The Varieties of Capitalism Approach Goes East: Institutional complementarities and law enforcement during post-communist transition[1]

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Abstract: The Varieties of Capitalism (VoC) approach is a popular paradigm used to explain the institutional diversity and economic performance in developed market economies. Does the VoC approach also have explanatory power for post-communist economies from Central and Eastern Europe and the former Soviet Union? This guiding question will be answered by analyzing the role of institutional complementarities and coordination for institutional diversity and development. It is argued that, while the VoC approach can serve as an analytical framework of analysis and in parts as a tool for classifying transition economies regarding their modes of coordination, because of its static perspective and the negligence of enforcement, it is less suited to explain the process of path-dependent and volatile institutional development in most transition countries. Therefore, the VoC approach can be applied only restrictively to post-communist economies.

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1. Introduction

With the accession into the EU, transition seems to be over for most post-communist countries. Remaining work is to be done in Central Asia and South-Eastern Europe (SEE), where transition has not come yet to an end. A comparison of countries from SEE, Central Eastern Europe (CEE) and Central Asia on the basis of selected institutional indicators (e.g. EBRD transition indicators 1989-2007; World Bank governance indicators, 1996-2007) reveals dissimilar institutional trajectories during the last two decades. According to the average transition score in the EBRD 2006 report, countries from SEE (except Bulgaria, Croatia and Romania) and the former Soviet Union still lag behind the development of the CEECs and the Baltic States (see EBRD 2006). So why do institutional quality and reform progress differ between post-communist countries? What accounts for persisting differences of institutional systems?

Research on institutional diversity is addressed by scholars of the VoC literature (Albert 1993; Whitley 1999; Hall/Soskice 2001; Amable 2003; Crouch 2005). The VoC approach, elaborated most prominently by Hall and Soskice 2001, sees institutional complementarities behind the persisting institutional and organizational diversity of developed Western countries. Hall and Soskice emphasize limited diversity of capitalism (institutional diversity) and limited ways to economic success (comparative advantage/economic growth). The reason for limited diversity can be found in complementary institutions, i.e. mutual enhancing institutions, which leave basically two possibilities for the coordination of economic activities, via the market or via the state (Hall and Soskice 2001).

The VoC approach has mainly been applied to developed Western countries and has only recently been extended to countries from CEE, SEE and Central Asia (Hancke/Rhodes/Thatcher 2007; Lane/Myant 2007). Scholars who apply the VoC approach to post-communist countries attempt to explain institutional diversity (type of emerging capitalism) and institutional development during transition. They do so by grouping post-communist countries into successful and less successful clusters, by comparing selected countries in qualitative case studies or by analyzing single countries. Dynamic comparative studies including all transition countries are rare (Knell/Srholec 2007) and the recent application of the VoC approach to post-communist countries seems to have only explanatory power for the most successful transition countries such as Slovenia and Estonia (Feldmann 2007; Buchen 2007). What makes it so difficult to extend the approach to other post-communist countries from the region? Unfinished transition in several states and methodological difficulties (missing data, comparability of data) could be part of the answer, but there are more reasons why the VoC has only limited applicability to post-communist transition countries.

The paper's aim is to explore these reasons. Particularly, the question should be answered, whether certain VoC concepts (institutional complementarity, coordination concept) can be helpful in explaining institutional diversity and institutional development during post-communist transition. The basic argument of the paper is that the creation of institutional complementarities is more difficult to achieve under conditions of transition (i.e. uncertain environmental conditions, changing power relations of diverse actors, capacity restrictions) than under conditions of stability, prevailing in developed countries. Such difficult transition conditions as well as persisting institutions from the past make the enforcement of new formal institutions difficult and require a cautious application of the VoC to transition economies.

The outline of the paper is as follows. The next section gives an overview of the literature which tries to apply the VoC to post-communist economies. The third section elaborates the limits and possibilities of VoC approach to explain divergent transition outcomes. In this section I am trying to reveal whether the concept of institutional complementarity and that of pure types of coordination are helpful in the transition context. I argue that in general, the VoC approach can be useful as a framework of analysis but its application in the transition context has also certain limits. In particular, I identify three limitations (uncertainty resulting from a changing environment, diversity of actors, lack of capacity) which restrict the *ex ante* design of a complementary institutional system. In the last section I conclude that the VoC approach is less suitable to explain institutional quality and diversity during transition and therefore restrictively applicable to the still evolving capitalist systems in most post-communist countries.

2. Varieties of capitalism and post-communist transition (literature overview)

Before giving an overview of the VoC literature focusing on post-communist countries, some basic differences must be kept in mind when comparing capitalist systems. By considering four types of capitalist classification (coordination, regionalism/nationalism, development stage, origin), the deeper underlying assumptions and sources of capitalist diversity should become clearer.

A first possibility to distinguish among capitalist systems is to classify them according to <u>regional and national</u> characteristics. This popular typology is based on similar national or regional logics of organization, which are related to socio-cultural and geographic factors. Forms of regional developed capitalist systems were labeled Scandinavian, East Asian, Latin American or Mediterranean capitalism. National typologies of capitalism are, for instance, British, Dutch, Prussian, American and Japanese. Most of these national and regional categories refer to developed economies and only recently have scholars begun to label the evolving forms of capitalism among post-communist countries as East European Capitalism (Stark 1996; Iankova 2002), Central European Capitalism (Lawrence/King 2007), Russian capitalism (Woodruff 1999) or post-soviet capitalism (Tholen 2005, p. 228).[2]

A second way to classify capitalism is according to the dominant logic of <u>coordination</u> (e.g. Hall/Soskice 2001; Amable 2003; Whitley 1999). Scholars focusing on different modes of coordination between sub-systems of the political economy identified coordinated market economies (CMEs, coordination via the state), liberal market economies (LMEs, coordination via the market) or mixed market economies (MME, coordination by state and market).

A third criterion of classification is the degree of "<u>capitalism ripeness</u>", i.e. the stage in capitalist development. This criterion makes more sense to distinguish between evolving capitalism in post-communist and developed capitalism in the West. Developed economies, which have already reached a certain level of stable and settled market economy, possess a more developed and settled form of capitalism than post-communist economies, which are still building up their economic and institutional systems. Given the different stages of development between the developed West and the lagging East, it is not surprising that there is a different logic of organizing in post-communist countries. This special logic in post-communist countries is driven by institutional and economic catch-up strategies in still young and evolving capitalist systems. Nevertheless, the degree of capitalism ripeness differs even among

[2] The notion of „Central Asian capitalism" does still not appear in the literature, however, a recently started research project aims to discover whether a distinct form of capitalism emerges in Central Asia. For details see www.centralasiaproject.de.

post-communist countries. On the one hand, very advanced frontrunners (Estonia, Slovenia) have already established clear and settled institutional structures and are classified in the Hall/Soskice framework as either LME's or CME's. On the other hand, laggards from South-Eastern Europe, Central Asia and the Caucasus are still constructing and improving their institutional system. Under such transitory conditions, their still unsettled institutional system does not allow for a classification in Hall/Soskice's framework. Yet, even the situation of stable but mixed type of capitalism in the Visegrad States makes categorization difficult and would imply that the there are additional criteria for capitalist variety.

A fourth way to classify capitalist systems is according to their origin. Basically, two forms are possible, internally or externally driven capitalism. Internally driven capitalism indicates a domestic and gradual development of capitalist institutions over time. Successful Western capitalist systems were developed internally (e.g. in USA, Great Britain, Prussia) and formal institutions could be adjusted to local conditions. In contrast, externally induced capitalism stands for imported capitalist institutions from abroad. Such institutional transfers based on Western models occurred in CEE after the end of Habsburg domination at the turn of the 19th century and again after the end of communism in the 1990s. Institutional development in the CEECs has been based on the imitation of technological or organizational leaders from the West, characterized by institutional or economic catch-up strategies and institutional recombination (Stark 1996) leading to an institutional patch-work system. According to the VoC literature, such mixed systems should not be very successful (Hall/Soskice 2001; Cernat 2006).

Which criterion matters most to explain post-communist capitalist diversity? Is it possible to apply Hall/Soskice's VoC framework to post-communist economies? Before trying to answer these questions myself, I would like to give an overview of what other scholars have written so far. Literature related to the application of VoC in post-communist countries can be divided into four kinds of analysis: single country case studies, comparative case studies, static comparative analysis and dynamic comparative analysis.

Single country case studies focus on the institutional development in a single country (see Charman 2007; Christophe 2007; Myant 2007; Hanson/Teague; Korosteleva 2007). While this frequent approach, conducted as a qualitative case study, is able to reveal complex agency-structure relationships over time, it does not permit to reveal the sources of capitalist divergence at a general level of analysis.

Another popular method to study VoC is the comparative case study of few selected countries (Mykhnenko 2007; Feldmann 2007; Buchen 2007; King 2007). Although this approach allows for institutional change over time, generalized findings are not possible, as only few CEECs are compared. However, this approach needs detailed information and enough data for a thorough qualitative analysis. For lagging post-communist countries data is still not available. Another problem is that most data is not standardized and difficult to compare. Thus, researchers prefer to focus on countries where distinct structures of capitalism are clearly discernible, like in Estonia and Slovenia. Other country studies (on SEE and Central Asia) are rare, mainly because their institutional systems are still evolving and data is difficult to obtain.

In static comparative analysis of a bigger group of countries, different indicators (e.g. state control, proportion of FDI, stock market capitalization) are compared at a certain point in time (Lane 2007). The authors of such studies are able to identify diversity among post-communist countries in terms of institutional and socio-economic indicators. Although these broad studies give a nice overview of the actual situation and enable the grouping of countries into clusters, their snapshot approach does not capture the dynamics of institutional change. Therefore, important dynamics, such as the switching from one type of capitalism to another type, are to be overlooked. Such changes in institutional and organizational structures are especially likely in transition countries where the structures are still developing, enforcement is weak and complementarities seem not to be developed yet. A static comparison brings about the danger to overlook important changes and therefore to incorrectly classify post-communist transition countries.

A sophisticated approach to consider institutional change and capitalist switching is dynamic comparative analysis (Knell/Srholec 2007; Paunescu/Schneider 2004). These studies compare several countries over time and are able to capture dynamics and change to a certain extent, but unfortunately are quite rare. Because of data and comparability constraints, dynamic comparative studies of CEE often consider few countries (e.g. Paunescu/Schneider 2004 consider just three CEECs) and only a short period of time (Knell/Srholec 2007 analyze the period 2001-2004). If the problem of obtaining and comparing data could be overcome, dynamic comparative studies are most promising for analysis of capitalist diversity.

Publication	**Conclusion**
Lane/Myant 2007 (edited volume)	Lane: Most post-communist economies have a high state control, a high proportion of foreign direct investment and a low market capitalization. Three types of capitalism are identified: Continental type, hybrid state/market uncoordinated type, non-capitalist type. Knell/Srholec: The diversity of production regimes is measured. Most post-socialist economies have liberal welfare systems (except SLO, BLR, BIH, CZ), coordinate business regulation (except RUS, LIT, HU, EST) and mixed forms of labor market regulation (period: 2001-2004). The difference of post-communist capitalist models is attributed to historical legacy. Buchen: The VoC approach is used to identify what kind of capitalism has been emerging in Estonia (LME) and Slovenia (CME), two post-communist countries with high degrees of complementary institutions. Myant: The Czech capitalist system shows institutional features of LMEs (wage bargaining) and CMEs (social policy). The hybrid Czech system is not a consequence of institutional complementarities, but the result of diverse interests and political compromises (government, management and foreign firms' interests), the need to comply with EU membership conditions, the legal heritage and state budget constraints. The VoC approach needs modification in order to be applied in the case of the Czech Republic. Hanson/Teague: The VoC approach is not useful to explain Russia's capitalist development as still many features of developed capitalism (financial system, independent judiciary, government efficiency) are lacking and other explaining factors must be considered (important role of the state, natural resources, international market integration, informal institutions). The VoC criteria which are applied to assess Russia produce a misleading picture and mask the economic role of the state. Charman: Kazakhstan has a still an unsettled dual-type economic structure ("state led liberal economy") resulting from two parallel developments (LME focus and hegemonic role of the state). Christophe: The VoC paradigm is difficult to apply in Georgia because the transfer of contradicting institutions from abroad (Germany, USA) has resulted in a non-complementary institutional system, because institutional subsystems (e.g. capital market, welfare system) are still underdeveloped and formal institutions are rarely enforced. Bartlett: The application of the VoC approach is difficult. War-torn Western Balkans relied on policy and institutional transfer from different international organizations, which created non-complementary institutions. Additionally, the strong reliance on informal institutions makes capital-

	ism classification difficult. An attempt of classification is made: Continental European model (Croatia, Macedonia), LME with strong influence of informal institutions/organized crime (Albania, Kosovo), Mediterranean model with informal economy/black market activities (Serbia, Montenegro, Bosnia and Herzegovina). Korosteleva: Belarus does not fit in conventional VoC type classifications and is considered to be a "state capitalist economy" (state ownership, state control over the economy, price controls and elements of market economy).
Hancke/Rhodes/Thatcher 2007 (edited volume)	King: The VoC can be applied to CEE as a framework of analysis, but it has to consider post-communist similarities (importance of backwardness, lack of working-class pressure) which are more important than the respective differences in terms of VoC typology. Two expanded typologies, "liberal dependent capitalism" in Hungary and Poland and "patrimonial capitalism" in Russia, are identified as a consequence of dependency conditions in the former (dependency on FDI and technology transfer, lack of domestic banks and stock markets, denationalized vocational training) and patrimonial network structures in the latter, resulting from financial crisis. Feldmann: The VoC approach is applied successfully to explain institutional diversity in Slovenia and Estonia. Diversity is explained by a different degree of old networks between economic actors, which were built under socialism and influenced by policy choices during transition (e.g. mode of privatization). Mykhnenko: Poland and Ukraine are institutional hybrids (mixed market economies) which can function successfully and escape predetermined trajectories. No complementarity effects between science/technology education system and revealed comparative trade advantage are detected. As institutional and organizational factors explain only a part of macroeconomic performance of post-communist countries, there is a need to integrate exogenous factors (internationalization, globalization, Europeanization) into the national state-oriented VoC approach.
Cernat 2006	In the Romanian case, the inconsistent mixture of domestic and external institutions ("cocktail capitalism") explains poor economic performance during post-communist transition.
Bohle/Greskovits 2007	The VoC approach is difficult to apply to Eastern Europe as institutions are still not consolidated. Four types of capitalist systems, based on institutional configurations and performances are identified: state crafted neoliberalism of the Baltic States, world-market driven neoliberalism of the CIS countries, embedded neoliberalism of the Visegrád countries, and neo-corporatism in Slovenia. Capitalist diversity is explained by differences in external factors and state capacity.
Paunescu/Schneider 2004	Several OECD countries moved towards the liberal market model in a relatively short period of time (1990-1999). Poland, Hungary and the Czech Republic have mixed systems.
Crowley 2008	The VoC framework is successfully applied to assess the type of capitalism which has developed in CEE, particularly in the sphere of industrial relations (labor). However, the VoC logic fails to explain the outcome in this sphere because it neglects the role of labor (its absence and presence), the state and international actors as the main drivers of change.

Table 1: Summary of VoC literature on post-communist countries
Source: Own elaboration.

Table 1 gives an overview of conclusions on the VoC studies in post-communist countries. On the basis of these conclusions, four summarizing statements are made:

a. Variety is noticed in most studies on post-socialist economies. However, this variety often refers to the stage of institutional and economic development (e.g. FDI proportion, stock market capitalization, privatization proportion), which is explained as an outcome of historical factors (socialist legacy) and current factors (EU membership, policy choices, wars). Because many different variables are chosen to explain variety, sometimes one and the same country is put in different clusters of countries. Therefore, classification of countries depends strongly on the level of analysis (micro/macro level), the research design, the length of the study period and the sectors chosen (Deeg 2007; Deeg/Jackson 2007).

b. No consistent relationship between economic performance and complementary institutions. The institutional trajectories of post-communist countries do not confirm a correlation of economic success and the purity of institutional system. On the one hand, countries with complementary institutions are economic frontrunners (Slovenia and Estonia) while countries with non-complementary institutions (most countries from SEE and the former Soviet Union) are economically less successful. On the other hand, there are mixed political economies with non-coherent institutions, which are also economically successful (e.g. Poland, Czech Republic, Hungary).

c. Unfinished transition process to capitalism. In most post-socialist countries, the transition towards a certain type of market economy is still unfinished and unsettled. Especially in South-Eastern Europe and former Soviet Republics capitalist structures are underdeveloped and institutional enforcement is low. Therefore, it is difficult to classify these economies and to predict which type of capitalism will emerge.

d. Extension of VoC is proposed. Most authors, especially those in the edited volume by Lane/Myant 2007, conclude that the VoC approach does not capture the development of post-communist transition countries because of the peculiarities of the former socialist societies (path dependent informal institutions, diverse communist legacies). Because of that, scholars propose to extend the CME and LME typologies and introduce additionally some "mixed type" or "hybrids of capitalism" (e.g. Bartlett 2007; Charman 2007; Cernat 2006; Lane 2007a; King 2007). Moreover, Hall/Soskice's VoC approach is extended by bringing in other actors (state, international organizations, political entrepreneurs, networks between economic actors), which bargain over institutional reforms, under different political systems (authoritarian or repressive state) and are constrained by informal institutions and history. To sum up, VoC literature on post-communist Europe claims that capitalist diversity cannot be explained solely by internal complementarities between institutional sub-systems and firms as the main actors. Instead, explaining capitalist diversity and institutional change must include diverse historical and future variables which can be internal (national state, national interest groups, structural legacy) or external (EU, international organizations).

3. The possibilities and limits of the VoC approach to explain institutional diversity and institutional development during transition

3.1 The possibilities of the VoC approach in the analysis of transition economies

Despite the critiques and the need of extension mentioned in the previous section, the analyzed literature gives several ideas of how the VoC approach can be applied to post-communist economies.

First, the VoC approach can serve as an analytical framework to classify economic institutions in post-communist countries. It can serve as the point of departure of *ex post* analysis. Therefore, it can help to conduct descriptive and explanatory research. Indeed, several researchers have employed the VoC approach as an analytical framework in their comparative case studies of post-communist countries (e.g. Crowley 2008; Buchen 2007; Mykhnenko 2007; Feldmann 2007; Knell/Srholec 2007).

Second, by shifting the focus of attention to coordination and complementarity between institutional sub-systems, the VoC approach opens up a fruitful perspective from which the transition process can be analyzed. Looking at institutional complementarities and their relationship with economic performance has been widely neglected in the transition literature. Given its relational perspective on the outcomes of complementary institutions, the VoC could help to refocus transition research on complementarity aspects. Studies which analyze complementarity in transition economies (e.g. Knell/Srholec 2007; Buchen 2007) are rare and there is still much potential for future research.

Third, to put the firm's behavior into the focus of attention can be a refreshing counterbalance to the strong emphasis of the state (and its role in reform strategies) by transition researchers. Considering the firm as an important actor during transition, shifts the attention to important long-term drivers of economic growth, such as innovation, technology, research & development, cooperation and skills. Although Hall/Soskice's approach sees firm behavior as an outcome of institutional structure, an extended version of the VoC to post-communist economies should consider –besides the supply side of institutional change (state, international actors)– the demand side as well, i.e. firms' pressure for institutional reforms and particularly, the influence of foreign firms on institutional and organizational change (see King 2007; UNECE 2001, p. 186).

To sum up, the VoC approach can function as a reference model of an ideal type of coordination between different institutional sub-systems and the firm. Such a model shows the researcher how a capitalist system should look like, i.e. which institutions it should contain and how the relationships between those institutions should be. Taking the VoC approach to understand the relationships between institutional sub-systems can be useful in explaining what kind of market economy has evolved in post-communist countries. Given its theoretical and conceptual strength, Drahokoupil argues, the VoC approach "seems to fill the theoretical vacuum left by the death of the 'transition' debate in the political economic research on Central and Eastern Europe" and provides a "major post-transition research agenda" (Drahokoupil 2008, forthcoming). At the same time, the uncritical and mechanical application of the concepts and preconditions of the VoC to post-communist countries can also be misleading (Bohle/Greskovits 2007; Drahokoupil 2008, forthcoming). In the next two sections I will share this critical view and describe some limitations of the VoC approach when applied in to post-communist transition countries.

3.2 The limits of institutional complementarities in the transition context

How useful is the VoC approach to explain divergent institutional development trajectories during transition? I will try to answer this question by focusing first on institutional complementarity, the central concept of Hall/Soskice's approach. According to Hall and Soskice, institutions are complementary "if the presence (or efficiency) of one increases the returns from (or efficiency) of the other" (Hall/Soskice 2001, p. 17).[3] Institutional complementarities are basically positive synergy effects, i.e. they create additional efficiency[4] for institutional performance. In a short formula we can portray institutional complementarity as follows:

efficiency (institution A + institution B) > efficiency (institution A) + efficiency (institution B)

[3] The concept of institutional complementarity was debated in detail elsewhere (Boyer 2005; Deeg 2005; Amable 2003; Crouch et al. 2005; Streeck 2004; Höpner 2005).
[4] Hall/Soskice understand by efficiency the "net returns to the use of an institution given its costs" (Hall/Soskice 2001, p. 17).

As we see in the formula, institutions are complementary if the combined efficiency of two institutions will be bigger than the efficiency of the single efficiencies, i.e. if the left hand side will have a higher value than the right hand side. The main message of institutional complementary is that institutions are not only important alone, but also in their composition.

Hall/Soskice are mainly interested in complementarities between institutional sub-systems of the political economy (education and vocational training, corporate governance, inter-company-relations, industrial relations).[5] Complementarity between these spheres will lead to limited clusters of capitalist systems which can be classified according to two ideal types of coordination, namely: economies with coordination by the market (LMEs) and economies with coordination by the state (CMEs). Typically LMEs are exemplified by the organizational system of the United States, and CMEs by that of Germany. Developed economies, which lie in between these two ideal poles of coordination, are identified as non-complementary, mixed systems (Mediterranean economies). Hall/Soskice assume that in the long-run complementary institutions are more efficient than non-complementary and therefore advise that "nations with a particular type of coordination in one sphere of the economy should tend to develop complementary practices in other spheres as well" (Hall/Sockice 2001, p. 18). In an empirical study Hall/Gingerich confirm the theoretical assumptions of limited diversity and the correlation of complementarity with economic performance in developed economies (Hall/Gingerich 2004). Kenworthy, however, does not find such a correlation and questions the importance of institutional complementarity for economic success (Kenworthy 2006).

Despite such different empirical results, why should institutional complementarities be so important for the functioning of institutional systems? According to Roland, institutional systems are not "modular constructions" which are interchangeable. Institutions rather complement each other and "replacing one institution by another can in some cases dangerously disrupt this systemic consistency" (Roland 2004, p. 113). Such disruptions of the institutional coherence are not desirable if the system is performing well economically. But if a country loses its institutional comparative advantage -for instance, due to changing environmental circumstances- institutional reforms are greatly required. Then complementary institutions become a burden because they are more resistant to change than non-complementary ones (Greif 1998, p. 82; Jackson/Deeg 2006, p. 37). Disrupting coherent but socially inefficient institutions is especially required when system complementarity is sustained by "brute force" (Mayntz 2007, p. 20) and provides sole benefits to a small predatory group (e.g. for the nomenklatura during the communism).

The 1990s fundamental institutional reforms, known as post-communist transition, were a rapid disruption of an inefficient but coherent communist system.[6] But did institutional complementarities play a role during this period of system transformation? I will try to answer this question by analyzing the extent of conscious *ex ante* design versus spontaneous, *ex-post* emergence of complementary institutions during transition. These two possibilities of conducting institutional reforms are grounded in two views about institutional change: institutions by design vs. institutions by bricolage.

Institutions by design: This view of conscious design of institutions is reflected in rationalist theories, such as property rights theory or rational choice theory (see Williamson 1985; Demsetz 1967; Shepsle 1989; Calvert 1995). According to this actor-centered approach, rational

[5] Note that Hall/Soskice's notion of institutions includes also organizations (Hall/Soskice, p. 9-10). Therefore, institutional complementarity should not be understood as a complementarity among rules only, but also among policies, relationships, strategies and skills.

[6] On the coherence of the classical communist system (Stalinist system) see Kornai 1992.

individuals construct and change institutions on the basis of cost-benefit calculations. This approach presupposes the existence of non-selfish designers[7] who are powerful enough to create efficient institutions. Transition scholars who follow the design approach believe that institutions and legacies from the past can be overcome by the adequate institutional and policy choices (Johnson 2003, p. 290). They assume that after getting rid of formal communist institutions (tabula rasa approach) and designing the new system on Western models a successful transition could be achieved. Therefore, they favor radical reforms, in form of "big bang" institutional change (Sachs 1993; Aslund 1991; Boycko 1992; Przeworski 1991; Lipton and Sachs 1990). These authors believe that "big bang reforms" (i. e. simultaneous liberalization, privatization and restructuring) are more effective than piecemeal gradual reforms as they benefit from complementarities between different policies and institutions. Partial reforms, instead, would eliminate the positive effects of complementarities (Murphy et al. 1992; Gates et al. 1993) and lead to rent-seeking and corruption (Havrylyshyn 2007, p. 3). The prevailing credo of the design view in the transition context is the introduction of market economy in one stroke.

Institutions by bricolage (trial-error): This evolutionary and structure-based view reflects the ideas of Austrian Scholars such as Menger or Hayek, who see social order not as the outcome of conscious design, but of spontaneous and unintended human action (see Ahrens 2002, p.60; Poznanski 1996). According to this view, historical legacies can constrain rational institutional design and produce unintended outcomes (Goodin 1996, p. 28). Institutional change and institutional complementarity are endogenous, i.e. driven by internal dynamics. They are the results of experimentation, bricolage and learning under a constantly changing environment (Stark/Bruszt 1998; Mukand/Rodrik 2005, p. 375). Referring to the design of complementary institutions, Amable summarizes as follows: "There is no social engineer in charge of the efficiency of institutional design, and there is no pre-established fit of institutions either. Economic models, i.e. specific sets of institutional forms and the associated complementarities, are not designed from scratch with all the different pieces intended to nicely complement each other. The coherence of a model is usually defined *ex post* and the complementarities may sometimes come as a surprise..." (Amable 2003, p. 12). Transition scholars, who adhere to the "bricolage view", stress the evolutionary and path-dependent nature of institutional change and support gradualist reforms (Portes 1990; McKinnon 1990; Murrell 1995; Poznanski 1996; Roland 2000). Gradualist reformers argue that in the presence of aggregate uncertainty gradual reforms are politically more acceptable because they have lower reversal costs, i.e. lower costs of trial and error (Dewatripoint/Roland 1995, p. 1209; Roland 2000). Therefore, this view stresses a sequenced design of reforms, i.e. to start with reforms which are socially less costly and provide constituencies for more difficult reforms. An example for sequenced reforms is to do privatization before painful restructuring (Zecchini 1997, p. 174-175).

Which view has more explanatory power for post-communist transition? Initially, without doubt, transition period was one of conscious institutional design. In all former communist states, basic institutions of a capitalist system were missing and had to be constructed in a short period of time. Post-communist states designed their formal institutional framework on the basis of Western models. Because capitalist knowledge was limited, reformers had to rely on advisors from the West, who were mostly advocates of the big bang approach (e.g. Jeffrey Sachs, David Lipton, Anders Aslund). Market-oriented institutions (e.g. fiscal and financial institutions, property rights) and government agencies (e.g. Central Bank, Finance Ministry, anti-monopoly agency) had to be created from scratch.

[7] In reality, this is seldom the case, especially in countries which lack the political institutions to control the grand designer (state).

However, supporters of radical reforms forgot that the degree of communist implementation differed among communist countries. Some states (Hungary, Poland, Yugoslavia) had already undertaken market-oriented reforms during the last decades of communism and had therefore better economic and institutional starting conditions (EBRD Transition Report 1999, p. 29) than states with more rigorously implemented communism (e.g. the Soviet Union, Romania, Bulgaria, Albania). The more beneficial communist legacy of Hungary, Poland and Yugoslavia was reflected in a less centralized economy, enterprise autonomy, small private sector, entrepreneurial skills, or even tax and banking regulations which were similar to Western ones (Szalai 2005, p. 9; Rona-Tas 1997, p. 130; Fischer/Gelb 1991, p. 92f). Because of this advanced starting position, in some economic or political areas institutional design from scratch was more pronounced in former Soviet republics than in CEECs. While the Baltic and Central Asian states had to design commercial laws anew, Poland, for instance, could rely on its pre-communist commercial code (Havrylyshyn 2006, p. 35). Rather than designing institutions from scratch, CEECs had to redesign them, i.e. to recombine old institutions with new ones (Stark/Bruszt 1998). In some cases, new institutions substituted for old ones, in other cases, new institutions only supplemented old ones (Grzymala-Busse/Jones Luong 2002, p. 542). What is important to see is that institutional reforms were not done on a *tabula rasa*, and no matter which transition strategy was used (big-bang or gradualism), historical formal and informal legacies influenced the functioning of new institutions.[8]

One has to bear in mind that the good intention to design a complementary institutional system is always subject to hindering factors. Unintended events (wars, external financial crisis) and historical structural restrictions can hinder the implementation of formal reforms and policies. Although in all post-communist countries institutional sub-systems were (re)designed, the relevant question is how strongly radical or gradual designers insisted on institutional complementarities (efficiency aspects) during post-communist transition and whether complementarities can explain post-communist institutional variety and performance. I will argue that the design of *ex ante* complementary institutions is difficult due to three limitations: Changing environment, lack of resources/capacity for law enforcement and changing power relations of diverse actors.

<u>Changing environment (uncertainty)</u>: All institutional designers face a changing external environment and an uncertain future (Streeck 2004, p. 102 and p. 112). These changing conditions guarantee neither that the goal to build complementary institutions can be maintained, nor that initially complementary institutions will remain complementary in the future. Future environmental changes are not always easy to predict by institutional designers. Thus it is not straightforward to evaluate which institutions will be complementary in the next years. According to Streeck "…institutional complementarity is hard to predict and provide for *ex ante*. Where it exists, it is mostly generated *ex post*, through corrective intervention and piecemeal mutual adjustment. Rather than planned and designed in one step, complementarity seems the product of continuous, more or less improvised de-bugging of perceived frictions..." (Streeck 2004, p. 107). A good example for changing effects of the same institutional configuration comes from Japan and Germany. The Japanese and German institutional systems, which were praised as highly complementary and efficient in the second half of the 20th century, are regarded some decades later as hard to reform and inefficient. The explanation according to Streeck is that, with the technological change in form of micro-electronic revolution, the for-

[8] For the impact of communist legacies (initial conditions) on institutional and economic outcomes during transition, see Jowitt 1992; Elster/Offe/Preuss 1998; Ekiert/Hanson 2003; Fischer/Gelb 1991; De Melo et al. 1998; Falcetti et al. 2000.

merly complementary institutional systems, although remained coherent, became less complementary (Streeck 2004, p. 112).

As post-communist countries experienced a great deal of geopolitical and economic uncertainty, institutional adjustments and experimentation were strongly required during the transition period (McFaul 1999, p. 28). Initial variation in uncertainty among transition countries can be explained by different exit modes from communism. Whereas CEECs (e.g. in Hungary, Czech Republic, Poland) created competitive democracies in roundtable negotiations "in Bulgaria and Romania, for example, the collapse of incumbent regimes caused greater uncertainty than in than in the negotiated transitions of Central Europe…" (World Bank 2002, p. 108). Similarly, the initial degree of uncertainty was relatively high in concentrated political regimes emerging from former regional blocks (Soviet Union, Yugoslavia).

Even if institutions were designed *ex ante* as coherent, they could not be sustained in a rapidly changing environment. For instance, in SEE (Croatia, Serbia, Bosnia-Herzogovina, Macedonia, Albania, Moldova), the Caucasus (Armenia, Azerbaijan, Georgia) and Central Asia (Tajikistan), economic and geopolitical uncertainty increased because of wars, civil wars, ethnic conflicts or spillovers from the Russian financial crisis. It is not surprising that under such quickly changing and uncertain conditions the design and implementation of complementary institutions was difficult. Wars and conflicts reduced sharply the living standards and the capacity of the state (World Bank 2002, p. 110). In the presence of negative feedbacks and aggregate uncertainty about reform outcomes, the leaders of unstable economies relied on former practices. According to Grzymala-Busse and Jones Luong, elites in Central Asia and the Caucasus relied on old formal and informal institutions (e.g. patronage) because of the rapidity of state-building and a weak central state apparatus (see Grzymala-Busse/Jones Luong 2002, p. 535 and p. 541). In contrast, geopolitical and economic uncertainty disappeared for the Baltic States, CEECs, Bulgaria and Romania with NATO and EU membership. The EU has served as an "outside anchor" (Berglöf/Roland 1997) and through its membership criteria conditioned the applicants to reform their political and economic institutions. An unstable environment (high uncertainty in the short-run) explains why complementary institutional design was not possible for a certain while during transition. It also explains why economic cooperation based on trust and repeated interaction was difficult in war-torn countries. But why was complementary institutional design also complicated in peaceful transition countries? The answer is closely related to lack of resources (low state capacity) and a weak enforcement of rules.

<u>Lack of resources</u> (time, capital, state capacity) can prevent the implementation of coherent institutional building, despite the focus of institutional designers on institutional complementarity. During rapid institutional building, reformers do not have the time to collect and evaluate "facts" about the environment (Grzymala-Busse/Jones Luong 2002, p. 541). Furthermore, institutional reformers can be constrained by financial resources and weak state capacity. Lacking the financial means, third parties (state agencies, courts) are not able to enforce new institutions, especially when other informal mechanisms of enforcement (shaming, gossip, ostracism, shunning) are absent (Ostrom 2005). The available state capacity to enforce institutions can result from historical structural deficits or from current environmental context (external shocks).

Post-communist transition involved both socio-economic and political reforms, which left relatively few time to conduct an analysis of the most efficient combination of institutions. As transition countries had to conduct reforms in different areas simultaneously (Elster/Offe/Preuss 1998), they often did not have the time resources for long-term master plans of complementary institutional systems.[9] The simultaneity of reforms compelled actors to prioritize and to neglect some areas of reforms (McFaul 1999, p. 31). Whereas developed countries had built up democracy and market economy over a period of several decades, post-communist countries had to do so in only a few years (Grzymala-Busse/Jones Luong 2002, p. 535). Similarly, EU candidate countries were under time pressure and the adoption of EU legislation (*acquis communautaire*) was often carried out as a rapid legislation passing in the parliament without a correct implementation.[10] According to Sadurski "…the sheer volume of the *acquis* meant that parliaments had to adopt fast-track procedures for passing the related laws…" (Sadurski 2006, p. 34). Such hastened institutional reforms could not have produced complementary institutions.

Similarly, resource constraints (resulting from the past, from financial crises or wars) hindered the enforcement of institutions and did not give way for a complementary design of institutions. The leaders of economically instable countries had to postpone reforms, relied either on transitional institutions or even alternative solutions by half-legal private actors. Initially, informal and unofficial practices (black market) were a popular mean to resolve coordination problems in almost all transition states. However, there were strong regional differences in terms of informal practices. According to the estimations of Johnson et al., the average share of unofficial economy in CEE was at its peak with 21,3% in the year 1992 much lower than in former Soviet countries, which had its highest value with 36,2% in the year 1996 (See Johnson et al. p. 182-183).[11]

With progressive institutional reforms, some transition countries (e.g. Poland, Hungary, Slovenia, the Baltic States) overcame these initial problems of the shadow economy and were able to provide a stable business environment and to attract FDI. Why? Higher state capacity seems to be an important key to success. Better state capacity in CEE can be attributed to structural differences of the past[12] and to the absence of wars and financial crisis (World Bank 2002, p. 13 and p. 110). In contrast, reform laggard countries from SEE or CIS neither had the "beneficial legacies" nor the resources to train lawyers, bureaucrats and teachers to change quickly to capitalist mentality and to guarantee the enforcement of capitalist institutions. While transplanted formal institutions were often the same, enforcement and implementation were not. Otherwise, best practices (first-best institutions) would have had the same effect everywhere. The Worldwide Governance indicators from the World Bank provide some evidence that enforcement and legal quality differed. Rule of law[13] has been on average lower in CIS (Commonwealth of Independent States) and SEE than in CEB (Central Eastern Europe and the Baltic States) between 1996 and 2006. Whereas average scores on legal quality have been constantly high in CEC (around 70%), SEE had a considerably lower and fluctuating development (score between 33% and 43%) and the CIS even a deterioration from about 24% to 19% (see table 2).

[9] According to Michel Camdessus, the former managing director of the International Monetary Fund, "…there was no master plan and scarce relevant experience to guide action. In the economic sphere, a host of proposals quickly filled the vacuum, jostling with the force of events and circumstance to determine what happened." (Camdessus 1999, p. 9).

[10] In Hungary's June parliamentary session in 1999, the majority of EU-required laws were passed in parliament without any debate (see Schimmelfennig/Sedelmeier 2005, p. 2).

[11] Despite these different average results, there are some exceptions in these two groups of countries. In the period 1990-1995, Hungary had a constant high share of shadow economy (approx. 30%). Uzbekistan (around 10%) and Belarus (around 15%) had instead relatively low ones.

[12] The better structural and economic conditions in CEE in contrast to the CIS are reflected in better starting conditions. For evidence see the initial conditions indicator in the EBRD Transition Report 1999, p. 29.

[13] The rule of law indicator „measures the extent to which agents have confidence in and abide by the rules of society, in particular the quality of contract enforcement, the police, and the courts, as well as the likelihood of crime and violence (http://info.worldbank.org/governance/wgi/pdf/rl.pdf).

	CIS	SEE	CEB
1996	24.3	33.3	69.4
1998	20.8	44.2	68.8
2000	18.6	33.9	68.2
2002	18.3	36.7	69.2
2004	19.8	40.8	70.2
2006	19.1	42.7	68.0

Table 2: Regional average scores on the rule of law in transition countries
Source: Worldwide governance indicators 1996-2006, World Bank.
Note: The Scores are calculated on a scale of 0 to 100, with 100 being the highest possible score.

This general evidence on different quality of the institutional environment is reflected in more specific economic institutions. The EBRD's legal indicator survey[14] from the year 2005 provides some evidence that enforcement (legal effectiveness) of corporate governance laws differed among transition countries and that "even excellent laws can suffer from poor implementation" (see EBRD Report 2005, Annex 1.2.: Corporate governance, p. 30). EBRD survey data reveals on average a weaker legal effectiveness of corporate governance[15] in CIS and SEE than in Central Europe and the Baltic States (see table 3). Although some countries in SEE (e.g. Macedonia) and in the CIS (e.g. Armenia, Kazakhstan, Moldova) have high compliance with international standards and score high on legal extensiveness (quality of "laws on the books"), they only score poorly on legal effectiveness, i.e. the laws do not work well in practice. In contrast, the corporate governance legislation in most Central European and Baltic States is in most cases reasonable well implemented.

	CIS	SEE	CEB
Effectiveness of disclosure	4.74	5.32	5.73
Effectiveness of redress	4.74	4.98	5.35

Table 3: Regional average of corporate governance effectiveness in 2005
Source: EBRD Legal Indicator Survey 2005 and author's own calculation.
Note: The Scores are calculated on 0 to 10, with 10 being the highest possible score. Data on SEE does not include Kosovo.

This implementation gap in SEE and former Soviet countries in contrast to CEECs recurs in other areas of legislation. The difference for these three groups of countries among extensiveness and effectiveness (implementation gap) is especially obvious in the area of commercial laws (see figures 2 and 3 in appendix), insolvency regulation (see figure 4 in appendix), concession laws[16], securities markets legislation (see EBRD's legal indicator survey 2007) and

[14] The quality of legislation ("laws on the books") is based on the EBRD's annually conducted survey of legal experts from 27 transition countries. See legal annex of various EBRD Transition reports.
[15] By analyzing the effectiveness of corporate governance laws, the 2005 EBRD survey tries to reveal how well minority shareholders are protected in each transition country. Legal effectiveness is assessed in terms of information disclosure for minority shareholders and effective mechanisms to obtain redress (legal actions).
[16] See EBRD Concession assessment project report on the quality of concession legislation in early transition countries. http://www.ebrd.org/country/sector/law/etc/etccon.pdf.

labor market institutions.[17] Using survey data from three different sources,[18] Pistor et al. 2000 confirm a weak institutional environment and weak implementation of economic institutions in most countries from SEE and the CIS (see Pistor et al. 2000).

Legal and economic research on institutional enforcement has shown that there are important constraints to implementation of economic institutions (most notably in the CIS and also in SEE) and consequently limits to a coherent or complementary system in this region. Thus, lower institutional quality and absent institutional complementarity in these regions can be explained. But what accounts for different institutional configurations among the most advanced transition countries? Why did only Slovenia and Estonia develop coherent institutional systems and the other CEECs (Poland, Hungary or the Czech Republic, Lithuania, Latvia) did not? The rule of law indicator for the CEE group may indeed explain coherence in Slovenia and Estonia, as these countries have the highest scores on effective legal environment (see figure 5 in appendix). However, as Hungary and the Czech Republic have similarly high levels, but less coherent institutions (see Knell/Srholec 2007, p. 60) even an overall good institutional environment (high enforcement) does not guarantee a coherent system. Another explanation why coherent and complementary institutions were difficult to create during transition could have been the degree of diverse interests and ideologies of domestic and external actors during transition.

<u>Power relations (diversity of actors)</u>: Scholars stress the increasing importance of actors over institutions during transition and emphasize the role of the state for institutional reforms (Hanson/Teague 2007; Charman 2007; Schmidt 2008; Higley/Pakulski/Wesołowski 1998).[19] However, it has to be considered that institutions and institutional complementarities are not only created at the regime level alone, but are the outcome of many actors with diverse interests and power positions (Streeck 2004, p. 111). Institutions are often the result of a political compromise and not an optimal solution to a given problem or, as Amable puts in: "…institutions do not emerge as the result of a welfare-maximizing process. They are the outcomes of a political process. The whole set of institutions is not chosen all at once, by agents possessing a clear view of all the interdependencies between institutions concerning all areas of the economy" (Amable 2003, p. 63). Both Streeck and Amable remind us that the pursuit of political and economic power can limit rational design of complementary institutions. This is particularly true if there is no benevolent "dominant social block" (Callaghan 2008, p. 9) and when institutional reformers have opposing ideological backgrounds. But even when ideologically diverse reformers find a compromise, this compromise will not necessarily lead to the first best solution (complementary institutions).

The emerging post-communist state was not a unitary actor with uniform authority, but underwent a formation process which was characterized by "multiple actors, domestic as well as international" (Grzymala-Busse/Jones Luong 2002, p. 533). Let me first focus on domestic actors[20] and explain why so few complementary systems emerged during transition. A main reason can be found in opposing ideologies and changing power relations of these actors. After the demise of communism, old power structures changed and a battle for political and economic power started among different domestic actors. Communist rulers lost their legitimacy

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[17] On the different degrees of enforcement regarding employment protection legislation in the CIS, SEE, and CEE, see Rutkowski/Scarpetta 2005, p. 37.

[18] Sources: Experts' assessment from the Central European Economic Review; EBRD legal indicator surveys; World Business Environment and Enterprise Performance (BEEPS) survey (see Pistor et al. 2000, p.341-342).

[19] This is particularly true in a rapidly changing environment, when new introduced rules are only forms without meaning. Then it is more plausible that the direction of influence goes mainly from actors to institutions.

[20] Internal actors are political parties with opposing ideologies (e.g. former communists, non-communists), oligarchs, business groups, trade unions and cultural or military elites.

and previously constructed institutions were contested. The early transition years became a period of bargaining about political power and about the future institutions to stabilize this power. Institutional change was not an outcome of designed complementarities, but of conflicts and compromises between different domestic actors. It is difficult to imagine that the competing interests between internal actors were reconciled in all post-communist countries and led to *ex ante* creation of complementary institutions. Although in some countries a political compromise by consensually united elites was reached, such as Poland, Hungary and Slovenia (Higley/Burton 2006, p. 83), in other countries (e.g. Bulgaria, Russia, Croatia, Serbia, Belarus and Romania) disunited political elites hindered the implementation of coherent transition strategies (see Higley/Burton 2006, p. 90 and p. 171). In these countries, quite often reform strategies changed with a change in the government (see Havrylyshyn 2007). Although electoral backslash and some modification of initial policies occurred even in advanced transition countries such as Poland, Hungary and the Czech Republic (King 2002, p. 8), the general reform paths were not altered.

Changing power relations and the redesign of institutional reforms were often the result of changing economic conditions, which differed among transition countries. In former Soviet Republics and SEE, prolonged economic decline and deteriorated living conditions made cooperation between domestic actors more difficult. Intense struggle among different domestic actors or ethnic groups, which produced also violence (e.g. in Yugoslavia), did not leave room for stability and a complementary institutional system. In war-torn countries (e.g. Azerbaijan, Georgia) and countries with high concentration of political power (e.g. Moldova, Russia, Ukraine, Kyrgyz Republic), domestic powerful groups actively influenced institutional reforms (see World Bank 2002, p. 106). Influence of such actors is nothing bad, as long as the state remains powerful enough and will not be captured by powerful internal business groups or oligarchs, who seek to extract rents from the state. The composite index of state capture[21] provides snapshot evidence that in the year 1999 the influence of firms on institutional and policy reforms was on average more pronounced in SEE and the CIS as compared to CEB (see table 4).

CIS	**AM**	**AZ**	**BY**	**GG**	**KZ**	**KG**	**MD**	**RU**	**UA**	**UZ**	**regional average**
state capture index	7	41	8	24	12	29	37	32	32	6	**22.8**
SEE	**ALB**	**BG**	**HR**	**RO**							
state capture index	16	28	27	21							**23**
CEB	**CZ**	**EE**	**HU**	**LV**	**LT**	**SK**	**SI**	**PL**			
state capture index	11	10	7	30	11	24	7	12			**14**

Table 4: Regional average of state capture among transition economies in 1999
Source: Calculations based on Hellman./Jones/Kaufmann, 2000, p. 9.
Note: The index is constructed as the average proportion of firms responding that their business are directly affected by private payments made to public officials to influence decision making in one or more of the following six institutions: parliament, the executive apparatus, the criminal courts, the civil courts, the central bank, and political parties (Hellman/Kaumann 2001).

[21] Hellman and Kaufmann define state capture as „ the efforts of firms to shape the laws, policies, and regulations of the state to their own advantage by providing illicit private gains to public officials" (Hellmann/ Kaufmann 2001).

While dealing with institutional change and institutional complementarity during transition, external actors should be taken into account. Post-communist institutional building has been subject to pressure from Western consultants, international organizations (IMF, World Bank, USAID), multinational corporations and foreign banks. The EU was particularly important for institutional reforms.[22] Although international actors produced initially institutional and policy similarities (best practices), at the same time multiple conditionalities and interests hindered coherent institutional strategies, as well. Bartlett shows, for instance, that former Yugoslavian states became dependent on financial aid from external actors (IMF, EU, World Bank) who were able to impose their own diverse interests and thus hindered the creation of a complementary institutional system (Bartlett 2007). However, because of different geopolitical locations and economic resource bases, external pressure to adopt the same institutions was far from universal among post-communist states (Grzymala-Busse/Jones Luong 2002, p. 547).

Even in states with a similar geopolitical location and resource endowments (EU candidate states from CEE) diversity persisted. Similar EU impact on economic institutions of candidate countries (see for instance Myant 2007; Cernat 2006) does not mean automatically a convergence towards a complementary "EU logic of coordination". According to Philip Hanson, who analyzed the impact of EU membership on economic institutions (labor market regulation and business regulation), considerable institutional diversity among the new EU members has persisted. His explanation of diversity is that economic accession requirements left a "wide scope for institutional variation" and that institutional convergence towards either state or market coordination was not enforced by the EU (Hanson 2007, p. 97 and p. 100). By setting the goal (minimum standards) of the institutional reform, but leaving enough room for the method to implement the economic regulations, the EU did not necessarily induce a full convergence, but rather a divergent convergence. However, despite persisting differences, the EU's indirect influence on post-communist diversity as a whole must be acknowledged. By accelerating institutional reforms in reform laggard countries (Romanian, Bulgaria), the EU accession process widened the gap with post-communist countries without an EU membership perspective.

Let me briefly assess the EU's role regarding complementary institutions. I would not consider external conditionality as the optimal solution to create complementary institutions, as it brings in additional external interests and is not based on a strategy of coherent design. However, I would consider EU conditionality as a second-best solution to accelerate institutional reforms in the short-run. This would imply that institutional reformers have to make a trade-off between institutional effectiveness (enforcement), which can be improved in the short-term and institutional efficiency (complementarity), which is rather a long-term goal. The best example for the EU impact on improved institutional quality in a short period of time comes from Romania, Bulgaria and Slovakia (see Schimmelfennig/Sedelmeier 2005; Vachudova 2005). However, if the improvement in institutional effectiveness will translate into long term complementarity is an open question, which can only be answered in the future.

The last puzzle which remains to be solved is why Slovenia and Estonia have created a coherent institutional system, while Hungary, Poland or the Czech Republic which had similar state capacities, beneficial historical legacies and the EU membership perspective did not. According to Feldmann, the mechanism behind coherent institutions in Slovenia and Estonia are economic networks between key economic actors (Feldmann 2007, p. 337). He argues that the

[22] The EU's influence on institutional development has been acknowledged by the Europeanization literature (Grabbe 2001; Schimmelfennig/Sedelmeier 2005; Vachudova 2005; Mendelski 2008) and the most recent VoC literature (Menz 2005; Schmidt 2002; Callaghan 2008).

combined effect of communist legacy (degree of centralization under communism) and policy choices during transition (privatization strategy, monetary policy, centralization of wage bargaining) encouraged network-promotion in Slovenia and network-disruption in Estonia and created two diverse but coherent systems. Although this may be an explanation for these two countries, Feldmann cautions: "The conditions necessary to promote or disrupt networks may be in fact quite stringent, and Estonia and Slovenia may be quite exceptional in terms of their combination of legacies and political preconditions for their reform paths" (Feldmann 2007, p. 348). Broader comparative analysis is required to clarify this remaining puzzle.

If we recapitulate the arguments on the design vs. spontaneous emergence of institutions (agency-structure importance), it is most reasonable to seek a reconciliation of both approaches. Particularly, if we conceive institutional change occurring simultaneously as a short-term change (e.g. agency design, external shocks) and long-term change (e.g. structural change, enforcement, informal institutions) it makes sense to see both views as complementary rather than contradictory. Institutional change is an interplay between agency and structure. It is an interaction between the old structure (historical legacy), the current agency actions (policy and institutional choices) and future possibilities (e.g. EU membership or new opportunities due to scarcity of resources). In such an interdependent process, where in the short-run the causal direction can run from economic performance to institutions, institutional complementarities can be no more than one consideration among others to explain institutional divergence. I have mentioned some limitations of the complementarity concept to explain short-term institutional diversity in post-communist countries: a changing external environment and uncertainty, diversity of actors and power relations, weak enforcement of institutions due to lacking capacity. If such limitations are absent thanks to beneficial legacies, or become absent, for instance after economic and geopolitical stabilization, the design of complementary institutions could be easier. Generally, the argument of complementarity is more convincing in the evolutionary, long run emergence of institutions. Nevertheless, particular institutional or policy reform areas (e.g. policy complementarities[23] between macroeconomic stabilization and price liberalization), where fewer actors or resources (lower state capacity) for enforcement are required, may make complementarity relevant in the short-run. The transformation of an entire economic system, however, needs time and experimentation.

3.3 The limits of pure types of coordination in the transition context

The VoC approach insinuates that, because of efficiency considerations, developed economies tend to converge towards two ideal types of coordination (LMEs and CMEs) and institutional complementarities constrain switching between CMEs and LMEs. After being criticized for not considering change in coordination logics (Goodin 2003; Blyth 2003; Watson 2003; Jackson/Deeg 2006), Peter Hall together with his co author(s) responded to the criticism and underlined the importance of politics for institutional change (Hall/Soskice 2003, p. 245; Hall/Thelen 2005; Hall 2006). A recent empirical study by Paunescu/Schneider has confirmed switching from state to market coordination for several developed economies (Paunescu/Schneider 2004). The relevant question for transition countries is whether mixed logics of coordination can become complementary and converge towards pure LMEs and CMEs or rather remain non-complementary hybrids. Put differently, will there be dual convergence towards pure forms of organization or rather a lock-in of mixed organizational logics?

[23] On policy complementarities during transition, see Braga De Macedo/Martins 2008; Staehr 2005.

In my opinion, sustained mixed logics of coordination (second-best solution) are possible due to positive feedbacks resulting from increased enforcement, i.e. more effectiveness. Let me illustrate a more dynamic model of capitalist diversity (see figure 1) to explain the fundamental differences between developed economies (CMEs, LMEs) and transitional market economies (TMEs). In contrast to transition economies, developed economies have strongly enforced and effective institutions. While in developed economies the possibility to increase economic performance by increasing the quality of institutions (effectiveness) is nearly exhausted, performance can still be improved by making institutions complementary (efficiency). Given that complementarity depends on external environment changes, developed countries can improve efficiency by adapting to external pressures by switching their logic of coordination (horizontal shifts between CMEs and LMEs).[24] These horizontal shifts tend to be slow, because of institutional complementarities, because of path dependence and because certain reforms (e.g. better protection of minority shareholders, adopting international accounting standards) often do not have a major impact on other sub-systems or corporate strategies. Therefore, despite "liberalizing" reforms, switching of coordination modes should remain difficult in developed economies (Hall/Thelen 2005, p. 26 and p. 31).

While gradual institutional and economic development may be true for developed market economies, transition economies experience rapid formal institutional change. Due to the unfinished stage of capitalism (lower economic development) and high uncertainty (transition as an open-ended process), institutions in post-communist economies have initially a transitory character, i.e. they are only weakly enforced. Because of weak enforcement, institutional change is easier and at least in the short or middle-run there are more alternatives for capitalist trajectories than in developed economies.[25]

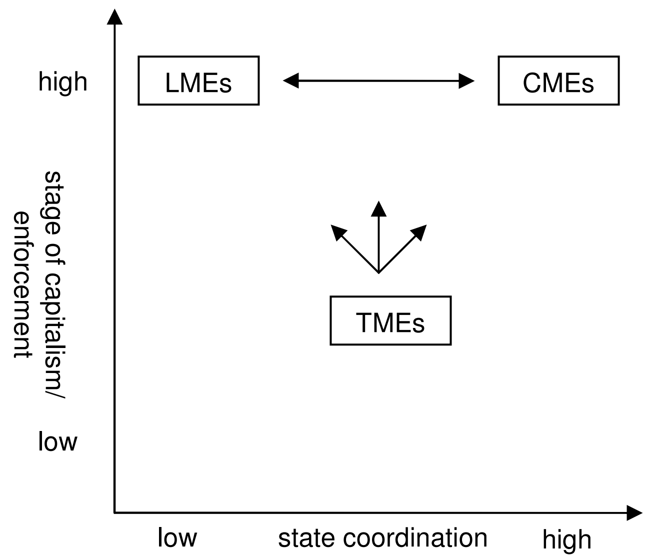

Figure 1: Modes of coordination under consideration of different development stages of capitalism
Source: Own elaboration

[24] Although most economies tend to shift towards the liberal model of coordination, Paunescu/Schneider's study shows that France and Belgium moved between 1990 and 1999 in the opposite direction, i.e. towards more state coordination. On the switching of coordination regimes, see Paunescu/Schneider 2004.
[25] There are more options to achieve institutional efficiency than in developed states. This was for instance the case when Taiwan, South Korea or Singapore were transition/developing countries and achieved economic success by developing a different type of capitalism than in the West.

At a lower stage of capitalism development, TMEs can move vertically and diagonally. The paths of institutional and economic development are not fixed yet and can develop towards LME, CME or a mixed form of both. In the absence of positive feedbacks, development towards a stronger role of the state and even less capitalism is possible (e.g. downward diagonal shift in Venezuela and Belarus). Such upward and downward diagonal and vertical shifts are reflected in capitalist reforms or reform reversals and are possible because political and economic institutions are enforced only weakly.[26]

How does the model reflect the transition period? At the beginning of transition, the initial strong decline of GDP and a lengthy and burdensome recovery hindered positive feedbacks to stabilize the institutional system. Weakly enforced institutions ("frames without content") could be changed more easily and reform reversals were the case in states with a low capacity (e.g. in Russia, Romania and Bulgaria). Transition countries, which succeeded in increasing state capacity and in enforcing formal institutions, created a stable institutional environment for economic cooperation and entrepreneurship. The Visegrad states, for instance, although having missed the chance to build complementary institutions, nevertheless established a stable and relatively effective institutional system. Institutional quality in Poland, Hungary and the Czech Republic was increased through better enforcement, not through better complementarity. If we consider positive feedbacks and lock-in effects, then these non-coherent systems should be difficult to reverse for a while. As long as efficiency or effectiveness gains are possible through improved enforcement or other means (for instance, by increasing the compatibility between formal and informal institutions), mixed market economies should persist.

The success story of transition frontrunners with non-complementary institutions shows that the primary step to an efficient institutional system and system stability is enforcement of rules. While enforcement does not exclude a focus on institutional complementarity, it should be a secondary step to increase efficiency. The main reason for precedence of enforcement over complementarity are capacity restrictions (time constraints, financial and human resources constraints), which make it difficult to create complementary (efficient) and well-enforced (effective) institutions at the same time. A look at the ranking of three post-communist countries in the coordination index constructed by Knell/Srholec 2007 will make my argument more clear. According to this index, Estonia, Armenia and Russia have all a strongly liberalized system with coherent formal institutions. However, because of weak enforcement capacity in Russia and Armenia (low effectiveness), coherence did not translate into complementarity and good *de jure* institutions are being undermined by the interests of powerful companies. In contrast, Estonia's coherent and well enforced institutions have facilitated competition and cooperation and translated in complementary institutions.

Enforcement does not mean enforcing every detail of the political economy and restricting critical institutional entrepreneurs and arbitrageurs who are discovering the weaknesses of the system and create a demand for improvement. What it does mean is that the state has to establish and enforce a set of core institutions, which guarantee the rule of law and stability for a stable business environment, while experimentation and change are still possible at the periphery. Such an approach, which distinguishes between core and peripheral institutions, allows to exploit the possibilities of both enforcement and complementarity. When enforcement is guaranteed for a set of central institutions across different sub-systems, complementarities between these core institutions can be established with less effort and resources than in the case of complementarities between all institutions (including peripheral, less enforced institu-

[26] The assumption of a beneficial effect of enforcement is only true when there is no predatory authoritarian regime, who has designed institutions to their benefit and who maintains the *status quo* by force.

tions). In other words, the basic skeleton of the political economy could be initially designed, but the flesh should be developed in a trial and error process.

Although I am suggesting that institutional complementarity should not be that important for transition and developing countries lacking enforcement capacities, it could become more important with increasing enforcement. Consolidated transition countries (e.g. Slovenia and Estonia), where efficiency gains resulting from good enforcement of institutions were already exploited, can increase their institutional and economic performance by focusing on complementarity aspects. In contrast, non-consolidated transition economies (e.g. most economies in the CIS and SEE) should focus on the enforcement of core institutions or if possible at pair-wise complementarities (e.g. between financial institutions and institutions regarding inter-firm relations). Only when a certain level of enforcement is achieved, institutional complementarities should bring about additional efficiency.

What we have to keep in mind is that the ability of enforcement and complementarity depend on the context (external environment, historical legacy, state capacity). As this context varies among transition countries, every country should conduct reforms which take into account different environmental pre-conditions in terms of economic development, geographic situation, resource endowment, human resources, networks and informal institutions. In my opinion, institutional complementarity in the transition context should be understood more broadly, namely as compatibility in time, in space and in existing structures. A good model of institutional change in post-communist economies should therefore incorporate resources, geography, history and the dynamic interplay between the economic and political arenas during transition.

The complementarity of institutions depends on changing environmental circumstances. This means that coherent institutions will be beneficial in the "good times" (i.e. when fundamental reforms are not required), but detrimental in the "bad times", when change is most needed. Because of a changing environment, institutional complementarity and enforcement should be understood as dynamic concepts, i.e., there should always be room for experimentation and adaptation of the institutional structure (see North 1990). To enable change and flexibility, adaptive institutional complementarity is required. If too much emphasis is put on static institutional complementarity, the political economy can become inflexible and can lose its comparative advantage. The emphasis on enforcement, which I made before, does not necessarily produce inflexibility and institutional inertia as long as enough room is left for institutional experimentation and competition. The dynamic approach of adaptive institutional efficiency would enable institutional change within particular types of institutions without necessarily changing the entire institutional sub-system. Allowing Siemens, Infineon or IBM to increase engineers' wages to cope with low supply of engineers, without changing the overall wage policy, is such an adaptive way of specific peripheral change. A second example for experimentation, under continuing dominant logics of coordination, is the introduction of temporary work agencies to reduce labor market rigidities in Germany (Höpner 2005, p. 333). Within such an adaptive process of change, learning and the adoption of new skills are important. However, learning does not mean transferring best practices from abroad, but searching for functional equivalents and local solutions.

4. Conclusion

The research question I started with was whether the VoC approach and particularly its concepts of institutional complementarity and limited coordination modes can be helpful in explaining institutional diversity and institutional development during post-communist transition. The answer is: “yes, but only in parts”. Let me summarize my results by evaluating the usefulness of the VoC approach for every research step in a comparative analysis (table 5).

Research steps in a comparative analysis of post-communist economies	**VoC’s usefulness**
1. Classification of institutions	Yes
2. Explaining the origin institutions	No
3. Explaining institutional development (enforcement of institutions)	No
4. Classifying the type of market economy based on coordination	Yes/No
5. Explaining the link between complementary institutions and economic success	Yes

Table 5: Concluding evaluation of VoC’s application to post-communist economies
Source: Own elaboration

As I argued before, the VoC approach can be used as analytical framework and point of departure to classify formal economic institutions (step 1). The VoC approach is also partly useful to identify which market economy has emerged in post-communist countries (step 4). Thus, it can help to shed some light on the formal institutional diversity of capitalist systems. Furthermore, its theoretical insights can be used to test the relationship between institutional complementarity and economic performance (step 5). However, the VoC approach in its current form has difficulties to explain institutional origin and institutional development of institutions (step 2, 3) and needs to be extended by theories of institutional change (e.g. New Institutional Economics, Historical institutionalism) in order to account for institutional enforcement and other actors (e.g. the state) than firms.

On the whole, Hall/Soskice’s VoC approach can be only restrictively applied to post-communist economies. Post-communist transition demonstrates that institutional complementarity is not a short-term project. Complementarity is more difficult to create in times of turmoil, rapid socio-economic change, low state capacity and diverse interests of actors. Although there are also diverse actors in stable and developed economies, well-enforced institutions control both state actors and other groups from predation (rent seeking, state capture). The dynamism of transition implies that other mechanisms than complementarities explain institutional diversity and performance. It has been argued that enforcement rather than complementarity is such a mechanism. If enforcement of rules is guaranteed, institutional stability will produce a good business climate for economic cooperation, innovation and FDI.

What are the implications of institutional complementarity for future reforms? As certain institutions (e.g. financial institutions and institutions regarding inter-firm relations) are established with less financial resources and time than others (e.g. educational or labor market institutions), there is room for the design of pair-wise institutional complementarities. However, an entire complementary institutional system (including core and peripheral institutions) is a long-term project which cannot be designed and implemented in several years. Therefore, the concept of institutional complementarity can be applied mainly in countries where the capacity for enforcement of institutions works (the developed West, advanced transition countries). Where the capacity for enforcement is low (the CIS, SEE) a first step should be the strengthening of enforcement and only then the fine tuning of efficiency through complementarity. In other words: Prefer second-best institutions that are implemented over first-best institutions that are not enforced (need for “small and pragmatic solutions that work” in the short-run).

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Appendix

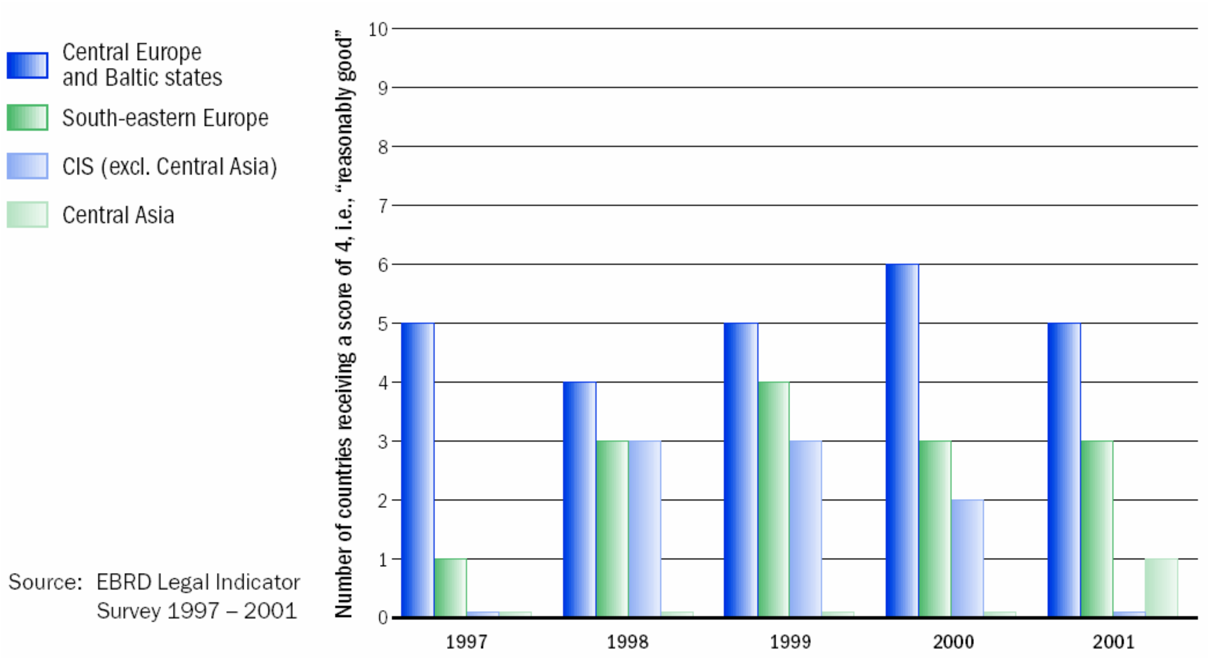

Figure 2: Perception of commercial law extensiveness over time
Source: Ramastry 2002 and EBRD Legal Indicator Survey 1997-2001.

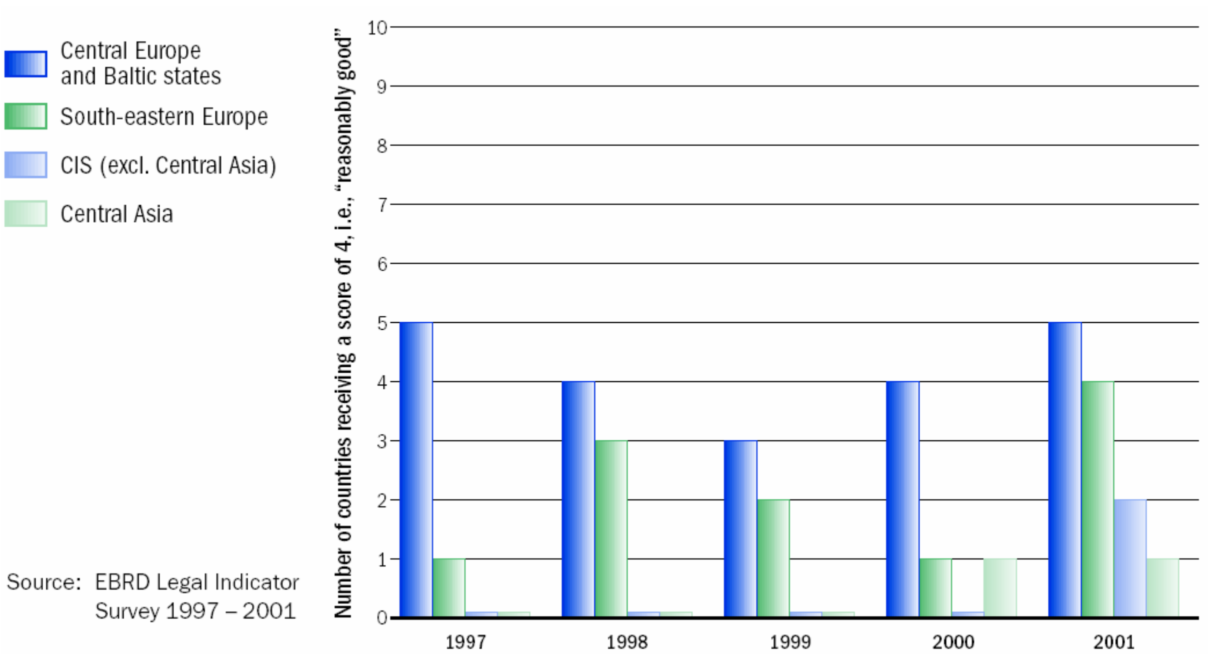

Figure 3: Perception of commercial law effectiveness over time
Source: Ramastry 2002 and EBRD Legal Indicator Survey 1997-2001.

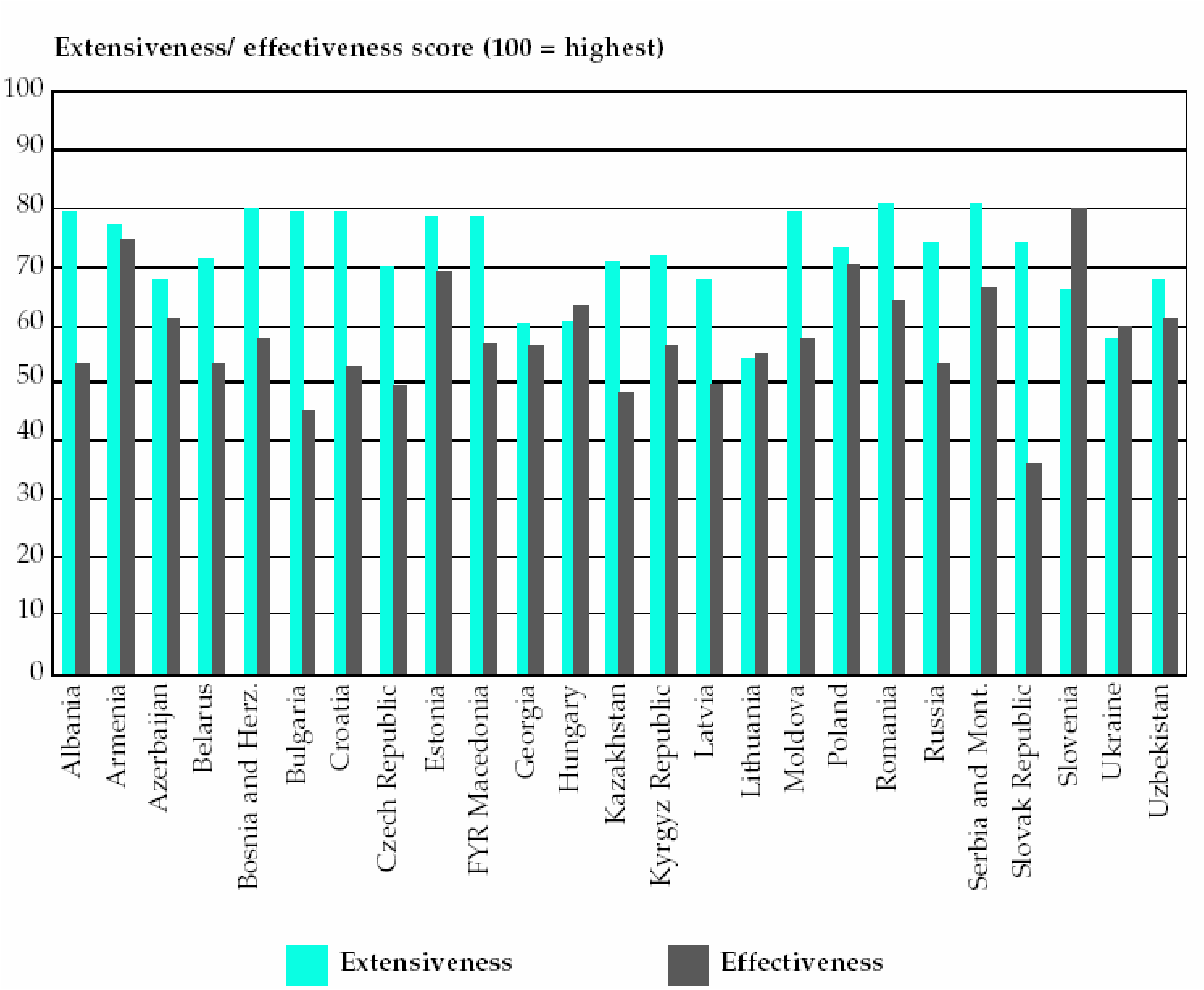

Figure 4: Extensiveness and effectiveness of insolvency legal regimes
Source: EBRD Legal Indicator Survey, 2004.

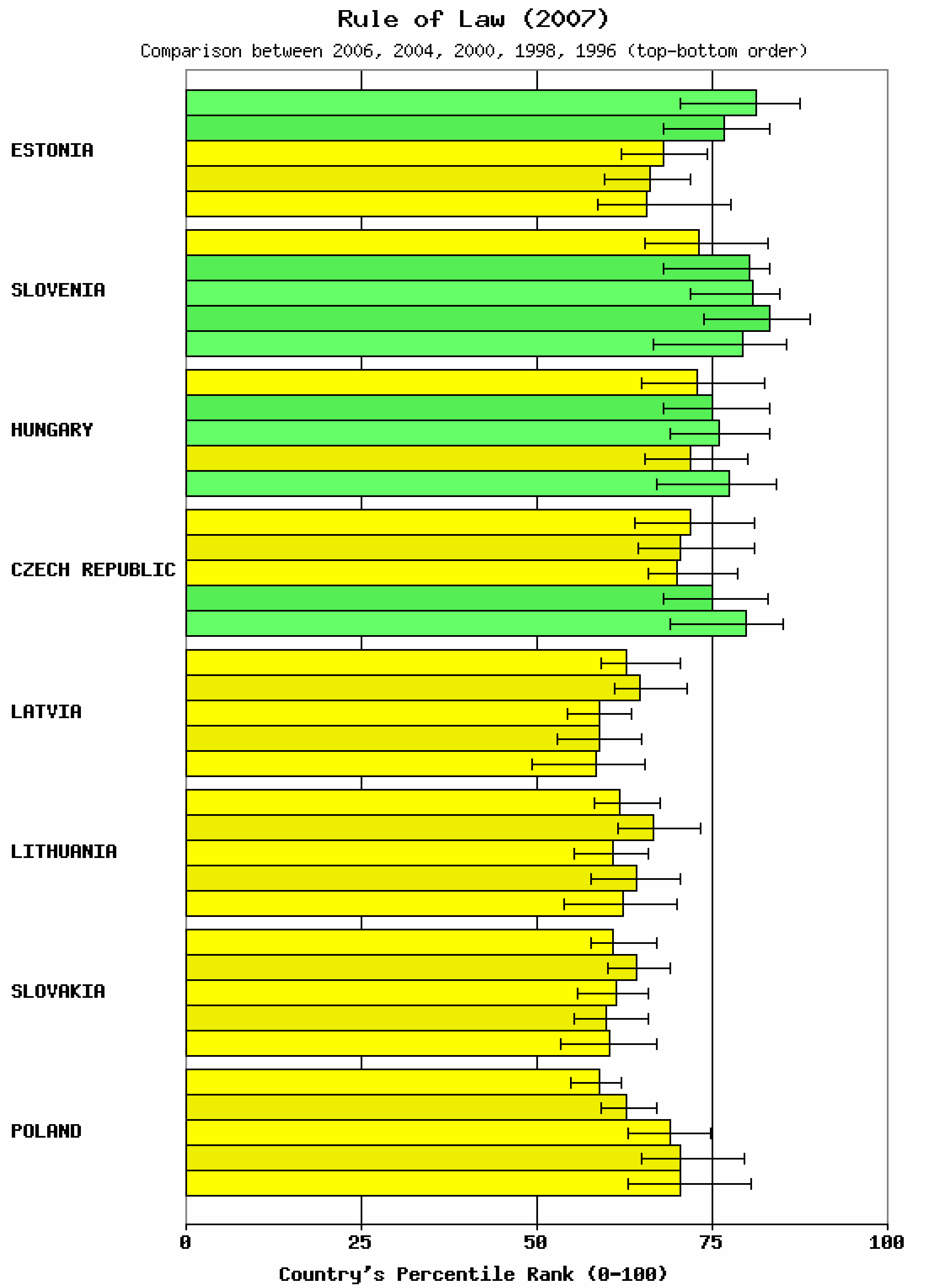

Figure 5: Rule of law in Central and Eastern Europe
Source: Kaufmann/Kraay/Mastruzzi 2008: Governance Matters VII: Governance Indicators for 1996-2007.