggestive of



the reasons why associations form and why firms join them. These case studies present a tentative probe into importance of regulatory environment. Chapters 4 and 5 further develop and test such arguments.

### **3. 3. 1 Guild for the Audio-Video Trade Development**

The story of *The Guild for the Audio-Video Trade Development* (The Guild) is an interesting example of association formation in a “new” sector of Russian economy. In Russia, the audio-video retail trade—and trade in computer software—is dominated by small enterprises that surfaced in the early stages of economic liberalization. The sector virtually developed from scratch after the soviet-era music-recording labels lost their distribution networks to the new small entities that were able to satisfy consumer demands for cheap entertainment. Russia inherited a legal system that had little recognition for the copyrights from the Soviet Union. The complete absence of a working system of copyright protection has precipitated the decline of the soviet-era audio industry. The general economic hardship stalled domestic film and audio production and foreign counterfeit products dominated the market. The video and computer software industry did not have any roots in the Soviet economy; naturally foreign pirated products have come to dominate the market.

Trade in pirated audio and video products, initially imported from Bulgaria and China and later produced at home, burgeoned by the mid-1990s. The 1993 law on "Copyright and Neighboring Rights" created a legal basis for copyright protection and the norms of international conventions on copyrights were incorporated into Russia's legislation. However, the enforcement mechanisms were lagging behind. The law did not

stipulate the mechanisms through which holders of the copyright are to be compensated. Copyright violations were classified as an administrative or economic crime, and no criminal charges could be brought against pirates. In 1996, the International Intellectual Property Alliance (IIPA) reported that a complete absence of any effective enforcement tools has meant that in Russia “piracy rates approached 100% in most sectors”(IIPA, 1996).

In 1995, introduction of administrative and procedural changes to the legislation opened new channels for copyright law enforcement. Nevertheless, the presidential veto on the criminal code amendments (including those that would make copyright violations into criminal offences) slowed the implementation of effective enforcement until 2002. The only available venues for copyright protection were civil damage remedies and administrative control by state authorities, who were now given the right to seize counterfeit products *ex officio*. The former mechanism resulted in meager compensations; thus, the holders of copyrights would rarely revert to legal actions. The latter mechanism consisted of police raids by the Ministry of Interior on street vendors and other locations where counterfeit products were suspected, resulting in the confiscation of pirated products. The producers of pirate video, audio, and software were also subject to such raids in which their equipment was confiscated.

Since the legitimate holders of the copyrights and legitimate producers lacked established legal mechanisms to fight counterfeit retailers, the major threat to the pirated audio-video trade was coming from the coercive power of the regulating state agencies that could use it at their discretion. Throughout the late 1990s, there were a number of crackdowns carried out against retail traders. Those crackdowns were sporadic and

targeted a few retail locations. They would hurt some traders, but left others unaffected. Multiple reports suggest that authorities often patronized pirated trade and harassed legitimate traders with arbitrary inspections (*C-News.Ru*, 2003, *Komersant*, July 30, 2003). According to IIRA, such raiding by the police and municipal authorities was rarely followed-up by prosecutors and the courts (IIPA, 2002). Since confiscations did not seem to deter pirates, the authorities tried to implement other mechanisms of control. In 2002, the ban on street-vendor video and audio trade was put in place in Moscow and some other cities (*Komersant*, July 16, 2003). Again, enforcement was sporadic and multiple mechanisms for avoiding confiscations and subsequent legal actions existed.

This “wild” pirate market has prevailed for a decade, allowing for the establishment of specialization, competition, and product promotion strategies. In other words, the “new” branch of commerce has developed with economic actors investing resources and developing skills adapted to the peculiarities of such a system. Although not clearly legal, this branch was not an outright illegal operation. Under the Russian law, pirating was not considered a criminal offence until changes were introduced to the penal code in 2002. As a result, few participants in audio-video trade regarded their activity as utterly illegal, but instead, as an activity dependent on the rapidly changing regulatory environment and inconsistent legislation.

In this “new” branch of commerce, few prerequisites for collective action existed. A large number of small competing firms or individual traders, operating in isolated locations, dominated the sector. By the mid-1990s, a number of larger production facilities established themselves with a few big plants producing CDs and DVDs. At the same time, the retail trade continued to be dominated by small, usually financially

unstable firms employing small number of people. Balancing on the fine line of legality, enterprises in the audio-video trade were especially vulnerable to corruption, albeit often using it to stay in business (*Vedomosti*, July 30, 2003).

If businesses join associations to fill institutional vacuum created by a state institution's failure to create effective regulatory environment, the situation developed in Russian audio-video trade sector by late 1990s would be a perfect ground for group formation. Legislative loopholes reared pirating putting legitimate business in disadvantageous situation. Not only firms complying with copyright regulations were loosing in market competition with pirates, but also legitimate traders were suffering from raids and inspections that interrupted their commerce. The state was failing to fulfill its functions of contract enforcement, property rights protection, and information provision via standards of quality and procedures. A large part of market participants who were willing to "play by the rules" suffered from the non-enforcement of the law and from the increasing insecurity associated with unclear regulations.

The last drop that tipped the situation in favor of collective action was the 2002 introduction of the new licensing procedures that created a real mechanism for copyright protection. The new regulation gave the entrepreneurs a real mechanism for legalizing their trade, at the same time it gave authorities more effective means of persecuting violators. Following changes to the criminal code that recognized copyright infringement as a criminal offence, the October 2003 raids on the Gorgunova market and "Moscow" Expo Center evoked a strong reaction from market participants. The 2003 crackdown on the largest concentration of audio-video commerce put the entire audio-video trade in danger. Moscow authorities began enforcing property rights by closing down enterprises

not able to prove that they sell licensed products. Such a measure on the part of municipal authorities caused panic throughout the audio-video market in Moscow and sent signals to provincial traders.

The actions of the Moscow authorities brought the involved entrepreneurs together in a hastily organized group. In a meeting instituting the Guild, they put together a program of reconciliation for the existing situation and made an effort to contact Moscow authorities. “We were not sure if the authorities would even talk to us,” said the Director General of the Guild, “in the end, we were just guys from the street.” However, authorities not only opened communication but were also eager to invite the representatives of the association to the working groups that developed new regulations. Despite the fact that the association did not have a long-established membership base, it became the primary channel for expressing the interests of the audio-video market traders in the emerging situation. Authorities were eager to win private-sector allies in their fight against pirates and corrupt enforcement mechanisms. The Guild pushed for legalizing products held by the retail traders prior to the introduction of the new licensing scheme. It advocated against repressive crackdowns and corrupt inspections, arguing that clear licensing procedures and improved transparency would eradicate pirating more effectively.

The authorities’ actions in threatening the interests of large numbers of entrepreneurs in the video-audio trade sector stimulated formation of a business association, bringing together the otherwise disorganized and fragmented group. This is an example of how the threat of unpredictable and increasingly costly bureaucratic intervention acted as a stimulus for group formation. The exogenous (mostly

international) pressures pushing towards increasing regulation in the sphere of audio-video trade, coupled with arbitrary and corrupt enforcement mechanisms, provided the stimulus for association formation among small, financially unstable, and for the most part, competing firms in the video-audio retail sector. Association declares formation of “civilized” market guided by consistent and fair regulations that are developed in consultation with the market participants as its major goal.

### **3. 3. 2 Federation of Restaurants and Hotels**

The Federation of Restaurants and Hotels (the Federation) presents an example of collective action in the established, but largely transformed sector. Dining and hotel sectors were largely underdeveloped under state socialism; few restaurants and hotels were oriented towards foreign tourists and the majority of enterprises offered cheap, low-quality services for the domestic consumers. Most demand for public dining was satisfied through cafeterias serving industrial enterprises and public organizations. Cooperative movement in the late 1980s hardly had an impact on the sector; only the liberalization of the early 1990s allowed for the establishment of new enterprises. The economic collapse that followed Russia’s shock therapy and resulting falling incomes and demand slowed development of such new enterprises. In the process of privatization, “vedomstvennye” cafeteria, restaurants, and hotels were among the first enterprises to undergo privatization, which removed state control in the sector. Up until the 1998 default, small restaurants were growing as side-businesses for the new entrepreneurial class, accommodating the emerging demand for dining and entertainment.

The sector got a strong impetus for development when the Russian economy underwent recovery after the 1998 collapse when an improving economy put more disposable incomes in the hands of the middle class. Class differentiation created customers who demanded higher quality services in the sphere of public dining and hotel accommodations. By the late 1990s, a large number of restaurants and cafeterias oriented for the middle class customers opened in the major Russian cities. In the most economically prosperous regions in the sphere of public dining, industry to this date is not able to accommodate rapidly growing demand, and the shortage of restaurants particularly is felt during lunch hour in Moscow. Such shortages, to some extent, can explain the fact that McDonald's restaurant in Moscow daily serves the largest number of customers in the world. The construction boom in Moscow and St. Petersburg has accelerated development in the hotel industry. Given the potentially large size of Russian internal market, the hotel and restaurant sector remains small with about 3,700 restaurants employing 189,000 individuals (Russian Statistical Yearbook, 2006).

In terms of the ownership structure and average size of businesses, the sector falls into the category for which one would not expect successful collective action. The majority of firms are domestically-owned and are of small size. Following economic liberalization, some major foreign hotels have entered Russian market; still, foreign-owned hotels are confined to the major cities of Moscow and St. Petersburg. Larger hotels, according to the Russian classification, would fall into the category of medium-size businesses, while restaurant business is dominated by small, locally-owned enterprises. Restaurants employ, on average, 50 people; the modal restaurant, however, employs fewer than half of this number. Although franchising schemes have been

introduced in Russia, the number of franchised brands is still limited, with the major one—McDonalds-Russia—operating 147 restaurants in 37 Russian cities (19 of these are located in Moscow oblast).

The industry, dominated by numerous, small, largely locally-owned, and geographically dispersed enterprises should, theoretically, face strong impediments to collective action. Despite this, in August 2003, leading Moscow restaurants, with participation from other Russian restaurants, founded the Federation of Hotels & Restaurants. The main purpose of the Federation, according to its founding documents, is the “development of the dining and hospitality industry by means of consolidation of its enterprises, unification of efforts of Russian restaurants into one powerful force to overcome obstacles for development” (Charter). The major tasks of the Federation, as formulated by its leadership, include the representation of industry’s interests in the state agencies, participation in the development of normative documents regulating the industry, facilitation of the development of markets for restaurant and related services, as well as the organization of training centers for the industry’s personnel. As of 2006, the Federation unites 980 enterprises in the restaurants and hospitality industry. Members include large and small hotels, high cuisine and fast food restaurants, clubs and entertaining centers. In three years since its formation, the Federation has established branched (regional associations) in at least one-half of Russia’s provinces, established contacts with related international (International Association of Restaurants and Hotels) and domestic (OPORA, Federal Chamber of Commerce) associations. The Federation made its way into a number of state working committees including the Advisory Councils under the Administration of the President of Russian Federation and the Ministry of



Economic Development and Trade. To pursue its task of facilitating professional recruitment and training, the Federation established contacts with the Ministry of Education and Federal Migration Service. The Federation also supports active contacts with the Federal Service on Supervision in Sphere of Consumer Rights Protection.

Unlike the case of business association formation in the sphere of audio-video trade, where association formation was stimulated by a changing regulatory environment, little regulatory changes have been made in the restaurant and hotel industry since the transition. In fact, by the turn of the century, regulatory state institutions were enforcing sanitary, consumer safety, and quality standards developed as early as mid-1950s. The executive officer of the Federation links formation of the association to the growing desire of its participants to change outdated practices and regulations that retard development of their businesses. Development of the sector has been greatly slowed down by extensive and costly regulations based on outdated standards and soviet-era norms. Restaurants have to comply with strict and corruption-prone sanitary and safety regulations; they also have to develop their menus along the soviet-era standards. Laws and regulations prescribe types and capacity of equipment to be employed in the kitchens, establish norms of handling and use of ingredients, and strictly regulate standards of quality of raw products and output. Such regulations not only make the task of establishing and operating restaurant a cumbersome process, but also discourage the introduction of new products, equipment, menus, and services. As an example, the storage standards for produce and partially processed food, developed in 1960s, make it impossible to utilize new refrigeration equipment to its full capacity. Although manufacturers' specifications would allow much longer storage time, existing storage

norms, developed for the old equipment, could not be extended. Novel, mostly imported, produce presents additional difficulties since quality, storage, and use regulations are non-existent. The lack of contemporary standards makes restaurants that experiment with novel produce vulnerable vis-a-vis regulatory state agencies.

While some standards are seen as excessive, most are regarded as blatantly low to promote development of greater quality services. For example, existing regulations do not stipulate any norms to be followed in dealing with the customers, making it more difficult to position restaurants that adhere to different standards of etiquette on the same market. Federation sees its goal in becoming a self-regulating association that develops norms and standards for the industry at large and enforces such norms among its members. This would allow members of an association to use their membership status as a marker, conveying information about quality of their services to the customers.

If inadequate regulations are the major catalyst of the association's development, why have businesses established association only in 2003—after a decade of sector's existence outside of the state's control? The reasons can be traced to the internal development of the sector. While initially there were many “random people” trying out the sphere of restaurant business, by the turn of the century, there emerged entrepreneurs who had accumulated the experience and expertise specific to the emerging market for restaurant and hotel services. Their ability to provide better services, increasing demand, and growing competition played a great role in bringing enterprises together in search for better standards. More available information about better products, equipment, and skills promoted articulation of their interests. In other words, restaurants of the mid 1990s, although realizing bureaucratic pressures of extensive regulations, neither had the vision

nor the need for alternative standards and regulatory practices. Only after the market transformation produced a more structured market in the sphere of dining services, did the sector develop its first nation-level association.

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Case studies of the emergence of associations representing business interests in two sectors of the Russian economy point to the connection between regulatory policies of the state that threaten the interests of businesses and the emergence of business associations. In the course of my field research in Russia, I came across a multitude of examples in which business associations were formed in an attempt to protect their members from costly and/or excessive regulations. There were also many examples in which associations positioned themselves as institutions of self-regulation in the corresponding sectors. In practice, those two different types of associations are hard to differentiate since most associations pursue multiple goals and shift their priorities in response to the needs of their members. The two case studies presented above reflect the most recently established associations. In my research, I came across sectoral associations formed as early as 1991. Qualitative research suggests that the goals, strategies, and activities of such associations changed along with the changing membership and economic conditions. Chapters 4 and 5 take a closer look at the effect of regulatory environment.

As to the sectors where associations failed to develop, I suggest that enterprises in such sectors either 1) do not feel extensive regulatory pressures; 2) have effective ways of avoiding regulations; or 3) do not have the need to establish alternative regulatory mechanisms. Such enterprises are most likely to operate in the least transformed sectors

of the economy. Alternatively, those might be the large, politically influential enterprises that can lobby their interests directly without pulling their resources and channeling their demands through formal channels of interest articulation. A good example of a sector where associations failed to emerge is the Russian coal mining. Coal sector is comprised of 461 enterprises (2000 data); 76% of those are privately owned (privatized) and 7% are in mixed Russian-foreign ownership (which is two times the ownership share across all industries). The average firm size in the industry is about 600 employees comparing to the economy average of 85 employees. Resource mobility is low as suggested by the nature of production requiring heavy investment in fixed capital and infrastructure. Still other factors, including firm size, concentration of production in relatively few firms, presence of foreign ownership, and political importance of this labor-intensive (and large) sector would make it likely to develop business associations. Still, this has not happened. The argument developed above provides a good explanation: the sector faced little regulatory pressure in the years following its restructuring. If firms form associations in response to regulatory environment, the coal sector simply has no need for such development. Russian coal industry case is further discussed in Chapter 5.

### **3. 4 SUMMARY**

This chapter described Russian system of interest representation and analyzed quantitative data on the number of and membership in business associations in Russia. Data coming from different sources demonstrates differential levels of associational membership as well as different numbers of business associations in different sectors of Russian economy. My major task in the second part of the chapter has been to provide an

explanation for such variation. I presented statistical tests for the hypotheses, derived from the theories of collective action emphasizing characteristics of the latent groups as important factors, explaining interest articulation and the creation of organized interest groups. I found support for some hypotheses, including the positive effects of sector and firm size and negative effects of number of firms per sector. At the same time, I found little support for the powerful argument about resource specificity as an accelerator of interest group formation. Quite contrary to the expected relation, my research shows that controlling for other factors affecting interest group formation, businesses in service and secondary sectors are more likely to join associations, comparing to the firms in primary sector that have the most specific resources.

To explain such a puzzling relation, I argued that one needs to examine the differential regulatory environment affecting firms in different sectors. I suggested that burdensome regulations that often do not reflect changed business practices, skills, and technologies serve as catalysts for interest groups' formation. This chapter argued that businesses join associations to pool the resources necessary to change such regulatory mechanisms, and sometimes, to develop alternative schemes of structuring and regulating the markets. To demonstrate the pliability of my hypothesis, I picked two sectors with strong obstacles to collective action and demonstrated how associations emerging in these sectors responded to the unfavorable regulatory environment.

What does this analysis tells us? One of the most important implications of this analysis is that business interests in Russia are not synonymous to oligarchs. Unlike a number of studies pointing to the detrimental effects of business interests on the entrenchment of market mechanisms and development of the Russian economy at large,

my analysis suggests that business interest groups can defend legitimate interests and promote more efficient economic relations. Quantitative data points to the existence of business associations in sectors rarely associated with oligarchic interests: retail trade and personal services, fishing and professional consulting, financial auditing and real estate. Case studies demonstrate that small firms that are vulnerable to regulatory practices organize to defend their interests and push for developing more efficient regulations reflecting changing economic realities.

## CHAPTER 4

### REGULATORY PRESSURE, CORRUPTION, AND ORGANIZATIONAL RESPONSE

*What is the difference between a taxidermist and a tax collector?*

*The taxidermist takes only your skin*

Mark Twain

The previous chapter evaluated arguments about the firm- and sector- level characteristics explaining the formation of organized interests. The examination of business association formation in Russia demonstrated that although group characteristics play an important role in solving the problem of collective action, they under-predict the extent of organizational participation in some sectors and over-predict it in others. Qualitative evidence points to the important characteristics of the business environment that seem to be related to the differential levels of participation in business associations. Regulatory rules affect production processes, relations with customers and suppliers, capital and labor hiring decisions, and other important economic choices of post-communist enterprises. These and many other rules and regulations comprise the regulatory environment in which firms operate.

This chapter takes a closer look at the institutional environment that affects the operation of post-communist businesses. I empirically investigate the effects of macro-economic, political, and bureaucratic environments in which firms operate. Empirical tests presented in this chapter reveal an interesting puzzle: despite theoretical predictions suggesting the negative effects of bureaucratic corruption on the formation of legitimately organized business groups, I find the opposite effects. To account for such an unexpected finding, the chapter proposes a formal explanation of organizational dynamics that models firms' decisions to join associations as a response to the challenges presented by bureaucratic environment.

The central argument advanced in this chapter is that business associations arise as a defense mechanism from the regulatory pressures particularly exacerbated by corrupt enforcement practices. I argue that protection from corruption can be provided in a form of selective incentives and, thus, is not subjected to the collective action problem. The chapter sets a stage for a more nuanced qualitative test of the hypotheses linking the formation of business associations to the challenges presented by the regulatory environment. Chapter 5 will further investigate the causal mechanism behind this theoretical argument by examining qualitative evidence on how post-communist business associations provide protection from stringent and corrupt state regulations.

#### **4. 1 BUSINESS ENVIRONMENT AND GROUP FORMATION**

A number of theories of interest group politics point to political and socio-economic factors affecting the formation of organized interests. Starting from the modernization theory to the neo-institutional arguments, the socio-economic and political



environment is seen as affecting the underlying composition of interests, institutional channels of organization and influence, and groups' opportunity structure. This section reviews the major arguments applicable to the analysis of the effects of the business environment on the development of business associations.

#### **4. 1. 1 Macro-Economics**

Different arguments linking group formation to the challenges and opportunities created by the rise of industrialized societies can be grouped under the modernization theory paradigm. Perhaps the most influential of these arguments, discussed in Chapter 2, are offered by Truman (1951) and Olson (1982). When extending these theoretical arguments emphasizing the effects of socio-economic modernization and growth to the post-communist cases, one can expect that in countries with more advanced economic organization—diversified economies, high trade flows, efficient corporate governance, and in general, higher levels of wealth—the resources available to invest in organizational activities and the potential gains from such activities would be higher. This should lead to higher levels of business associational activities. The overall levels of economic development according to these arguments should have a positive effect on groups' propensity to organize.

A cursory look at some of the data on the formation of interest groups in the sphere most affected by economic transition—business associations—seems to support the development theory arguments. The levels of business organization in the wealthier, more economically developed post-communist countries are generally higher than in their poorer, less developed neighbors. The mean percentage of associational membership in

the region's higher-income countries (Poland, Slovakia, Slovenia, Hungary, Estonia, Lithuania, Croatia, Czech Republic, and Latvia) is 38 percent, while the mean for the region's lower-income countries (GDP per capita below \$2,000) is only 16 percent. If wealth (measured as per capita GDP) is a good proxy for the overall level of development, the post-communist group formation dynamics seems to provide strong empirical support for the levels of development argument.

#### **4. 1. 2 Institutional Structures**

The study of interest groups cannot ignore the institutional structures within which interest groups have to operate in order to achieve their goals. Some governmental and political institutions make it easier for interest groups to organize and influence public policy; some make these processes harder.<sup>1</sup> Interest groups are formed in a specific institutional context and their organization is shaped by existing institutions. In this respect the institutional diversity of post-communist countries provides fruitful ground for analyzing how institutions influence the emergence of interest groups (Gray, 1989; Taagepera, 2003; Bawn & Thies, 2003).

The degree of organizational success of business interest groups should increase as post-communist political systems become more democratic. Democratization should aid the process of interest articulation and should ease the process of interest group organization. This hypothesis addresses both the temporal and cross-national dimensions. The expectation is that consolidation of democratic regimes should lower the costs of

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<sup>1</sup> It is safe to argue, for instance, that the democratic nature of American politics, its system of checks and balances, its independent judicial system, and constitutional guarantees for the freedom of expression and association all contribute to the high degree of interest group organization in the U.S.

organization associated with the official registration and supervision requirement which exists in authoritarian regimes. Democratization also provides interest groups with institutionalized mechanisms of influence such as stable political parties and independent media access. In countries with more accountable and participatory political regimes interest groups should find it easier to organize and exercise their influence. As more authoritarian regimes deny freedoms of association and expression and undermine political competition and accountability, social interest groups might seek alternative mechanisms of expression, for example, patron-client relationships. In addition, prior research indicates empirical links between parliamentary regimes and highly concentrated (thus not numerous) interest groups (Lijphart & Crepaz, 1991). On the other hand parliamentary regimes can provide groups with easier access to political decision-makers stimulating group formation.

In addition to institutions shaping the political environment, state bureaucratic structures shape the regulatory environment in which firms operate. During profound socio-economic transformation, post-communist firms are deeply affected by the state. The actions of state bureaucrats and the quality of state governance influence firms' economic viability, business strategies, costs, and opportunities. Rules and regulations imposed and enforced by state bureaucratic agencies, in many ways, structure the emerging markets. The unpredictability of changes associated with post-communist economic reforms should be highly disruptive to business. It has been suggested that the uncertainty associated with unpredictable regulatory regimes accounts for many post-communist economic problems (Hellman et al., 2002).

In the centrally planned economy, regulations were an integral part of the comprehensive framework of the bureaucratic management of the economy and were designed to work not along market mechanisms but, rather, instead of them. With the collapse of central planning, direct resource allocation mechanisms were abandoned. However, the rules and regulations that affected product standardization, labor managements, equipment and machinery use, and many other aspects of production and distribution were slow to change (Hellman et al., 2002; Kaufmann et al., 2003; EBRD, 1999). Developed for the management of a centrally planned economy and with central planners' goals in mind, these regulations continued to impact the ways products were designed, produced, transported, and sold in post-communist transitional economies. As enterprise managers began discovering new market opportunities emerging after the dissipation of direct state controls, they started searching for the ways around slowly changing rules and regulations. This desire to ease up bureaucratic costs associated with conducting business paved the way to bureaucratic corruption, which, by the mid 1990s, became the notorious companion of economic transition.

#### **4. 1. 3 Corruption in the Post-Communist Business Environment**

Anyone who lived, traveled, or did business in post-communist Eastern Europe can tell (or at least have heard) a tale of an unpleasant encounter with a bureaucrat—a customs official, policeman, bank clerk, fire inspector, or residency registration officer. There is a multitude of rules and regulations explaining, amending, and “clarifying” laws, and both an average person and a not-so-average businessman usually feel lost when confronted by officials enforcing these rules. It appears that the rules are made to confuse

the people who are supposed to follow them. In this respect, bureaucratic corruption—a distasteful practice nobody would want to defend—often provides the most convenient and “customer-friendly” way of conducting business with bureaucrats. If you can show your gratitude, public servants—otherwise not very customer-friendly—might go an extra mile to help you. While navigating across the field of bureaucratic obstructions is difficult, corruption appears to be the *path of least resistance* when dealing with public servants.

If you are a businessman who needs to obtain registrations, licenses, permissions, and approvals from regulatory state agencies,<sup>2</sup> the path of least resistance is a typically the only way to ensure your business can function legitimately. Illegal incomes of corrupt bureaucrats depend on their patrons, and since businessmen can pay more than average citizens, they are subjected to greater attention from bureaucrats. Corruption has become the subject of much of the post-communist transition research (Boycko, et al. 1995; Hellman et al., 2000; Gaddy & Ickes, 1999; Miller et al., 2002). It is generally considered a formidable obstacle to the effective functioning of emerging markets and a great impediment for businesses in transitional countries. But should it also impede the emergence of legitimate interest groups defending business interests? According to one theoretical perspective, corruption opens informal channels of interaction between

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<sup>2</sup> The number and control powers of such regulating agencies vary by country. Comparative data spanning all post-communist states are unavailable; however, evidence points to a vast divergence. Frye (1998), for instance, reports that while in Russia retail traders, on average, are inspected by 4 different bureaucratic agencies. By comparison, Polish shopkeepers are inspected by 2.6 agencies. This translates into differential bureaucratic barriers with an average of 19 inspections per year in Russia and 9 in Poland. Other accounts point to cases of even more severe regulatory pressure. In Moldova, according to a survey of business people, enterprises are inspected, on average, 38 times per year (*The Impact of Corruption on Small Business*, 2002). According to the president of Alamyty Entrepreneurs’ Association, Viktor Yambaev (2005), of 56 controlling and supervising state agencies, 30 are the most harmful to the development of small business. For a worldwide comparative measure of bureaucratic barriers, see Brunetti, et al. (1997).

individual firms and state bureaucrats; thus rendering superfluous any collective action on the part of a larger business community. Therefore, one might expect that in highly corrupt political systems—including many post-communist countries—fewer legitimate associations representing business interests will emerge. Before proceeding to the presentation of these arguments, however, a proper definition of administrative corruption is needed.

### *Two Types of Corruption*

In this chapter, I will use corruption to designate the abuse of a public office to obtain personal and narrowly defined group benefits that fall outside entitlements designated by law. Corrupt practices that might exist outside the public sphere are not included in this definition. Two broad types of corruption have been identified in the literature: the low-level administrative or petty corruption and political corruption or state capture. The distinctions have been drawn primarily at the level of state-business interactions.<sup>3</sup> On the one hand, bureaucratic corruption is something that affects businesses, households, and low-level local bureaucrats in the day-to-day economic and administrative functions. Grand-scale corruption or state capture, on the other hand,

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<sup>3</sup> In addition to the petty/administrative vs. capture/grand political corruption, the distinction between these two distinct types of corruption has also been conceptualized in terms of the *ex ante* vs. *ex post* corruption in relation to bureaucratic screening of private beneficiaries (Guriev, 2003) and “corruption without theft” vs. “corruption with theft” (Shleifer & Vishny, 1993). The first reflects the fact that *ex ante* administrative corruption that involves “speed” or “blinders” fees removes administrative pressures from all economic agents, regardless of their type: both good (compliant and eligible) types and bad (disqualified) types are provided with a convenient way around the red tape. The *ex post* corruption is less benign in a sense that the information about the actual type of business is known to the bureaucrat who colludes with the bad type to supply benefits to which the beneficiary is not eligible. In a similar vein, corruption without theft refers to the cases where business is not getting any additional transfers from the government. When corruption leads to re-distribution of resources by the government in favor of the bribe-paying economic agent, the “theft” of public resources occurs, resulting in a diminished social welfare.

affects industrial tycoons, financial magnates, and high-ranking public officials and has an impact on the allocation of public funds, large contracts, and property.

The distinction between these two types of corruption can be demonstrated on a stylized Banker-Baker contrast. Following Webster's (2002) imaginary petty businessmen and an executive of a large holding company, quite distinct forms of business-state interactions can be observed. For the small businessman—the Baker—the majority of interactions with the state would take the form of routine visits from the local tax inspector, policemen, and registration officer who would let him know about mistakes and irregularities in his registration papers or about incorrectly followed instructions when filling out tax reports, license applications, or other official papers. The manager of a large company—the Banker—is more likely to interact with ministerial staff and local and national politicians in formal (working groups, political functions, conferences and roundtables) and informal channels (elite networks, “business” dinners, and seemingly business-unrelated social events). If both of these businessmen are to exploit the power of bribes, the nature of the corruption they would be involved in would be drastically different.

A Baker's corruption would most likely involve payments that would allow him to “keep his business running” (Webster, 2002, p. 11). The side payments to state inspectors and bureaucrats this Baker makes are not purchasing any advantages: he is not getting any services from the state bureaucrats in addition to the ones they are expected to provide by law. He might get some reduction in the cost of running his business through the “blindness fees” paid to officials to overlook his business' irregularities, but it comes at the cost of increased dependency on those corrupt bureaucrats in the future.

A Banker's corruption is likely to be of another type, often referred to as "state capture" (Hellman et al., 2000). State capture is characterized by close relationships between political decision-makers and large businesses that dictate the rules of the game to ensure that continuing streams of benefits are attained at the expense of other (sometimes more efficient) economic actors while producing socially sub-optimal economic outcomes. Large businesses' payments to politicians and high-ranking bureaucrats are likely to purchase preferential treatment in export-import operations, public procurement, selective protectionism, and other economic advantages over a firm's competitors. "This is the payment of bribes to shape the policy and legal environment to the captor firm's advantage" (Webster, 2002, p. 12). Economic benefits for the captor firms are usually immediate and conspicuous, while costs are often long-term and are placed on society at large.

Although grand political corruption clearly has a stronger negative connotation, it would be misleading to think of petty administrative corruption as an insignificant phenomenon that has only a marginal effect on post-communist societies. Administrative corruption is less likely to be the focus of the mass media that covers scandals implicating high-visibility business and political elites. Murky privatization deals, private enrichment through government concessions, multi-billion dollar contracts, and the scandalous re-nationalization of private industries are closely followed in the press. Such corruption, although having long-term (and sometimes immediate) effects on a large number of businesses and households, is not directly observed by the average businessman. This is in sharp contrast to the low-level administrative corruption felt by economic agents in their daily economic activities.



Although the scale of corrupt deals at the lower levels of state bureaucracy is small, the amounts of bribes transferred in the immense number of corrupt transactions involving millions of households and enterprises might add up to a colossal number. The costs of such corruption not only involve the redistribution of resources from productive (enterprises that re-invest them) to unproductive users (bureaucrats that are most likely to spend them for private consumption), but also distort state regulatory mechanisms, disrupting tax collection, public safety monitoring, contract enforcement, and the social safety net. Petty corruption also impinges on state capacity. Corrupt bureaucrats find their rewards, not in ensuring the meticulous workings of the state machine, but rather in complicating the bureaucratic process that fuels the demand for corruption. Even if the central government is committed to a clean, efficient, and stable legal environment, local corruption on the part of low-level bureaucrats entrusted with carrying out regulatory orders might stall otherwise good-intentioned reforms.

#### *Two Arguments about Corruption and Formal Organization of Businesses*

Equipped with the definition of bureaucratic corruption, I now return to its effects on group formation. It's been argued that petty corruption has a debilitating effect on businesses in the transitional countries (Murray, 1999; Frye, 1998; Webster, 2002; *The Impact of Corruption on Small Business*, 2002). If businesses are affected by the regulatory and institutional environment in which they operate, the extent of administrative corruption should have an effect on the levels of organizational membership.

The standard expectation developed in the literature is that businesses should be *less* likely to form legitimate associations in highly corrupt systems. Two explanations have been proposed. One theoretical argument linked to Huntington's (1968) view on corruption in developing countries implies that because corruption allows *individual* firms to solve their problems by bribing public officials, it reduces the need for collective action and formal organization.<sup>4</sup> This notion of corruption as means of reducing government's administrative rigidity is rooted in the Coasian theory predicting that, under costless transactions, any market-driven re-allocation of resources leads to a more efficient social outcome (1960). Thus, side payments to bureaucrats allow more efficient producers (those willing to pay highest bribes) to acquire access to otherwise unattainable markets and resources. Corruption becomes a productive activity, leading to Pareto-efficient outcomes. Bureaucrats receive bribes while entrepreneurs acquire opportunities to pursue profitable activities unavailable under rigid state regulations. According to this line of thought, since state interventions are, for the most part, counter-productive—less efficient than markets—society, as a whole, only gains by reducing, albeit through corrupt mechanisms, the number of administrative barriers limiting economic activities.

This notion of corruption as a productive activity has direct implications for the issue of a formal business organization. Here, corruption becomes the substitute for other means of problem solving (such as lobbying or self-regulation) that require firms to organize.<sup>5</sup> According to such a perspective, the prevalence of personal channels of influence in post-communist settings is likely to undermine the formation of business

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<sup>4</sup> See also Harstad and Svensson (2005) for similar treatment of corruption.

<sup>5</sup> Operating under the assumption that corruption is an alternative to lobbying, Campos and Giovannoni (2005) found that lobbying is more effective than bribery in transitional countries.

associations, making any collective action on the part of firms superfluous. If this is true, one should observe low levels of business participation in associations when corruption is widespread.

The second argument advocated by McChesney (1997) adopts a different notion of corruption, but arrives at the same prediction—that corruption should reduce associational membership. McChesney sees corruption as a form of extortion by bureaucrats. In his framework, politicians and bureaucrats threaten businesses with the imposition of new regulations, in an expectation that an organized business will channel financial contributions to them to prevent those regulations from happening. According to this argument, the easier it is to identify these potential clients, the less problematic it becomes for corrupt officials to extort resources. By organizing, businesses become an easier target for extortion since they are better informed about proposed regulations and can organize a collective lobbying effort. Therefore, where bureaucrats and politicians are corrupt, there is a disincentive to organize. If this logic is correct, corruption should negatively affect group formation.

To sum up, various arguments have been proposed in the literature about the possible effects of the socio-economic, institutional and regulatory environment. Such an environment is of major importance to transitional firms because it affects the way of conducting business and contributes to the cost of that enterprise. Therefore, I expect that the socio-political and institutional environment shapes the interests of businesses in transitional countries. Of particular relevance to post-communist countries are the arguments about the effects of the overall level of economic modernization and development, political freedoms and specific (parliamentary) political institutions, and

state bureaucratic institutions responsible for enforcing the rules and regulations directly affecting economic activities. The latter, being characterized by high levels of unpredictability, and in many post-communist countries by bureaucratic corruption, deserve special attention as having perhaps the most immediate effect on business interests.

## **4. 2 THE BUSINESS ENVIRONMENT AND THE BUSINESS ORGANIZATION: AN EMPIRICAL INVESTIGATION**

To test the hypothesized effects of the economic and institutional business environment on group formation, I develop statistical tests utilizing an available cross-national survey and aggregate data reflective of firms' participation in business associations. This section presents quantitative data and develops firm- and aggregate-level statistical tests. The tests produce a somewhat counter-intuitive finding about the effect of bureaucratic environment. Specifically, they detect the positive relationship between corruption and business association formation.

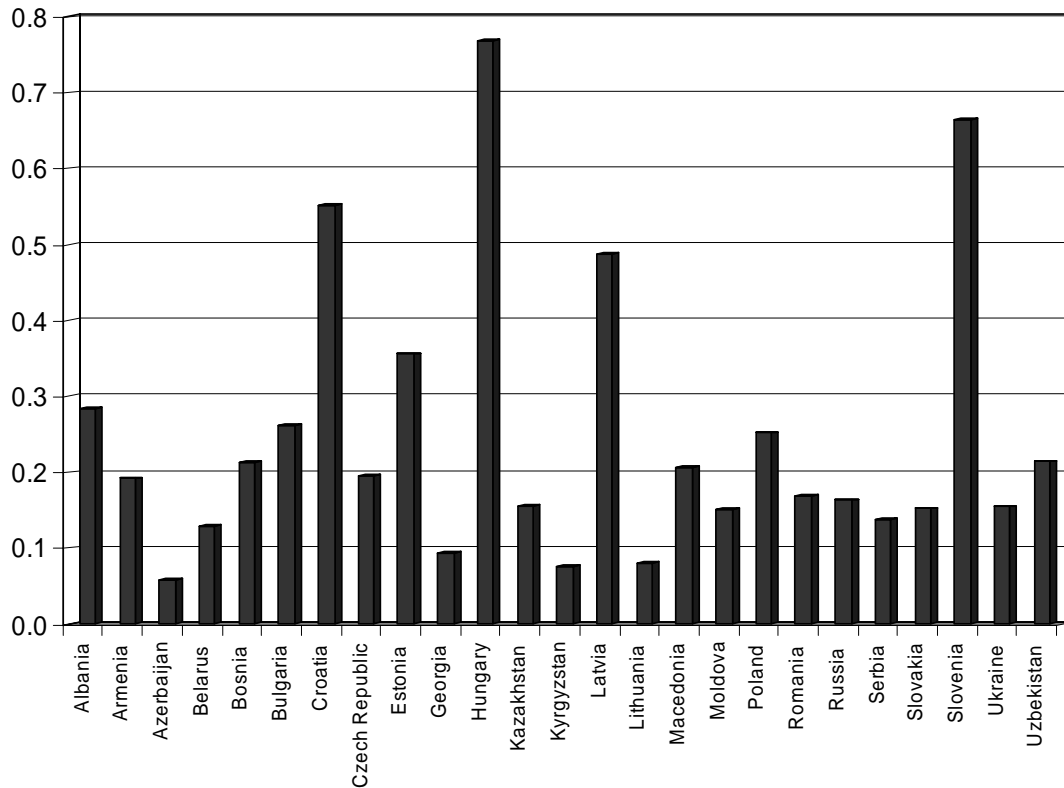
### **4. 2. 1 Data**

The quantitative data I use operate at two different units of analysis. For the firm-level analysis I rely on the business survey data while the country-level analysis uses aggregated socio-economic data. To capture business participation in associations I use data from the European Bank for Reconstruction and Development (EBRD) and the World Bank Business Environment and Enterprise Performance Survey (BEEPS).<sup>6</sup> A number of questions in the survey address the issues of organizational membership and

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<sup>6</sup> See Chapter 3 for the description of BEEP survey.

corruption. The responses to the question about membership in business organizations reveal that 26.5% of firms participated in the survey belonged to at least one association. The survey also reveals a vast divergence between levels of organizational membership in different countries. Figure 4.1 reflects the extent of cross-national variation.



**Figure 4.1:** Membership in business associations. Source: Business Environment and Enterprise Performance Survey, World Bank, 2000.

Business survey data allows assessing the effects of a number of environmental and firm-specific variables. I capture the argument about the effect of uncertain regulatory regimes by the firm's responses to the survey question about how

unpredictable are the rules and regulations. Unpredictability of regulations reflects the instability of business environment and should increase the probability of associational membership. To measure the perceived frequency of bureaucratic corruption, I construct a scale variable (Corruption) from firms' responses 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; 7) to influence the contents of new laws, decrees, or regulations directly affecting your business; 8) other (specify).

Responses to these questions—on six-point scale ranging from “never” to “always”—were added resulting in a forty-eight point scale, with a larger number corresponding to more frequent occurrence of corruption. Factor analysis on the above-mentioned aspects of corruption suggests that they capture the same underlying phenomenon.<sup>7</sup> This justifies the use of the composite measure. Constructed in such a 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-country differences in the scope, kinds, and methods of corruption, this measure provides greater flexibility and on average is less prone to error.

Some of the areas of corruption reflected in this battery of questions—e.g. public services, licenses, tax collection, customs—are unambiguous attributes of low-level

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<sup>7</sup> Results of the factor analysis are summarized in Appendix A.

bureaucratic corruption; others are not easily indistinguishable from grand political corruption. For instance, in the area of government contracts, depending on the types of businesses and size of contracted project, higher-level political authorities might be implicated. Still, a vast number of services contracted by the state institutions, such as garbage collection, transportation, landscaping, repair and others, are implemented locally. Thus, in the majority of cases of contracting with the local entities, one should expect instances of bureaucratic, rather than high-level political corruption. A similar argument could be extended to the court of law corruption. The majority of post-communist firms, due to their size and geographic location away from capital cities are likely to deal with the local courts. Although linkages to the higher-level political authorities might be suspect in corrupt court decisions, local bureaucrats working in the judicial sphere are likely to be the center of the corrupt deals.

Perhaps most contentious is the sphere of influence on the content of laws, rules and regulations. Classifying this question as a measure of administrative corruption depends on whether one believes that firms are entitled to exert such an influence on the government via legitimate means and on what institutions should be the subject of such influence. If rules and regulations affecting firms are devised by high political authorities only, this question is clearly capturing the extent of political corruption. If, on the other hand, business regulations are formulated by bureaucrats, the question is indicative of bureaucratic corruption. One cannot give a definite answer to this question without a prior comprehensive analysis of regulatory regimes across post-communist countries. This, however, is beyond the task of this dissertation. Still, a number of accounts point to the state bureaucracy rather than to high-level public officials as the driving force behind

the implementation of the “hard” institutional reforms shaping the rules and regulations governing post-communist businesses (Murray, 1999; Webster, 2002).<sup>8</sup>

The meaning and operationalization of corruption is a highly debated topic. The primary variable operationalizes bureaucratic corruption in terms of its perceived frequency. 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, it might drain resources needed for collective action. To control for the cost of corruption, a variable reflecting the usual amounts of bribes (in terms of the share of firms’ revenue) is introduced. Such a variable is constructed from the firms’ evaluation of an average share of revenues spent by “firms like theirs” on unofficial side payments to public officials.

BEEP survey also allows controlling for a number of variables reflective of the characteristics of firms and economic sectors. Building on the analysis of firm- and sector characteristics presented in Chapter 3, I control for the type of ownership, firm size, financial standing, and the sectoral effects. Dummy variables for *de-novo* firms (to distinguish from privatized and state-owned firms) and foreign ownership are introduced to capture the ownership effects. Measures of financial problems (FinProblem) and a number of employees (Employees) are introduced to capture the extent of resource

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<sup>8</sup> For an illustration, consider the 1995 tax reform in Russia that was designed to simplify taxation mechanism by introducing a single, flat 10% tax on small enterprises. The reform was introduced in response to a wide-spread criticism of the Russian taxation system that taxed not only profits and revenues, but also physical transfers of goods and assets. Strong complaints were voiced about the complexity of old tax legislation that was virtually incomprehensible to business practitioners. Existing legislation was open to multiple interpretations, creating loopholes for de-facto tax reductions, achieved in collusion with tax authorities. With the falling tax collection rates and growing budget deficit, the Russian government hoped that a simplification of taxation mechanisms and a reduction of businesses’ tax burdens would, in fact, increase state revenue and stimulate domestic investment. The 1995 law, however, gave local governments the responsibility for its implementation that, in effect, led to blocking the central government’s intent. In St. Petersburg, for instance, authorities imposed a \$8,500.00 fee on enterprises willing to switch to the simplified taxation scheme (Murray, 1999). It has clearly been a case of bureaucratic rule-making.



endowment and enterprise size. To control for sectoral effects, I use dummy variables for the secondary sector and for the tertiary sector. The base category is the primary sector. To evaluate the hypothesized effects of political environment I supplement survey data with country-level data reflective of institutional and political variables such as the overall level of democracy and parliamentary regimes.<sup>9</sup> Freedom House data were used to measure democracy. Parliamentary regimes I coded myself.

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

**Table 4.1:** Firm-level analysis: Summary statistics.

For the aggregate analysis performed later in the section I constructed a cross-sectional dataset including observations on 25 post-communist countries. The aggregate-level measure of membership—association membership index—was constructed by

<sup>9</sup> I also introduced a control for the country-level corruption (Transparency International Corruption Perception Index), but dropped it from the final regression results due to its high collinearity with the Freedom House political rights and civil liberties (democracy) score. Introduction of the country-level corruption control did not affect my results.

aggregating the BEEPS data on associational membership. The index presents a proportion of enterprises that report membership in business associations. This index reflects the extent to which businesses—regardless of their ownership, sector, and size—are organized in a given country. A number of socio-economic variables—per capita GDP, level of urbanization, and infant mortality rate—are taken from the World Bank country tables. The data set also includes ratings of economic and institutional reforms, the private sector proportion of GDP, measures of state regulative capacity, and political polarization. I use two alternative measures of corruption. One is based on aggregated data from the BEEP survey; the other is the averaged ranking based on multiple existing indicators of corruption (Kaufmann & Mastruzzi, 2003). Variable description and sources are given in Table 4.2.

Variable Name	Description	Source
<i>Organization Index</i>	Proportion of firms reporting membership in business associations	Aggregated BEEPS data
<i>Ln (Wealth)</i>	Natural logarithm of GDP per capita (USD), 2000	World Bank
<i>Corruption1</i>	Aggregated Corruption Score	Aggregated BEEPS data
<i>Corruption2</i>	Averaged corruption score given by different rankings (standardized from -2.5 to 2.5)	Kaufmann et al. 2003
<i>Private GDP</i>	% GDP produced in private sector, 1999	EBRD Transition Report
<i>Infant Mortality</i>	Infant mortality per 1000 births	World Bank
<i>Regulatory Capacity</i>	State regulatory capacity score	Kaufmann et al. 2003
<i>Urban</i>	Percent urban population	World Bank
<i>All Reforms</i>	Average for enterprise restructuring, trade, and banking and financial institutions reforms, 2000	EBRD Transition Report
<i>Institutional Reforms</i>	EBRD score for banking and financial institutions reforms, 2000	EBRD Transition Report
<i>Polarization</i>	Political polarization score	Frye 2002
<i>Parliament</i>	Dummy variable for parliamentary regime	Self-coded

**Table 4.2:** Aggregate Analysis: Variable Summary.

#### 4. 2. 2. Firm-Level Analysis

In this section I statistically analyze firm-level data on membership in business associations. I develop a hierarchical model to investigate the effects of bureaucratic

environment and political institutions controlling for a number of firm characteristics. Since the outcome variable—membership in business associations—is dichotomous, I start with logit estimation of the following model:

$$\begin{aligned} \Pr(Y_{ij} = 1) = & \beta_0 + \beta_1(\text{democracy})_i + \beta_2(\text{parliamentary})_i + \beta_3(\text{corruption})_{ij} \\ & + \beta_4(\text{employees})_{ij} + \beta_5(\text{foreign})_{ij} + \beta_6(\text{denovo})_{ij} + \beta_7(\text{fin.problems})_{ij} \\ & + \beta_8(\text{unpredictability})_{ij} + \beta_9(\text{secondary})_{ij} + \beta_{10}(\text{service})_{ij} + \beta_{11}(\text{corruptioncost})_{ij} + e_{ij} \end{aligned}$$

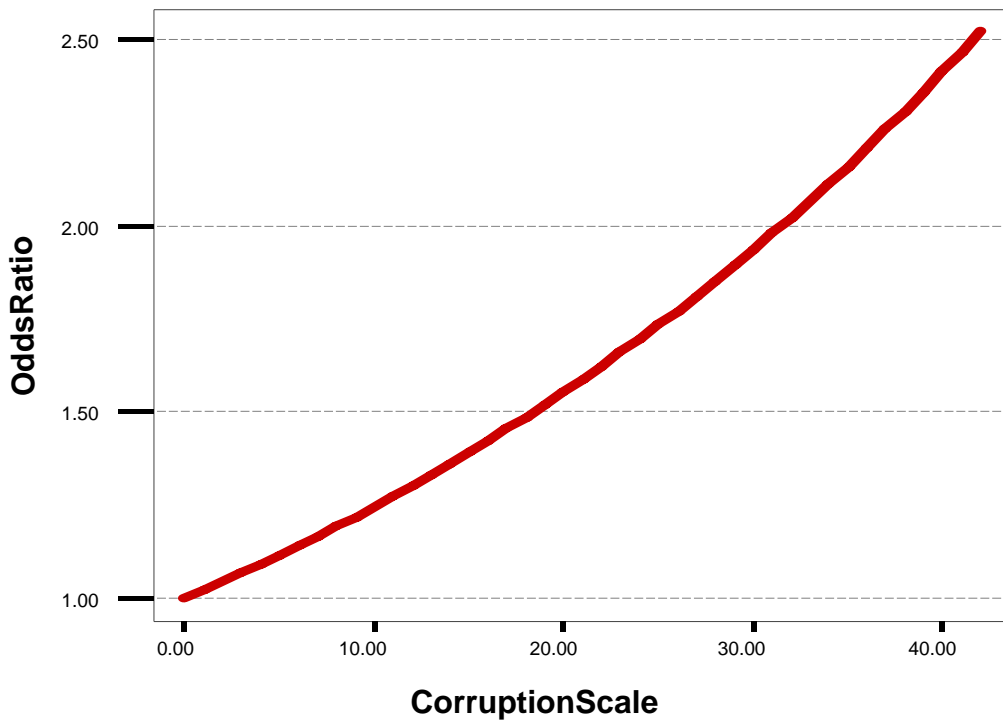
For  $i = 1, \dots, 25$  countries and  $j = 1, \dots, 1833$  firms.  $\Pr(Y_{ij} = 1)$  is the probability that a firm has membership in at least one association or lobby group. Results of the estimation are reported in Table 4.3, Column 1. The goodness-of-fit test (G), as reported in the table, is significant and suggests that the model fits the data better than the null model (i.e., the intercept only). As evident from the reported standardized coefficients, business association formation in the post-communist countries follows the patterns predicted by the established theories of group formation. The effects of institutional environment, enterprise size, ownership, and economic sectors are statistically different from zero, substantively significant, and robust to different estimation techniques. Parliamentary regimes, enterprise size, and foreign ownership are conducive to business organization. De-novo enterprises and enterprises in the primary sector at the same time are less likely to participate in associations. Variables capturing unpredictability of business environment and self-reported financial problems are not statistically significant predictors of membership. When non-significant variables are excluded, the remaining coefficients retain their predicted signs and statistical significance.

A very interesting and counter-intuitive result emerges regarding the effects of

corruption. Controlling for the effects of other variables, the primary measure of corruption is positively associated with group formation.<sup>10</sup> Such effect is statistically significant at the conventional level. This goes contrary to the positive relation between bureaucratic corruption and business association formation suggested by the literature. Exponentiating the estimated corruption coefficient ( $\exp(\beta_3)$ ), 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 forty-eight-point corruption scale. A firm that scores the highest on all eight corruption-related questions (the highest actual score is forty-two) is 2.5 times more likely to be a member of business association than a firm reporting no corruption. Figure 4.2 plots estimated odds ratio against the scale measuring frequency of corruption.

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<sup>10</sup> This result holds when I divide the sample into the EU member/applicant and non-member/applicant countries.



**Figure 4.2:** Odds of membership status.

Caution however should be exercised when accepting these results because of the simultaneous inclusion of the firm- and country-level variables. *Within-* observations on the country-level variables are not independent from each other; this violates the standard assumption underlying regression techniques. As a result, the standard errors are likely to be biased. This presents a problem for statistical analysis operating at the 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 a model are reported in Table 4.3, Column 2 and result in only a marginal change in the remained regression coefficients and standard errors. The model-fit statistics are significant and  $\exp(\beta_3) = 1.02$ . Pooling firm

observations across twenty-five countries, however, assumes homogeneity among firms in different countries and is likely to suffer from specification (omitted variables) problems.

Alternatively, to account for the country-level characteristics that influence association formation (in addition to political variables included in the model, such influences may come from differential legal frameworks, historical background, cultural attitudes, level of economic development, etc.), one might 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 country dummy variables. I report the results of estimating the regression equation including country dummies in Column 3. The group dummy models allow 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:

$$\begin{aligned} \Pr(Y_{ij} = 1) = & \beta_0 + \beta_3(\text{corruption})_{ij} + \beta_4(\text{employees})_{ij} + \beta_5(\text{foreign})_{ij} \\ & + \beta_6(\text{denovo})_{ij} + \beta_7(\text{fin.problems})_{ij} + \beta_8(\text{unpredictability})_{ij} \\ & + \beta_9(\text{secondary})_{ij} + \beta_{10}(\text{service})_{ij} + \beta_{11}(\text{corruptioncost})_{ij} + \alpha\mu_i + e_{ij} \end{aligned}$$

Where  $\mu_i$  corresponds to the unspecified country-specific effects and  $e_{ij}$  is a stochastic disturbance term. Here country effects are treated as fixed parameters to be estimated. Since  $\mu_i$  are not directly observable and their coefficients  $\alpha$  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 the 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 conditional fixed effect logit (Chamberlain, 1980; Baltagi, 2005). Country dummy and conditional fixed effects logit estimates are reported in Columns 3 and 4. Both models fit the data better than the intercept-only models, the coefficients of interests are positive and statistically different from zero, and the marginal effects of corruption are given by  $\exp(\beta_3) = 1.028$  and  $\exp(\beta_3) = 1.035$  respectively. Notice that the 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 random-effect estimation. Unlike the fixed-affect dummy variable models, the random coefficient hierarchical (or variance component) models treat country-level effects as random variables.<sup>11</sup> Different model specifications allow for varying both the intercept and slope coefficients.<sup>12</sup> I estimate the random-effect varying intercept model (Column 5) using probit estimation as developed by Butler and Moffitt (1982) which is the binary-choice dependent variable counterpart for the hierarchical linear MLE estimator (Raudenbush & Bryk, 2002; Luke, 2004). I also report the random intercept and slope hierarchical MLE estimates in Column 6. The coefficients on the corruption variable retain their sign and statistical significance.

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<sup>11</sup> For issues involved in estimating models for discrete-response data see Goldstein (1991), Hsiao (2003), Baltagi (2005).

<sup>12</sup> I estimate variance component models of the following forms:  $Y_{ij} = \alpha + \sum \beta_k X_{kij} + u_{0i} + e_{ij}$  for the random intercept and  $Y_{ij} = \alpha + \sum \beta_k X_{kij} + u_{0i} + u_{1i} X_3(\text{corruption})_{ij} + e_{ij}$  for the random intercept and slope.



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

**Table 4.3:** Results of firm-level analysis. Dependent variable: Pr(membership = 1).

Maximum likelihood estimator. Significance:  $\wedge$ .05 (1-tail), \*.05, \*\*.01, \*\*\*.001 (2-tail).

The effects of the cost of corruption variable deserve special mentioning. The negative signs reported in Columns 1, 2, and 3 support my expectation that high costs might have a prohibitive effect on collective action. The variable, however, loses its significance when unobserved country-level effects are taken into account (Columns 4, 5, and 6), meaning that cross-country variation in the levels of bribes has driven the spurious correlation. At the same time enterprise size, foreign ownership, de-novo status and sectoral dummies retain their signs and statistical significance.

The positive effect of corruption on association membership appears as the most puzzling empirical finding. The statistical tests developed above reveals that business associations' membership is statistically related to corruption when controlling for other factors, such as parliamentary political institutions (and other unobserved country-level variables), sectoral effects, and enterprise characteristics. The results of applying alternative statistical techniques and different model specifications all suggest a positive statistically and substantively significant relationship between perceived frequency of corruption and firms' likelihood of being a member of business associations. The positive relationship between frequency of corruption and membership in associations is an unexpected finding given the standard arguments asserting the negative relation between corruption and legitimate collective actions. The results of statistical analysis, contrary to the standard arguments, suggest that as more and more bureaucrats enter the corrupt relations more firms chose the organizational strategy. Such findings, however, require additional investigation and theoretical interpretation.

#### 4. 2. 3 Aggregate Level Analysis

If the detected relationship between corruption and group formation is actually taking place in the post-communist context, such effects should be observed, not only at the enterprise level, but also at the aggregate levels. Countries with higher levels of corruption should also have a higher proportion of businesses joining associations. Here, I present the results of the aggregate-level analysis of the effects of corruption on group formation. Analyzing the country-level effects of corruption is complicated by the mutual interdependence between this explanatory variable and the overall levels of development and economic transformation. The relationship between corruption and group formation, for instance, might be driven by the endogeneity of corruption to the economic development and rapidly transforming socio-economic environment.

Indeed, in the sample of 25 post-communist countries there is a .88 correlation between per capita GDP and the extent of corruption, a .59 correlation between corruption and the private sector share of GDP, and a .87 correlation between corruption and the regulatory quality of the government.<sup>13</sup> At the same time, correlation between corruption and the least controversial indicator of the levels of economic development—infant mortality rates—is -.72. The institutional and political variables (levels of democracy, parliamentary regimes) have the positive, but statistically insignificant correlation with the extent of economic reforms and levels of development.

Corruption is empirically linked to the overall levels of economic development. Higher levels of corruption in Eastern Europe and former Soviet Republics are usually associated with a higher per capita GDP. Although scholars studying corruption as

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<sup>13</sup> The last measure is taken from (Kaufmann & Mastruzzi, 2003).

independent variable in the corruption—development puzzle (Nye, 1967; Myrdal, 1968; Rose-Ackerman, 1999; Mauro, 2002) accentuated the long-term negative developmental consequences of the former, the opposite relationship is observed in post communist cases. The negative effect of corruption on growth and development might be expected in the future as the created market distortions, development of unproductive institutions, and detrimental effects of rent-seeking behavior might accumulate considerable deadweight social costs.

At this point, however, corruption might be better conceived as a consequence of the levels of economic activities, amounts of potentially extractible wealth in the possession of the private sector (Miller et al., 2002) and the extent of bureaucratic complexity (Huntington, 1968) which comes as a product of economic development. In wealthier countries, businesses are more likely to come into contact with state officials when trading with their domestic or foreign partners, or while introducing more sophisticated services that require state licensing. An alternative interpretation is that wealthier economies, on average, generate more producer surplus, which can be extracted by the corrupt public officials without disrupting economic incentives on the part of private sector. The extractive *capacity* of state officials also increases as a result of higher levels of socio-economic development.

This theoretical and empirical connection between development and corruption suggests that any attempt to study their separate impact on business interest organization must confront the endogeneity problem. Such a problem arises from mutual dependence between causal variables. The pitfalls of including endogenous variables on the right-hand side of the multivariate regression analysis are underscored by Kitschelt (1999) in

his methodological critique of “shallow” explanations focusing on the most proximate, but not necessarily the root causes of political phenomena. Including variables of different spatial-temporal proximity to the dependent variable in the multivariate regression might lead to a situation when the effects of more distant causes are “washed out” by the effects of the more proximate causes. The danger is in attributing the independent effects to the proximate causal variables, which are, in fact, driven by the “deeper” underlying causes. In terms of my puzzle, the analysis should confront the following problem: If corruption has an effect on group formation in its own right, such an effect should be independent from the effects of the deeper factors (such as levels of economic development and political and economic reforms) which might be causing corruption.

While controlling for the extent of economic reforms, wealth exhibits a statistically significant positive effect on the organizational index. It loses its effect when control for corruption is introduced. This suggests that corruption might be a more “proximate” cause of interest organization formation. The above analysis however, does not allow ruling out levels of development as a more distant cause. Two interpretations are consistent with the results. The independent effects of wealth on association formation might be zero and the correlation between wealth on corruption might be causing correlation between wealth and associational formation. Alternatively, in addition to its indirect effect on association formation, economic development might have direct effect undetected by the OLS regression due to the violation of the assumption of independence between explanatory variables.

In order to measure independent from the level of development’s impact of

corruption on business groups' organization, I express levels of corruption as a function of economic, socio-political, and institutional variables.<sup>14</sup> These variables are identified by prior research as important explanations for levels of corruption. The extent of privatization and per capita GDP, already mentioned above, will be supplemented by variables reflective of the overall socio-economic development—infant mortality rate and the percent of urban population. In addition, I will use political competition and polarization indices to address the argument about political causes of corruption (Johnson, 2002; Heidenheimer, 2002). To address the argument about links between institutional reforms and corruption (Kaufmann and Mastruzzi, 2003), I will use indices measuring the extent of reform within financial and monetary institutions as proxies for the overall extent of institutional reform. Two political variables capture the argument about political competition and democratic institutional safeguards against corruption: the political polarization score and parliamentary regime dummy.

The endogeneity problem can be treated in a variety of ways—various multi-stage regression techniques, instrumental variables, and panel data analysis. The available data permits the use of the two-stage OLS in which the predicted levels of corruption (in this case—the endogenous variable), rather than the endogenous variable itself is used. I estimate the following two-state model:

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<sup>14</sup> The dependent variable—association membership index—is a measure of business participation in associations and is based on the aggregation of BEEPS data. The primary independent variable is operationalized through 1) the aggregated BEEPS corruption measure and 2) the averaged ranking based on multiple existing indicators of corruption (Kaufmann & Mastruzzi, 2003).

$$1^{\text{st}} \text{ stage: } Y_1(\text{Corrupt2}) = \beta_1 + \beta_2(\ln \text{Wealth}) + \beta_3(\text{PrivateGDP}) + \beta_4(\text{InfantMortality}) + \beta_5(\text{UrbanPopulation}) + \beta_6(\text{RegulatoryCapacity}) + \beta_7(\text{InstitutionalReform}) + \beta_8(\text{Polarization}) + \beta_9(\text{Parliamentary}) + \varepsilon$$

$$2^{\text{nd}} \text{ stage: } Y_2(\text{OrganizationIndex}) = \beta_1 + \beta_2(\ln \text{Wealth}) + \beta_3(\gamma) + \varepsilon ,$$

where  $\gamma$  is the vector of the predicted values of  $Y_1$  from the first stage. This technique allows for isolating the effect of development on corruption from the independent effect of the former on the organizational formation. Table 4.4 Column 1 reports the results for the second stage model.<sup>15</sup>

Variable	1 Coefficient (Standard Error)	2 Coefficient (Standard Error)
Corruption 2 <sup>16</sup>	.219374* (.122130)	.301744*(.173505)
<i>Ln</i> (Wealth)	-.007126 (.077466)	-.025990 (.084715)
All Reforms	...	-.084697 (.122610)
Constant	.370836 (.603871)	.774321 (.854379)
Adjusted R <sup>2</sup>	.42701	.39657
DF	19	18
N	25	25

**Table 4.4:** Aggregate analysis second-stage 2OLS model estimates. \*— significant at .05 level in one-tail test.

When the indirect effect of development through corruption is accounted for by the use of the two-stage model, wealth does not exhibit any statistically significant

<sup>15</sup> The adjusted R<sup>2</sup> for the first stage model is .92 which suggests that the instrumental variables predict 92 percent of the variation in the endogenous variable.

<sup>16</sup> Here I report results for *Corrupt2* only. When *Corrupt1* is used, results are similar.

independent effect on organizational formation. Moreover, unlike in the OLS regression, the coefficient for the level of development is negative, running contrary to the predictions of the development thesis. In the final analysis of the independent effects of corruption I add the economic reform variable to the above two-stage model:

$$1^{\text{st}} \text{ stage: } Y_1(\text{Corrupt2}) = \beta_1 + \beta_2(\ln \text{Wealth}) + \beta_3(\text{PrivateGDP}) + \beta_4(\text{InfantMortality}) + \beta_5(\text{UrbanPopulation}) + \beta_6(\text{RegulatoryCapacity}) + \beta_7(\text{InstitutionalReform}) + \beta_8(\text{Polarization}) + \beta_9(\text{Parliamentary}) + \beta_{10}(\text{AllReforms}) + \varepsilon$$

$$2^{\text{nd}} \text{ stage: } Y_2(\text{OrganizationIndex}) = \beta_1 + \beta_2(\ln \text{Wealth}) + \beta_3(\text{AllReforms}) + \beta(\gamma) + \varepsilon$$

Again, the only statistically significant variable is the corruption index (See Table 4.4, Column 2). Reforms and development are not statistically significant and have signs opposite from those expected. This suggests that the empirical relationship between wealth and associational formation detected by the OLS analysis is a product of endogenous effects linking development and corruption. The deeper analysis reveals that corruption, rather than development or economic reforms, facilitates the formation of business associations. I conclude that the deeper cause (economic development) does not have a direct effect on the dependent variable, but has only an indirect effect through corruption.

From the empirical tests based on available cross-national firm-level data, corruption emerges as an important explanatory variable distinguishing the process of business associations' formation. An analysis of aggregate-level data points to levels of corruption as a key explanatory variable driving the cross-country variation in levels of associational membership. The presented tests, however, cannot reveal the mechanism of



how corruption affects business association formation. These questions require theoretical exploration and qualitative empirical investigation. In the remainder of the chapter I concentrate on developing the argument that might be suggestive of the mechanisms behind this unexpected empirical finding. The next chapter focuses on qualitative evidence supporting my theoretical propositions.

#### **4.3 EXPLAINING THE CORRUPTION PUZZLE**

The arguments postulating the negative effects of corruption on group formation have concentrated on the opportunities corrupt transactions present to businesses: reduction of red tape, avoidance of bureaucratic restrictions on businesses, reducing paperwork processing time, etc. Still, consider the following threats corruption poses to businesses. As the costs of regulations and bureaucratic inefficiency mount, the interests of individual businesses come under greater pressure. As the extent of corruption grows, individual firms spend more resources on “greasing the wheels” of the predatory bureaucratic machine (Huntington, 1968, p. 386). As corruption penetrates more and more bureaucratic agencies and as the amounts of bribes rise, costs mount on businesses. Corruption directly threatens the interests of economic actors in transition. By joining business associations, individual firms might be better able to protect their economic interest without resorting to illegal corrupt practices: Organization stimulates the transfer of information about effective strategies of dealing with state regulatory regimes, helps develop legal protection mechanisms, provides better access to political decision-makers to report instances of low-level bureaucratic inefficiency and abuse, and makes bureaucratic misdeeds more visible. When corruption is rampant, the legitimate means of

dealing with regulatory pressures might in fact provide greater advantages in defending firms' economic interests.

When corruption becomes costly to sustain, businesses can do much better in advancing their economic interests by contributing their resources to a legitimate institution—a business association. By organizing in associations, firms can better protect themselves from regulatory pressures and bureaucratic inefficiency. Associations can become a medium of coordination, information-transfer, and representation. By pooling their resources, organized firms can better navigate through the complicated rules and regulations structuring their economic activities. When regulations are complicated and corrupt bureaucrats hold a monopoly over their implementation, business associations capable of interpreting and navigating regulatory regimes became much more attractive alternatives. The more widespread the corruption, the greater the gains derived from joining such associations. Thus, at higher levels of corruption, the incentives to form associations should be higher.

This argument suggests that business associations provide the selective benefit of reducing the cost of regulatory compliance and, thus, compete with bureaucrats that might offer comparable benefits through corrupt transactions. Business associations, therefore, would not directly reduce instances of corruption, but would rather make their members less likely to engage in corrupt relations. (When most firms join associations, corruption should become less attractive to bureaucrats). The protection from a hostile regulatory environment that business associations supply for their members, thus, can be seen as a club rather than as a purely collective good. As with other club goods,

protection is excludable, and its net benefit is an increasing function of associational membership. In the following pages, I formalize this argument.

#### **4. 3. 1 Modeling Participation**

I model business decision to participate in associations as a strategic interaction between businesses, state bureaucrats, and associations. Business behavior under regulatory regimes is conditioned by the cost of compliance with the rules and regulations as well as by the cost of alternative strategies. I arrive at predictions opposite to the standard arguments about relations between corruption and collective action. I specify conditions under which organizational response (forming business associations) become the optimal strategy for businesses. Consider the following model of business participation in voluntary associations.

##### *Model Assumptions*

I start with two plausible assumptions about bureaucrats and businesses. First, I assume that businesses incur costs associated with regulatory compliance—receiving licenses, permissions and certifications to operate; meeting various public, environmental, consumer, and worker safety requirements; ensuring state-enforced quality standards; keeping up with paperwork required by tax and customs authorities, local state administrations and various ministries and specialized agencies—and they want to reduce that cost. Second, the bureaucrats can overlook noncompliance with the regulatory regimes on the part of the businesses in exchange for bribes. Let us examine these assumptions. Compliance with regulations imposed by the state is costly not only

because of the direct monetary transfers (taxes, fees, and wages), but also because of monetary costs of adopting required business practices (having a specialist on staff, using more expensive, certified equipment and technology) along with non-monetary costs expressed in managerial time spent dealing with regulatory state institutions. In the model, these costs are factored into the businesses' profit maximization function.

The total cost associated with running a business can be broken down to the market cost of production and the cost of compliance with the regulatory environment that includes taxes, registration, licensing, inspections, managerial time, etc. Firms maximize their profits by increasing revenues and reducing costs. It is in their best interests to reduce the cost of regulation. If we allow a firm to have little market power and, thus, unable to manipulate its market-related costs and revenues through market strategies and technological innovations—a special case of a firm in competitive market settings—reduction of regulatory costs becomes the more feasible way to increase profits. One of the possible ways of reducing regulatory costs—and this is consistent with Huntington's view—is offered by corruption. “Speed” fees reduce processing and managerial time spent dealing with the state bureaucracy, while “blindness” fees allow businesses to avoid expensive environmental and labor regulations, use unapproved equipment and production processes, and hide taxable transactions. A profit-maximizing firm might find it advantageous to strike a corrupt deal with a regulating bureaucrat and pay bribes in exchange for violating costly regulations. As long as bribing is cheaper than compliance, a firm prefers one to the other. In other words, it will pay bribes up to the amount equal to the cost of regulatory compliance, subject to the total profit constraint.

### *Actors and Strategies*

The model has three players: a firm ( $F$ ), a bureaucrat ( $B$ ), and an organization ( $O$ ). All are assumed to be rational utility maximizers. The firm maximizes income (profit) or the difference between revenues and costs:  $I_F = r - c$  where  $I_F$  is income,  $r$  is total revenue, and  $c$  is total cost. Businesses operate under the total budget constraint set by  $0 \leq I_F = r - c$ . The cost ( $c$ ) can be disaggregated into production cost ( $c_p$ ) and regulatory cost ( $c_r$ ). The bureaucrat maximizes his personal income rather than pursues public interest. The bureaucrat's income is derived from his/her salary and any bribe ( $b$ ) s/he might receive as a "side payment" from the firm. Provision of such "additional" bureaucratic services does not entail any direct monetary costs. The organization's income is a function of the membership and consists of the difference between dues ( $d$ ) charged and particularistic goods ( $g$ ) provided. The particularistic good ( $g$ ), or selective incentive, is in the form of legal and professional help in complying with rules and regulations.

The firm chooses among three options for satisfying regulatory requirements: *comply* with existing regulations at a cost of  $c_r$ , *bribe* the bureaucrat, or *join* the organization and receive assistance in complying with existing regulations.<sup>17</sup> The bureaucrat chooses to be *honest* or *corrupt*; a corrupt bureaucrat must decide on the

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<sup>17</sup> The fourth strategy in fact exists. The total profit constraint means that, if the cost of regulatory compliance exceeds firm's revenue minus the cost of production and other strategies are not available, the firm might be forced to go under. Operating illegally, the firm runs the risk of being prosecuted, thus private protection mechanisms, including mafia-kind organizations are going to insure firms' continuing operation in the illegal sector. The firm's activity per se is not illegal—in might continue producing legal products and provide legal services. What makes the firm's operations illegal is that it exits regular regulatory relations with the state, such as paying taxes, obtaining permits and licenses, and submitting its practices and products to the state control and protection. Such strategy, however, goes beyond the scope of this investigation.

amount of a bribe,  $b$ , to charge the firm in exchange for overlooking regulatory violations. The organization decides on a level of dues ( $d$ ) and on the amount of a particularistic good ( $g$ ) that will be provided to the firm, subject to  $F$  paying  $d$ . If the firm and bureaucrat engage in corrupt behavior, both risk being prosecuted with probability ( $p$ ) and paying a fine, ( $f$ ). Under three strategies available to the firm it maximizes income, ( $I_F$ ) as defined below.

$$\begin{aligned}
 I_F(\text{comply}) &= r - c_p - c_r \\
 I_F(\text{bribe}) &= r - c_p - b - pf \\
 I_F(\text{join}) &= r - c_p - c_r - d + g
 \end{aligned}$$

The bureaucrat maximizes income,  $I_B$ , where  $s$  is salary.

$$\begin{aligned}
 I_B(\text{honest}) &= s \\
 I_B(\text{corrupt}) &= s + b - pf
 \end{aligned}$$

All variables are assumed to be non-negative and  $p$  ranges from 0 to 1. I further assume that the organization's payoff is an increasing function of membership and is greater when  $F$  joins than when  $F$  does not join. The organization therefore maximizes ( $d - g$ ) or, equivalently, minimizes ( $g - d$ ), subject to  $F$  joining.

The bureaucrat and the organization make simultaneous proposals to the firm. The bureaucrat proposes a bribe,  $b$ , and the organization proposes dues,  $d$ , and a selective good,  $g$ . The firm then chooses *comply*, *bribe*, or *join*. Equilibrium outcomes will be Nash. The firm chooses *join* over *comply* if and only if  $I_F(\text{join}) > I_F(\text{comply})$  or, equivalently,  $g > d$ . Similarly, the firm chooses *join* over *bribe* if and only if

$I_F(\text{join}) > I_F(\text{bribe})$  or  $c_r + d - g < b + pf$ . Hence, in order to entice the firm into the organization, the organization must offer a combination of  $(g - d)$  such that

$$(1) \quad g - d > c_r - b - pf .$$

The bureaucrat is corrupt whenever  $I_B(\text{corrupt}) > I_B(\text{honest})$ , or

$$(2) \quad b > pf .$$

To entice the firm into corrupt behavior, the bureaucrat must offer a bribe such that  $I_F(\text{bribe}) > I_F(\text{join})$ , or

$$(3) \quad b < c_r + d - g - pf .^{18}$$

Notice from (3) that if the organization proposes  $(g - d) = c_r - pf$ , then the necessary and sufficient condition for the firm to bribe rather than join is  $b < 0$ . The bureaucrat, however, will be honest rather than offer a negative bribe, and so, for  $(g - d) = c_r - pf$ , the firm joins rather than bribes and the bureaucrat chooses to be honest. In addition, assuming  $c_r > pf$  so that  $g > d$ , the firm joins rather than complies. This will not be an equilibrium, however, because the organization can attain grater utility and still entice participation by offering less than  $(g - d) = c_r - pf$ . The smallest  $(d - g)$  the organization can offer and still deter the bureaucrat from corrupt behavior is  $(d - g)$  such that  $b < pf$  in (3), and the bureaucrat prefers honesty. The organization's minimum offer that will entice the firm into membership is therefore  $(g - d) = c_r - 2pf$ ,

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<sup>18</sup> The bribe should simultaneously satisfy  $I_F(\text{bribe}) > I_F(\text{comply})$ , so that  $b < c_r + pf$ .

assuming  $c_r > 2pf$ . Given this offer, the bureaucrat's best response is honesty, and the firm's best response is to join.

### *Implications*

Suppose organizations are more likely to thrive the smaller  $(g - d)$  is; that is, the greater the dues they can charge relative to the particularistic goods they offer. A couple empirical predictions then follow. First, *ceteris paribus*, organizations should be more prevalent in regimes where  $p$  and/or  $f$  are relatively high. Second, *ceteris paribus*, organizations should be less prevalent in regimes where  $c_r$  is relatively high. And third, and most important, all other things being equal, organizations should find it easier to entice participation when  $b$  is high. Let us consider these implications closer.

Since the organization minimizes  $(g - d)$ , the lower  $g - d$  guaranteeing participation, the greater are incentives for establishing an association. Lower  $g - d$  means that in order to induce participation the organization could either charge higher dues,  $(d)$ , or provide fewer benefits,  $(g)$ . Remember that  $F$  joins rather than bribes then condition (1) is satisfied. Since both sides of inequality (1) are positive, when terms  $(pf)$  and  $(b)$  increase, the corresponding difference  $(g - d)$  decreases. *Ceteris paribus*, this means that when fines  $(f)$ , probability of prosecution  $(p)$ , and bribery  $(b)$  are high organization can entice firms to participate by offering either lower particularistic goods  $(g)$  or higher dues  $(d)$ . At the same time as  $c_r$  increases,  $(g - d)$  also increases, meaning that when regulatory compliance is costly, organization has to offer a particularly lucrative combination of benefits and contributions to attract firms.



The model predictions, therefore, suggest that, all other things equal, organizations should find it easier to form and attract members in regimes marked by higher bribery, lower regulatory costs, and more serious anti-corruption measures.

The latter of these implications comes as no surprise given the conventional wisdom. When corruption is costly—either due to severity or certainty of punishment—corrupt behavior is deterred and participation in business associations becomes a more attractive strategy for defending business interests. The other two implications are somewhat counter-intuitive. It might seem logical to expect that costly regulations would stimulate the formation of legitimate associations demanding the reduction in regulatory pressures. The model, on the contrary, suggests that when regulatory costs are high, associations have to work harder to provide cost-effective regulatory relief. Lastly, and most importantly, the model demonstrates that when, other things being equal, firms are spending more resources in bribes, associations find it easier to organize and attract members.<sup>19</sup> This theoretical prediction contradicts the conventional arguments about the negative relation between corruption and legitimate collective actions, but finds support in the empirical tests indicating the positive relationship between corruption and collective action presented earlier in this chapter.

#### **4. 3. 2 The Defensive Organization Argument**

The strategic interaction between firms, bureaucrats, and associations modeled above offers a new approach for conceptualizing the effect of state regulatory institutions

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<sup>19</sup>Further notice that, in the absence of an organizational alternative, bribes charged by bureaucrats are given by  $b < c_r + pf$ . Thus, there is a relationship between the cost of regulatory compliance and bribes. This, however, is changed once the organizational strategy becomes available.

on collective action of businesses. State regulatory regimes, bureaucratic probity, and functions performed by associations appear as important pieces of the emerging explanation for organizational formation. Building from the limited set of assumptions about firms' interest vis-à-vis state regulatory regimes, the model arrived at conclusions linking associational formation to regulatory pressures, the extent of corruption, and anti-corruption measures. The presented model traces the roots of bureaucratic corruption to the regulatory environment and to businesses' desire to reduce the cost of complying with regulatory costs. When corruption becomes wide-spread and bribery mounts, business interests become threatened. A solution can be provided by business organizations. They present the legitimate means of selectively reducing the cost of regulations and bypassing corrupt bureaucrats. Because business associations provide such services selectively to their members, the model does not imply an economy-wide corruption reduction. Rather, it suggests that, in highly corrupt regimes, business associations can more easily extend their protective services to the members most exposed to corruption.

In the proposed framework, business associations can reduce regulatory costs as a selective incentive to their members. Organizational strategy, although by means different from corruption, is aimed at achieving the same results—curtailing regulatory pressures. Unlike corruption, which provides immediate relief, the organizational strategy is more effective in the long run. The corrupt deals with the low-level bureaucrats do not change the economy-wide regulatory cost, but just provide one-time relief from the regulatory burden. Business associations can provide protection to a business that finds it increasingly costly to comply with official rules and regulation or to pay bribes. As such,

the business organization strategy provides a defense from the bureaucratic-regulatory predicament.

Organizations can reduce the costs of regulatory compliance by either undermining the bureaucratic monopoly on regulation or challenging the rationality of regulatory practices. The former might appear in a form of self-regulation by industry associations that would call into question the necessity of elaborate state regulatory mechanisms. The latter can be done by employing legal expertise, litigations with state institutions, and other means that might be too expensive for a single firm. Creation of organizations representing the interests of businesses in a particular region or industry offers additional channels for advocating the cause of regional or sectoral development and adds legitimacy to the demands for reduced regulations. Overall, by pooling their resources, organized firms can better fight costly regulations by increasing public awareness, appealing to the higher authorities, or employing legal protection.

The organizational strategy outlined above offers businesses the benefits of reduced regulatory costs and an escape from administrative corruption. The success of this strategy, however, depends on simultaneous actions of many individual firms and might become a subject of the collective action problem. This problem is by-passed when organizations are able to provide concentrated private benefits to their due-paying members, so the reduction of regulatory costs is internalized by the firms participating in organizations. Organizations—business associations—can produce protection from regulatory pressures in a form of private goods to be purchased through organizational membership. Protection from bureaucratic extortion, therefore, is provided in a form of selective and not collective goods that would imply an economy-wide reduction in

regulatory costs. In this formulation, the formation of business associations ceases to be the collective action problem.

As the initial problem of organization is solved through the selective benefit provision, opportunities for truly collective benefits may arise. Individually, firms do not have the bargaining power to change the cost of regulatory compliance or bribes. However, as a group, firms might get greater leverage over state rules, regulations, and enforcement mechanisms. If they are able to organize collective action, they can act as an interest group, legitimately demanding industry- or economy-wide benefits.

Although the data analysis I presented earlier is consistent with the theoretical argument emphasizing defensive nature of business associations, the direction of causation cannot be established since the quantitative data lacks temporal dimension. The finding can be interpreted as signifying that members of business associations, on average, face greater corruption pressures. Or, in the case of the firm-level analysis that uses perception-based measures of corruption, one could argue that associations simply increase awareness about corruption. It is hard to rule out these possible objections with the snapshot data analyzed in this chapter. Thus, in order to establish the direction of causation and evaluate the possibility of causal mechanisms implicit in the presented formal model, the next chapter conducts a qualitative analysis based on case studies of business associations.

Empirical evidence available in the related literature suggests that post-communist business associations provide a range of benefits exclusively (or cost-effectively) to their members. It was demonstrated empirically that functions and activities of voluntary business associations developed in the post-communist countries include various

particularistic benefits that have been of important value to associations' members (Recanatini & Ryterman, 2001; Pyle, 2006; Markus, 2007). My own field work in Russia, Ukraine, and Croatia has revealed that the provision of information, expert advice, training, legal assistance, and other types of "protection" against rapidly changing rules, regulations, and procedures affecting businesses are the most demanded services provided by business associations to their members. In the next chapter, I present a detailed qualitative analysis of the development of business associations. My analysis demonstrates that the particularistic and collective goods provided by associations are important factors affecting business participation in associations.

#### **4. 4 SUMMARY**

This chapter investigated the effects of the socio-economic, institutional, and regulatory environment on the formation of post-communist business associations. The most important findings concern the effects of a state regulatory environment. Such an environment in many post-communist countries is characterized by extensive regulations as well as by low-level administrative corruption. Administrative corruption was analyzed as presenting opportunities and creating pitfalls for the business in transitional countries. Based on previous research on the causes of interest group organization, testable propositions were formulated and submitted to quantitative analysis. A statistical analysis of cross-national survey data on 1833 firms in 25 countries of Eastern Europe and the former USSR as well as aggregate socio-economic indicators supported some standard arguments about the causes of interest group formation, including the effect of

political institutions and characteristics of firms and industries. I also find virtually no support for the claims about the impact of socio-economic factors.

The most interesting empirical finding, however, was discovered in the sphere of a regulatory environment and, more specifically, bureaucratic corruption. My analysis reveals that the frequency of bureaucratic corruption has a positive effect on membership in business associations. This suggests that an interesting pattern of relationships between economic agents and state structures is emerging in the post-communist context. Higher perceived levels of bureaucratic corruption in transitional countries, quite surprisingly, stimulate collective action on the part of 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 order to theoretically explain such an unexpected empirical relationship, this chapter presented a stylized model of interactions between firms, bureaucrats, and business associations. I modeled participation in business associations as firms' responses to the corrupt bureaucracy and intrusive regulatory regimes. In this analysis, firms organize to pool resources needed to push their demands for regulatory relief. I argued that business associations arise as a defense mechanism to protect businesses against corruption and extensive regulations. Business associations help reduce the regulatory burden in a form of selective benefits. This allows firms to escape the pitfalls of the collective action problem. The model predicts that, other things being equal, business associations should find it easier to organize firms in a system marked by higher degrees of corruption and more effective anti-corruption measures. Another prediction is that more intrusive regulatory regimes, in fact, make it harder for associations to attract

members. The expectations derived from the formal model are consistent with the empirical finding about the positive effect of corruption on business association formation. The model is subjected to further testing in the subsequent chapters.

It is important to reiterate that my argument about the influence of corruption on the formation of business associations addresses low-level bureaucratic corruption. Entirely different dynamics can be observed if one considers other types of corruption involving higher-level civil servants and politicians. In my analysis, corruption operates at the rule-implementation level where public servants can withhold enforcement of regulations in exchange for unofficial payments. At the higher levels, the development of rules and regulations favoring special interests is likely to become the center of corrupt practices. This is likely to alter incentives on the part of businessmen, politicians, and bureaucrats and lead to different consequences for business associations.

## CHAPTER 5

### PROTECTIVE ORGANIZATION: THE QUALITATIVE EVIDENCE

*Nothing is particularly hard if you divide it into small jobs.*

Henry Ford, Founder of the Ford Motor Company

Although data analysis presented in the previous chapter is consistent with the argument that businesses organize to provide protection from corruption and extensive state regulations, more investigation is needed to identify the mechanisms through which business associations achieve this goal. This chapter examines the ways in which business associations respond to the demands of their constituents and interact with state regulators. My qualitative analysis concentrates on examining the functions performed by business associations, and suggests that their services and activities are, in many cases, specifically directed to reduce bureaucratic intervention and vulnerability of businesses. I find that protection from corruption and reduction of bureaucratic barriers is provided in a form of selective incentives and, in fewer cases, as industry-wide collective benefits. I will present case studies of business associations that presently function in Russia, Ukraine, Croatia, and Kazakhstan. These case studies demonstrate different approaches undertaken by business leaders to tackle the problems of suffocating regulatory environments and corrupt bureaucracy. Before proceeding to cases of selective incentives



and collective benefits provision, I will describe the qualitative data and outline the general pattern of associational life in Ukraine and Kazakhstan to parallel similar descriptions of the Russian system of business representation presented in Chapter 3. A description of the Croatian system of business representation is provided in Chapter 6. Interested readers may consult the corresponding section before proceeding to the association case studies.

### **5.1 ADVANTAGES AND LIMITATIONS OF THE QUALITATIVE DATA**

The quantitative analyses presented in the previous chapter are consistent with my defensive organization argument postulating that associations provide their members with services that reduce the cost of doing business. According to the quantitative cross-national survey data analysis, businessmen who perceive corruption to be a problem are more likely to join associations. This finding is consistent with the predictions derived from the formal model, suggesting that associations provide a cost-effective alternative to corrupt behavior. Still, the quantitative analysis does not rule out possible competing arguments that might be consistent with the observed empirical relationship. Most importantly, the direction of causation cannot be established on the basis of regression analysis. The finding can be interpreted as signifying that members of business associations face greater corruption pressures. Or, when considering perception-based measures of corruption, one could argue that associations simply increase awareness about corruption. It is hard to address these possible objections with the snapshot survey data, since it lacks a temporal dimension.

A different type of data is needed to rule out these possible objections. Thus, in

order to establish the direction of causation, I will trace the development of business associations in different sectors of Russian, Ukrainian, Croatian, and Kazakh economies. If the hypothesized relationship between corruption and group formation is taking place in the post-communist context, it should be possible to detect these effects by investigating concrete examples of associations' formation. Another rationale for these case studies is that available quantitative data does not allow us to understand *how* corruption affects business association formation.

To establish the direction of causation and trace the causal mechanisms behind my claims, this chapter will present ten case studies of business associations. Five cases illustrate the ways in which associations provide protection from corruption in the form of selective incentives, and five present examples of collective benefits associated with regulatory relief that produce a common good for the entire business community, including both organized and unorganized firms. These case studies do not cover all types of activities undertaken by business associations that, in addition to their protective function, play other political and economic roles.<sup>1</sup> The cases, however, are representative of the different ways in which associations provide protection from corruption and reduce regulatory burden. In order to accomplish these tasks, associations interact with state bureaucracy and political elites; thus, the adopted strategies are shaped not only by the demands of the business community and resources available to associations, but also by the opportunities presented by state institutions. In choosing which cases to give a more detailed descriptive analysis, I took into consideration associations' size and resources

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<sup>1</sup> See Chapter 3, as well as the next section of this Chapter, for discussions of these political and economic roles.

and selected associations operating in different countries under different institutional constraints.

Case studies are essential to understand the mechanisms through which associations are providing responses to regulatory burden and corruption. In this respect, the question of how representative the selected cases are acquires major importance. Published sources, such as newspapers and specialized reports, are more likely to report success stories of associational activities. Failed campaigns are likely to escape media attention. In personal interviews, the leaders of associations are more likely to emphasize their points of pride rather than fiascos. Thus, we might never know about many unsuccessful ways of answering the demands of association members, regardless of how numerous they might be. Without survey data on association members, it is also impossible to assess the value of the protection mechanisms provided by associations and how important they are in the larger array of services provided by associations.

Unfortunately, there are no comprehensive data to give an indication of the prevalence of protective functions performed by business associations, how valuable they are to associations' members, or how effective one strategy is compared to another. Still, the qualitative data sometimes indirectly provides valuable insights. I judged the effectiveness of any given strategy by its end-results, such as changes in the regulatory environment. I paid special attention to the evolution of associations' functions, as such evolution signifies rising demand for a particular type of associational activity and associations' attempts to satisfy members' needs. Lastly, an analysis of failed campaigns points to potential causes of associational demise and can reveal ineffective strategies and irrelevant activities. I tried to evaluate the role of business associations in providing

protection from predatory bureaucratic environments through first-hand field research and the analysis of published materials.

I analyzed and systematized qualitative data on 43 business associations collected in the field and from printed sources. Such analysis allowed me to select interesting cases to illustrate the causal mechanisms linking regulatory and bureaucratic environments to the development of business associations. My case selection was guided by two principles. First, I wanted to present the most typical functions and activities undertaken by associations. Associations employ a number of very diverse strategies in addressing the needs and demands of their current and potential members. Each association, therefore, presents a unique combination of functions and ways to accomplish them. This complicated my task of finding the most typical associations. Instead, I attempted to cover the kinds of activities that seemed to be the most prevalent across a wide range of associations. The second criterion in my selection of association cases was to cover a range of different strategies available to associations in advancing their agenda. Therefore, I tried to select cases as diverse as possible in the kinds of activities and strategies undertaken by business associations.

These cases have to be situated within the larger systems of interest representation emerging in the corresponding countries. The following section lays out such a background for Ukraine and Kazakhstan. These descriptive analyses of business representation in Ukraine and Kazakhstan generally follow analytical guidelines developed for the discussion of the Russian business representation system in Chapter 3. The presentation of the Croatian system of business representation as a representative case for the compulsory membership systems is done in the next chapter. After presenting

the background information on Ukraine and Kazakhstan, I will proceed to the presentation of the case studies. The chapter concludes with a systematic overview of the larger pool of qualitative evidence alluding to the structure of associational activities emerging from the examination of 43 business associations in Russia, Ukraine, Croatia, and Kazakhstan.

To assess the validity of the protective organization hypothesis, it is also important to consider conditions under which businesses do not join associations. As with any non-occurring phenomena, it is hard to study organizations that never came to existence. Still, the concluding section offers discussion about “dogs that never barked”—sectors that failed to develop associations despite some strong reasons to expect associational formation. It will be shown that such cases can best be explained within the defensive organization framework.

## **5. 2 SYSTEMS OF BUSINESS REPRESENTATION: UKRAINE AND KAZAKHSTAN**

This section briefly describes the emerging systems of business representation in Ukraine and Kazakhstan and draws on public statements, program documents, media coverage, and personal interviews with leaders of business associations. In Chapter 3, I described the system of business representation that evolved in Russia, characterizing the number, organizational bases, structural forms, membership, functions, and the general patterns of creation of business associations in that country. This analytical framework provides a template for characterizing the development of interest representation and

relations between business associations and the state in Ukraine, Kazakhstan, and later in Croatia.

Development of business representation in Ukraine and Kazakhstan follows Russian patterns in many ways. This can be traced to their similar institutional structures and the common Soviet legacy of business-state interactions. There is a considerable degree of replication and cross-national learning evident in organizational forms, strategies, and leadership styles. There are also important differences in the development of associations in Ukraine and Kazakhstan traced to the unitary nature of their states, divergent political development, sector composition, and enterprise characteristics.

### **5. 2. 1 Ukraine**

According to the BEEP survey data, Ukraine, with its 15% and 24% of associational membership in 2000 and 2003, respectively, belongs to the low-intermediate membership group. According to the Ukrainian state administration, 858 national, regional, and municipal business associations officially existed in the country in 2005 (Bilych, 2005). The estimated number of actually functioning associations, however, is believed to be considerably smaller. One report suggests that the number of functioning associations in 2005 was around 200 (Bilych, 2005), while another study reports about 500 organizations (Liapin, 2005). Such disparity between the officially registered and actually functioning associations is explained by the complex procedure of both instituting and liquidating a civic organization that, similarly to the Russian practices discussed in Chapter 3, does not provide an easy mechanism for removing an disbanded organizations from state statistics.

The formation of business associations and their legal rights are regulated by two pieces of legislation. The 1992 Law on Civic Organizations stipulates two ways in which civic associations can be legalized: by official registration with municipal and regional state authorities and the Ministry of Justice, or by notification. Organizations that have not been recognized by the state are banned from civil life. Official registration involves the process of reviewing the founding documents by the corresponding state authorities. This process can take up to two months. Legalization by notification provides for a simplified mechanism, but the 1992 law is vague on the mechanisms and eligibility for this simplified procedure. Business associations established after 2001 could undergo their legalization under another piece of legislation: the 2001 Law on Employer Associations. Unlike the 1992 law that recognized only individuals and other civic organizations as legitimate founding entities and potential members, the 2001 law allowed both corporate entities and individuals to organize and participate in business associations. Both laws stipulate an official registration as the necessary requirement for legalization and allow for the state authorities to deny a registration. In addition to the legalization process, the formation of a business association in Ukraine involves an obligatory incorporation, as well as registration with the statistical and social security offices, the state pension fund, tax administration, and other state authorities.

According to one survey of 19 business associations conducted in 2005, about two-thirds of studied associations were registered under the 1992 law on Civic Associations, while only one of the five associations established after 2000 was registered under the 2001 law on Employer Associations. Four out of 19 associations were registered as for-profit entities (Liapin, 2005b). This legal status allows associations

to conduct economic activities, such as provision of services on a commercial basis and renting out equipment and premises to association members and non-members alike.

According to the legislation, associations can be established at the municipal, provincial, and national levels. Municipal associations are formed by enterprises or businessmen located in one municipal unit. Provincial and national organizations unite lower-level territorial organizations or individual employers from different municipalities or provinces. In addition to this territorial differentiation, the 2001 Law recognizes sectoral bases for organization. The law, however, does not assign any special status to the sectoral associations. See Appendix B for the regional distribution of officially recognized business associations.<sup>2</sup> Regions of central and eastern Ukraine with higher concentration of industrial production on average have a higher number of associations per thousand of privately owned firms.

The cross-membership of business associations that distinguishes the Russian system is present in Ukraine, but is not such a widespread phenomenon. Associations maintain their organizational independence and there is little horizontal integration. One exception is a loosely-organized group that has been established for the purpose of strategic coordination. In 1998, the Coordination Expert Center of Business Associations of Ukraine (CEC) was founded as a permanent coalition of business associations. Although CEC has a permanent staff—the analytical expert body—and regional offices, it sees its role not as a hierarchical umbrella organization, but rather as an ongoing

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<sup>2</sup> The Autonomous Republic of Krym has a special status within Ukraine. In the Ukrainian official documents, it is recognized as having higher than a provincial status, and its administrative and civic institutions are referred to as “republican,” rather than provincial. For the purpose of simplification, instead of writing “provincial and republican,” I will use “regional” in reference to the sub-national political and social institutions and organizations.



coalition. Since 2000, the permanent expert body functions as a think tank under the name of the Institute for Competitive Society. CEC is the largest and most significant horizontally-integrated group uniting Ukrainian business associations. Its organizational structure is loose and fluid. CEC emphasizes partnership and cooperation among its members and refuses to take on issues that could be seen as protectionist or anti-free market (<http://www.ics.org.ua>; Liapin, 2005).

Although the law does not require the development of vertical organizational structure for an association to claim a regional or national status, several vertically integrated business associations emerged in Ukraine. The Ukrainian League of Industrialists and Entrepreneurs (ULIE),<sup>3</sup> Ukrainian Chamber of Commerce and Industry (UCCI),<sup>4</sup> and Ukrainian Employers' Federation (UEF) are the major associations with strictly hierarchical organizational structures. The national-level ULIE and UCCI unite territorial organizations from all of Ukraine's provinces, federal cities, and the Republic of Crimea. Membership in these associations is structured on a territorial basis. While other hierarchically organized associations function as cross-sector, general purpose

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<sup>3</sup> ULIE was established in 1992 as a successor to Ukraine's Association of Industry, Construction, Transport and Communications that emerged in the 1980s. From the beginning, the ULIE represented large state-owned and privatized enterprises mainly located in central and eastern Ukraine. One of the most important developments for the association was the election of A. Kinakh as its president in 1997. Kinakh's important positions in the government, including his central role in the parliamentary commission on economic reform, 1990, the governor of Mykolaiv, 1992, vice-premier for industrial policy, 1995, a member of the presidential administration, 1996, the head of the parliamentary commission for industrial policy, 1998, first vice-premier, 1999, premier, 2001, and the founder and leader of the Ukrainian Party of Industrialists and Entrepreneurs, 1999, considerably strengthened the ULIE position. According to the association's documents, nowadays ULIE unites both large and small businesses that jointly produce more than 80% of Ukraine's GDP.

<sup>4</sup> UCCI was created in 1972 as a branch of the Chamber of Commerce and Industry of the USSR. Beginning in 1992, it functioned as a state institution of the independent Ukraine. In 1997, by a special law passed by the Ukrainian parliament—Verkhovna Rada—it was transformed into a non-governmental, non-profit, self-governing voluntary organization of Ukrainian enterprises, private entrepreneurs, and their associations. UCCI inherited from its state predecessor its staff, buildings, and equipment, which gave it a head start in providing services to its established and new members.

organizations, the UEF was organized in 1998 with the specific purpose of creating a representative institution that would be party to the mechanisms of the tripartite negotiations. The UEF is organized on a territorial and sectoral basis, uniting 29 regional, 121 sectoral, and 246 local chapters.

Most business associations do not enjoy a large membership base, although the Ukrainian League of Industrialists and Entrepreneurs and the Ukrainian Chamber of Commerce and Industry claim 38,000 and 7,000 members, respectively. According to one study of 19 business associations—members of CEC—roughly half of associations have less than 100 members, one-third between 100 and 1000 members, and one-fifth over 1000 members (Liapin, 2005b). These numbers, however, are likely to exaggerate the actual membership.<sup>5</sup> Associations rarely differentiate between individual and enterprise membership. There is a tacit assumption that enterprise leaders represent their respective firms and that when management rotates, the new manager will continue at least formal, if not active, personal support for the association. The association leaders seem to value active, involved individuals more than influential enterprises as their members, although the former combined with the latter is an even greater asset. “People are everything! It is not the ‘Zaporozhstal’ [Ukraine’s largest steel producing corporation] who sits at the meetings and battles our opponents. It is the people who represent it” (Kyiv, March 2006, personal interview).

Personality seems to be a very important component contributing to associations’ reputation and popularity. The quest for influential members, however, has been particularly thorny because associations have to compete with other institutions offering a

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<sup>5</sup> See discussions on this topic in Chapter 3.

direct representation of large businesses. From 1993 to 2005, large and some medium-sized businesses had direct personal access to the top executive institutions through the Entrepreneurs' Council under the Cabinet of Ministers (Bilych, 2005; Liapin, 2005). The formation of the Council's membership was not a transparent process. The national legislature also functioned as an additional venue for direct political influence. Throughout the 1990s, Ukraine was a leader in the post-communist world in terms of the number of business people elected to the national legislature. The direct influence on the executive and legislative branches that large and medium-sized businesses enjoyed in the post-communist Ukraine has diminished the attractiveness of business associations as instruments of business representation and influence.

Since the early 2000s, business associations have been becoming more attractive as institutional mechanisms of business representation in politics and as active defenders of business interests (primarily those of small and medium businesses effectively excluded from big politics). More business and political leaders became active in the existing associations while others initiated new organizations. Yuri Yehanurov (CEC, Ukrainian Union of Small, Medium, and Privatized Enterprises), Anatolii Kinakh (UEF, ULIE), and Ksen'ia Liapina (CEC) have been active leaders of business associations while simultaneously occupying high governmental offices. A number of successful campaigns organized by Ukrainian business associations in the late 1990s and early 2000s have brought greater recognition of business associations' legitimacy and led to the development of formal mechanisms of interactions between the state and business organizations. This marks a departure from the direct, personalized methods of

interaction between big business and the state, and opened opportunities for the larger circle of business community to represent their interests.

In May 2000, the first advisory board (Council of Business Associations) consisting exclusively of representatives of business associations was established under the State Committee for Economic Development. Unlike the advisory board that existed under the Cabinet of Ministers, the Council was a more transparent institution that represented the interests of diverse groups of entrepreneurs. This guaranteed a more balanced position and the emphasis on the issues of stimulating business development, particularly in the private sector. The Council was liquidated by Viktor Yanukovich in 2004, but revived in 2005 by Yulia Tymoshenko to replace the individual-based Entrepreneurs' Council under the Cabinet of Ministers. This was done in response to street protests organized by small entrepreneurs in the aftermath of the Orange Revolution.

In 2000, a presidential decree established other formal venues for interactions between associations and the state in the form of the Civic Collegium under the State Committee for Regulatory Policy and Entrepreneurship and the Commissions (Coordinating Councils) for Enterprise Development under regional and municipal authorities. Although these institutions did not consist exclusively of representatives of business associations but included other civic organizations, media, academicians, and representatives of industrial giants, and had only consultative powers, they signified the official recognition of business associations as the legitimate representatives of business interests. This created additional opportunities for voicing and defending the demands of the business community.

“Defense of the legitimate rights of the association’s members” appears as the first objective declared by the statutes of an overwhelming majority of Ukrainian associations. Other declared goals include lobbying the interests of their members, facilitating business contacts, and promoting market and industry development, as well as informational, business, and professional development services. Such a long inventory of objectives is often included in the statutes of business associations following the standardized blueprint established by the legislation. This use of standard language seems to ease the process of registration of newly established organizations.

The actual functions performed by business associations largely depend on the membership base, size, leadership, and resources available to associations. Associations’ functions are also evolving in response to the challenges and opportunities presented by business and political environment. Similarly to Russian business associations, a vast majority of Ukrainian associations perform multiple functions. According to the CEC study, 20% of business associations offer legal and organizational protection to their members, 17% lobby on behalf of their members, 14% organize meetings and round tables to discuss common problems, 14% provide business information, 12% organize training seminars, 8% search for potential business partners, and 7% organize informal club meetings (Liapin, 2005b). Although suggestive of the variety of activities performed by business associations, these figures do not reveal the nature of these functions and services.

In the course of interviews with leaders of business associations, I was particularly interested in the services associations provide to their members and other activities, the nature of which was usually hidden under a vague “protection of members’

rights.” Such services include “legal protection” in the form of class action lawsuits, professional legal advice, or various information and training opportunities that help businessmen to defend their rights and make informed legal decisions. In addition to the legal services, “protection” usually implies lobbying of collective interests and representation of business interests in state institutions.<sup>6</sup>

About 90% of the associations I visited provide services targeted to their members. The only associations that seem to disregard this sphere of activity are the hierarchically organized umbrella groups. (UCCI, at the same time, has an outstanding record of service provision in a variety of aspects relevant to many different spheres of economic activity.) “Informational” services are perhaps the most widely provided ones, although the majority of associations do not provide information exclusively to their members. The oldest and most well-known of associations’ publications are *The Bulletin* of the Union of Small, Medium, and Privatized Enterprises (USMPE) and *The Employer* of the Union of Leasing Companies and Entrepreneurs (ULCE). Other informational services include maintaining databases for facilitating business contacts (USMPE) or business reputation (UCCI). Such services are particularly valued by the provincial members who feel isolated from the vibrant business environment of the capital city.

Business exhibitions, fairs, and public events that offer opportunities for bringing the public’s attention to goods and services offered by local enterprises constitute another sphere of associational activities. UCCI specializes in organizing international trade

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<sup>6</sup> It should be noted that until the early 2000s, there were few legitimate methods of business representation in state institutions. “Representation” therefore involved establishing contacts with local and national politicians who could promote associations’ agendas. As a result, business associations have not been important instruments in lobbying and representation, with most of such activities carried out through direct contacts between businesses and politicians.

shows in Kiev and abroad. This leaves an empty niche for the regional associations to organize local events. For instance, the Ukrainian Bakers' Association organizes a Bread Festival in the city of Khmelnytski. The Association for the Development of International Business in Kremenchytsi has an eight-year record of managing an international fair in this provincial city. Organizing official meetings, conferences, and seminars that bring together businessmen, bureaucrats, politicians, and media is another sphere of activity widely pursued by a large number of business associations. The association "New Formation," for instance, attracts a large share of members who seek publicity, contacts in state administration, and recognition of the business community through its regular meetings with the high-ranked public officials. Such meetings are highly publicized social events covered by the media and open only to the association's affiliates. The European Business Association, whose membership is open to foreign and reputable domestic firms, often organizes roundtable discussions with state officials and political figures on the topics of economic reforms and state policy. In Zhytomyr, the municipal Union of Entrepreneurs has, for five consecutive years, organized a Business Forum that brings together representatives of the local business community, administration, and international guests.

One important contrast between the activities pursued by the Ukrainian and Russian business associations is that many Ukrainian associations have been able to successfully utilize public campaigns in their effort to defend business interests. In sharp contrast to the pro-establishment position and political neutrality of their Russian counterparts, many associations representing small *de novo* Ukrainian businesses were boldly involved in the street politics of the late 1990s and explicit in their alliances with

the political forces of the 2005 Orange Revolution. Sometimes spontaneous, but often led by business associations, the street protests attracted owners of family businesses, open-market traders, taxi drivers, and other “micro-businessmen.” Such street actions were held in front of the parliament building, the seat of the cabinet, and the Kiev city administration in 1999, 2000, and 2001 and in the immediate aftermath of the 2005 Orange revolution. Many business associations (USMPE, ULCE) actively participated in these protests and even planned such street actions as a part of larger advocacy campaigns (see the Ukrainian case studies).

The first Ukrainian non-government non-profit organizations representing the emerging non-state (cooperative) sector were the Union of Ukrainian Cooperators and Entrepreneurs (1989), Federation of Professional Unions of Cooperative and Enterprises of Alternative Forms of Property (1990), Ukrainian Union of Small, Medium, and Privatized Enterprises (1990) and Ukrainian Union of Leasing Companies and Entrepreneurs (1990). The names of these associations reflect the realities of post-communist economic transition—cooperative and leasing forms of property in the emerging non-state sector and the absence of clear differentiation between employees and employers in small family and cooperative production collectives (as exemplified by the term “union,” traditionally used for workers’ organizations). The latter two of these associations, however, adapted to the new economic realities, and in 2006 were among the most stable and reputable organizations representing the Ukrainian small business sector.

The Ukrainian Association of Enterprises in Industry, Construction, Transport, Communication, and Science, whose members included the giants of Ukrainian industry,



also formed in 1990. This association was modeled after the Industrial-Scientific Union of the USSR<sup>7</sup> and was re-organized in 1992 as ULIE. The greatest surge of associational formation was in the mid- and late- 1990s, when the majority of sectoral and regional associations were established. According to the CEC study, about half of the existing associations were established between 1995 and 2000, with 10% tracing their existence prior to 1995 and a quarter established after 2000 (Liapin, 2005b).

An important question in accessing the sources of business association formation is the issue of foreign donor assistance. At the outset of economic transition, a number of international organizations developed programs for assisting the development of nascent private businesses. Some Ukrainian business associations benefited from such programs as either direct recipients or fund distributing agencies. My interviews revealed that many associations have at some point participated in foreign-sponsored programs. I also learned about multiple cases in which business associations were established with the purpose of obtaining donor money or executing donor-sponsored programs. Reliance on donor funds, according to my respondents, had disastrous consequences for associations' survival. "Everybody knew that these were well-financed façades with no substance behind them. Serious businessmen never took them seriously," shared one of my respondents. Most of these associations were short-lived unless they were able to secure an independent membership base. According to the CEC survey, 3 out of 19 associations reported donor money as the primary source of their financing, compared to 12 reporting

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<sup>7</sup> The influence of the Russian-style organizational forms can be seen in the examples of many other associations. Business Incubators, the Franchising Association, the Association of Manufacturers and Consumers of Packaging Products, and many others closely resemble their Russian counterparts in their organization, agenda, and activities. In many cases, however, such resemblance can be explained by the same legacy of communism creating virtually the same business entities and similar problems faced by these business entities during the period of economic transition.

membership dues and 4 private and corporate donations as the primary sources of financing.

### **5. 2. 2 Kazakhstan**

The system of business and employer associations in Kazakhstan is presented here as a side case offering two additional dimensions. Kazakh interest representation closely resembles Russian and Ukrainian cases in many aspects of membership, coverage, legal foundations, organizational forms, and strategies. In these respects, it does not warrant a new analytical model or require extensive empirical overview. At the same time the Kazakh case offers important insights on business interest representation under a personalistic authoritarian regime with rapidly shrinking political space and a curtailed civil society. Kazakhstan, as a society with very limited opportunities for expression, presents an important case to see whether civic liberties and political freedoms affect the development of business representation.

Kazakhstan, among other Central Asian states, is particularly prone to corruption (Miller et al., 2002; Henderson, 2000; Werner, 2000; Nichols, 2001; Kaser, 2003). In addition to its high administrative corruption, Kazakhstan is notorious for its political corruption that has led to high-profile criminal investigations in the UK, Switzerland, and the USA.<sup>8</sup> If, as suggested by the Huntingtonian argument, corruption opens informal

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<sup>8</sup> The corruption scandal labeled by the Western and oppositional Kazakh press as “Kazakhgate” started with the 1997 lawsuit in Great Britain against three US businessmen and the Kazakh prime minister. The investigation of murky oil deals led to the freezing of Swiss bank accounts opened in the names of high-ranked Kazakh officials, including President Nazarbaev. Nazabraev maintained that the arrested accounts were part of Kazakhstan’s secret oil fund rather than his personal wealth accumulated through oil concessions. In 2001 the US State Department opened its own investigation of Foreign Corrupt Practices Act (FCPA, 1977) violations by the US businessmen. The investigation and the resulting indictments

channels of interaction between individual firms and state bureaucrats, one might expect that in such a highly corrupt political system, fewer legitimate associations representing business interests will emerge. Yet, starting from the mid 1990s, we see an increase in the number of national, sectoral, and regional business associations. By the most pessimistic accounts, over 100 business associations have been established in Kazakhstan, uniting 15.6% of firms in 2000 and about a quarter of all surveyed firms in 2003.<sup>9</sup>

Through Internet, newspaper, and specialized literature searches, I came across 68 Kazakh business associations. Of those, 36 were sectoral, 32 general, 30 regional, and 36 national associations (see Appendix C).<sup>10</sup> Even by a conservative estimate, this large number of business associations points to a high degree of organizational fragmentation. This, magnified by low membership figures, competition among associations, and duplication of functions, suggests organizational weakness.

Kazakh business and employer associations differ in their organizational bases and structural forms. As is evident from Appendix C, the number of associations is split evenly between the national and regional organizations. Many of the regional and local

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implicated high-ranked Kazakh officials in oil corruption. See the *New York Times* 6 Nov. 2006; *Financial Times* 18 Nov. 2006; *Economist Intelligence Unit* 2003.

<sup>9</sup> Data on the number of business associations reported according to Kazakh Business Forum, <http://www.businessforum.kz>, the membership data – World Bank and EBRD Business Environment and Enterprise Performance Survey (BEEPS), <http://info.worldbank.org/governance/beeps/>.

<sup>10</sup> Still, more precise quantitative data on the number of Kazakh business associations are lacking. Although Kazakh legislation strictly regulates the process of establishing civic associations and requires all organized groups to apply for official recognition by the state authorities (to “register”), incorporation/registration registries are not particularly useful in identifying the number of business associations. Once registered, an association may stay on the books even after it ceases to exist. The other problem is presented by the fact that in order to determine whether a civil association in fact represents business interests, it is important to examine not only the organization’s statute, but also its current activities. For instance, among the oldest Kazakh business associations, established in the early 1990s, is a number of so-called “professional unions” of entrepreneurs. There are other business associations that take the names of foundations, civil organizations, unions of workers in a particular industry, etc.

associations are integrated into the larger national associations. This hierarchically (vertically) integrated structures are the central organizational principles of such associations as the Kazakh Business Forum (created in 1992), the Chamber of Trade and Industry (functioning since 1965),<sup>11</sup> and the Employers' Confederation of the Republic of Kazakhstan (1999). Although vertical integration is widespread, many associations do not belong to any of the vertical structures, but are rather integrated in horizontal networks. The difference between horizontal and vertical integration can be demonstrated by the example of the Kazakh Business Forum, which has regional offices that function as integral parts of the Forum (vertical integration) and a number of independent associations that join the forum while maintaining their organizational and financial independence (horizontal integration). The legal frameworks regulating the formation of associations are responsible for such peculiar patterns of associational cross-membership—when one association becomes a member in another association while retaining its autonomy. Kazakh civil code allows for public entities—non-commercial associations—to be founded by other “legal entities” such as firms and civic associations. This has become a popular form of organizing a new business association. This explains why many associations have other associations as their (founding) members.

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<sup>11</sup> The Chamber of Trade and Industry of the Republic of Kazakhstan (CTI) is a re-created Soviet structure that presets a unique example of rapid adaptation to the transitional environment. In the USSR, the Kazakh Republican Chamber was created as a counterpart to the foreign institutions of this sort and specialized in foreign economic relations. It was the primary organization responsible for expos, accreditation of foreign trade missions, arbitration, certification, some technical standard setting, and quality evaluation. The Soviet structure was reorganized as the CTI of the Republic of Kazakhstan in 1995 as a public (non-state) non-profit association with independent financing and a wider range of functions. Expertise developed by the Chamber during the Soviet times in the sphere of international trade was expanded to include domestic economy. In 1999, a system of regional chambers was developed to extend services offered by the national chamber to the local enterprises.

The other important characteristic of the system of business associations emerging in Kazakhstan is the differential bases on which associations are formed. A large number of business associations in Kazakhstan do not aspire to encompass diverse business interests. Unlike large cross-sector associations that seem to (or claim to) represent business at-large, a growing number of business associations organize on sectoral, professional, or issue-specific principles. For instance, the Kazakh Bar Association and National Freight Forwarders' Association are professionally-based groups. The Association of Milk and Dairy Producers, The Tourism and Hotel Industry Association, and The Association of Construction Industry are sectoral groups. Other associations, although not sector-specific, unite firms involved in different stages of production of a certain product. The Eurasian Industrial Association, for example, unites enterprises in metal ore mining and metallurgy. Some cross-sectoral associations have a much narrower focus than their general status would entail. For instance, the Association for the Development of Small and Medium Business unites such diverse enterprises as small retailers, sub-contractors, bakers, and private dentists. Although it is not a sector-based association, it focuses on a much narrower range of issues (specific to small business) than general associations.

It logically follows from the above discussion that associations founded on differential organizational bases and attracting members with diverse interests and demands should also vary in their activities and functions. Individual companies joining national umbrella associations are mainly large, resource-rich firms. Regional associations, as well as many professional and sectoral groups, are joined by medium and small businesses, with the primary exceptions of such sectoral organizations as the

Kazakh Energy Association, Kazakh Banking Associations, and others. It deserves mentioning that although large companies constitute a sizable membership share in the national umbrella associations, small and medium-size companies constitute the majority of their members due to horizontal and vertical integration, or organizational cross-membership. Thus, Kazakh business associations cannot be seen as the “clubs of industry tycoons” as they are frequently portrayed in the media (*Nachnem s Ponedel'nika*, Sep 16, 2005; *Argumenty I Fakty Kazakhstan*, June 29, 2005).

Another widespread misconception about Kazakh business associations is that lobbying constitutes their primary activity. Although many associations try to promote the interest of their members, the majority of their interactions with state institutions can be better captured by the term “representation”—implying a less active stance on the part of business associations. In the 1990s, Kazakh business associations and directors of large firms were able to voice their opinions during the annual meetings with the president of Kazakhstan. In fact, in the early 1990s some Kazakh business associations enjoyed the support of the executive branch with President Nazarbayev’s public appearances at the Business Forum congresses (see the case study) and regular high-profile meetings of business leaders with the president. The executive’s favoritism to business organizations, however, ended in the late 1990s. Although there is little evidence that such channels of representation have led to any substantive collective benefits to Kazakh businesses at large, it offered an opportunity to complain about actions of bureaucrats and the absence of needed legislation (Batalov, 2005; Yambaev, 2005).<sup>12</sup>

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<sup>12</sup> See also the Kazakh Business Forum at <http://www.businessforum.kz>.

Although by the 2000s the frequency of such high-level meetings somewhat diminished, business associations continued to participate in consultative and expert commissions and working groups under the president, central government, ministries, state agencies, and local administrations. At the same time, rather than concentrating on lobbying or representation, a large number of associations focused on providing services to their members. Such services included legal and technical consulting, support in finding new business partners, assistance in developing business plans, positioning products and services on the market, and professional training. Interest representation and provision of services that help firms to deal with regulating officials appeared to be the two major spheres of associations' activities.

What issues attract the attention of Kazakh business associations? What do they lobby for and how do they try to defend the interests of their members? Public figures as well as the leaders of business associations have accused their colleagues of promoting the economic interest of a company or a sector at the expense of the general well-being of society (Yambaev, 2005). One can see a mixture of particularistic and public benefits in the agenda of various business associations. The menu of services they offer to their members is very similar to the services provided by Russian, Ukrainian, and Croatian associations. Their use of public space, however, is much more limited. In no instance did a Kazakh business association participate in or organize a public protest against the government. Still, Kazakh business associations use the media, take active part in government-sponsored events, and participate in officially recognized public forums and conventions. The examples of activities undertaken by two Kazakh associations presented in the following sections suggest that Kazakh associations perform functions

beneficial to entrepreneurs suffering from rampant corruption. In many cases, associations put forward successful actions that minimize the effects of bureaucratic pressures on their members and on the larger business community.

### **5. 3 PROTECTION IN THE FORM OF SELECTIVE INCENTIVES**

In this section I return to the central theme of the chapter: investigation of how business associations are able to reduce regulatory burden and protect firms from administrative corruption. Here I consider five examples of business associations providing regulatory relief and protection from corruption in the form of selective incentives—particular services directed specifically to their due-paying members. Such services and activities undertaken by business associations provide firms with strong incentives for joining and maintaining membership in these organizations. Some of these examples are continuous services, some are periodic activities, while others are sporadic responses to changes in regulatory environment that lead to greater instances of predatory bureaucratic behavior.

#### **5. 3. 1 The Ukrainian Chamber of Commerce and Industry**

Perhaps the most effective forms of protection from state regulatory pressure and bureaucratic predation are achieved through the delegation of state functions to business associations. This is best accomplished when a business association does not become the instrument of state regulatory policy, but rather a voluntary alternative to the existing state control mechanisms.<sup>13</sup> The Ukrainian Chamber of Commerce and Industry (UCCI),

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<sup>13</sup> When business associations become the only providers of the regulatory control formerly exercised by the state, as in the case of the Croatian Chamber of Economy, this also provides effective protection from



since its re-formation in 1998 as an entity independent from the government, has acquired many functions instrumental in providing regulatory relief and defending its members against bureaucratic predation.

Building on its legacy of regulating foreign economic relations, the Chamber has extended its services of inspecting goods and services and arbitrating in commercial disputes to its members.<sup>14</sup> The Chamber's surveyor and inspection services guarantee that the quality and quantity of all kinds of goods in various trade operations correspond to contractual obligations. The association offers the services of marine agents, forwarding agents, and customs brokers that facilitate fulfillment of contracts. This also puts the authority of a reputable association behind the businessmen in their interaction with the state. The Chamber acts as a more powerful agent in these interactions. International and domestic arbitration courts and the Maritime Arbitration Commission are governed by the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards (1958) that provides for a greater protection of firms' economic rights that often remain unenforceable under the national legal code. (See <http://www.ucci.org.ua/arb/icac/en/icac.html>).

The Chamber's law department offers legal services of preparing templates of legal documents used to conclude contracts and interact with state institutions. The department surveys Ukrainian legislation and offers updated information on regulations specific to member company activities. A special resolution of the Ukrainian Cabinet of

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predation insofar as the internal organizational structure is governed by electoral principles and associations' executives are accountable to the member enterprises. Internal accountability prevents corrupt practices from making their way into the administrative structures of business associations. Internal electoral processes are attributes of virtually all business associations and are formally prescribed by law.

<sup>14</sup> Some services discussed here are free to the Chamber's members, while others are provided for a fee. Non-members can receive all the services provided by the Chamber at substantially larger costs.

Ministers (April 1<sup>st</sup>, 1999, #529) requires all government agencies to periodically submit their regulatory documentation and statistics to the Chamber. The department also offers support in formulating claims and complaints against actions of business partners and state authorities.

In 2001, the Chamber's Central Test Laboratory of Quality Surveillance received accreditation from the State Certification System. The laboratory specializes in testing the quality of foodstuffs and raw materials used in the food industry. The laboratory carries out complex testing and certifies the health safety of foodstuffs. This service is particularly valuable to companies importing new products and raw materials, introducing new transportation, storage, and processing in the sphere of food production. Independent certification reduces companies' dependency on bureaucratic controls and guards against predatory bureaucratic behavior that thrives when certification and control functions are fused in one state organization.

Additional certification services are provided by the Chamber's "Norma" certification agency. "Norma" issues quality certificates for consumer products, raw materials, and equipment that are not subject to the compulsory state certification. In some sectors, however, the lack of compulsory certification requirements results in a sub-optimal information provision and high transaction costs. To reduce transaction costs and signal valuable information to potential customers, some producers voluntarily undergo UCCI certification and the Chamber's reputation serves as a measure of reliability (Kyiv, March 2006, personal interview).

These services do not directly target state predation. Still, by providing institutional alternatives to the state agencies, the Chamber's activities facilitate contract

enforcement, reduce transaction costs, and provide valuable legal information instrumental in protecting property rights in the environment of complex and frequently changing rules and regulations (various UCCI publications). Such alternative institutional solutions reduce business vulnerability and curtail areas in which the state exercises uncontrollable authority over business.

### **5. 3. 2 League of Trade Merchants, Russia**

The League of Trade Merchants (hereafter referred to as the League) also provides selective benefits in reducing the cost of regulatory compliance and corruption for its members. The association was established in the early 1990s when fast economic changes were sweeping Russia. The League dates its existence to the price liberalization of 1992. The shocks of the newly liberalized prices, inflation, and more importantly, the breaking of the Soviet-style, state-controlled retail trade left Moscow's grocery stores in complete disarray. Initially, the League brought large supermarkets and grocery stores together in an attempt to cope with the challenges of building new markets. Organizational stimulus came from the former Ministry of Trade and its Moscow branch. However, in the following years, the association's membership composition, personnel, and activities changed dramatically. Privatization of retail trade enterprises and mushrooming of small *de novo* stores has resulted in the demise of traditional large retail stores. Small firms came to dominate the sector. The League found itself poorly equipped for the task of attracting new members whose interests were quite different from those of its initial membership base. Firms that emerged on the new economic landscape were no longer interested in an association taking over the functions of coordination formerly

performed by state agencies.

To attract new members, the League changed the focus of its activities. The association had to offer its constituents valuable services they could not achieve individually. Starting from the mid-1990s, the League realized that the most important service it could offer to its constituents was intermediation between the firms and the state bureaucracy. The activities undertaken by the association included educating the firms about the best strategies to confront corruption, informing them about their legal rights in respect to inspections and regulations, and providing legal advice and assistance to the firms coping with new regulations on trade. The kinds of mechanisms the League uses to defend its constituents include lawsuits against regulatory agencies, informational support to keep the firms updated on new regulations and legal mechanisms of safeguarding their interests, and active attempts to influence new legislation and regulations at both the formulation and implementation stages. According to the association officials, these services are most appreciated by association members, and although association membership rates remain low in the sector—estimated at about 15-20%—the firms that find themselves in legal disputes or experiencing continuing harassment on the part of authorities constitute a sizable portion of the new members.

The following example illustrates how the League's activities benefited small retail stores whose operations were burdened by low-level bureaucratic corruption. A new regulation that came into effect in 2004 demanded that all retail traders install electronic cash registers that would make auditing and control more effective. Firms had to purchase the new registers and dispose of the old ones, and small firms found it expensive to comply with the new regulation. The firms who purchased registers of the

old type shortly before the regulation also incurred losses. According to the law, the firms had the right to keep their old equipment to settle its amortization (depreciation) value. But when such a firm was inspected, it was given a large fine for not complying with the regulation. Most firms were unaware of the right to keep their old registers in use. The League used its newsletter to educate its members about their rights and advised them to report all unlawful fines to the League. Small firms receiving the fines were unlikely to dispute them with the authorities due to their time and resource limitations. The League, however, collected the reported instances of unlawful fines and disputed them in the court of law. The judge annulled most of these fines. Other examples of issues the League was involved in include fees and regulations on trash disposal, city regulations on signboards, and appraisal of the market value of store premises (Moscow, August 2005, personal interview).

Although the initial formation of the League seems to exemplify the role of associations in providing collective goods, the subsequent changes in the association's functions suggest that "defensive" function is provided in a form of selective incentives. The association discovered that by providing defense mechanisms against bureaucratic pressures to its members, it could attract new members when its old tactic for the creation of alternative mechanisms of self-regulation in the industry did not pay off. The new functions assumed by the League help to allow the association to continue its existence and increase its membership base.

### **5. 3. 3 Almaty Association of Entrepreneurs, Kazakhstan**

One of the most proactive solutions in providing protection from bureaucratic extortion is exemplified by the actions undertaken by Almaty Association of Entrepreneurs in Kazakhstan. Since its formation, the association has pursued a multi-dimensional program for reduction of administrative barriers. The major problem faced by any Kazakh business, according to the president of the association, Viktor Yambaev (2005), is presented by “uncontrolled bureaucratic rulemaking” that leads to the creation of “unreachable administrative barriers” and, as a result, extortion and corruption. The association sees the solution to these problems in state’s withdrawal from strict regulation of business and dismantling of bureaucratic hurdles. This would create a favorable business environment. The majority of the association’s members—small family-owned firms—complained about endless, unannounced inspections from about 50 regulating agencies that slowed down their operation demanding side payments. Such unannounced visits “during which the former [inspectors] would often pressure the latter [entrepreneurs] into paying bribes” (Nazarov, quoted by Chebotaryov, 2003) were seen as particularly destructive to small businesses.

In 2002, in response to a public campaign organized by a number of business associations and foreign-sponsored development agencies, state authorities implemented an experimental measure of suspending unannounced regulatory inspections. Starting from its establishment in 1998, the association has been active in publicizing its position, submitted its proposals for new laws shaping business climate, and organized events making businessmen aware of their common problems and strengths. Partly as a result of its active public stance, the association became an active player in the 2002 experimental

halt on unannounced inspections. The association had advocated such a halt on unannounced inspections, and once it took effect, it signed an agreement with state agencies allowing its legal team to monitor the legality of fines and inspections (<http://www.aekz.com/org/five/>).

The 2002 suspension of unannounced inspections, although positively evaluated by both the business community and high-ranked state officials, was a temporary measure that failed to become a permanent rule. Once the experiment ended, building on its experience of monitoring the legality of inspections, the association hired a small group of lawyers and accountants that its members could call on at the time of inspection. This emergency-response mobile legal team was available at the request of the association's members. The expert team comes to the enterprises' premises and its presence at the time of inspection makes bureaucratic pressure less likely. This service is provided to the Association's members and, for additional fees, to other interested enterprises, and is a clear example of a selective incentive providing protection from corrupt implementation of extensive bureaucratic regulations on business.

#### **5. 3. 4 Association of Trading Companies and Producers of Appliances and Electronics (ATCPAE), Russia**

The ATCPAE was created in 2000 as a professional association of the consumer electronics sector (Statute). By 2005, the association had united 55 companies, including domestic producers, distribution and service networks, and trading companies in appliances, electronic and computer equipment, and mobile phones that work in 400 Russian cities. In 2005, the association estimated that its members cover about 60% of the Russian electronics market. The associations' functions include voluntary product

certification, organization of business forums, seminars on the development of new markets, joint advertising campaigns promoting interests of its members, market research (some results are published while others are provided exclusively to the members), comprehensive marketing and technical databases, and lobbying for sectoral interests (A. V. Onishchuk; A. Gus'kov). The association members enjoy discounts on a number of services provided by the association's affiliates (ATCPAE, 2005). Since 2002, ATCPAE has published a magazine, *Electronika*, and in 2003, it launched a web-site. The association is a member of the National Chamber of Trade and Industry, Russian Union of Industrialists and Entrepreneurs, Moscow International Business Association, and other business organizations.

My interview with the vice-president of ATCPAE, Aleksandr Onishchuk, and the director for public relations, A. Gus'kov, was hard to schedule despite the initial agreement. Unlike other Russian associations that were hard to get audience with due to the lack of public relations department or unavailability of their leadership, ATCPAE had a convincing reason to postpone the interview. At the time of my field research in August-September 2005, troubling news was shaking the cellular market. On August 17, 2005, at the Sheremetyevo air cargo terminal, the Ministry of Interior seized a large shipment—300 tons—of cellular phones and accessories (*Komersant*, Aug. 25, 2005). Another shipment of 55 tons was seized a few weeks later. These amounted to two months' national sales of cellular phones. The firms importing these mobile phones were charged with smuggling and tax evasion. The “gray schemes” of importing electronics this importing company used involved declaring such products as scrap metal or other cheap products at the customs and paying VAT on the under-stated value. This resulted



in cheaper imports that later were sold to retail chains and mobile service providers—the members of ATCPAE. Although these import machinations were executed by “one-day-firms” registered under fake names and addresses, authorities initiated an inquiry into legality of products sold by the retailers (*Lenta.ru*, Aug. 17, 2005). Rumors about possible confiscations of phones and accessories already bought by retail chains from “gray” importers and charges of tax evasion touched even the largest cellular companies.

The ATCPAE leadership reacted quickly by formulating its position based on the analysis of the existing legislation. The association maintained that its member companies involved in retail trade had not violated the law by purchasing their equipment from the importing companies. ATCPAE analyzed sales contracts of its members and concluded that there was no evidence of fraud or tax evasion on the part of the retailers: they were buying products in their original manufactured packaging, designated for the Russian market and accompanied by corresponding customs documentation. The ATCPAE leadership participated in countless meetings with state officials and investigating authorities that prevented unlawful persecution and harassment of retail companies.

Even though the associations’ actions have helped in defending members’ property rights, the “August cellular crisis” had a strong economic impact on the sector. The ATCPAE’s monitoring of cellular market fluctuations indicated an immediate increase in retail prices resulting from the emerging shortage. The association’s members, as well as other retailers, faced long-term losses because of the disrupted supply chains. Although mobile service providers and retailers have decided to start direct purchases from the manufacturers, the development of new contacts required time and expertise. An

immediate task for the ATCPAE was to push for legalization of the seized 355 tons of equipment so its members could purchase the products stored at the Sheremetyevo facilities. The ATCPAE's members were interested in buying these products after legally clearing them through the customs. The association was instrumental in evaluating the value of different models of arrested mobile phones so that a proper VAT could be applied to the shipment. The ATCPAE's participation facilitated the legalization of the shipment, making it available for purchase by the association's members. This provided a much-needed intermediate solution until the newly established direct contacts between foreign producers and Russian retailers resulted in legally imported equipment.

### **5. 3. 5 Ukrainian Association of Leasing Companies and Entrepreneurs (ALCE)**

As one of the oldest of Ukrainian business associations (see the earlier section on Ukrainian business representation), the ALCE underwent a profound transformation of its membership, functions, and prioritized activities. Established as a part of the All-Soviet organization in 1990, the Ukrainian ALCE pioneered the representation of the first non-state proprietors—over one thousand formerly state-owned enterprises that were privatized or leased into private operation at the outset of economic transition. ALCE defined its primary goal as protection of the emerging private property through legal assistance, leadership development, training, and lobbying for changes in legal frameworks that would guarantee property rights of private and leasing companies. Starting in 1993, the ALCE participated in the processes of tripartite negotiations through the National Council on Social Partnership under the president of Ukraine and became

one of three employer associations to sign the General Tripartite Agreement for 2004-2005.

Initially, in 1990-1996, activities of the ALCE concentrated on the process of privatization and development of a legal foundation for private property. ALCE advocated the long-term lease with buyout as a mechanism for privatizing state property. This mechanism allowed for the development of small and medium-size enterprises on the basis of state-owned land, equipment, production facilities, and premises without any initial capital required for a buyout, but offering a constant stream of benefits to the state coffers. This plan was favored by the low-rank managers of state-owned enterprises, cooperators, and *de novo* start-ups. In 1991, the ALCE was able to propose its draft bill, “On Entrepreneurship,” to the Parliament; in 1992, it made its proposal to the draft laws, “On Leasing the Property of State Enterprises and Organizations;” in 1994, “On Privatization;” and in 1996, “On the Specifics of Privatization in the Agro-Industrial Sector” (*Rabotodavets’*, February 2004, December 2005).

Starting from the early 1990s, the representation of the legal interests of association members in the court of law became the major selective benefit provided to association members.<sup>15</sup> Legal assistance includes providing information, consulting, class action suits, and coordination of collective complaints on the actions of regulating state institutions. As early as 1990, the association put together a publication summarizing legal norms regulating taxation of non-state enterprises. The publication was distributed to the association members to educate them about their rights. The ALCE legal

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<sup>15</sup> By 2005, the ALCE united 1020 direct members (firms); 4 all-Ukrainian associations, including the Association of Employers in Trade and Commerce, Barber’s Union, All-Ukrainian Union of Trade and Services, and the Association of Ukrainian Glass; 36 regional organizations; and 19 local offices. The ALCE estimates that over 40% of its members are small firms.

department offers individual consultations regarding taxation, enterprise registration, licensing, and other aspects of conducting business in Ukraine. Corruption in state regulatory agencies is one of the most frequent issues raised by ALCE members. To facilitate its anti-corruption actions, the ALCE established a telephone hotline and a dedicated mailbox where members are instructed to direct their complaints about corrupt officials. Below are excerpts from one of the letters sent to the “anti-corruption mailbox” and the associations’ response as reprinted in the ALCE illustrated monthly publication.

”When I started my business, I came across the problem of corruption...the most profitable business opportunities and contracts were taken by the close associates of key bureaucrats at the Kyiv city administration, police, and other official institutions... Whenever I come up with a new business idea, I find myself confronted with all kinds of “inquiries” from the controlling state organizations. Only later I realize that my ideas are put into practice by someone else without any licenses, permissions, or control from the state institutions. I even know the rates of bribes paid to the representatives of state agencies and organizations... I’m not alone in this situation. What should be done when my rights are clearly violated? What else can I do in addition to going to the court? Is bribing the easiest way to get things done?”

The ALCE gave the following response in its monthly publication:

”Unfortunately, you are right that many businessmen find themselves in similar situations. There are multiple ways to fight corruption. In addition to going to court, you can file complaints against actions of state officials, or report instances of corruption to the special investigating agencies. If you have concrete evidence

of corruption, we recommend, either individually or with our assistance, that you report it to the investigating agencies... You are right that giving bribes seems to be the most rational way... But it is also true that legal action is the most efficient—if not most effective—and civilized way to confront corruption that has ever been invented... Understandably, it is hard to do so alone: you have to find an attorney, spend time in consultation, and come up with strong arguments for your litigation. All these at the expense of time needed for your business. But for that there are business associations, such as the ALCE. We exist, among other reasons, to help defend entrepreneurs' rights. *Rabotodavets'* [Employer] magazine for two years has been working towards our main goal of uniting employers into one civil force. Although individually businessmen like you can do nothing but pay bribes (and if you don't pay enough or at all, you lose!), when they unite into a socially important force, everybody—and the corrupt officials in particular—has to take them into account." (*Rabotodavets'*, November 2005)

This selection from *Rabotodavets'* magazine points out two important aspects of the ALCE mission. First, the association routinely offers legal support in defending property rights against bureaucratic predation. It pays special attention to protection from corruption and the association's legal specialists can reduce managerial time and effort in litigations and other mechanisms of legal protection. Second, the ALCE clearly recognizes its protective function in firms' relations with regulating authorities. The association response clearly identifies bureaucratic predation as a common threat to businesses and proposes organization as a rational response to this common enemy.

Evidently, the legal assistance and benefits of protection in this case are available exclusively to the organization's members. Although the ultimate goal might be the complete eradication of corruption, which is a collective good, the mechanisms used by the association imply selective benefits.

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The above examples of business associations providing protection from predatory bureaucratic behavior and navigating businesses through administrative barriers speak to the plausibility of the defensive organization hypothesis. Associations offer legal advice, channel collective complaints, supply information about firms' rights and mechanisms of dealing with state regulatory regimes, and initiate class action suits. The simple fact of membership in a reputable association in some cases provides protection from corruption. Membership in reputable associations sends a strong signal about both compliance with the rules and regulations on the part of an enterprise, and available mechanisms of protection and influence, and attests to firms' important social position and connections to the political and economic elite.

#### **5. 4 PROTECTION AS A COLLECTIVE GOOD**

Although much of the reduction in bureaucratic pressures is often achieved through selective incentives available to association members only, a more effective way of defending firms against invasive regulatory regimes is to alter regulatory framework affecting the entire business community. Some associations are able to organize collective actions to providing industry- or economy-wide benefits. Such a course of

action creates collective benefits—those that occur to firms participating in associations and contributing to the collective efforts to reduce regulatory barriers and bureaucratic abuse, as well as to those firms that free ride on the collective efforts of others. Therefore, the provision of collective goods of such sort is a subject to collective action problems. The affected firms lack the incentives to actually participate in associations that provide public goods freely for all. Still, some associations are able to successfully fight corrupt regulatory practices in a way that benefits both members and non-members. Such efforts, however, are most likely to succeed when associations effectively solve the collective action problem.

#### **5. 4. 1 Croatian Exporters Association**

The Croatian Exporters Association (CEA) is one of the voluntary organizations providing organizational alternatives to Croatia's official compulsory business organization. Created in 2004 by the managers and owners of several reputable domestic enterprises (some are also well-known political figures), the CEA declared its independence from the official Chamber of Economy and emphasized voluntary membership. According to one of the members of the CEA managing board, the reason for the formation of this association was the inability of the official chambers to adequately respond to the needs of Croatian exporters. The Croatian Chamber of Economy did not allow for two-way information flow in the organization and prevented timely response to the dynamic environment of firms seeking to establish their presence in the foreign markets (Zagreb, July 2006, personal interview). Although CEA's statute delineates its membership base as enterprises exporting or seeking to export Croatian

products, membership includes many firms that cannot be classified as exporters (e.g. Croatian Airlines, Hauska & Partner International Communications, and the Institute for Business Research).

By 2006, the CEA had two paid full-time staff members, utilized services of a legal advisor, united 800 dues-paying members (with an estimated potential membership base of 1,500), and derived 90 to 95% of its financing from membership dues (Schaw 2006). According to the USAID evaluation report, the CEA is very effective in making the wishes of its members known to its leadership through regular member surveys. The CEA provides informational services by publishing a newsletter and maintaining a password protected website that facilitates information flow between members. Approximately half of the association's members list their products, services, and business interests in the association's database. This provides members with information on potential business partners, suppliers, and transporters. The CEA also received "good" evaluations in the public policy advocacy category due to the political activism of its leaders and in the "impact" category measuring effectiveness of its advocacy campaigns in addressing members' demands (Schaw, 2006).

One of these advocacy campaigns addressed corruption in customs. Shortly after its formation, the CEA initiated a public campaign that was successful in extending the working hours of the customs offices throughout the country to minimize delays that frequently would give rise to the demands for unofficial payments to speed up customs clearance. When the customs offices were open on weekdays only, many owners of perishable goods were at the mercy of the customs officials, who could deliberately slow down processing of goods in an expectation of a side payment. Around-the-clock



operation left little room for bureaucratic abuse of this sort. This was an important victory for the CEA that created a collective good of more accessible customs for all exporters, irrespective of their membership in CEA.

Another example of a public good achieved by actions of the CEA is the case of the EU sugar quota. In 2004-2005, as part of the reform of the EU sugar industry, the European Council's Commission started re-evaluating the duty-free import quotas on sugar from non-EU countries. On February 28<sup>th</sup>, 2005, the European Council's Commission opened negotiations with the Republic of Croatia to amend the preferential arrangements that regulated Croatian imports since 2002. These preferential, unlimited, duty-free arrangements were established under the Stabilization and Association Agreement (SAA) between the EU member states that the Republic of Croatia signed in Luxembourg in October 2001 and under the Interim Agreement on trade and trade-related matters effective since January 2002. The proposed levels of a duty-free import quota would have resulted in a substantial increase of the price of Croatian sugar on the EU market. Decreasing demand for Croatian sugar would have put Croatian sugar beet growers and processing industry under pressure.

CEA organized a coalition including the National Bank, the Croatian Employers' Association, and the Chamber of Economy to put pressure on both the Croatian government negotiating a new agreement and the members of European Commission (Schaw, 2006). It emphasized the negative impact on the Croatian agriculture that could result from setting the quota at the proposed 80,000 tons per year. CEA demanded increasing this quota to 180,000 tons, referring to similar deals concluded with other Balkan countries. On March 14<sup>th</sup>, 2006, the Commission concluded the negotiations with

Croatia with a new arrangement coming to force in January 2007 that permits Croatia to export sugar to the EU under a duty-free quota of 180,000 tons (European Commission, 2006). With an estimated capacity of the Croatian industry to export 170,000 tons in the following years, the tariff quotas effectively preserved the duty-free exports, securing the Croatian sugar industry unrestricted access to the European market. Higher tariffs benefited some 2,000 family farms growing sugar beets—these small family farms account for over half of beet cultivation area in the country and, naturally, they are not members of the CEA—as well as sugar processing plants scattered throughout the country (*Assessment and Outlook in the Sugar Sector*, 2005). This exemplifies the associations' capacity to reduce regulatory constraints that, in this case, were imposed not by the domestic government, but by a foreign party.

#### **5. 4. 2 Kazakh Business Forum**

The Kazakh Business Forum was created in 1992 by a group of young entrepreneurs who relied on the organizational support of the Kazakh Youth Union (formerly the communist youth organization) and was supported by the country's president, Nursultan Nazarbayev, who attended and delivered a speech at the Forum's first convention in June 1992 (<http://www.businessforum.kz/>). The Forum's publicity and regular participation in high-profile meetings with the country's political leadership over the years attracted large companies, business leaders, and other associations to join the membership ranks. Kazakh Business Forum unites 90 members and has regional offices in all provinces. The regional offices function as integral parts of the Forum, while 13

business associations joined the forum and maintained their organizational and financial independence.

In the 1990s, Kazakh business associations and directors of large firms were able to voice their opinions during annual meetings with the president of Kazakhstan. The Forum was a regular participant in these high-profile meetings. Based on the frequency of news reports about these meetings, authorities' keen attention to the business community characteristic of the 1990s was replaced by rather passive recognition and *de facto* marginalization in the 2000s. This coincided with proliferation of both sector-specific as well as cross-sector business associations, ending the Forums' near monopoly on business representation that it enjoyed in the early 1990s.

In the 2000s, the Forum continued to participate in many consultative and expert commissions and working groups under the president, central government, ministries, state agencies, and local administrations. It also initiated a number of media campaigns and lobbied business interests using its government connections. For instance, the Forum rallied against increasing bureaucratic burden in the highly publicized case of tobacco advertising. In 2005, the Almaty city government attempted to increase fees on displaying posters advertising tobacco. In January 2005, the city government increased the fees collected for displaying these posters in retail locations (<http://www.zakon.kz>). This local regulation followed the 2003 Kazakh law banning tobacco advertising in public places. According to the legislation, the only places legally permitted to display visual tobacco advertising were specialized tobacco retail stores.

Although the Kazakh Business Forum had not voiced its opposition to the 2003 law, it organized a vigorous campaign against the local regulation and brought the issue

to the court—arguing that the city government had no right to raise fees. A number of Almaty newspapers reacted with a fierce criticism of the Forum’s initiative, citing the law on “Prevention and Limitation of Tobacco Consumption” (*Nachnem s Ponedel’nika*, Sep. 16, 2005; Shahnazarov, 2005). The proponents of the Forum’s position maintained that the city government’s actions had little to do with public health concerns and claimed that the regulation gave government inspectors an additional reason to bribe retail stores. The Forum’s campaign resulted in a partial victory: although the advertising fees were reduced, the city authorities strengthened local regulations on tobacco advertising. The high sensitivity of this case clearly demonstrates how hard it is to draw a clear line between lobbying for particular interests and carrying out the fight against increasing state regulation. However, the Forum’s stance against increasing intervention on the part of the state supports the idea that business associations can, in fact, provide an alternative to the “path of least resistance” when dealing with pervasive regulations.

#### **5. 4. 3 Coordination Expert Center of Business Associations of Ukraine: The Stamp Duty Case**

The Coordination Expert Center of Business Associations (the Center) was founded in 1998 by a number of Ukrainian business associations with the purpose of coordinating associations’ contacts with state authorities. The Center concentrated on monitoring authorities’ initiatives in the regulatory and other business-related spheres, analyzing draft legislation, and developing proposals that reflected the demands and interests of the business community. The Center’s think tank was established in 1999 to:

”1) Carry out complex legislative expertise of draft laws... analyze their direct and indirect influence... define effective mechanisms of influence and evaluate the consequences of regulation. 2) Elaborate independent recommendations and analytical materials; provide organizational support for a coordinated strategy for advocacy and promotion of draft legislation... 3) ...to assess the effectiveness of implementation of regulative acts.” (Liapin, 2005, pp 29-30)

As seen from the program statement of the Center, tracing changes in and affecting the content of the regulatory environment has been the primary purpose for creating this umbrella group that by 2005 united 60 member associations, including national, sector-specific, and regional organizations. The association has opened offices in 5 regional centers. As an umbrella group, the Center has rejected calls to participate in activities benefiting narrow interest and has taken on only “general good” advocacy. This has limited its attractiveness to member associations, but significantly strengthened its political weight in conflicts over regulatory reform. The Center activities concentrated on coordinating member associations in their advocacy campaigns. The Center’s analytical and coordinative functions were indispensable in coordinating efforts of several business associations to solve common problems. The CEC support is believed to have increased campaign efficiency and, in many cases, aided in their success.

One of the first successful advocacy campaigns coordinated by the center was the 1999 campaign on stamp duty. In 1998, the Ukrainian state budget was in dire straits. An economic crisis stripped the country of needed investment. Declining production and growing unemployment were experienced against the backdrop of a largely unreformed state sector and social safety net. This created demands for additional state spending

while tax collection fell due to the stagnating economic activity and record-high tax evasion. In an attempt to improve tax collection, the president enacted the decree “On Stamp Duty” that expanded the tax base and eased the task of tax collection that had been lagging due to legal loopholes, bureaucratic incompetence, and corruption. The newly introduced stamp duty was in essence a regressive sale tax collected by issuing pre-paid sale stamps. Any sale contract, as well as any sale invoice (in the absence of a contract), was subject to the stamp tax. The issued sale stamps were of equal value, thus, the less the value of the contract, the larger the share to be paid in dues (Liapin, 2005). The stamp duty immediately reduced consumption by enterprises, which was particularly harsh on small firms that tended to make multiple small purchases.<sup>16</sup>

One month after the decree introducing the stamp duty was signed (becoming effective in 1999), CEC presented to Verkhovna Rada (the parliament) an analytical note on the detrimental effects of the tax on the national economy. The arguments against the stamp duty included its regressiveness, suppression of economic activity, overwhelming burden on the small enterprise sector, incentives for under-reported, and as a result, unenforceable contract obligations, proliferation of redundant occupational tasks, and the infeasibility of efficient enforcement that required expanding control functions of tax authorities to monitor a large number of small-scale operations. Verkhovna Rada failed to consider the matter, and the decree became effective in January 1999. By February 1999, businessmen flooded business associations with appeals and complains about injustices of the new tax. Practically all member associations (14 at the time) made their proposals to CEC to organize a united campaign for stamp duty cancellation.

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<sup>16</sup> In some instances, the stamp duty on a sale could even exceed the value of the goods exchanged.

The campaign started in the media, with representatives of business associations demonstrating the detrimental impact of the stamp duty on small domestic firms and calling for its elimination. Business associations sent official letters to the legislators demanding to put the issue on the parliamentary agenda. It would require a simple majority to overturn the presidential decree, but by that time the stamp duty revenue had made its way into the next year's budget and it seemed unrealistic to expect full cancellation (Liapin, personal interview).

The CEC leaders found allies in the parliamentary Committee on Finance and Banking Activities that had developed an alternative draft of "On Stamp Duty" that would completely re-define the nature of activities subject to such a tax. Under this alternative bill, the stamp duty was imposed on import cargo only (CEC analytical note, Feb. 18, 1999). To put this bill on the parliamentary agenda, it required the support of 150 legislators. CEC utilized the political capital of its president Yuri Yekhanurov, who was able to gather 150 signatures to put the bill on the floor. The bill was returned to the committee because it contradicted other legal regulations allowing for duty-free imports, but after adding provisions for minimum value of imports subjected to the stamp duty, the bill was passed in the second reading. To speed up the second reading, the CEC members exerted pressure on legislators through a massive media campaign and petitions. On May 13, 1999, the new law limiting stamp duty application to imported goods was passed. In the final stage of the campaign, the CEC members sent an open letter to the president. It was feared that the president would veto a law so dramatically different from his initial intent. Against the backdrop of heated parliamentary debates and enormous attention to the issue in the mass media, the president signed the new law on

May 29, 1999. This first victory for the CEC and its members was a considerable one that demonstrated their ability to defend the business community—primarily small businesses—from the pressure of increasing taxation.

#### **5. 4. 4 The 2000 Cash Registers Case and the Ukrainian National Association for the Development of Trade and Services**

Associations uniting large and small retail traders in Moscow and Kyiv—the League of Trade Merchants and the National Association for the Development of Trade and Services—are quite similar in respect to their membership base and issues they deal with. Unlike the Russian association, which emerged in the early 1990s, the Ukrainian organization was established in 2004. Its development was stimulated by a failed campaign to confront the new regulations on cash registers that were introduced in 2000, creating a situation quite similar to the one discussed in the Russian League of Trade Merchants case. The Moscow association’s case presents an example of protection from regulatory pressure and corruption in the form of selective incentives for its members. The League offered legal protection to its members, but did not attempt to change the regulatory mechanism affecting a large number of enterprises nation-wide. Then confronted with virtually the same problem, Ukrainian business associations fought for collective goods and lost the battle.

In 2000, Verhovna Rada (the Ukrainian parliament) passed the law “On the Use of Electronic Cash Registers (ECR) and Cash Books in Processing Payments by Consumers in the Trade, Public Catering, and Service Sectors” (June 1, 2000). The new regulations required installing electronic registers, and an army or inspectors were



threatening non-compliant firms with large fines in an expectation of bribes. About 90% of firms inspected by public officials after the law was passed were found in violation of the new regulation and were fined (Blyzniuk, personal interview). The penalties under the new regulation were severe and did not discriminate between small and large firms or the gravity of a violation. Although the law was circulated as a draft in 1998-1999, it attracted no attention on the part of the business community that would be directly affected by it. Thus, when the law was introduced to the floor, all but one legislator voted in its favor and many later admitted that they were unaware of its content (Liapin, 2005).

The new regulation directly threatened the interests of the most disorganized sectors: small retail traders and family-owned businesses in the service sector using the simplified taxation mechanism introduced in 1999. For the former, the new regulations meant additional expenses associated with purchasing new registers and increased vulnerability to corrupt bureaucrats empowered with the increased amounts of fines (in a sense, the law drove up the cost of compliance, and thus the amount of bribes bureaucrats could demand). For the latter, the law effectively invalidated any benefits under the simplified taxation mechanism (the flat tax). These interests were recognized by a number of associations; however, neither specialized in representing interests specific to groups of small retailers. The Coordination Expert Center of Business Associations took over the issue and organized a public campaign to put pressure on the executive and legislative branch.

The interests benefiting from the new regulation, however, were better organized. The Association of ECR Manufacturers and Service Centers, created shortly after the start of the cash registers campaign, advocated for the new regulations, pointing to

international practices. It was not a secret that the new law created greater demand for the services of association members and their commercial interests were obvious to all involved parties (Liapin, 2005). CEC leaders petitioned the president and the cabinet and raised the issue in the Business Association Council under the Cabinet of Ministers of Ukraine. The ECR Manufacturer's Association was able to block the CEC's attempts to persuade the president into vetoing the law. Then, on July 6, 2000, a number of business associations called for picketing Verhovna Rada, and about 3,000 businessmen joined the rally, demanding to put the law on hold until 2001 (Liapin, 2005). The central argument of the protesters was that the law allowed for vague interpretations, allowing bureaucrats to impose fines irrespective of the gravity of violations. Although the demands were supported by the Deputy Speaker and the First Prime Minister in the absence of a dedicated pressure group, no procedural steps were taken to secure deferring the enactment of the law to a later date. At the same time, the association of ECR manufacturers organized a counter-campaign that emphasized the benefits of greater consumer protection.

It took another rally that gathered about 5,000 participants in front of the parliament building on July 13 to gather 300 votes (required majority) to uphold the enactment of the law until January 1, 2001. It took five more months of petitioning, press conferences, pamphlet publication, and lobbying efforts for the parliamentary Committee on Financial and Banking Affairs to propose changes exempting small vendors (particularly open market traders) from the new requirements. These amendments were made on December 21, 2000, and the law came into force marking a partial victory for the small business interests. In a situation when the harsh regulatory environment

directly threatened business interests, a coalition of general-purpose business associations managed to alter regulatory requirements that would provide collective benefits for the business community. Faced with the opposition of concentrated industrial interests, the CEC's advocacy campaign was able to achieve only limited benefits for the most marginalized and thus politically valuable sector—self-employed open-market traders.

The dissatisfactory outcome of the cash registers campaign led to the realization of limitations of the general-purpose organizations. In response, businesses in the retail sector formed the Ukrainian National Association for the Development of Trade and Services in 2003 (Blyzniuk, March 2006, personal interview). The association has concentrated on providing informational and legal support to its members, and on advocating their interests in the media and state institutions. Some of the successful actions of the association include the 2005 campaign against new health safety permits in the retail trade of baked goods, and a more recent advocacy against monopolistic schemes in introducing plastic card processing terminals in the retail sphere (Blyzniuk, March 2006, personal interview; *Konersant* June 8, 2006; *Ekonomicheskie Izvestiia* June 16, 2006).<sup>17</sup>

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<sup>17</sup> By 2006, the introduction of plastic cards that would decrease the amount of out-of-bank cash flows did not produce the expected results: the population preferred cashing their deposits at ATMs rather than using plastic cards for daily purchases. State authorities considered solving the problem by making it illegal not to have card processing terminals in retail locations. The UNACTS campaigned against such proposals, arguing that market mechanisms should be allowed to solve the problem. The UNACTS leadership presented market analysis suggesting that slow introduction of the card processing terminals is linked to the high commission charged by the banks on purchases. This commission largely exceeded ATM and cash collecting fees imposed by the banks. The association's president, Andrei Blyzniuk maintained that the major reason for the unpopularity of plastic cards among retailers was the lack of competition between the banks servicing plastic cards and unwillingness of the government to regulate inter-bank agreements. In 2006, the UNACTS was able to gain some concessions from the regulating authorities, although the final outcome is still uncertain.

#### **5. 4. 5 Russian Association of Ice Cream Producers**

The Russian Association of Ice Cream Producers (RAICP) was established in 2000. The list of its 11 founding organizations includes the ice cream producing plants, milk processors, equipment manufacturers, distribution and marketing corporations, and a research institution. As with many other Russian business associations whose development was facilitated by state agencies, RAICP has received organizational support from the Federal Agency on Regulating the Food Market under the Ministry of Agriculture. By 2005, RAICP had grown from 11 to 175 members, including 5 associations of producers, 67 manufacturers, 8 retail companies, 25 producers of raw materials, 35 manufacturers and suppliers of equipment and packaging, 9 research and educational institutions, 11 publishing houses and media outlets, and 17 foreign companies (*Ezhegodnik*, 2005).

In the first years of its existence, RAICP had to compete for membership, media attention, and reputation with another sectoral business organization, but by 2005, it had virtually monopolized sectoral representation. The competing Association of Russian Producers of Ice Cream and Frozen Products was established in 2001 as an organization of domestic producers of ice cream that united 38 large ice cream producers, whose output amounted to over half the national production of ice cream. This association, after a couple of years of independent existence and competition with RAICP, joined RAICP and ended fragmentation in sectoral representation (Elhov, August 22, 2005, personal interview).

The consolidation of sectoral representation was achieved due to RAICP's aggressive activities in the spheres of membership recruitment, information (the

newspaper, monthly magazine, and annual pamphlet) and expo (annual international and sectoral exhibitions and numerous regional events) services, research and training programs, promotion of sectoral cooperation, and representation in the state institutions (including an Expert Council on food market regulation under the parliamentary committees) (*Ezhegodnik*, 2005; *Morozhenshchik Rossii*, Feb., Apr., June 2005). Because of its elaborate organizational structure, multi-directional activities, and near-universal participation of the sector's enterprises, RAICP has been called "The Ministry of Ice Cream" by both its members and partners in the business community and state institutions (Moscow, August 2005, personal interview).

Not being a separate sector under the planned economy, the self-organization of the ice cream industry has marked a new development in structuring business relations. According to the association leadership, at the dawn of market economy, producers of ice cream faced greater regulatory obstacles and more promising growth opportunities compared to other spheres of food processing. Greater technological sophistication and expanded opportunities associated with newly available technologies, recipes, ingredients, and marketing techniques of the ice cream industry would lead to greater benefits if changes were introduced in the regulatory environment that had been characterized by archaic standards in food processing and distribution. The state standard (GOSTs) regulating production processes and product quality in the industry were developed decades ago. This, in many cases, prevented the use of new ingredients and more sophisticated technology. Many enterprises purchasing new equipment and introducing new products later found themselves in violation of the outdated regulations.

The association has vigorously lobbied for the development of the new state standard (GOST) for whole milk ice cream products, traditionally the most popular in Russia. RAICP has provided research, organizational, and financial support for the development of the new state standard, which was approved by the regulating authorities in February 2003. This milestone regulation affects all the industry participants, providing the collective benefit of a standardization scheme based on contemporary production technologies, consumer demand, and available ingredients. Other activities of RAICP that have offered regulatory relief include reduction of VAT on ice cream from 20% to 10% and a campaign for lifting tariffs on imported equipment and ingredients that do not have domestic substitutes. These actions provide regulatory relief in the form of collective benefits for the entire ice cream industry.<sup>18</sup>

## **5. 5 SUMMARY OF EVIDENCE**

The cases of business associations in Russia, Ukraine, Croatia, and Kazakhstan demonstrate the different mechanisms available to business associations for providing protection from burdensome regulations and corruption. My analysis of activities undertaken by business associations unravels the causal mechanism linking regulatory pressures and bureaucratic corruption to membership in business associations. As seen from these examples of associations' activities, business associations recognize the state regulatory pressure as a threat to their constituents and organize action to counteract such a threat. This, coupled with a popular belief that dealing with corrupt officials is

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<sup>18</sup> In addition to collective goods of regulatory relief, RAIP provides its members with a large array of selective benefits. For instance, it has acquired the right to certify production facilities of its members, ending the state monopoly on certification. This serves as a selective protection form bureaucratic predation in the certification process.

increasingly costly for businesses, provides an explanation for the empirical connection between corruption and associational membership levels. For businessmen suffering from extensive bureaucratic barriers and irritated by corrupt officials, business associations, fighting concrete regulations (e.g. Ukrainian Coordination Expert Center, Kazakh Business Forum, Croatian Exporters Association) and providing services that protect against bureaucratic abuse (e.g. Almaty Association of Entrepreneurs, Russian League of Trade Merchants, Ukrainian Association of Leasing Companies and Cooperatives) offer valuable organizational opportunities for defending their interests.

Qualitative causal-process evidence reveals that activities undertaken by business associations, although in many cases not fighting corruption at large, are directed at the root of corruption—extensive and arbitrary state regulations of economic activity. Although one might doubt that the source of corruption actually lies at the bottom of the bureaucratic hierarchy, the fact that bureaucratic barriers and corruption are linked is unlikely to be disputed by those familiar with post-communist business environment. Thus, when confronted with high bureaucratic corruption, businessmen become more likely to throw their support behind organized groups fighting regulations.

In addition to the cases presented here, there are many more examples that suggest a general pattern of activities undertaken by business associations. Table 5.1 shows that of the 44 associations I visited during my field research, more than half provide their members with valuable information, including strategies to avoid extortion. Some associations have undertaken legal actions, and many others offer legal expertise to help their members navigate through complicated paperwork required to comply with rules and regulations. Additionally, a number of associations educate their members about

regulations in their corresponding industry and/or the legal rights the entrepreneurs have. Other associations organize valuable training in accounting practices, tax preparation, licensing, and certification procedures that, in many cases, minimizes the cost of compliance.

Type of Service	Number	%
Information on business promoting and cost-saving strategies	27	61
Legal advice and paperwork processing	26	59
Training in accounting, tax preparation, licensing, and certification	16	36
Legal action on behalf of members	12	27
<b>Total number of associations</b>	<b>44</b>	<b>100</b>

**Table 5.1:** Member services provided by business associations.

About 70% of association leaders I talked to admitted that delegating a number of regulatory functions—such as licensing, standardization, quality control, and arbitration—to business associations would be desirable; however, over half of these respondents thought that either their association was not yet ready to perform such functions, or voiced their disbelief that bureaucrats would allow delegating their functions.<sup>19</sup> In some instances, however, associations were successful in demanding such delegation of bureaucratic tasks.<sup>20</sup> In cases where such delegation has not happened, associations were active in lobbying for reducing bureaucratic barriers and changing

<sup>19</sup> For a discussion on why politicians might be interested in allowing business actors to play a greater role in economic policy formation and implementation, see Markus, 2007.

<sup>20</sup> Sectors that face fewer regulations—usually “new” sectors that did not exist in the command economy—have been more successful in self-regulating themselves. Realtors, accountants, bankers, consulting firms of various sorts, as well as the tourist and hotel industries in Russia and Croatia have imposed much stricter self-regulations than the existing bureaucratic policy.



regulatory regimes in a way that would make regulations more transparent and less costly. There are multiple examples of associations trying to reduce bureaucratic intervention or navigating businesses through the rough terrain of bureaucratic barriers.

Pervasive corruption and bureaucratic pressures are wide-spread phenomena in the post-communist context. According to the expert surveys and popular attitude studies, corruption penetrates virtually all spheres of post-communist societies (Shleifer & Vishny, 1993; Miller et al., 1998, 1999; Antoniuk & Alavidze, 1999; Murray, 1999; *Public Opinion on Corruption*, 2000; *The Impact of Corruption on Small Business*, 2002; Webster 2002; Jandosova et al., 2003). The post-communist countries are consistently ranked at the bottom of the clean government scales (Brunetti et al., 1997; Kaufmann et al., 2003; Transparency International CPI, 1995-2006). Still, variation across countries and state agencies is eminent. While contrasting corruption levels across countries presents researchers with the problems of comparability, within-country variation across sectors and agencies is less problematic. Such comparison allows, for example, considering conditions under which association fail to emerge or attract members. Naturally, such non-existing cases of associational formation are hard to study due to the lack of data. Still, by identifying economic interests that fail to organize, I can put the association formation theory to an additional test.

One of the cases of non-formation of business associations is Russia's coal mining sector.<sup>21</sup> Emerging from the profound IMF-led restructuring programs of the 1990s, the sector employs 233,000 people, and in 2003 had 449 enterprises territorially concentrated

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<sup>21</sup> For a comprehensive review and analysis of the situation in Russian coal industry, see Crowley (1997, 2001b).

in the coal producing regions of Western and Eastern Siberia (Statistical Yearbook, 2004).<sup>22</sup> The sector's resources are highly specific to the current use with high capital investment in existing mines and infrastructure. A painful process of economic restructuring and privatization has re-shaped the industry that throughout the 1990s witnessed uncompensated lay offs, wage arrears, closures of loss-making mines, braking down large production units, and a rise in private ownership that by 2003 constituted 76% of industry's firms.

The flagship of Soviet industrialization, following the arrival of cheaper energy sources in the 1960s and 1970s, the coal mining sector enjoyed state subsidies. Despite worldwide trends to downscale coal production, the sector's size, output, and employment were maintained through a system of direct and indirect transfers. At the beginning of the post-communist economic transition, the coal industry presented a state monopoly that was selling coal at a fraction of the world price, while simultaneously receiving subsidies amounting to 1.4% of the country's GDP. Naturally, the sector became the target of economic restructuring programs pushed by the reformer-minded Chubais government (Crowley, 1998) and the IMF (Kudat & Borisov, undated). Restructuring programs were slowed down by the state-owned coal company, Rosugol, and political activism of the labor force. Professional solidarity and the large size of production units in the coal industry made coal workers the most potent labor group in Russia, with the history of coal strikes dating back to the late Soviet times.<sup>23</sup>

Geographical concentration, high resource specificity, large enterprise size, militant labor

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<sup>22</sup> Compare the 1990 figures with 484,000 employees and 334 enterprises, the majority of those controlled by the giant state-owned monopoly Rosugol (Russian Statistical Yearbook, 2004).

<sup>23</sup> In fact, the coal workers are characterized as "the most militant segment of Russia's labor force" (Cowley, 2001, p. 130), staging strikes in 1989, 1993, and 1996.

force, as well as the threat of economic losses associated with economic restructuring, seem to be strong reasons to expect the emergence of a sectoral association uniting managers and new owners of the coal producing enterprises. Still, no association to represent the interests of coal business was established in Russia in the 1990s or 2000s.

This outcome, however, is consistent with the defensive organization theory. With declining production, the coal industry has lacked investment in new production technology, equipment, and infrastructure improvement. With little to no economic growth or expansion, the sector has little to gain by altering the existing regulatory practices. Additionally, economically depressed and loss-making enterprises in the coal sector do not have large extractable surpluses for corrupt bureaucrats to prey on. As a result, one can expect that coal enterprises are not confronted with costly regulatory regimes and high level of bureaucratic corruption. In fact, since the 1997 dismantling of Rosugol, which had been accused of misallocating the IMF structural adjustment funds in the early 1990s, there have been no reports of bureaucratic abuse in the coal sector. The economically depressed coal industry presents an example of a relatively low bureaucratic corruption that coincides with the absence of collective action on the part of businesses.

Another example of a low bureaucratic corruption sector that developed no sectoral association is the Russian healthcare sector. Although reports of corruption in the health sector abound, they exclusively refer to doctor—patient bribes and compensations, with little evidence of bureaucratic corruption between regulating state officials and hospitals and clinics. By the 2000s, Russia had failed to reform its highly socialized

healthcare system.<sup>24</sup> With the exception of dentists, plastic surgeons, and few other medical specialties, Russian doctors and hospitals are financed primarily by the state health insurance fund, with virtually no market mechanism introduced in the selection and provision of medical services to the population. State-financed rather than profit-making, the healthcare professionals and hospitals have not become the subject of bureaucratic corruption. In this environment of low bureaucratic impediments, no association of hospitals or business association of practicing doctors (as opposed to the professional medical organizations) have come into existence. At the same time, a number of associations of private dentists and dentistry clinics were created in Russia in the 1990s, when independent practitioners started and expanded their businesses as profit-making enterprises subject to economic regulations. These examples suggest that corruption is a crucial characteristic in business association formation. Absence of business associations in these two sectors of low bureaucratic corruption presents an additional support for the defensive organization hypothesis.

In conclusion, I want to reiterate the central hypothesis scrutinized in this chapter that businesses join associations in a search for more effective ways to deal with the regulatory environment. The formal analysis of businesses' decisions to join associations presented in Chapter 4 suggested that bureaucratic corruption, among other things, plays an important part in stimulating associational membership. Corrupt bureaucrats and business associations may decrease the cost of doing business. When corruption is high, business associations have to provide firms with the benefits of reducing the cost of regulatory compliance, thus making corrupt behavior less attractive. Empirically, the

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<sup>24</sup> For a review of the Russian healthcare system, see Figueras and Marshall (1998) and Tragakes and Lessof (2003).

positive connection between high levels of corruption and associational membership has been demonstrated by the cross-national survey and aggregate data analyses presented in Chapter 4. This chapter presented qualitative evidence that business associations can, in fact, reduce regulatory costs associated with running a business. I presented a number of illustrative examples of functions and activities performed by post-communist business associations. These were directed specifically at the regulatory environment. Some associations attempted to reduce the costs of complying with rules and regulations affecting businesses; others, to change them. These examples showed that when corruption and bureaucratic pressures on businesses are high, associations arise to provide protection in a form of selective incentives or collective benefits of altering the underlying regulatory regimes and reducing the cost of regulatory compliance. Although the alternative outcome—non-formation of business associations—is hard to investigate, I briefly alluded to the enclaves of low corruption in which no business association effectively exists.

## CHAPTER 6

### COMPULSORY VS. VOLUNTARY MEMBERSHIP

*Peak associations cannot always satisfy the policy preferences of their diverse constituencies. Larger associations tend to take positions that minimize internal conflict, thus encouraging specialized interests to develop independent strategies*

Heinz, et al., *The Hollow Core*

Previous chapters largely examined business participation in voluntary associations. This chapter takes a closer look at the compulsory business associations that have been created by governments in a number of post-communist countries. In the early 1990s, legislative foundations for the development of interest representation were created in Eastern Europe as a part of political transition. Such foundations differed from one country to the other. Voluntary and compulsory membership models of business representation emerged in East European countries. Subsequently, some compulsory-membership models were abandoned, and others evolved towards greater pluralism and voluntarism. This chapter examines similarities and differences in the ways that post-communist states structured business representation, and investigates their influence on

the subsequent evolution of East European systems of business representation. I am primarily concerned with the characteristics and development of the particular model of business representation that relies on compulsory membership in the state-created peak associations characterizing a few countries of the region. This model is frequently referred to as corporatist, although closer examination reveals its profound differences from either the classical democratic corporatism of Western Europe or the bureaucratic corporatism of the developing world.

My analysis of compulsory and voluntary business and employer organizations in post-communist countries suggests that despite the different legislative and institutional frameworks adopted at the outset of transition, patterns of business representation exhibit a degree of convergence in Eastern Europe. I explain this failure of compulsory systems by arguing that compulsory institutions have been ineffective in channeling the interests of the business community. This gave rise to voluntary associations competing with officially designated groups for business representation and business “protection.” This chapter substantiates this claim with references to a mathematical model of organizational formation and with empirical evidence from Croatia—the representative case of a compulsory membership system.

The chapter is organized as follows. The chapter first outlines the alternative frameworks guiding business representation in different countries and extends my theoretical model in respect to compulsory and voluntary membership systems. I, then, describe empirical developments across the post-communist world in regards to the institutional framework of business representation. The historical sketch of the development of systems of business representation in post-communist countries points to

a puzzling situation; compulsory legal frameworks adopted by some countries in the early 1990s did not preclude the development of organizational pluralism and voluntarism in the subsequent years. In order to explain such a paradoxical outcome, I extend the mathematical model of business participation developed in Chapter 4 to the analysis of compulsory representation regimes. One implication of this model is that compulsory membership institutions should be less effective in channeling the interests of business community; thus, demands for alternative means of representation should emerge in compulsory regimes. Section 4 presents a more detailed account of the erosion of the compulsory membership system in one of the post-communist countries—Croatia. I discuss the evolution of the Croatian system of business representation as a representative case of compulsory membership regimes. The chapter concludes with discussions on whether the divergent legislative frameworks have an effect on business participation in associations.

## **6. 1 ALTERNATIVE MODELS OF BUSINESS REPRESENTATION**

Institutions of business representation and coordination shape the patterns of business-state relations, labor policies and conditions, lobbying strategies and outcomes, and other aspects of economic organization that define the nature of capitalism (Hall & Soskice, 2001; Hall & Soskice, 2004; Hiscox & Rickard, 2002). Such institutions have been broadly categorized along pluralist-corporatist lines (Lehmbruch, 1982; Lijphart & Crepaz; Schmitter & Lehmbruch, 1979; Hodgson, 1998). The corporatist-pluralist analytical framework has long been developed by the students of interest group politics to refer to the structures of state-group interaction. While pluralism has been characterized



by the existence of multiple competing organizations representing different social interests—labor, farmers, professionals, business etc. (Olson, 1965), the corporatist (neo-corporatist) arrangements are associated with the existence of encompassing associations organized in a highly hierarchical manner, and effectively monopolizing group representation vis-à-vis the state (Cawson, 1986; Lehbruch, 1982). This division has affected the way we think about different types of capitalist economies in the world and in the 1990s has made its way into the scholarly analysis of the emerging capitalist economies in post-communist Europe and Eurasia.

The application of the corporatist-pluralist framework to post-communist cases, however, has been quite controversial. Some scholars called many evolving systems corporatists despite the dominance of many pluralist traits. Discussions of post-communist corporatism emphasized subtle variations distinguishing institutional, functional, and relational forms of groups representation—the permanent or occasional tri-partite negotiations (Waller, 1994), cohesion of positions and policies in corresponding area (Myant, 1994), the government’s preferential treatment of loyal but not necessarily representative groups (Colton, 1992; Kubicek, 1996), or domination of umbrella associations (Remington, 2004)—has led many authors to stretch the notion of corporatism beyond its conventional meaning.<sup>1</sup> At the same time, the corporatist label was extended to the systems characterized by organizational fragmentation and volatility, voluntary and cross-cutting membership, and few institutionalized channels of interaction

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<sup>1</sup> For instance, Waller (1994) talks about a “form of pluralism with corporatist features” (p. 34), Remington (2004) labels Russia as a corporatist system because although “...there is a plurality of associations ...there is a tendency to the domination of the umbrella all-Russian associations” (p. 152). The compulsory-voluntary distinction adopted in this paper rules out such obscure labels and classifications.

between business associations and the government.

Concentrating on the “soft” features of corporatism presents a danger of losing the analytical utility of the corporatist-pluralist distinction and creates the need to introduce a number of qualifiers (e.g. pseudo, post-communist, mixed, etc.). No doubt, post-communist cases do not provide the perfect fit for the ideal types of corporatist and pluralist interest representation because they are still in the process of formation. For the sake of conceptual clarity, however, I refrain from using the corporatist-pluralist distinction to categorize a developing system of interest representation, as well as qualifying and, thus, stretching the terms to accommodate any idiosyncratic features. Instead, I use clearly demarcated categories based on identifiable and uncontroversial voluntary and compulsory membership requirements. I use specific and easily-measured criteria to distinguish between two distinct types of business representation: the existence of a *compulsory* membership requirement in organizations created and officially recognized by the state as exclusive channels of business representation and self-regulation. It should be kept in mind that this research is concerned with the patterns of business representation, which might or might not be paralleled by structures of representation of other social interests. Thus, when discussing the compulsory membership model, I refer specifically to business organizations, realizing that other spheres of interest representation in a given country might be organized along the pluralist lines.

Compulsory and voluntary membership organizations have different implication for collective action. The major problem encountered in organizing a group of individuals or individual-like entities to pursue their common interest is the problem of free-riding—

the collective action problem. Since its formulation by Olson (1956), multiple solutions have been proposed, ranging from self-enforcing mechanisms that relied on the characteristics of the groups to third-party enforcement through the state and other institutional mechanisms. A definite solution to the collective action problem is provided by the corporatist-type compulsory institutions where the state creates rules and punishes free-riders. Formation of voluntary associations, on the other hand, is not enforced by an outside authority and, therefore, presents greater difficulties. By solving the endemic free rider problem, compulsory organizations should have more resources, produce coherent collective action, and, ultimately, better represent the interests of their members. Membership in compulsory organization, *ceteris paribus*, should entail fewer risks associated with free-riding and greater benefits resulting from guaranteed contributions. One should expect, therefore, that compulsory membership associations should be more stable, produce more visible benefits, and better respond to members' demands than voluntary associations.

## **6. 2 FROM DIFFERENCE TO CONVERGENCE: THE DEVELOPMENT OF POST-COMMUNIST SYSTEMS OF BUSINESS REPRESENTATION**

The early 1990s witnessed the formation of a number of associations aimed at representing the interests of business in different countries, regions, and sectors of the economy (Wyn, 1993; Ingleby, 1996; Recanatini & Ryterman, 2001; McMenamin, 2002; Remington, 2004; Pyle, 2006). The emerging systems of business representation, however, were structured along different organizational principles following what, at the

time, seemed to be distinct models of state-society relations. In the early stages of post-communist transition some countries adopted the voluntary membership model of business representation based on the development of multiple, competing voluntary organizations. Others favored compulsory membership in peak associations monopolizing representation. Despite historical institutional legacies, underlying legal frameworks, and official support for compulsory business representative organizations, most of these systems have eroded throughout the 1990s to incorporate many elements of competition and voluntarism.

Business associations representing first the interests of managers of state owned and privatized enterprises and later de novo private businesses, including small and foreign firms, have become a considerable social force in many post-communist countries. In comparison to other special interest groups in the post-communist settings, business associations have enjoyed greater membership, organizational strength, and resources. By the end of 1990s, overall organizational strength and membership figures varied dramatically across country borders. Some countries enjoyed up to a 70% membership rate by the end of the 1990s while others lagged with under 10% of firms reporting membership in associations (BEEPS, 2000). One particular institution is pivotal for understanding the differential organizational forms and participatory dynamics—the Chambers of Commerce and Industry.

Although at the beginning of the economic transition communist countries lacked a developed business community, organizations uniting employers and managerial elites preceded capitalist transition and the formed genuine business elites (Waller, 1994; Fortescue, 1997; Remington, 2004, Kubicek, 1996). In this respect, the post-communist

organizational landscape in the early 1990s was not the *tabula rasa* of many early accounts (Jowitt, 1992, Schopflin, 1994; Geddes, 1995; see also McMenamin, 2002 evaluating the “flattened landscape” hypothesis). Under the communist rule, all countries of Eastern Europe and the Soviet Republics had quasi-state Chambers of Commerce and Industry that coordinated inter-state trade and economic cooperation, mediated cross-enterprise disputes, and performed product inspection. Following the political transitions, such organizations were re-organized as public entities independent of the state.

National Chambers of Commerce and Industry were created in all post-communist countries by special pieces of legislation. Many countries passed additional laws regulating the formation of institutions of business representation. The emerging systems of representation generally fell into two patterns: some countries opted for the so-called continental chamber system that emphasized compulsory membership and exclusive claims for representation on the part of the Chambers of Commerce created from the top down (for the Hungarian case, see Ingleby, 1996). But the legal framework in the majority of the post-communist states provided for voluntary membership in Chambers of Commerce and other business and employer associations and created conditions for the emergence of organizational pluralism in the sphere of business representation and self-coordination (see Fortescue, 1997, for the Russian case).

In line with the continental chamber model of representation, the successor states to the former Yugoslavia, Albania, Hungary, and Slovakia (Ingleby, 1996; Luksic, 2003) have created compulsory business organizations with guaranteed access to political decision making, exclusive participation in the mechanisms of tripartite negotiations, and were given a number of state-prescribed functions in the sphere of economic regulations.

Such institutional arrangements—hierarchical territorial and sectoral structures, regulatory functions formerly performed by the state institutions, and a compulsory membership<sup>2</sup>—have been explicitly modeled after the “continental European” (predominantly Austrian and Italian) chambers system.

There has been some variation in this group of countries to the extent of organizational fragmentation of compulsory representation. Some countries (e.g. Albania and Slovenia) established centralized organizational structures uniting the entire business sector (Luksic, 2003; Fink-Hafner & Krasovec, 2005). Others, such as Croatia or Hungary, created several compulsory hierarchical organizations that split the responsibility for organizing small artisan-type producers, industrial enterprises, and the agricultural sector. Despite these differences in the number of the hierarchically organized compulsory groups, their functions, internal structures, and patterns of interaction with the state have exhibited strong similarities within the corporatist-type category while drastically differing from those organizations developed in the compulsory membership context.

Other countries in the region, including Poland, Czech Republic, Bulgaria, Romania, Baltic countries, CIS, and Mongolia, have re-organized their communist-era Chambers of Commerce along the lines of voluntary membership, removing virtually all state backing of the chambers and creating legislative frameworks for the formation of alternative organizations for business representation, coordination, and self-governance. Table 6.1 groups the post-communist countries according to the basis of membership in Chambers of Commerce.

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<sup>2</sup> In most cases, compulsory membership is automatic for all enterprises filing their incorporation documents with the state authorities.

Compulsory Membership <sup>3</sup>	Transitioned from Compulsory to voluntary	Voluntary membership <sup>4</sup>
Albania (6 000)	Hungary 2000 (400 000)	Bulgaria (35 000)
Bosnia-Herzegovina (40 000)	Slovakia 1996 (1 748)	Czech Republic (15 000)
Croatia (64 508)		Estonia (3 318)
Macedonia (32 000)		Latvia
Montenegro		Lithuania
Serbia (62 000)		Poland (500 000)
Slovenia (53 000)		Romania (6 000)
		Armenia
		Azerbaijan
		Belarus (1 400)
		Georgia (1 000)
		Kazakhstan (670)
		Kyrgyz Republic
		Russia (32 000)
		Moldova
		Mongolia
		Tajikistan (170)
		Ukraine (3 810)
		Uzbekistan

**Table 6.1:** National Chambers of Commerce: Type of membership. Official membership figures, where available, are reported in parentheses. Source: Central European Initiative, Euro Chamber, available at <http://www.unioncamere.net/cei/whoswho.htm> and country-chambers web pages.

Adoption of such different institutional structures of business representation can be explained through path dependencies and the institutional continuity of the Chambers

<sup>3</sup> Categories of enterprises obligated to join Chambers of Commerce differ across countries. Albania, for instance, excludes agricultural enterprises, while Croatia has additional compulsory associations for cooperatives (mostly agricultural) and artisans. Serbia effectively excludes micro business from the compulsory membership clause.

<sup>4</sup> Refers to member enterprises. Some countries require local employer organizations to join corresponding national organizations. Ukrainian legislation, for example, mandates that all provincial and local organizations that use the name “Chamber of Commerce” are part of the national Chambers of Commerce system.

structures. Chambers of Commerce (or Chambers of Trade and Crafts) trace their history to the 19<sup>th</sup> century chambers established throughout Eastern Europe under the influence of the West European tradition or that grew out of the indigenous medieval merchant associations. For example, in the Austro-Hungarian partition of Poland, the first Chambers were created in 1850, while in the Prussian partition, they were created in 1951 (Wykretowicz, 2004). The Croatian Chamber of Economy in Zagreb was established in 1852; although in the City of Dubrovnik that traditionally engaged in European maritime trade, the Chamber of Economy was created as early as 1808 ([www.hgk.hr](http://www.hgk.hr)). The history of voluntary merchant associations in the Russian Empire dates back to the Moscow Merchant Society established in 1813 ([www.tpp.org.ru](http://www.tpp.org.ru)). Compulsory merchant organizations were established in Russia in 1909 under the name of Chambers of Commerce; however, they did not survive the 1917 revolution.

Eastern Europe has been influenced by two competing traditions of business representation and self-regulation. In the areas that, in the 19<sup>th</sup> century, were directly occupied or strongly influenced by Austria and Prussia, a compulsory-membership chamber system has taken root. This compulsory encompassing system was historically a French creation, first established by Napoleon Bonaparte in 1802, and later introduced to the rest of Europe in the course of Napoleonic conquest. Where such influence has not been profound, traditions of voluntary business associations have developed. The Baltic States in the intra-war era, for instance, established Chambers of Commerce and Crafts based on voluntary membership.<sup>5</sup>

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<sup>5</sup> With French capital and commerce playing an important role in the economic development of Eastern Europe in the 19<sup>th</sup> and early 20<sup>th</sup> centuries, the compulsory chamber tradition has influenced all of Eastern



Under communist rule, both the compulsory, state-affiliated chambers of commerce and voluntary organizations of the capital were first liquidated and later re-created as state-controlled organizations serving coordinating, intermediating, and standard-setting functions, predominantly in foreign trade. They were designed to parallel some functions performed by western business associations (third-party arbitrage, certification, and facilitation of economic contacts) and largely served as institutional facades for the state-planned economies in the international economic arena. Such organizations, however, were not genuine associations of businesses because 1) they did not rely on membership for their survival; 2) were financed, staffed, and directed by the state, and 3) were lacking any representative functions vis-à-vis the state. Membership in these organizations was either non-existent or nominal. As a result, despite institutional continuity of the Chambers throughout the communist era, these organizations lost their substantive significance and were reduced to mere institutional shells operating as extensions of the state bureaucracy.

Re-definition of Chamber networks as a part of the newly emerging systems of business interest representation that followed the post-communist transitions has, for the most part, been a re-discovery of pre-communist patterns of business organization. It is of little surprise, therefore, that the majority of countries with pre-communist legacies that were associated with the Austro-Hungarian empire—Hungary, Croatia, Slovenia, Slovakia, Bosnia-Herzegovina—have re-created compulsory chamber system with universalistic claims for business representation, while countries ruled by the Russian empire, as well as Bulgaria and Romania, have adopted voluntary pluralist arrangements.

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Europe, hence, the Russian compulsory experiment of 1909 and Polish all-encompassing chambers of the interwar period.

More interesting in this respect are the cases of Poland and Czech Republic. Their deviation from 19<sup>th</sup> century and interwar institutional patterns might either be a tribute to the indigenous traditions of the medieval voluntary merchant institutions preceding foreign-imposed Chambers or the desire to stimulate the development of societal voluntarism and pluralist competition deemed essential for the survival of their new democracies.

Following the creation of the legislative foundations that put East European countries on the diverging paths of business representation, interesting developments were under way in a number of countries. The compulsory system, for the most part, did not live up to the high expectations on the part of business and government. Although representative and regulating functions of the compulsory Chambers were expected to generate close integration of the business community into the political processes and a gradual development of beneficial self-regulation, businesses in different countries started voicing their dissatisfaction with the compulsory nature of the system and the inability of the Chambers to adequately reflect their demands and protect their interests. In particular, the compulsory Chambers were criticized for giving little recognition—and virtually no representation—to the small business sector and industries undergoing profound transformation. The official responses to this criticism ranged from the legislation mandating the creation of a specialized compulsory organization for the representation of under-represented sectors (Croatia in 1993), reforms of the internal organizational and governance structures of the Chamber (Serbia in 2001 and 2003, Croatia in 1994), and the abandonment of the compulsory membership clause altogether (Slovakia in 1996 and Hungary in 2000).

On the part of the business community, spreading dissatisfaction with the work of the compulsory chambers has produced the spontaneous self-organization of rival business associations in all post-communist countries. A number of sector-specific and cross-sector organizations emerged to represent businesses who felt their interests and vision were ignored by the state-created compulsory Chambers. Such alternatives to the official Chambers included organizations of small business and leading industrial enterprises, banks, and trade corporations. Perhaps the largest and the most influential of such voluntary associations are the national Employer Associations that by the late 1990s had organized predominantly large business in different countries of the region. In such countries as Croatia and Macedonia, the employer associations have successfully demanded an exclusive role in the tripartite negotiations, becoming the official organization representing countries' businesses in general agreements in the sphere of labor relations. In Slovenia, the Association of Employers unites over 1,200 enterprises that jointly constitute about half of the entire private sector.

In Albania, the first voluntary business association providing an organizational alternative to the official Chambers—Union of Democratic Businessmen—was created in 1993. Currently, the two largest voluntary umbrella business associations are the Albanian Council of Employer Organizations and the Union of Organizations of Albanian Businesses. Similarly, two major voluntary associations compete for membership in Serbia and Montenegro: the Serbian and Montenegro's Employers' Association and the Association of Industrialists and Entrepreneurs of Serbia and Montenegro. There has been a steady increase in the number of sector- and issue-specific voluntary associations throughout the region, in both pluralist-type and corporatist-type

systems. Examples of successful voluntary associations developed alongside the compulsory Chamber systems include the National Real Estate Association and the Professional and Business Women Association in Albania, the Association of Serbian Banks, the “Krov” Association of Real Estate Agencies of Serbia and Montenegro, the Croatian Association of Travel Agencies, and the Association of Croatian Exporters.

Paradoxically, the compulsory representation system instead of creating favorable conditions for business representation and coordination by providing a strong resource base, solid legal foundation for the business role in political decision-making, and, most importantly, solving the problem of collective action involved in the initial organization, started crumbling. Although participation in and contributions to voluntary associations do not replace the need to pay compulsory membership dues, businesses in corporatist systems have formed and actively participate in alternative associations. Some of such associations not only attained considerable membership, expanded their functions and activities, and actively participated in the political process, but also attained an officially recognized status in representing the business community. Finally, two countries—Slovakia and Hungary—have replaced compulsory corporatist-type institutions with pluralist systems. These developments point to a *de facto* erosion of corporatist-style systems of business representation in Eastern Europe. Why has this been the case?

Despite the clear advantages of compulsory associations in solving the collective action problem of organization and contributions, the compulsory chamber systems seem to have failed to satisfy the needs of at least a part of the business community. Naturally, some dissatisfaction with the compulsory chamber systems stems from the fact that businessmen might perceive organizational dues as a tax applied universally, without

adding any benefits to the firms. Still, this does not explain why businesses throughout the compulsory membership systems were eager to join alternative voluntary associations—a decision involving additional contributions of time and money.

It is indicative that the cost of membership, although variant by country and sector as well as between national-level and local associations, is far from trivial, especially for the small and medium-sized firms. As an example, in 2003, membership fees in the Russian Chamber of Trade and Industry were 60,000 rubles, or about 2,330 US dollars, while annual fees in the Russian Union of Industrialists and Entrepreneurs were 150,000 rubles, or 5,820 USD (*Polozhenie*, 2003; [www.rspp.ru](http://www.rspp.ru)). At the same time, the average annual wage in the Russian economy in 2003 was estimated at 65,982 rubles (Russian Statistical Yearbook, 2004). Thus, the annual cost of membership in a voluntary organization was equivalent or greater than the cost of hiring an additional worker. Notice that in these examples the membership fee schedules do not discriminate between large and small enterprises, increasing the cost of participation as the enterprise size decreases.

Other associations, however, have flexible fee schedules, tagging contributions to the enterprise size, assets, and profits. For instance, the compulsory membership Croatian Chamber of Economy distinguishes between three categories of member enterprises. Depending on the number of employees, firms' assets, and profits, monthly membership fees range from 55 Croatian kuna (10 USD) to 5,500 kuna (1,015 USD). This amounts to 660 to 66,000 kuna annually (<http://www.hgk.hr>). Compare this to the membership fees in the voluntary Croatian Employers' Association ranging from 150,000 to 500,000 kuna (roughly 27,700 to 92,340 USD) annually, plus .05% of firm's profit (Croatian

Employer's Association, 2004). These numbers do not include membership fees in sectoral groups organized within these associations. Within the Croatian Employer's Association, these annual fees range from 350 USD for membership in the textiles association to 1,108 USD for membership in the financial sector association. To put these features in some perspective, in 2003, an average annual wage in Croatia was equal to 47,064 kuna (Women's Information and Documentation Center, <http://www.zinfo.hr/index.htm>).

These examples suggest that the monetary costs of participation in associations, although generally not prohibitive, nevertheless cannot be regarded as negligible. Add to these the non-monetary costs of managerial time, paperwork, and other organizational activities associated with membership in one or several associations. Such costs cannot be neglected by either the enterprise managers or the analyst of collective action dilemma. Considerations of additional costs involved in participation in yet another association tap into the underlying fundamental problem of collective action. Why such indisputably rational and money-maximizing actors as firms and individual businessmen would participate in the formation of a voluntary organization subject to classic free-rider problems, especially when they are already paying members of a compulsory group not subject to free-riding?

To solve this apparent paradox, I step back and consider the choice of participating in business associations as a strategic interaction between firms, the state bureaucracy, and business associations. In the following section, I extend the model developed in Chapter 4 to the compulsory membership settings. The base model, as presented earlier, applies specifically to voluntary association formation. Still, as will be

shown later, it can easily be extended to the behavior of associations and firms in compulsory settings. On the basis of the formal model of business participation in associations, I advance an argument suggesting that compulsory encompassing associations are less motivated to provide the services most sought by firms in post-communist settings and, thus, are necessarily inferior to well-motivated voluntary organizational alternatives.

### **6. 3 MODELING BUSINESS PARTICIPATION**

In Chapter 4, I proposed a model of business participation in voluntary associations that has taken into account business' desire to minimize the cost of compliance with state-enforced rules and regulations governing economic activities. The model assumes that membership in an association entails both costs and benefits. To attract members, a business association offers particularistic benefits or selective incentives of legal and professional help in complying with rules and regulations. The association also charges membership dues. Under voluntary membership, a firm joins the association when the benefits of jointing (net of membership dues) exceed the benefits of not joining and confronting regulatory costs or engaging in corrupt behavior. In this formulation, particularistic goods, along with the collective goods provided by associations, become the important factors affecting participation in associations.

Qualitative analysis of business associations in Russia, Ukraine, Kazakhstan, and Croatia presented in Chapter 5 supports this claim by demonstrating that the functions and activities of voluntary business associations developed in post-communist countries

include various particularistic benefits that have been valuable to associations' members.<sup>6</sup> The provision of information, expert advice, training, legal assistance, and other types of "protection" against rapidly changing rules, regulations, and procedures affecting businesses are the most demanded services provided by business associations to their members. Particularistic benefits that associations provide exclusively (or cost-effectively) to their members, therefore, appear to be very important for the post-communist context solution to the collective action problem.

To extend this model of business participation to the analysis of compulsory-membership organizations, consider the original set up. The players are a firm ( $F$ ), a bureaucrat ( $B$ ), and an organization ( $O$ ). They maximize income, which for the firm involves considerations of revenue ( $r$ ), cost of production ( $c_p$ ) and regulatory cost ( $c_r$ ). The bureaucrat's income is derived from his/her salary ( $s$ ) and any bribe ( $b$ ) s/he might receive as a "side payment" from the firm. The organization's income is a function of the membership and consists of the difference between dues  $d$  charged and particularistic goods  $g$  provided to the firm, if joining.

Under voluntary organization settings the firm has a choice of three strategies: *comply* with existing regulations at a cost of  $c_r$ , *bribe* the bureaucrat, or *join* the organization and receive assistance in complying with existing regulations. The bureaucrat's strategies include *honesty* or *corruption*; the organization chose the combination of dues,  $d$ , and particularistic goods,  $g$ . Corrupt behavior entails a fine,  $f$ , imposed with the probability ( $p$ ). The model assumes that the organization's payoff is an increasing function of membership. The organization therefore maximizes its utility by

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<sup>6</sup> See also Pyle (2006) on this issue.



minimizing  $(g - d)$ . From this setting the model derived an equilibrium solution under which the organization offers  $(g - d) = c_r - 2pf$ , the firm joins, and the bureaucrat remains honest.

Consider what happens when compulsory membership is introduced. Since now the organization receives dues  $d$  with certainty and the firm joins irrespective of the amount of collective good  $(g)$  supplied<sup>7</sup>,  $d$  becomes absorbed in the firm's cost function. Compulsory membership reduces the firm's choices to *join and comply* and *join and bribe*, with the payoffs as follows:

$$I_F(\textit{join + comply}) = r - c_p - c_r - d + g$$

$$I_F(\textit{join + bribe}) = r - c_p - d - b - pf$$

Because particularistic good  $g$  is defined in terms of reduction in compliance cost  $c_r$ , when a firm selects *join and bribe*, effectively avoiding  $c_r$ , it also cannot receive the benefit of  $g$ .

The bureaucrat maximizes income,  $I_B$ , where  $s$  is salary.

$$I_B(\textit{honest}) = s$$

$$I_B(\textit{corrupt}) = s + b - pf$$

The bureaucrat is corrupt whenever  $I_B(\textit{corrupt}) > I_B(\textit{honest})$ , or

$$(1) \quad b > pf .$$

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<sup>7</sup> Note that now  $g$  is a collective good due to the universalistic nature of organizational membership.

The organization maximizes its utility under the constant contribution  $d$ , by minimizing the member benefits  $g$ .<sup>8</sup> Assuming that organizational regulations permit any non-negative level of member benefits provision,  $I_O(\text{compulsory}) = d - g$  is maximized at  $g = 0$ . The bureaucrat proposes a bribe  $b$ , such that (1) holds; otherwise  $B$  is *honest*. The firm chooses *join and comply* over *join and bribe* if and only if  $I_F(\text{join} + \text{comply}) > I_F(\text{join} + \text{bribe})$  or when  $c_r - g < b + pf$ . When  $g = 0$  this reduces to  $c_r < b + pf$ . To entice the firm into corrupt behavior, the bureaucrat must offer a bribe such that  $I_F(\text{join} + \text{bribe}) > I_F(\text{join} + \text{comply})$ , or

$$(2) \quad b < c_r - pf.$$

Whenever  $c_r > pf$ ,  $B$ 's best strategy is to offer  $b < c_r - pf$  and  $F$ 's best strategy is to *bribe* rather than *comply*. When  $c_r < pf$ , the equilibrium outcomes are  $B$ : *honest*,  $F$ : *comply*, and  $O$ :  $g = 0$ .

Under compulsory membership, the firm's choice has been effectively reduced to *comply* vs. *bribe*, with the compulsory organization becoming an irrelevant actor in the firm-bureaucrat interaction. It follows that the compulsory organization in the equilibrium creates no benefits that would reduce the cost of regulatory compliance to the member firm, leaving this niche of activities open to other (voluntary) organizations. This brings us back to the voluntary organization game with the only difference being that

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<sup>8</sup> This follows from the assumption that the organization maximizes utility by minimizing  $(g - d)$ ; that is, the greater the dues they can charge relative to the particularistic goods they offer, the larger is organization's utility. The model assumes constant contributions  $d$  specified by law in a compulsory system and allows organization to choose the level of collective good  $g$ . An alternative conceptualization would involve a set level of collective goods  $g$  mandated by the law and organizational choice over the amount of contribution  $d$ . Clearly organization would set  $d$  such that  $(d - g) > 0$  and the model predictions would hold.

compulsory membership fees are now incorporated as an obligatory payment in the firm's regulatory cost  $c_r' = c_r + d$ .

The major implications are as follows. First, participation in compulsory business associations does not substitute for participation in voluntary associations. Second, since compulsory membership dues effectively become part of the regulatory cost, particularistic benefits sought by voluntary associations might include measures directed against the compulsory membership systems.<sup>9</sup>

These two implications of the strategic interaction modeled above provide analytical bases for explaining observed empirical developments in the compulsory membership systems of business representation in Eastern Europe. Neither the emergence of and growing participation in voluntary business associations nor the reforms and abandonment of compulsory systems appear to be unexpected; the model suggests that irrespective of the existence of compulsory organizations, voluntary business associations should provide an attractive alternative to the unofficial ways of "getting things done" when regulatory compliance is a burden. Since compulsory organizations do not have to lure businesses in by offering valuable services that decrease the cost of doing business, voluntary associations offering such services will rise and attract new members. In effect, compulsory organizations' lack of incentives to provide regulatory relief as a means of increasing membership preconditions the development of organizational pluralism.

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<sup>9</sup> There are other important implications not directly relevant to the focus of this paper but highly suggestive for the study of business associations' development and bureaucratic corruption. First, assuming that under voluntary participation  $(g - d) > 0$ , *ceteris paribus*  $b(3) < b(4)$ . This means that under the compulsory organization settings corrupt bureaucrats can charge higher bribes in exchange for overlooking non-compliance. Second, all other things equal, organizations should be more prevalent in regimes where  $p$  or  $f$  are relatively high. Third, organizations should be less prevalent in regimes where  $c_r$  is relatively high. For associations to create a valuable alternative to corrupt behavior under burdensome regulatory pressures they would need to be particularly efficient in providing selective incentives.

Yet another extension of the model suggests that under the compulsory membership arrangements, membership dues, in fact, become an element of regulatory burden. This predicts the eventual breakdown of compulsory membership systems. Note that, for such a prediction to hold, compulsory membership does not necessarily have to be associated with net losses, such that  $d - g < 0$ , it just has to be *perceived* as such. Even if compulsory organizations might be providing valuable services to the firms, by the nature of the system, such goods are common to all firms in the economy and, thus, are unlikely to be seen as a direct result of compulsory organizational arrangements. Firms are likely to assume the provision of such goods and services without giving credit to the compulsory association and legislative frameworks mandating universal participation and contributions. Thus, firms are likely to underestimate the benefits and overestimate the costs of compulsory membership and argue for its abandonment. Voluntary associations could start campaigning against such obligatory contributions to reduce the cost of compliance for their members. This would create an organized opposition to the compulsory membership system, increasing the chances of reforming the legislative underpinnings of the compulsory business representation.

So how does one know if this story is true for the post-communist cases? Clearly the model's implications are consistent with the erosion of corporatist-style regimes manifested in the development of multiple voluntary business associations, loss of monopoly on representation, and, in some cases, retreat from the compulsory institutional forms. But do the model assumptions in regard to the associational functions, enterprise demands, and bureaucratic position correspond to the reality? The following section

offers a more detailed description of the formation and erosion of the compulsory system of interest representation in Croatia.

#### **6. 4 EVOLUTION OF BUSINESS REPRESENTATION: THE CASE OF CROATIA**

The Croatian case is representative of the post-communist systems of business representation that were patterned after the “continental” chamber systems. Its institutions and developments in respect to business representation exhibit strong similarities to other countries of the former Yugoslavia. The country’s system of interest representation, therefore, is representative of the large group of corporatist-style systems that, unlike those in Slovakia and Hungary have survived into the 2000s. By tracing the formation, functions, and activities of the official compulsory and a number of voluntary associations, I attempt to put some substantive “meat” on the bare bones of theoretical arguments. Descriptive analysis of the Croatian business representation follows the analytical framework used to present the country cases of Russia (Chapter 3), Ukraine, and Kazakhstan (Chapter 5).

The system of interest representation developed in Croatia is considerably different from other country cases presented earlier not only because of the compulsory membership model that was chosen at the outset of Croatian independence, but also because this Balkan country has drastically different economic and institutional legacies lingering from the Yugoslav model of socialism usually portrayed as the most liberal of the socialist economies. The system of Croatian interest representation therefore deserves a special attention because its differential structure might have provided different

challenges and opportunities for addressing business demands. It will be shown, however, that although Croatian business representation initially was different from those developed in Russia, Ukraine, and Kazakhstan, it later converged with other analyzed countries in organizational structures and functions and activities performed by business associations.

Croatia with its 55% membership rate in 200 and 77% in 2003 is among the most participatory post-communist countries in respect to business representation. It is surpassed only by its neighboring Slovenia—another splinter of the former Yugoslavia—and in 2000 by Hungary and in 2003 by Albania. Such enthusiastic participation in business associations has an apparent institutional explanation. In the early 1990s Croatia adopted legislation that seemingly put the representation of economic interests on the neo-corporatist path. Peak associations—Croatian Chamber of Economy (CCE), Chamber of Trades and Crafts (CTC), and Croatian Association of Cooperatives (CAC)—were created on the bases of compulsory membership for enterprises satisfying the requirements of size, official registration, sector, and location.

Given the peak associations' claims for universal membership and representation, it seems puzzling why the membership rates detected by BEEP survey fall short of 100%. The explanation lies in the mechanisms of official enrollment in the compulsory associations. For the most part membership in corresponding associations is automatic upon the official incorporation of an enterprise or licensing of entrepreneurial activity. Thus, many businessmen might simply be unaware of their membership status. Awareness about membership in associations usually comes as a result of firm's joining of a local or sectoral organization of the corresponding Chamber, which are the voluntary

business decisions (see below). Additionally, some spheres of economic activities, particularly in sectors dominated by small businesses that do not require special operation certificates are effectively exempt from the official membership requirement.

The central peak organization of the Croatian industry and commerce is the Croatian Chamber of Economy. CCE traces its history to the 19th century. The Chamber was established in 1852 following the European chambers of commerce tradition. The Chamber continued its operations—with a significant modification of its functions—when Croatia was integrated into Yugoslavia and survived as a part of the Yugoslav chamber system through the socialist period. After the independence of the Republic of Croatia from Yugoslavia, the Chamber of Economy Act enacted by the Croatian Parliament in 1991 established CCE as a business organization independent from the government. The Chamber was structured as the only Chamber that represents all economic entities in the country following the continental European public-legal model based on the compulsory membership and a comprehensive scope of prescribed activities. The official vision of the Chamber purpose and its place in the political and administrative systems specifically referred to the so-called continental model of Austrian and German chambers. Every company of at least 50 employees operating in Croatia and registered with the Commercial Court automatically becomes a member of CCE.

In addition to the central office in the capital city CCE has 20 county chambers. The highest governing body of CCE is the Assembly those members elect Management and Supervisory Boards, the President and five Vice Presidents responsible for different aspects of Chamber's activities. The Assembly members do not represent all the CCE member enterprises but are representatives of local chambers— usually “reputable”

business people. The Chamber has seven sectoral departments covering respective branches of the economy and two centers responsible for education and statistics. It also has five additional business centers to implement specialized programs, the Permanent Arbitration Court, Conciliation Center that mediates in minor business conflicts, and the Court of Honor that enforces Responsible Business Practice Code of business ethics that goes beyond rules enforceable through the court of law.

Professional and sector-specific business associations exist also at the county level functioning as sub-divisions of county chambers. The county chambers heavily rely on activities of sectoral and professional associations that concentrate on the particular aspects of business, depending on the sector composition of the county economies. Many activities of CCE including the development of business propositions, provision of information about local conditions, monitoring the effects of government policies, and others are conducted through such associations. Trade associations in cooperation with the central CCE office organize sectoral fairs, monitor economic trends within sectors, develop specific regulatory propositions, and directly participate in consultative bodies of various government agencies.

Croatian legislation provides the Chamber with institutionalized channels of access to the political decision making to facilitate the representation of economic interests. CCE's participation in the workings of government institutions, including the ministries and the cabinet is organized on either permanent basis or upon invitation to the working sessions and meetings. The Chamber prepares mandatory position statements for parliamentary committees on economic, budgetary, financial, labor, and social policy issues (CCE, 2006). The Chamber also routinely provides economic information to the



parliamentary committees and individual legislators. Written reports, position statements, proposals, and other materials issued by the Chamber are known as *joint proposals of the business community*. The Chamber commissions studies to the professional research institutions. Official status of the Chamber as the representative body of Croatian business community allows for its direct participation in international negotiations including negotiation on the Croatia's accession to the WTO, signing of the Stabilization and Accession Agreement (SAA) with the EU, free trade negotiations with Central European Free Trade Association (CEFTA), joining CEFTA and EFTA (European Free Trade Agreement), and bilateral economic talks.

In its functions the central office of the Chamber traditionally concentrates on the foreign economic relations. It organizes international fairs and exhibitions and closely cooperates with foreign organizations of business facilitating information sharing and collaboration between Croatian firms and foreign partners. The Chamber functions as a designated agency to enforce the implementation of the Agreement on Trade in Textiles between Croatia and the EU. CCE also represents Croatia in several regional agreements including Stability Pact, Central European, Adriatic-Ionian, and Southeast European Co-operative (SECI) initiatives. CCE has assumed regulating and certifying functions in various fields of international commerce and transportation.

For instance, in 2004 special government regulations authorized the Chamber to issue and validate the import/export documentation including ATA Carnets (documents facilitating customs procedures for the temporary import /export such as commercial samples, fair and show exhibits, etc.), certificates of origin for goods, FORM A—origin of goods for GSP exemptions, third country origin, end use and cross-border certificates,

certificates of non-Croatian origin, and export permits. Special agreement with the Ministry of the Sea, Tourism, Transport and Development (Under the Road Transport Act NN 178/04) authorized the Chamber to issue international goods transport permits, coordinate passenger transportation schedules, harmonize bus price schedules, and participate in the occupational certificate examinations.

In the sphere of domestic market regulation in 1997 the Chamber enacted a voluntary quality control and domestic producer support projects that visually marked Croatian products with “Croatian Quality” and “Croatian Creation” labels. The quality labels designate products that meet the highest standards in ingredient, design, ergonomic, environmental and recycling-friendly criteria. This creates reliable information, reduces transaction costs, and promotes producer reputation building. The Chamber tries to ensure impartial and professional evaluation standards. The “Croatian Creation” label is awarded to the original Croatian products that reflect Croatian traditions and inventions in addition to meeting the quality criteria described above.

The Chamber’s representative and regulating functions were expected to generate close integration of business community into political processes and a gradual development of beneficial self-regulation. However, from the moment of CCE formation, businesses in different sectors started voicing dissatisfaction with the compulsory nature of the system and inability of the Chamber to adequately reflect the demands and protect the interests of diverse economic sectors. The movement has produced spontaneous self-organization of rival business associations. A number of sector-specific (Association of Travel Agencies, Association of Croatian Exporters) and cross-sector (Croatian Employer

Association) organizations emerged to represent businesses who felt their interests and vision were ignored by CCE.

CCE was criticized for giving little recognition—and virtually no representation—to the small business sector and particular industries. In response to this criticism in 1994 the Chamber convened founding meetings in order to establish professional associations and specialized groups that would become the sub-divisions of CCE. 40 professional associations and 87 specialized groups were established as semi-autonomous organizations operating within the CCE structure. Membership in such groups is voluntary and members are expected to pay additional fees for joining these groups. Sector-specific associations are governed by their own charters that can be amended by the members, although the law provided for a compulsory membership of such sectoral groups in CCE.

In addition to the elaborate organizational structure of CCE, special legislation established representative association for firms with cooperative form of property (mainly in agriculture, but also housing cooperatives, artisans, and credit unions)—Croatian Association of Cooperatives, and the small business sector—Croatian Chamber of Trades and Crafts. Membership in these groups substitutes for the membership in CCE and is open to firms established under the Law on Cooperatives and the Trade Law. These organizations have separate staff, budget, and organizational structure. The latter however in many ways parallels the organizational structure of CCE.

The 1993 Trade Law (*Narodne novine* 77, 1993) that outlined regulatory principles of entrepreneurial activities of physical entities—in various spheres of

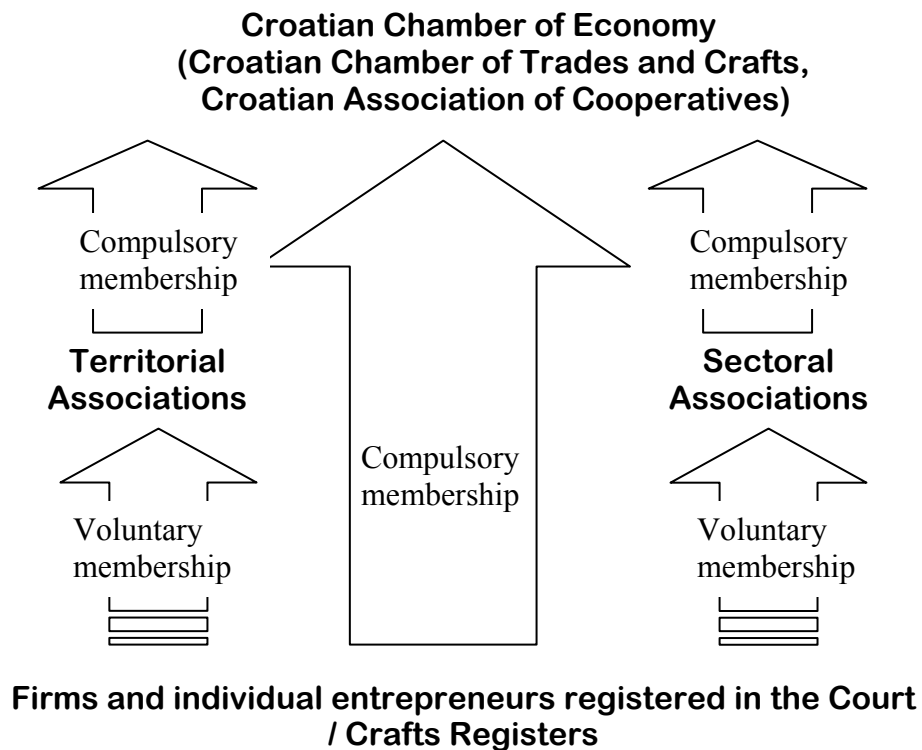
production, services and commerce also created Croatian Chamber of Trades and Crafts<sup>10</sup> as a compulsory organization of craftsmen who become members at the time of entering in the county crafts registries. The law does not prescribe creation of local and sector-specific associations of craftsmen, but restricts the number of such associations, whenever these emerge, to one per geographical location and sphere of commercial activity. The law prescribes internal structure, governance mechanisms, and broadly outlines the spheres of activities of the Chambers. The Ministry of Craft, Small and Medium Entrepreneurship ensures conformity of the Chamber of Trades and Crafts statute with the Law, and the Croatian Chamber of Crafts guarantees conformity of local and sectoral chambers with the law. Following the adoption of the law, in 1994 the Chamber convened its re-constituting assembly and has taken over the property of the socialist-era trade chambers in Zagreb and provincial cities.

Croatian Association of Cooperatives was established in 1995 based in the provisions of the Law on Cooperatives as a compulsory organization of Croatian cooperatives and sectoral and territorial cooperative associations. All cooperatives registered in the Court Register automatically become Association's members. CAC has regional offices that operate as organizational sub-divisions of the association and 12

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<sup>10</sup> Similarly to CCE, Croatian Chamber of Trades and Crafts has a long history dating back to 1879 when craftsmen and merchants of Zagreb have organized crafts convention. The first union of Croatian craftsmen organized in 1906 struggle for the formal recognition on the part of the state authorities. The Union has strengthened its base in the interwar period expanding its activities to the founding of the crafts museum, local craft schools, philanthropic and credit organizations. The establishment of the socialist economy resulted in the banning of the operations of the Crafts Union and nationalization of its property. Unlike in the Soviet-style economic system though, private small-scope economic activity was not completely outlawed in Yugoslavia, but the majority of the artisan production from late 1940s was transferred to the social (primarily cooperative) sector. Occupational Chambers giving the upper hand to the state and cooperative enterprises were established and existed until 1962 when they were replaced by Chambers of Economy. In 1980 the craftsmen organization was revived in a form of the Union of Craftsmen Organizations. In 1992 this organization has inherited the former property of the first Croatian Crafts Union that was nationalized in 1947 (<http://www.hok.hr/hok/>).

regional and sectoral associations such as Croatian Union of Housing Cooperatives, Cooperative Union of Slavonia, Croatian Association of Credit Cooperatives, and others (Interview, Internal publications). Figure 6.1 below illustrates such dual organizational structure based on both compulsory and voluntary membership. In fact such structure is common to the three official peak associations established by the Croatian government.



**Figure 6.1:** Croatian compulsory associations: membership structure.

CAC's goals according to its statute include promotion, harmonization, and representation of cooperative interests before state administration. Association performs a number of functions ranging from logistic support to cooperatives and sectoral

development programs in education, product promotion, and stimulating exports to expert monitoring of economic trends in cooperative sector and developing recommendations to the government on the issues affective enterprises of cooperative form of property. Association published a monthly magazine covering economic issues and problems common of cooperative sector. It actively participates in national and international trade shows promoting products and services of its members. CAC's activities are financed through the membership fees and contributions from member associations as well as through government programs effectively subsidizing cooperative sector.

The top-down creation of the compulsory organizational structure has been criticized by the Croatian businessmen. The system was seen as unwieldy, it was deemed to pay little attention to the actual needs and concerns of business community and as a direct extension of the state institutions allowing little room for business initiative for challenging the state official position. Those dissatisfied with or suspicious of the representative capabilities of the official peak organizations has developed alternative organizational forms that over time became formidable rival to the top-down Chambers system. Starting in the early 1990s a number of voluntary organizations have emerged to occupy different sectoral and issue specific niches. Some of these associations found it hard to compete with the compulsory chamber structure because business participation in voluntary organizations would double business annual contributions. Another difficulty for the survival of independent voluntary associations was presented by the organizational reform within the Chamber of Economy with the legislative prescription for the voluntary sectoral groups to join the Chamber. In effect voluntary associations

formed from the bottom up through the initiative of business community have become absorbed into the official Chamber system.

Nevertheless, there have been remarkable success stories of the formation and independent development of sectoral and cross-sector voluntary groups. For example, as early as 1992, the newly established travel agencies have organized a trade association rival to CCE. Through the 1990s association grew and expanded its activities to include travel database, voluntary quality standard enforcement, code of business ethics mandatory to its members, customer informational portal and a variety of research and lobbying initiatives. The interview with the executive director of the Croatian Association of Travel Agencies made me believe that association attracts its members because its activities create a common informational space and a level playing field, guarding against unfair competition frequently emerging in this still developing market (Zagreb, June 2006, personal interview).

Perhaps one of the most significant players in the Croatian interest representation system that was established on the voluntary basis is Croatian Employers' Association (CEA). CEA was founded by the initiative of a German investor joined by prominent Croatian businessmen in 1993 as a voluntary, non-profit and independent employers' association. A prominent Croatian businessman I. Todoric served as a first president through his networking attracting a large number of entrepreneurs to the association. In 2006 CEA's membership surpassed 5 000 members from all parts of the country that employed over 400,000 workers (<http://www.hup.hr>).

CEA is based on voluntary membership and democratic internal governance and while its statute declares the representation of members' interest and protection of private

property as the central goals of organization, CEA's major role is largely seen as participation in tripartite relations. Organized as a confederation of individual enterprises and 23 voluntary sectoral associations<sup>11</sup>, CEA has been recognized by the government and trade unions as the only representative employers' organization in the tripartite relationship. Since the establishment of the National Economic and Social Council in 1994 CEA became a legally authorized negotiator on behalf of employers in collective bargaining and signing of collective agreements.

In addition to its participation in the collective bargaining—primarily in the field of labor and social legislation—CEA is an active player in the sphere of industrial relations conducting studies, making proposals, and organizing conventions on the issues of private property protection, promotion of economic development, and regulation of market economy. Since the UE accession negotiations opened up a possibility for Croatian integration in the UE, CEA have prioritized issues relating to harmonization of Croatian industrial legislation and relations with the EU practices and creation of favorable investment climate. In addition to lobbying, information provision (through its website, *Eukonomist* magazine, and specialized reports), and expert studies, CEA maintains a dispute mediation center and a Center for EU Pre-Accession Programs. In 2004 CEA launched a specialized “benchmarking” project that focuses on the development of best-practice recommending in the sphere of corporate governance.

The system of businesses representation that developed in Croatia after its independence from Yugoslavia seemingly presents a drastically different model of

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<sup>11</sup> Upon joining CEA a new member may join a sectoral association in his respective industry. The sectoral associations have independent charters, specialized functions, and different membership fees. Membership is voluntary.



representation. Still, many similarities in strategies, organizational forms, and activities undertaken by business associations can be seen in Croatia, Ukraine, Russia, and Kazakhstan. Based on nearly universal business participation the peak association was developing non-state mechanisms of executing economic policies and monitoring economic regulations. The compulsory institutions have promised greater participation, cohesion, and representativeness that would translate into a stronger position of business community vis-à-vis the state. The compulsory membership organizations however did not fulfill early expectations for creating the better mechanisms of defending business interest and regulating intra-industry relations. The failure of the compulsory membership model has manifested itself in the development of alternative voluntary associations that took on the roles forsaken or underperformed by the official peak organizations. Self-organization of rival associations and creation of official peak association to represent small businesses and cooperatives de-facto annuls the CCE monopoly on business representation and introduces principles of voluntarism and competition.

#### **6. 5 COMPULSORY VS. VOLUNTARY MEMBERSHIP: WHAT DIFFERENCE DOES IT MAKE?**

As the above discussion demonstrates, the existence of the compulsory membership requirement does not prevent firms from seeking membership in alternative voluntary membership organizations. Theoretical predictions and empirical evidence suggest an increasing similarity between systems of representation originally based on compulsory and voluntary membership. Empirical analysis presented in this and the previous chapters shows that although the repertoire of associational activities might

differ depending on sectoral and country-specific conditions, in both systems, business associations perform analogous functions. But how does the compulsory vs. voluntary membership distinction influence the overall levels of participation in associations? More importantly, can one justify a comparative analysis of business participation in associations in countries adopting different systems of representation?

This question goes back to the quantitative cross-national analysis presented in Chapter 4. There, business survey data was utilized to assess a number of competing hypotheses about determinants of associational membership. Does the existence of compulsory-membership regimes invalidate the results of this analysis? Here I argue that the compulsory membership requirement does not invalidate the comparison of compulsory and voluntary membership systems, neither does it undermine the validity of conclusions based on the comparative analysis of business survey data.

A brief glance at the mean levels of membership across the compulsory and voluntary membership regimes should rule out any suspicion that compulsory membership translates into universal participation. Table 6.2 presents average shares of firms reporting participation in business associations in compulsory and voluntary membership regimes, according to the 2000 and 2003 BEEP data. I have calculated group averages based on two different classifications. The “current regime” categories are based on the compulsory-voluntary system division after two originally compulsory-membership countries—Slovakia and Hungary—abandoned the compulsory clause in 1996 and 2000 respectively. The “initial institutional design” categories reflect the original post-transition representation system division with Hungary and Slovakia included in the compulsory membership category. According to the table, in the 2000

sample of compulsory membership systems, 34% of firms reported membership in business associations, comparing to 22% membership rate in voluntary systems.

The 34% membership is much lower than the 100% membership rates implied by the compulsory membership legislation. Additionally, the small difference between the compulsory and voluntary membership figures does not support a notion that compulsory membership largely determines the level of participation. As discussed above in the case of Croatia, I interpret these descriptive figures as capturing the rates of an actual *active* participation associated with real benefits from associational services and activities, rather than as an indicator of nominal and automatic membership in official associations.

	Compulsory	Voluntary
2000 membership level among current regimes	.34	.22
2000 membership level (initial institutional design)	.37	.19
2003 membership level (current regimes)	.66	.33
2003 membership level (initial institutional design)	.62	.32

**Table 6.2:** Share of participatory firms in compulsory and voluntary membership systems. BEEPS data.

In 2003, the difference between participation levels in compulsory and voluntary membership systems increased when compared to the 2000 figures. In the compulsory membership category, participation almost doubled from the 2000 to 2003 survey; for the voluntary membership category, business participation increased by about 50%. The compulsory category figures, however, include participation in both voluntary and compulsory associations which does not allow for discriminating between the growth of

compulsory and voluntary organizations. The descriptive qualitative analysis presented in this chapter points to the recent growth in the number of and membership in voluntary groups throughout compulsory membership countries, suggesting that the membership increase, at least in part, is attributable to the growth of voluntary groups. Formal analysis outlining the motivation for joining voluntary organizations in the compulsory-membership settings provided a strong theoretical rationale for expecting a growing participation in voluntary groups. If firms join voluntary associations to countervail the regulatory pressures imposed in part by compulsory membership, then participation levels in compulsory settings have to be twice as high as in voluntary regimes.

In addition, there is a rather weak correlation between membership levels and the compulsory membership requirement. Table 6.3. presents bivariate correlations for the 2000 BEEPS data analyzed in Chapter 4. While the correlation between membership levels and the current compulsory regime category is not statistically significant, when the originally compulsory membership systems of Slovakia and Hungary are included in the compulsory category, correlation becomes positive and significant at .05 level. This demonstrates the country-case sensitivity of this relation and the long-lasting effects of institutional factors on the patterns of participation. The compulsory membership as such, therefore, does not determine levels of participation. Other factors largely connected to institutional foundations of business representation systems, including but not limited to the awareness of membership status, benefits associated with participation, costs of membership, and regulatory pressures, are likely to contribute to the differential levels of participation reported in the compulsory and voluntary settings.

Variables	Correlation	Significance (2-tail)
Membership 2000*compulsory current regime	.298	.148
Membership 2000*compulsory initial design	.476*	.016

N=25

**Table 6.3:** Bivariate correlations.

I conclude that given the on-going evolution of compulsory membership systems towards greater voluntarism, the existence of differential systems of representation does not present a problem for the quantitative analysis that groups together compulsory and voluntary membership systems. My analysis suggested that business associations across compulsory and voluntary regimes, although with differential degrees of effectiveness and member satisfaction, perform very similar functions that help protect their members from regulatory pressures. The descriptive statistics presented above demonstrate that differences in self-reported levels of participation in associations are not over-determined by the compulsory nature of business representation. If anything, the country-level fixed effects incorporated in the analysis of the cross-national survey data have ensured the accuracy of the qualitative data analysis. Although the compulsory membership requirement has some affects on the levels of participation, such effects can legitimately be modeled as country-invariant conditions. The empirical results of the fixed-effect models presented in Chapter 4, therefore, should be valid for both the compulsory and voluntary membership systems.

## **6. 6 SUMMARY**

Summing up, this chapter analyzed interesting patterns in the institutional development of business representation across post-communist Eastern Europe. While initially, the legislative frameworks adopted after the collapse of communism created different institutional foundations for business representation, subsequent developments brought about an increasing organizational pluralism. Voluntary business associations were formed even in the systems built on the principles of compulsory membership. As a result, post-communist business interest representation systems have exhibited converging patterns a decade after transition. After the abandonment of compulsory chamber systems in two out of eight compulsory membership regimes, coupled with the growing number of independent voluntary groups in others, it became apparent that organizational pluralism and voluntarism are becoming the points of convergence.

A close look at the formation and development of business associations, their activities, and their membership suggests that despite different legislative and institutional frameworks adopted at the outset of transition, patterns of business representation exhibit a degree of convergence throughout post-communist states. This finding goes contrary to the plethora of scholarly accounts of the growing dissimilarities between post-communist countries in the political, economic, and social spheres (Ericson, 1992; Crawford, 1995; Stark, 1996; Holmes, 1996; Stark & Bruszt, 1998; King, 2000; Fish, 2001). If the arguments presented in this chapter are correct, business representation represents one of the few areas of increasing (since the early 1990s) homogenization across post-communist countries.

This chapter explained these developments based on the underlying calculus of voluntary group formation which has to take place in the corporatist system for pluralism to take root. By returning to the model of strategic interaction between post-communist firms, business associations, and state bureaucracy, this paper arrived at the conclusion that despite certain advantages associated with the prior solution of the collective action problem, compulsory associations have fewer incentives to satisfy business demands. This opens up opportunities for the development of voluntary groups. The empirical developments and theoretical arguments presented in this paper are relevant to a number of topics specific to the post-communist and cross-regional comparative studies.

Interestingly, one can detect parallels between developments in the post-communist compulsory membership systems of interest representation and business representation in the developed capitalist world. The empirical criticism of West European “democratic corporatism” has led some scholars to notice that monopolization of interest representation by centralized peak associations no longer characterizes many long-term corporatist systems. Scholars have pointed to the crumbling of democratic corporatism under economic liberalization and globalization pressures (Lash & Urry, 1987). Such an apparent metamorphosis of democratic corporatism has led some scholars to the notion of “coordinated economies” as a conceptual alternative to corporatism (Iversen & Pontusson, 2000; Soskice, 1990). Corporatism has been seen as increasingly diverse institutional and functional arrangements, varying greatly across advanced industrialized countries (Siaroff, 1999) and developing economies (Lavdas, 2005). The development of many elements of pluralism and voluntarism within the compulsory membership systems in Eastern Europe might be a part of a more universal

phenomenon. The proposed model of organization, therefore, might have a more universal application.

Cross-regional parallels in the systems of representation go beyond Western Europe. Observing the evolution of interest group organizations in the United States, Heinz et al. (1993) have pointed to the declining role of large umbrella groups representing economic interests that used to be the central lobbying actors in the US. Instead, a profound fragmentation is apparent. Explaining such changes, the authors argued that “peak associations cannot always satisfy the policy preferences of their diverse constituencies. Larger associations tend to take positions that minimize internal conflict, thus encouraging specialized interests to develop independent strategies” (Heinz et al., 1993, pp. 375-76). Such an argument resonates with the East European experience, showing that even when peak associations are imposed through legislation, economic interests would find alternative channels of expression if a large encompassing group fails to respond to their specific demands.

Perhaps the most far-reaching implication of the presented analysis concerns the issue of institutional design. The evolution of organizational forms of business representation in Eastern Europe calls into question theories emphasizing the creation of the “right” institutions through deliberate political engineering. The erosion of business representation systems based on compulsory membership and centralized hierarchical organization, in fact, reinforces the notion of local knowledge and experimentation as the driving forces behind social change (Stark, 1996). The spontaneity of the developing pattern of governance in Eastern Europe is yet another evidence of the failure of the “blueprint” approach to transition (Grabher & Stark, 1997).



## **CHAPTER 7**

### **CONCLUSIONS**

In this chapter, I summarize the major findings of this manuscript and re-state the central arguments. I then proceed to the discussion of major implications of this research for the theories of politics. The chapter concludes with a brief outline of directions for future research.

#### **7.1 SUMMARY OF ARGUMENTS AND FINDINGS**

This dissertation explored the formation and evolution of important and perhaps most highly developed institutions of the post-communist civil society—business and employer associations. I started with the empirical puzzle that has profound theoretical implications. Namely, given the generally similar starting points of post-communist countries, the cross-national and sectoral diversity in membership levels and organizational development of the post-communist business representation called for a theoretical explanation. I advanced a theoretical argument emphasizing the “defensive” functions of business associations as the major driving force behind growing membership.

On the theoretical level, post-communist empirical diversity has presented a wonderful testing ground for investigating conditions that facilitate collective action on the part of unorganized economic interests. This addresses problems of a profound theoretical importance and far-reaching consequences for a plethora of region-specific and universally applicable socioeconomic issues. I have reviewed a host of theories providing explanations for why interests organize. I then designed an integrated approach for testing the relative strengths and weaknesses of these alternative theories. The major argument emerging from my theoretical and empirical exploration of the topic is that businesses join associations in response to regulatory conditions imposed by the state bureaucracy. Economic sectors and countries where business associations are able to find cost-effective ways of “protecting” member interests against invasive bureaucratic intervention and the adverse effects of rapidly-changing regulatory regimes, therefore, enjoy greater participation.

My empirical exploration has been structured along two major theoretical approaches to the study of the formation of organized interests. The first emphasized the role of latent group characteristics, or the demand side of the group formation puzzle. The second paid closer attention to the institutional and macroeconomic conditions that shape strategies available to the organized interests and their opportunity structure. In this dissertation, I referred to these as the supply-side hypotheses. To summarize the empirical findings of this dissertation, Table 7.1 lists hypotheses developed at the outset of this manuscript (see Table 2.1). Through the multi-level nested-design empirical analysis, I found support for some factors advocated in the literature. Other theoretical

explanations are proven to have limited relevance in the post-communist context. Still others seem to directly contradict the observed empirical relationships.

<b>Demand-Side Independent Variables</b>		<b>Supply-Side Independent Variables</b>	
Firm size	+	Laws regulating association formation	0
Ownership (private de novo, foreign)	+	Political Openness/Democracy	0
Financial standing	0	Parliamentary regime	0
Fixed assets	0	Bureaucratic corruption	+
Concentration (firms per sector)	-	Business-inhibiting regulations	+

**Table 7.1:** Results of hypotheses testing.

For instance, smaller group size (the number of firms per sector), ownership structure (foreign and de-novo private ownership in particular), and the relatively large size of enterprises (that lowers interest fragmentation) increase the likelihood of association formation. At the same time, the existence of large business and employer associations that transcend sector and regional divisions attests to the fact that diversity of interests and multitude of group members do not preclude voluntary groups from forming. In fact, cross-industry associations have been the first ones to form in Eastern Europe, well before the formation of industry-specific groups (Fortescue, 1997; Pyle, 2006b).

Although the cross-national variation in the levels of membership in business associations seem to be related to overall levels of economic development and to the success of market reforms, hypotheses derived from the economic development theory, in the closer consideration, find little support in the post-communist countries. Rather than

economic development and macro-economic transformation per se, more institutionally-based factors, such as the bureaucratic and regulatory environment, seem to be responsible for the observed cross-national differences in business association development.

This dissertation finds that, quite contrary to established theoretical accounts, firms in economic sectors characterized by high resource specificity—the cost of moving production resources to another use—are less likely to join associations. Resource specificity appears to be unrelated to interest aggregation and to the formation of business organizations. I argue that other industry-specific factors, apart from resource specificity, are responsible for producing cross-sectoral variation. Specifically, rules and regulations structuring industrial relations, production processes, and business practices have played an important role in stimulating organizational responses on the part of post-communist firms. As such rules and regulations vary not only across national borders, but also across different industries and spheres of economic activity, varying levels of organizational formation can be observed in different sectors of the economy.

Another counter-intuitive finding reflects the effects of bureaucratic probity on business interest organization. Although legitimate lobbying is frequently seen as antithetical to the parochial state capture and pervasive corruption, this dissertation finds that high levels of bureaucratic corruption, in fact, stimulate participation in business associations. Contrary to the wide-spread belief that corruption and business interests go hand in hand, I argued that business associations, rather than using corruption to advance their causes, provide an organizational alternative to corrupt practices that increase the cost of running business in transitional countries. With corruption is pervasive, bribing

the bureaucrats responsible for enforcing state regulatory practices becomes costlier for a firm. In these settings, business associations, through their targeted member benefits and collective actions directed at reducing the cost of regulatory compliance, become more attractive for the prospective members. Firms, therefore, join associations as an alternative to the corruption strategy of dealing with state regulatory regimes.

The supply-side factors affecting the formation of business associations, including the institutional environment and characteristics of business associations themselves, emerged from this analysis as the most promising explanatory variables. Qualitative analysis of functions and activities performed by business associations in response to regulatory pressures faced by their constituents pointed to particularistic benefits that associations provide exclusively (or cost-effectively) to their members as the most suitable for post-communist context solutions to the collective action problem. Once the problem of organization has been solved, associations become important agents for the provision of collective goods. Chapter 5 has demonstrated that the functions and activities of voluntary business associations developed in the post-communist countries include various particularistic and collective benefits that have been of important value to associations' members.<sup>1</sup>

Yet, another important finding involves the effects of legal foundations laid out for the development of business representation at the outset of transition. Although in the early 1990s, two distinct systems of businesses representation have been adopted in Eastern Europe—one based on voluntary membership and the other on compulsory membership in state-created associations—subsequent developments brought two

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<sup>1</sup> See also Pyle (2006) on this issue.

systems closer. Voluntary business associations have become the common element of business representation throughout the region. The central argument of this dissertation postulating that post-communist businesses form and participate in associations as a way of protecting their economic interests against the regulatory pressure emanating from the outdated, cumbersome, and frequently business-retarding bureaucratic oversight and control of economic activities has universal applicability through the region.

## **7. 2 LESSONS AND IMPLICATIONS**

The theoretical arguments and empirical findings of this dissertation speak to a number of theoretical domains. Some are specific to post-communist politics; others have implications going beyond the post-communist region. This research is important along four dimensions. It contributes to the on-going exploration of economic transitions, evolving patterns of governance, development of post-communist civil societies, and the debates about patterns of business-state relations that are emerging in the region.

### **7. 2. 1 Economic Transitions and Development of Capitalism**

The best way to conceptualize business associations is to think of them as institutions distinct from the states and the markets that have resources and potential to promote economic coordination, link economic and political systems, and impact patterns of distribution and the allocation of economic and political resources. This dissertation, by focusing on business and employer associations as intermediary institutions filling in the gap between the state and the markets, calls into question some of the underlying assumptions in scholarly accounts of post-communist “transitions.”

The study of transition has been dominated by discussions of the initial conditions (Jowitt, 1992), speed (Sachs, 1990; Przeworski, 1991; Boycko, 1992), sequence (Brown, 1991; Bunce, 1995), and general patterns of economic reforms. Such discussions are natural focal points from the perspective of both the prior study of the 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 & Lijphart, 1997; Sachs, 1993). Such a notion traces back to Hayek (1945) and his analysis of planned and market economies as two mutually exclusive alternatives. The 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 general agreement about what constituted the failure of the 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 socialist failures. Early accounts of transition established a general consensus on the goals of transition: good economic performance and alleviation of the inefficiencies associated with central planning. The major focus was on the tasks of building functioning markets, efficient property regimes, and stable macroeconomic policies.

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 (2000) terms) has challenged such dogmatism. Institutional diversity (Murrell, 1992) and importance of local knowledge (Stark, 1996) in devising the most appropriate strategies and methods of achieving better economic and social outcomes have been acknowledged. The calls to put more emphasis on local knowledge and institutional experimentation have challenged the neo-liberal paradigm. 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, 2000; Hellman et al., 2002). Corporate governance structures, the development of financial institutions and capital markets, and institutions facilitating information exchanges and securing property rights are examples of institutional mechanisms reinforcing 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, non-market economic and social institutions are very important elements of capitalism (Polanyi, 1957). Prior research has shown that these non-market institutions have, to a large extent, shaped the outlook of capitalist societies by affecting the patterns of distribution, macroeconomic stability, and developmental paths available to different capitalist countries (Murrell, 1992b, Hall & Soskice, 2001; Hiscox & Rickard, 2002).



This dissertation demonstrates that business and employer associations are entrenching in the post-communist countries as the central non-market institutions of information transfer, standard setting, economic coordination, and public policy setting. Business and employer associations are emerging as increasingly important mechanisms of interaction between the state and private businesses. Their patterns of organization and influence have an effect on many aspects of evolving economic relations. Most importantly, they affect the developing norms and practices of the state economic intervention and regulation. All of these point to associations representing business interests as important actors in directing the trajectories and producing the outcomes of socio-economic transformation in post-communist economies.

This project, in many ways, speaks to the issues of “soft” institutional reforms that have been a rather evasive topic in the studies of economic transition. Development of economic and quasi-economic institutional framework has been essential to the entrenchment of capitalism in Eastern Europe. To understand the nature of the emerging capitalism, it is important to understand the roles, forms, and patterns of influence business and employer associations assume. Business associations are consequential for economic coordination, work organization, skill acquisition and certification, and public policy formation. By 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, this manuscript contributes to the fuller understanding of business-state relations and of the type of capitalism that has emerged in Eastern Europe and former Soviet republics.

### **7. 2. 2 Bureaucratic Probity and Good Governance**

By analyzing the interaction between state institutions and organized economic interests, this dissertation underscores the importance of state bureaucracy and contributes to the on-going debate about causes and effects of good governance (Holmes, 1996; Whitley & Kristensen, 1997; Hellman et al., 2002; Kaufmann et al., 2003). As suggested by the statistical analysis of the cross-national survey data, bureaucratic corruption that, in recent years, has become a notorious characteristic of many post-communist states is an interesting and novel explanatory variable for group formation dynamics. Although the existing theories of corruption predict that it should undermine collective action on the part of the business community, this dissertation presented evidence for the positive effect of bureaucratic corruption on the formation of business associations. I argued that business associations arise as a defense mechanism to protect businesses against corruption and extensive regulations. If this argument is true, the effects of bad governance should include not only the impediment to economic growth and functioning of the markets, but also stimuli for the bottom-up institutional development, mitigating its negative effects on economic actors.

The defensive organization argument advanced in this manuscript provides a theoretical alternative to the state capture argument, suggesting that powerful economic interests have dominated and shaped the post-communist reform projects to their parochial advantage. Unlike the state capture argument that sees business interests as venues of rent-seeking that have negative consequences on economic performance, accountability, fairness, and efficiency, the defensive organization argument paints an optimistic picture. If, as I argued, by joining associations, businesses enter the field of

legitimate, rather than corruption-prone, interactions with the state regulatory institutions, one might expect the positive effects of group formation—institution-building resulting in improved business climate, efficiency, and growth. This argument suggests that business interest group formation may indeed lead to improvements in public institutions and promote better governance practices.

It is important to reiterate that my argument about the influence of corruption on the formation of business associations addresses low-level bureaucratic corruption. Entirely different dynamics can be observed if one considers other types of corruption involving higher-level civil servants and politicians. In my analysis, corruption operates at the rule-implementation level where public servants can withhold enforcement of regulations or provide their services in exchange for unofficial payments. At higher levels, the development of rules and regulations favoring special interests is likely to become the center of corrupt practices. This is likely to alter incentives on the part of businesses, politicians, and bureaucrats and lead to different consequences for business associations. By addressing the puzzling relationship between corruption and participation in business associations, this dissertation helps to understand the development of a crucial part of the post-communist civil society—business associations. Only by solving this puzzle can one fully address one of the most important issues of the post-communist political economy, namely, the developmental consequences of the business-state relations.

### **7. 2. 3 Civil Society and Democratic Development**

The study of business associations' formation in the new capitalist economies provides an opportunity to trace the developments of a very important component of civil society—business and industrial interests. It brings to light previously unexplored aspects of post-communist state-society relations, namely, the consequences of state behavior for the development of legitimate groups representing business interests. At the same time, it contributes to the study of the reverse influence of civil actors on state institutions and policies. Such research inevitably touches upon the central problem of post-communist politics—transitions to and consolidation of democratic politics.

On one hand, as this research has shown, the formation and development of business associations are influenced by political freedoms and democratic political institutions. Business associations enjoy more substantive membership in parliamentary democracies that are usually associated with greater institutionalization of political parties, cleaner electoral practices, and less centralized and individual-centered political power. Democratization of the political sphere, as the Ukrainian example suggests, gives business associations more opportunities to use the public space to lobby the interests of their members, appeal to higher political authorities, and influence the public opinion. On the other hand, this research demonstrates that business associations are perfectly functional in the non-democratic context: they use the legal system and strictly economic self-organized actions and attain leverage in relation to bureaucrats and political authorities based on the specialized knowledge and information they possess.

Business associations, although benefiting from the political openness of democratic regimes, do not require substantial political freedoms for their formation and

continuing existence. This, however, does not mean that business associations are largely inconsequential for the prospects of democratic transition. Transitions to democracy and the survival of democratic regimes have been linked to entrenched civil traditions (Tocqueville, 1835; Lerner, 1958; Almond & Verba, 1963; Putnam, 1993). According to this long-established intellectual tradition, the existence of autonomous civil society organizations is believed to be one of the essential prerequisites of democratic politics. Civil organizations that go hand in hand with strong civic engagement, interpersonal trust, and participatory political culture are also believed to be largely lacking in the post-communist context.<sup>2</sup> Underdevelopment of civic organizations that would function as a counterbalance to the power of the state and become the foundation of a democratic participatory culture is frequently named as the major impediment to the progress of democratization in Eastern Europe and the former Soviet Republics.

Business associations have emerged as the most organizationally stable, reputable, and self-sustained institutions of civil society in the post-communist context. Even in the countries where the state has taken an active part in organizing business interests under the state-created official chamber systems, voluntary business associations organized outside the state authority. Despite the state's attempts to control business representation through officially-designated associations, non-state voluntary organizations based on complete organizational and financial independence have taken root. Other civic associations to this date, for the most part, lack the stable membership, financial independence, and institutional authority to become dynamic actors in the political arena of East European and post-Soviet nations. If strongly entrenched, independent civic

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<sup>2</sup> See the review of literature in Chapter 1.

groups are essential for democratic stability, the post-communist business associations should be particularly consequential for the prospects of democracy in the region.

The growth of voluntary organizations representing economic interests in the non-democratic countries of the region and the countries with mixed records on democratic reforms might become the contributing factor to their eventual democratic progress or to second-wave democratic transitions. By creating the alternative to the state centers of power, business associations can potentially become the organizational platforms for criticism, may challenge the authoritarian government, and may even assume democratizing functions.<sup>3</sup> If property classes are going to be as important in bringing about and supporting the entrenchment of democratic institutions in the post-communist world, as they historically have been in the West—following Barrington Moore’s (1966) “no bourgeoisie, no democracy” formula—organizations uniting the interests of the property-owning class should be taken seriously by students of democratic change in the region.

In this respect, the counterintuitive finding about the positive effects of bureaucratic corruption on participation in business associations leads to a rather paradoxical implication. This finding suggests that bureaucratic corruption, ironically, may strengthen business associations—a crucial element of civil society. If petty corruption, in fact, strengthens business associations, it might, perhaps indirectly, also support democratic consolidation through the creation of this vital civil society actor that can later serve as an alternative center of power and a check on the state.

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<sup>3</sup> It was symbolic that the only organizations in Russia who openly condemned the arrest and imprisonment of Russian millionaire and the head of Yukos oil company, Michail Khodorkovsky, were business associations, including the Union of Industrialists and Entrepreneurs and “Opora” (*Nezavisimaia Gazeta* Oct 28, 2003; *Komersant* Oct 27, 2003).

#### **7. 2. 4 Patterns of Business Representation: The Pluralist—Corporatist Divide**

Characterizing the emerging systems of business representation in Eastern Europe has become a subject of increasing scholarly attention. Specifically, a number of scholars have explored the notion of corporatism as an analytical tool in making sense of the post-communist business-state relations. A number of scholars have pointed to the seemingly corporatist features of these relations developing in a number of countries. That led to what I would argue was a premature characterization of some East European polities as developing corporatist-style arrangements, if not for all production-related social groups, but at least in the area of business representation.

Russia and Ukraine, for example, have been characterized as developing a corporatist mode of representation due to the large associations of capital and labor dominating the interest group scene and enjoying close relations with the state (Colton, 1992; Kubicek, 1996; Remington, 2004). Waller (1994) argued that “pluralism with corporatist features” has been developing across Eastern Europe. Myant (1994) detected corporatist arrangements in the patterns of tripartite negotiations in Czech Republic and Slovakia. All these analyses extended the corporatist label to the systems characterized by organizational fragmentation and volatility, voluntary and cross-cutting membership, and few institutionalized channels of interaction between business associations and the government.

Based on the analysis of business representation in Russia, Ukraine, Croatia, and Kazakhstan presented in this dissertation, I would argue that these accounts, although building on insightful empirical observations, have generally mischaracterized the emerging systems of business representations. Unlike many earlier accounts, this

manuscript points to the generally pluralist pattern of interest intermediation developing in the region. Recent developments in a number of post-communist countries also point to the still-evolving nature of business representation systems that are perhaps too early to characterize as either following the corporatist or the pluralist ideal types. Partly because more time is needed to observe the outcomes resulting from the developing institutional and un-institutionalized arrangements and partly because of on-going institutional change and organizational dynamics, caution should be taken in putting the post-communist cases, including the Balkan countries, in the corporatist-style category.

In fact, returning to the classic definitions of the alternative systems of representation provided by Schmitter (1974), post-communist cases, although considerably variegated and deviating from the analytical ideal types, seem to better fit in the pluralist category. Schmitter's analysis concentrated on the pluralist-corporatist distinction, although he develops alternative analytical categories of syndicalism and monism. The former referring to the state-less intermediation between representative groups, while the latter modeled to accommodate the Soviet-style experience and defined as "a system of interest representation in which the constituent units are organized into fixed number of singular, ideologically selective, noncompetitive, functionally differentiated and hierarchically ordered categories, created, subsidized, and licensed by a single party and granted a representation role ...vis-à-vis the state..." (96). As this manuscript demonstrates, this "monist" category no longer applies to the countries of Eastern Europe and Eurasia. What the systems of interest representation have been transitioning to, however, has remained an open question.



Corporatism and pluralism have been two alternative analytical categories to be applied in the analysis and classification of new post-communist systems of interest representation. If one is to avoid ideologically loaded labeling and stick to Schmitterian definitions of the ideal-typical alternatives, one has to consider a number of defining characteristics. These include the number and representative claims of interest organizations, their internal organizational structure, functional differentiation, fragmentation and competition, as well as their relationship to the state that may or may not create, license, and grant representational monopoly (93-94). Table 7.2., reproduced from Schmitter (1993: 329), summarizes these different defining characteristics. I underline the ones that apply to the post-communist business representation.

	Pluralist	Corporatist
Representation		
In relation to members	<u>Multiple units</u> <u>Overlapping claims</u> <u>Autonomous interaction</u> <u>Voluntary adherence</u>	Monopolistic units <u>Differentiated domains</u> <u>Hierarchical co-ordination</u> <u>Involuntary contribution</u>
In relation to interlocutors	<u>Mutual tolerance</u> <u>Opportunistic access</u> <u>Consultative access</u> Shifting alliances (log-rolling)	<u>Explicit recognition</u> Structured incorporation “Negotiative” role Stable compromises (package-dealing)
Control		
In relation to members	<u>Persuasive conviction</u> <u>Leader prestige</u> <u>Discriminate treatment</u> <u>Selective goods</u>	Interest indoctrination <u>Organizational authority</u> Coercive sanctions <u>Monopolistic goods</u>
In relation to interlocutors	<u>Provision of information</u> Irresponsibility for decisions <u>Autonomous monitoring</u> <u>Mobilization of pressure</u>	Organization of compliance Co-responsibility for decisions <u>Devolved implementation</u> Withdrawal from concentration

**Table 7.2:** Properties distinguishing pure pluralist and pure corporatist models of intermediation. Adopted from Schmitter, 1993.

Multiple defining characteristics that distinguish corporatist and pluralist types of interest representation have allowed scholars of post-communist politics to apply these ideal-typical categories with freedom, basing their assessment on a singular or a limited number of corresponding traits. However, overall comparison of the distinctive elements characterizing the emerging post-communist systems of business representation (underlined on Figure 7.2) is more favorable to the pluralist pattern. The representation patterns taking root in Eastern Europe and in the former Soviet republics, although containing the elements of functional differentiation, hierarchy, and, in some cases, involuntary membership and explicit recognition by the state, nevertheless are strongly competitive, increasingly voluntary, and exhibit consultative and opportunistic patterns of assess. In terms of member and policy control, post-communist business representation gravitates even more towards the pluralist ideal type with little evidence of organizational capacity for coercive sanctions, binding decisions, and effective enforcement. This dissertation's descriptive analysis of the emerging systems of business representation highlighted important traits characterizing business representation that allow for advancing a more general understanding of the direction in which the relations between the state and social actors have been transforming in post-communist countries.

## **7. 3 DIRECTIONS FOR FUTURE RESEARCH**

### **7. 3. 1 Factoring in Labor Organizations**

One important component that might have profound effects on the pattern of business representation—labor organization dynamics—has been missing from this manuscript. The organizational and political strength of labor groups is believed to

condition the extent of organizational concentration as well as the nature of issues undertaken by business organizations. Streeck and Schmitter (1992), for instance, assert that "...neo-corporatism has always been conditional on a measure of political strength of organized labor..." (p. 216). The absence of strong labor organizations, therefore, precludes the emergence of "significant factions with an active interest in centralized negotiations with labor" on the part of business (p. 206).<sup>4</sup>

An examination of organizational patterns and political strength of labor interests, however, remained outside the scope of this project. One important reason for omitting this potentially powerful explanatory condition has been the generally universal weakness of labor organizations throughout the post-communist space. Lacking the available comprehensive analysis of distinctive models of labor representation across the post-communist cases, I was unable to make a valid comparative assessment of the effects of labor strength on the formation and development of business organizations. Exploration of business representation in a complex system of class and functional interest representation that have been developed in post-communist countries presents a promising venue for future research. Such research would put business representation in a larger perspective of social interest organization and influence.

### **7. 3. 2 Business Organization as an Independent Variable**

Although this dissertation investigates the causes of business interest group formation, the effects of interest group politics on the trajectories of the economic and political development of post-communist countries remains to be an attractive empirical

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<sup>4</sup> There have been other accounts linking specific configurations of business interests to the patterns of labor organization. See, for example, Salisbury (1979).

and theoretical topic motivating any investigation of why groups form. The effects of interest group politics are likely to be derived not only from the differential levels of business interest organization, but also depend on the political systems that emerged after the collapse of communism. This is likely to have important implications for the developmental strategies of post-communist states.

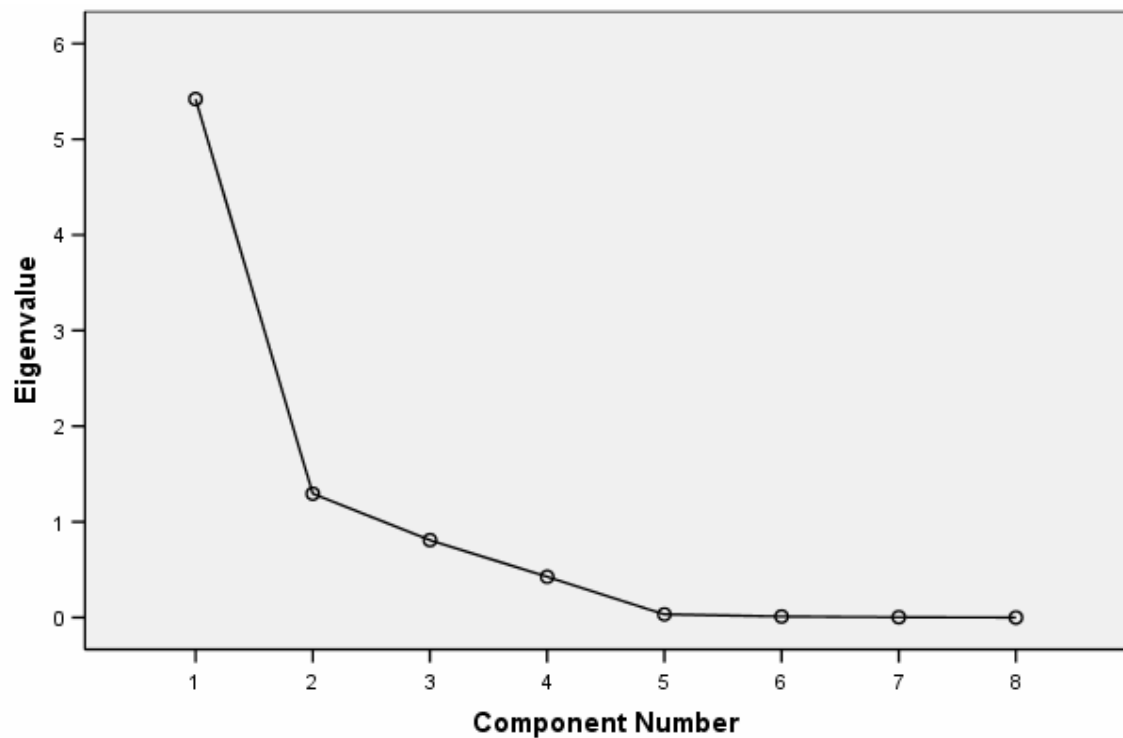
Examination of the consequences the emergent systems of business interest representation have on the democratic and economic development of post-communist countries is a promising venue for future research. In this respect, this research logically precedes the debate about state capture, influence, and exchange that is waged about the consequences of group politics. It is an important step in the on-going exploration of economic transitions in the post-communist countries of Eastern Europe and the former Soviet republics. Understanding why post-communist countries differ in the ways in which social groups organize is an important element in solving the overall puzzle of success and failure in political and economic transformation.

**APPENDIX A**  
**PRINCIPAL COMPONENT ANALYSIS**

Factor	Eigenvalues	% of Variance
1	5.420	67.748
2	1.295	16.186
3	.809	11.119
4	.427	5.332
5	.034	.427
6	.011	.140
7	.004	.049
8	.000	.000

**Table A.1:** Principal component analysis on eight corruption-related categories.

Cronbah's  $\alpha = .907$ , which is larger than the cut-off point of .6 suggesting that it is safe to treat these eight dimensions of corruption as an index.

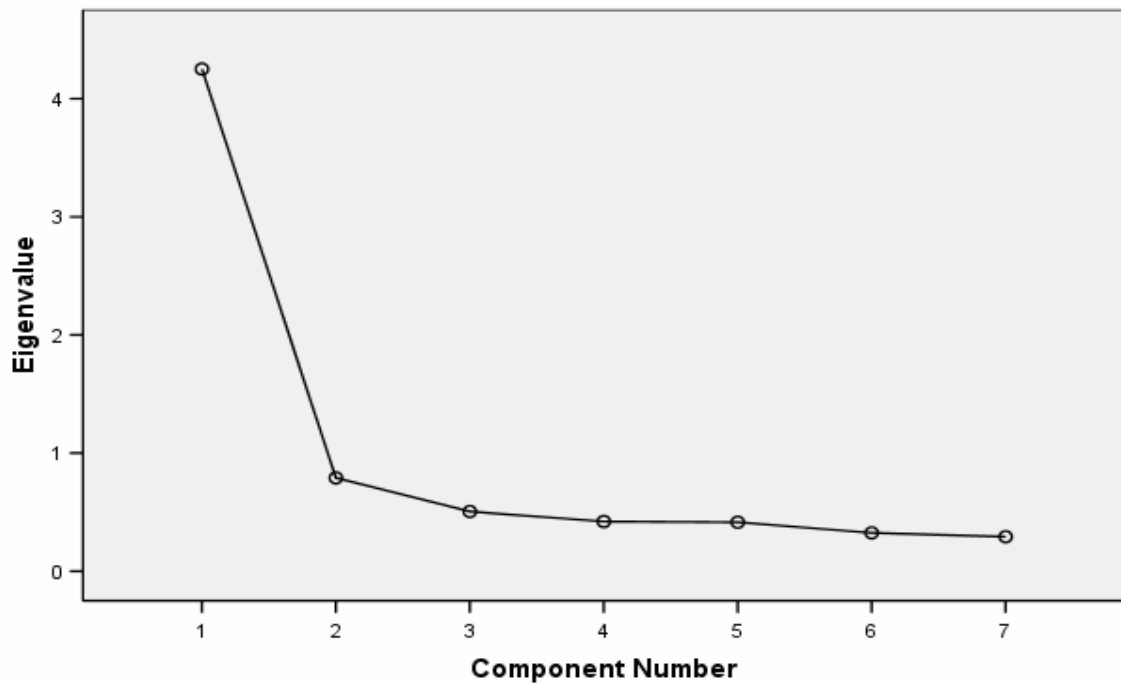


**Figure A.1:** Cree plot for 8- variable principal component analysis.

The principal component analysis returned two distinct components (two eigenvalues larger than 1). In the subsequent analysis I excluded the variable capturing an open-ended response: the “other areas” of corruption. The results are as follows:

Factor	Eigenvalues	% of Variance
1	4.251	60.730
2	.790	11.291
3	.506	7.224
4	.421	6.013
5	.415	5.925
6	.325	4.641
7	.292	4.175

**Table A.2:** Principal component analysis on seven categories



**Figure A.2:** Cree plot for 7-variable principal component analysis.



This presents a clear one-dimensional pattern suggesting that seven substantive corruption-related questions capture the same underlying phenomenon. The open-ended question, in my opinion, has added a second dimension due to the greater frequency of missing values, rather than on any substantive ground. Therefore, I decided to keep the eighth variable in the composite measure instead of throwing out valuable information. Regression analysis on the 7-question composite variable produces very similar to the 8-variable model results.

Variable	Coefficients	Odds Ratio
Democracy	.042(.051).....	1.043
Parliamentary	.564(.150)***	1.758
Corruption	.022(.009)**..	1.022
Employees	.135(.027)***	1.144
Foreign	.440(.162)**..	1.553
De novo	-.324(.131)*...	.724
Financial Prob.	-.014(.060).....	.986
Unpredictability	.042(.043).....	1.043
Secondary	1.006(.212)***	2.734
Services	.885(.219)***	2.423
Corruption Cost	-.128(.052)**...	.880
Intercept	-3.087(.441)***	.046
log likelihood	-915.098	
Cox & Snell R2	.070	
$\chi^2/df/$	138.08/11/***	
N	1833	

**Table A.3:** Logit estimation of the alternative composite corruption measure.

**APPENDIX B**

**REGIONAL AND MUNICIPAL BUSINESS ASSOCIATION IN UKRAINE**

Region	Regional Associations	Municipal Associations	Total
Autonomous Republic Krym	14	no data	14
Vynnyts'ka oblast'	13	12	25
Volyns'ka oblast'	21	10	31
Dnipropetrovs'ka oblast'	35	7	42
Donets'ka oblast'	20	8	28
Zhytomyrs'ka oblast'	11	11	22
Zakarpats'ka oblast'	8	15	23
Zaporiz'ka oblast'	27	35	62
Ivano-Frankivs'ka oblast'	10	14	24
Kyivs'ka oblast'	4	7	11
Kirovohradc'ka oblast'	20	67	87
Luhans'ka oblast'	45	22	67
L'vivs'ka oblast'	15	no data	15
Mykolaivs'ka oblast'	8	5	13
Odes'ka oblast'	23	no data	23
Poltavs'ka oblast'	26	30	56
Rivnens'ka oblast'	14	11	25
Sums'ka oblast'	8	1	9
Ternopil's'ka oblast'	9	no data	9
Kharkivs'ka oblast'	17	no data	17
Khersons'ka oblast'	38	38	76
Khmel'nyts'ka oblast'	20	26	46
Cherkas'ka oblast'	8	13	21
Chernivets'ka oblast'	7	2	9
Chernigivs'ka oblast'	5	no data	5
Kyiv city	34	59	93
Sevastopol' city	5	no data	5
Total	465	393	858

**Table B.1:** Distribution of business associations across administrative units in Ukraine.

Source: Ukrainian State Administration.

**APPENDIX C**  
**KAZAKH BUSINESS ASSOCIATIONS**

	Association	Sec- toral	Scope	Member of an umbrella group	Member firms and associati ons
1	Kazakh Business Forum, 1992	No	National	Yes	82
2	Confederation of Employers of the Republic of Kazakhstan, 1999	No	National	No	90
3	Chamber of Trade and Industry of the Republic of Kazakhstan, 1959	No	National	No	
4	Chamber of Trade and Industry, Astana, 1994	No	Regional	Yes	
5	The Eurasian Industrial Association, 2001	Yes	National	Yes	
6	The National Union of Entrepreneurs and Employers “Atameken”, 2005	No	National	No	
7	Association of Retirement Funds	Yes	National	Yes	8
8	Association of Enterprises of Light Industry (Manufacturing)	Yes	National	Yes	28
9	“Quality” Association	No	Regional	Yes	20
10	Banking Association of the RK	Yes	National	Yes	6
11	Better Business Bureau (Association)	No		Yes	48
12	Association “Medfarm” Kazakhstan	Yes	National	Yes	23
13	Association of Independent Media of Central Asia	Yes	Internation al	Yes	30
14	Kazakh Brewers’ Association	Yes	National	Yes	17
15	Association of Auto-transport Complex	Yes	National	Yes	142
16	Association of Commodity Producers	No	Regional	Yes	7
17	Association for Development of Pharmaceutical Industry, Shymkent Region	Yes	Regional	Yes	

Continued

**Table C.1:** Kazakh business associations identified in the process of research

Table C.1 continued

18	Association for Support and Development of Pharmaceutical Industry	Yes	National	No	
19	Association of Pharmaceutical Importers	Yes	National	No	
20	Guild of Pharmacists of Astana	Yes	Regional	Yes	
21	Northern Kazakhstan Association of Pharmaceutical Organizations	Yes	Regional	No	
22	Association of Medical Entrepreneurs	Yes	Regional	Yes	23
23	Stock Exchange Union	Yes	National	Yes	11
24	Petroleum Union of Kazakhstan	Yes	National	Yes	11
25	Almaty Regional Organization “Employers’ Confederation”	No	Regional	Yes	
26	Union of Construction Firms of Kazakhstan	Yes	National	Yes	
27	Union of Food Producers	Yes	National	Yes	31
28	Uigur Association of Industrialists, Entrepreneurs, and Agrarians	No	National	Yes	95
29	Association “Pavlodar Business Forum”	No	Regional	Yes	27
30	Union of Industrialists and Employers of South Kazakhstan	No	Regional	Yes	
31	Association of Mining Equipment Producers	Yes	National	Yes	25
32	Union of Employers of Akmola Region	No	Regional	Yes	8
33	Confederation of Employers (entrepreneurs), city of Astana	No	Regional	Yes	34
34	Central Kazakhstan Business Association, city of Karaganda	No	Regional	Yes	
35	Union of Industrialists and Employers of Almaty	No	Regional	Yes	17
36	Atyrau Chapter of the Union of Industrialists and Entrepreneurs	No	Regional	Yes	22

Continued

Table C.1 continued

37	Aktiubinsk Regional Union of Industrialists and Employers	No	Regional	Yes	
38	Confederation of Civic Organizations and Employers of East Kazakhstan	No	Regional	Yes	
39	Kazakh Association of Customs Brokers	Yes	National	Yes	
40	Association of Workers of Printing Industry	Yes	National	Yes	
41	Association of TV and Radio Broadcasters of Kazakhstan	Yes	National	Yes	
42	Kazakh Association of Independent Consultants and Appraisers	Yes	Regional	Yes	
43	Kazakh Association of Gaming Business	Yes	National	Yes	11
44	Association of National Freight Forwarders	Yes	National	Yes	
45	National Association of Freight Forwarders	Yes	National	Yes	
46	Union of Entrepreneurs and Employers of Atyrau Region	No	Regional	Yes	83
47	Association for Support of Entrepreneurship, Kostanai Region	No	Regional	Yes	18
48	Kazakh Association of Business Women	No	National	Yes	
49	Alamty Chamber of Trade and Industry	No	Regional	Yes	
50	Association Lumber Processing and Furniture Producing Enterprises	Yes	National	Yes	
51	Kazakh Franchising Association	Yes	National	Yes	
52	Association of Milk and Dairy Producers	Yes	Regional	Yes	
53	Kazakh Association of Office Supplies Producers	Yes	National	Yes	
54	National Energy Association	Yes	National	Yes	

Continued

Table C.1 continued

55	Sectoral Association of Recycling Metallurgy	Yes	National	Yes
56	Kazakh Tourist Association (Association of Hotel Industry)	Yes	National	Yes
57	Union of International Auto Transporters	Yes	National	Yes
58	Association of Producers of Milk and Dairy Products, RK	Yes	National	Yes
59	Kazakh Association for Copyrights Protection	No	National	Yes
60	Independent Professional Union for Protecting Small and Medium Business	No	Regional	Yes
61	Professional Union of Small and Medium Businessmen	No	Regional	Yes
62	Chamber of Auditors of Kazakhstan	Yes	National	Yes
63	Public Foundation "Business and Development"	No	Regional	Yes
64	Association "Business," Pavlodar	No	Regional	Yes
65	Professional Union for Small and Medium Business, Ust'-Kamenogorsk	No	Regional	Yes
66	Association for Protection the Rights on Entrepreneurs, Petropavlovsk	No	Regional	Yes
67	Association of Kyzylorda Entrepreneurs	No	Regional	Yes
68	"Asem" League of Entrepreneurs	No	Regional	Yes



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