Introduction

In 1990 Aleksander Gudzowaty chartered a plane, filled it with cheap consumer goods and Polish fashion models, and flew to Siberia for a meeting with an old acquaintance, the chairman of the Russian natural gas supplier Gazprom. When Gudzowaty returned ten days later, he approached the heavily indebted Polish government as the sole mediator with which Gazprom would negotiate gas supplies to Poland. Poland depended on the Russian natural gas supplied by Gazprom and earned a substantial income from transit fees on gas headed west through the Yamal pipeline, but it found itself in constant negotiations over its gas debts. With winter approaching and Poland's gas supply threatened, the Polish president had to accept the businessman's terms: a percentage fee on all natural gas arriving in and transiting through Poland to western Europe. By taking a remarkable gamble and banking on his connections, Gudzowaty became Poland's first overnight dollar billionaire.

Gudzowaty began to invite a coterie of powerful new friends to visit his walled and heavily guarded home—complete with a private zoo and glass meditation pyramid—in a forest outside Warsaw. Although his first move toward wealth had depended on the protection of foreign patrons, he quickly understood that political allies at home were a key element of any future success in the highly uncertain market environment. As Poland began to practice democracy in fits and starts, Gudzowaty started to finance acquaintances from before 1989 who had entered the new left political party, the Democratic Left Alliance (SLD); to hire former bureaucrats as executives of his holding company;[1] and to purchase shares of other firms. He did not hide his support of the left and openly admitted to good relations with the SLD. He routinely used these contacts to influence regulatory policy and the legislative agenda.

[1] His company, Bartimpex, reportedly employed seventeen former ministers.

The party system was sharply divided between the post-communist SLD and the anti-communist Solidarity coalition. Thus, at each change of government, Gudzowaty had to re-evaluate his position and work to maintain the material and legislative goods he had obtained. He became known as a close ally and supporter of the SLD and was received as an almost holy figure at the annual party congress – a strange relationship between a gas magnate and a supposedly social democratic party. Party finances were opaque but it was alleged that he contributed millions of dollars to each campaign.[2] When the SLD was in opposition, his business fared less well, and his ability to participate in privatizations and government contracts suffered because right-wing politicians spoke against his plans and favored other businesspeople. When asked in an interview in 2000 about his ties to political parties, he said: "With the last [left] government we had good contacts. This current [right] government, of Mr. Buzek, is simply aggressive toward us and we have constant conflicts with it. We try to use state institutions – courts, the prosecutor's office – and nothing works out."

The ties of businesspeople to parties remained stable over the first decade and a half of reform. In 2006, when changes in the party system seriously weakened the left, Gudzowaty tried to shift alliances, but with only limited success. In an attempt to distance himself from his old allies, he leaked tapes of a private conversation with the former SLD prime minister, Josef Oleksy, about dealings between politicians and businesspeople. In that discussion, Oleksy told Gudzowaty that the Polish president, Aleksander Kwasniewski, had established "political capitalism" in Poland and cultivated a group of insider businesspeople who supported the left.

By "political capitalism," Oleksy meant that there existed a cohort of businesspeople who were closely allied with political parties and depended on their support for business success. In fact, Gudzowaty operated among a group of such businesspeople. They did not form a strong, united front to speak with one voice, but they were recognized as businesspeople who had benefited from ties to left politicians and were, consequently, eager financial supporters. Similarly, they had all created relationships of reciprocal benefit and commitment with politicians. Their wealth depended on these ties, which allowed them to participate in privatizations, win government contracts and licenses, and influence laws and regulations when the left was in power. And they all actively sought to employ former bureaucrats, ministers, and elected officials to strengthen their ties to government. In other words, "political capitalism"

[2] Until recently there was only anecdotal evidence of Gudzowaty's contributions to the left, because party budgets provided no detail of such contributions in Poland. In March 2009 documents surfaced detailing the transfer of 3 million złoty from Gudzowaty's companies to the SLD (*Rzeczpospolita* 2013). Gudzowaty himself confirmed these donations (*Newsweek Polska* 2009). And Marek Belka, long-time SLD member and future prime minister, sat on the supervisory board of one of the donating companies (*Newsweek Polska* 2009).

was a headline-grabbing label for the embeddedness of the polity in the economy. What Oleksy failed to observe was that Poland exhibited only one of the varieties of embeddedness emerging across the region.

In this book, I examine the emergence of different varieties of links between the polity and the economy: the network relationships between businesspeople and political actors that have emerged across the post-socialist world. In Poland, networks between economic and political elites have been a key component of robust economic development and the emergence of broadly distributive, as opposed to selective advantage, institutions.

I define institutions as "the rules of the game in a society or, more formally, …the humanly devised constraints that shape human interaction" (North 1990: 3). More specifically, "[i]nstitutions are relatively stable sets of widely shared and generally realized expectations about how people will behave in particular social, economic and political circumstances. Expectations structure behavior by informing individuals about the likely consequences of alternative courses of actions" (Weimer 1997: 2). I focus on formal institutions, which set out these expectations in rules enforced by the state. "Broadly distributive" institutions are those that distribute benefits to broad segments of the affected population, such as whole classes or types of actors. Such institutions are the result of policy making that does not deliver selective advantages and rewards supporters only indirectly (Kitschelt 2000: 849–50). These institutions may provide club or collective goods but they do not bestow private benefits. Further, the redistributive consequences of these institutions are applied regardless of whether an actor supported the party initiating a particular institutional reform. By contrast, "selective advantage" institutions distribute benefits to targeted recipients, and only those who engage in the quid pro quo with political actors receive the benefit. The purpose of this book is to explain the effect of network ties between the political and economic sphere, as well as the effect of uncertainty, on the emergence of broadly distributive institutions.

The negotiated nature of the Polish transition – accompanied by the widespread belief that no single party would dominate post-socialist Polish politics – set Poland on a particular trajectory of political capitalism. As in the case of the SLD, the parties that emerged on the right from the Solidarity movement also sought economic allies. Beginning with Lech Wałęsa's first presidential campaign, parties sought a-legal donations to increase their chances of winning. They found allies in the likes of Jan Kulczyk,[3] partial owner of the privatized telecommunications company TPSA, who had strong ties to the parties on the right.

[3] Kulczyk was selected as the buyer of the important Lech and Tyskie Breweries by the privatization minister, Janusz Lewandowski, in the center-right government of Hanna Suchocka. He was also selected in partnership with France Telecom for exclusive negotiations in the privatization of the Polish telephone company TPSA under the Solidarity government of Jerzy Buzek.

Politicians also frequently sought out ties with businesspeople, particularly when their parties depended on business as a source of political finance. The linkage of politics and business was initially very direct. Quite quickly, however, the opportunities for the direct political creation of firms disappeared; they constituted too great a liability for Polish politicians. Instead of politically creating firms, politicians from all parties sought to acquire political control of privatized firms by staffing corporate boards with the party faithful. This became another source of revenue for political parties in addition to the financial support of individual business owners. One by-product of this broad enmeshing of politics and business was that political responsiveness to business interests and effective business regulation came to be in the interest of political elites.

Across post-communist Europe businesspeople and politicians eyed each other as possible allies or resources to different extents. The central place of ties between politicians and businesspeople in the Polish economic transformation is surprising, however, given the emphasis placed on rapid reform in explaining Poland's early emergence as one of the best-performing post-communist countries. The prominence of networks thus challenges the traditional explanation for Poland's success: relatively rapid progress on privatization and economic reform that established functioning markets (Lipton and Sachs 1990b; Sachs 1994; Åslund 1995) and allowed firms to operate with little regulation (Shleifer and Vishny 1998; Frye 2010) while disrupting pre-1989 social networks.

In this book, I re-examine both paradigmatic success stories and frequently cited laggards of political and economic reform in post-communist Europe between 1989 and 2005, by focusing on the neglected role of networks between firms and political parties. My goal is to explain the role of networks and uncertainty in the emergence of broadly distributive institutions in the region. The combination of business and politics was by no means peculiar to Poland or members of the former Communist Party. In the Polish case, however, the purpose of bringing together the two spheres – economy and polity – was quite different from what it was in many other countries, due to the intensity of Polish political competition in the early 1990s. Polish businesspeople sought to secure their place in the economy and approached politicians to offset some of the uncertainty that the early period of transformation to capitalism entailed. Their political counterparts, faced with sharp electoral competition, sought to increase their chances of victory at the polls. Both groups recognized that the changes that began in 1989 would completely change their understanding of politics and the economy, but no one knew exactly how. Because so many different actors were involved, no one could hope to control the process or its outcome.[4]

[4] Ostrom refers to such contexts as "unstructured problems" in which individuals are at best engaged in a "trial and error effort to learn more about the results of their actions so that they can evaluate costs and benefits more effectively over time" (Ostrom 1990).

In an attempt to offset the uncertainty inherent in periods of massive social change, politicians and businesspeople forged networks of social ties, political financing, and favors. In addition, party members moved between political organizations, jobs in the state bureaucracy, and positions in the private sector. The networks linking the polity and the economy grew deeper over time, and with each passing year the links between a particular political party and their business allies grew more intense. As on K Street in Washington, and in many other capitals of established democracies, these businesspeople provided jobs to former party officials and politicians in exchange for access.

There is no question that the first two decades of transformation in Poland were marred by corruption between businesspeople and politicians, as they were in all post-communist countries.[5] Blame was placed on everyone from the socialist *nomenklatura* after 1989 to the new "nomenklatura," composed of elite members of the former opposition, the secret services, lobbying and pressure groups, and "networks" (Żakowski 2009).

Instead, however, in the context of strong networks between the state and business, broadly distributive institutions emerged in Poland. This outcome was not a given, as the trajectories taken by the two other case studies in this book, Bulgaria and Romania, clearly demonstrate. Hence, I seek to understand how the configuration of networks determined the institutional trajectories of post-socialist states. The three basic questions of this study are as follows. Why do networks among firms and between politicians and firms emerge? Why did variation emerge in the types of networks and in relationships between the state and the economy? And what is the relationship between networks and institutional development?

I develop the argument in greater detail in the next chapter. Briefly, I argue that the structure of networks and the level of uncertainty within which these networks operate shape the incentives of elites to act collectively. Networks emerge to fill the space left by incomplete institutions. Broad networks link cross-sectoral coalitions and thus facilitate collective action. The effect of uncertainty on collective action depends on the type of network present. Under high levels of uncertainty, cooperation emerges if networks are broad, because information flows and the threat of damage to reputation undermine defection from agreements between politicians and businesspeople. Under high levels of uncertainty and narrow networks, parties are weakened by high levels of competition and are unable to credibly commit to agreements with business because the narrow network makes their defections hard to detect, and uncertainty lowers the value of their promises. The result is that cooperation between firms and parties is unlikely, and, consequently, business can prey directly on the state. Under low levels of uncertainty and narrow networks, dominant political elites, safe from the threat of political competition, exploit atomized

[5] Corruption here means illegal or a-legal exchanges between these groups.

firms. Under low levels of uncertainty and broad networks, dominant political elites enter into collusive relations with firms.

These findings challenge the traditional view by suggesting that broad networks are not anathema to the emergence of broadly distributive institutions. To the contrary, in conditions of widespread uncertainty, networks are necessary for the development of broadly distributive institutions. Chapter 2 develops a theory of how networks function dynamically in times of widespread institution building, how network variation shapes institutional development, and why network variation emerges.

The starting point for this analysis is identifying the distinctive features of Poland in comparison to other post-communist countries. As will be explored in more detail in the pages below, Poland stands out because the networks widely blamed for post-communist corruption were broad at all levels of society. These networks made possible the gradual institution building that took place.

Two types of network are examined in this book. First, Polish ownership networks were much broader than those in other countries, meaning that firms in many different sectors were joined in a horizontal web linking state firms and private firms. Ownership cross-holdings are a common way for firms to enable credible commitments when institutions are still incomplete or when the complexities of market activity are such that contracting cannot cover all contingencies in a practical fashion (Williamson 1985; Gerlach 1992).

Second, Polish personnel networks – those created among the individuals who hold high-level positions within the same organization – included many more individuals than those in other post-communist countries. This came about because appointments were highly politicized in Poland, with the result that high-level employment experienced significant turnover after every election that brought about a shift in the ruling party. These personnel networks spanned the state and the private sector. They had a sharp partisan logic, as bureaucrats and private individuals often depended on party support to obtain elite positions. Although changing jobs frequently imposed regular start-up costs on individuals, it also limited the length of time any one person spent in a particular position of power, increased the level of connection among the elite, and thereby produced another key form of state–economy embeddedness.

As a result of Poland's broad networks, political and economic elites looked to the long run: they all knew their fortunes did not lie in maximizing short-run benefits but, rather, in working within lasting political structures. Alternation in power of the two largest coalitions – center-left and center-right – held for the first four fully democratic elections, in 1991, 1993, 1997, and 2001. Business elites realized that short-run benefits might be fleeting and defecting from a party could lead to future punishment. In contrast, lasting alliances were likely to deliver long-run benefits, even if those benefits were unavailable when the allied party was out of government. They also had invested into developing relationships with political allies that were not so easily shifted to the opposing political side. The alternation of parties in power alone was not sufficient to realize coordination, however. Only because networks connected a large group of firms and politicians, providing many points of contact and creating a web of mutual obligation and commitment, were political and economic actors able to focus on the long term. No one group of businesspeople could coordinate to steer the process of institution building in its own direction, because networks included too many different firms with too many disparate interests.

Thus, instead of pushing for narrow, selective benefits, firms and parties eventually sought to turn over power to broadly devised institutions and to empower the state with decision-making authority through a series of compromises. This state functioned both by command and by adjudication, mediating between various competing interest groups that would otherwise face a stalemate. In the process, stakeholders developed a functioning competition policy, built financial institutions and regulation, reformed banking policies, and developed a comprehensive corporate governance system before neighboring countries managed these feats. Polish financial law was more effective in 2000 than financial law in almost all the other countries in the region (Sanders and Bernstein 2002). Corporate governance law more closely approached international standards for the protection of shareholder rights than that of any country in the region. Poland was even comparatively successful in developing a framework to regulate lobbying relations between business and politicians.

Evidence that networks drove this process appears in the surprising persistence of network-based economic activity in an otherwise rapidly developing liberal institutional context. According to a 2005 survey, of all the Balkan, Baltic, and east European countries, Polish firms were most likely to turn to collective associations to resolve disputes with other firms (EBRD 2005b). According to Williamson (1985: 166), recourse to dispute resolution mechanisims other than courts is a key signal that credible commitments are a cornerstone of inter-firm relations and play a larger role in market relations than is customarily recognized. Polish firms also used network-based sources of capital as a primary form of credit (EBRD 2005b). In the first two decades after 1989 Poland underwent a great deal of institutional change in the context of broad networks that played a central role in the day-to-day ability of firms to navigate an uncertain environment. Broad network ties enabled firms to make credible commitments and forge broad coalitions with political actors. The cooperative relationship that developed between business and politics determined the trajectory of Poland's institutional development.

Not all countries fared so well; most much more closely resembled the stereotypical "wild East" that we have come to associate with the post-communism era. For the sake of illustration, the next pages briefly contrast the case studies discussed at greater length later in this book.

In sharp contrast to his Polish colleagues, the Bulgarian businessman Ilya Pavlov, who ranked among the ten richest men in eastern Europe until 2003, had a different impact on institutional development. Pavlov was a well-known wrestler (Bulgaria was an international leader in the sport) who married the daughter of the last communist secret police chief. He was well acquainted with high-ranking party officials and members of the military and security services. As the communist regime was unraveling, Pavlov and others like him – many of them emerging from professional sports circles, the military, and the secret police – began to take part in foreign trade. Pavlov founded a company called Multigroup that, formally, dealt in the import and export of art, although it quickly expanded to trade in other products. Multigroup established a bewildering array of shell companies in offshore tax havens, making it impossible to trace the company's structure. It used these shells and the vast resources the company quickly acquired to avoid the control of the state – even flying products directly out of Bulgaria without submitting to customs procedures (Ganev 2001: 15).

The methods employed by Pavlov and a group of other businesspeople blurred the lines between (semi-)legitimate business activities and mafia methods. They formed companies with names such as Alpha and Beta and business groups such as VIS-2[6] that traded small arms to developing countries, captured the privatizations of large resorts, offered insurance and private security services, and fought among themselves over the division of Bulgaria's valuable tourist infrastructure and industry. As they came to control banks, hotels, and heavy industry, Bulgaria was rocked by car bombings and contract killings of businesspeople in broad daylight. In 2000 the capital, Sofia, averaged three per week. The interior minister even publicly stated that the police were powerless to do anything, but that normal people should not be concerned because the killers were conscientious and rarely involved innocent bystanders. As violence became part of the standard toolkit of business, it ultimately consumed even Pavlov – several times named "Bulgarian businessman of the year" and ranked the eighth wealthiest man in central and eastern Europe – with a single bullet to the heart outside Multigroup's headquarters in 2003.

The business groups behind this violence were in a position of asymmetrical force and influence. Rumors that they had infiltrated the police, the military, and the state bureaucracy were plausible, given the lack of energy with which contract killings, bombings, and illegitimate business deals were investigated.

Pavlov and his cohort show how, despite internal conflicts among business leaders, a small group was able to use its strength to influence the political scene. Bulgarian parties, in effect, became clients of a narrow field of businesspeople. In this context, businesspeople had no interest in creating pacts with politicians and found it difficult to sustain alliances among themselves. Networks among firms and members of the state bureaucracy, as well as those between businesspeople

[6] VIS-2 was a successor company to VIS-1, which was blacklisted by the government for selling insurance to owners of expensive Western cars in what was alleged to be a protection racket.

and politicians, were much less broad than in Poland and offered fewer points of contact. As a result, businesspeople did not have the same network assets to negotiate broad institutions with a view to the long term. Competition policy remains poorly developed in Bulgaria, and low enforcement capacity means that even the weak existing institutions of market regulation function poorly. Moreover, secured transaction law that regulates the risk of giving credit does little to protect creditors, because influential interests have managed to block institutional development. Despite intense pressure in the process of EU accession, business elites and politicians operate in a highly uncertain environment based on domination, without the network ties that create webs of joint obligation or mutual reassurance, and large areas of the state remain under the influence of narrow, mafialike groups (Andreev 2009).

Romania's transition set in motion yet a third dynamic. One dominant party emerged out of the jarring revolution of 1989 as a national unity government: the National Salvation Front (NSF). The central actors of the NSF subsequently dominated Romanian politics through a new umbrella party, the Party of Social Democracy of Romania (PDSR),[7] which lost its first election, in 1996, to an ineffectual opposition party that spent most of its mandate on internal squabbles. The PDSR, renamed as the PSD in 2001, returned in 2000 to further dominate Romanian politics until 2004. Romanian business elites grew out of this milieu dependent on political support. In turn, they provided financial support to the NSF and PSD. To limit financial extraction, however, some business elites attempted to develop a margin of autonomy by forming their own satellite political parties with strange names and obscure platforms, such as the vaguely liberal Humanist Party and the nationalist New Generation. These personal parties brought their business sponsors some attention and limited autonomy from PSD politicians. In turn, personal parties served the PSD by taking voters from opposition parties by offering similar platforms. For example, the Humanist Party, founded by one of Romania's wealthiest men, Dan Voiculescu, brought votes and the support of Voiculescu's television station to the PSD from 2000 to 2006.

Although this strategy was available only to a few, it contributed to fragmenting the business community and prevented the development of organizations. Networks of cross-ownership were weak and firms rarely shared directors. As a result, institutions were poorly developed until the intense pressure of the EU accession process generated a significant degree of business regulation. At that time, progress was made in the reform of banking law, and the state of secured transaction law improved. Overall, the level of institutional change lay somewhere between Poland and Bulgaria, but networks between firms tended to be weak.

[7] I refer to this party throughout the text as the PSD – its current name – to indicate also the period when it governed as the PDSR.

Thus, three sharply different forms of the business–politics relationship emerged in Poland, Bulgaria, and Romania. In Poland, collaborative exchanges between two politically allied sets of business elites and their political sponsors defined the first two decades of struggles over reform, with the effect of a gradual consolidation of state power. In Bulgaria, the dominance of a narrow group of business actors over politicians undermined the development of broadly distributive institutions. In Romania, the dominance of political actors similarly failed to support the development of institutions.

The divergence between these cases points to the role that networks play in reducing uncertainty and complementing the development of institutions. The absence of such networks limits the extent of collective action by promoting the interests of narrow coalitions. By contrast, broad networks allow cross-sectoral coalitions to emerge. Thus, broad networks are crucial for the development of collective action and a necessary but not sufficient condition for the emergence of broadly distributive institutions (which additionally require the condition of widespread uncertainty).

The next chapter reviews relevant contributions in the literature and then moves to develop a theory of how networks affect the emergence of broadly distributive institutions. Before moving to that task, the next section reviews alternative explanations of post-socialist state development.

Traditional explanations of variation in institutional development are largely the product of a long-standing debate between two camps: those who feared widespread popular opposition to painful reforms and those who believed that powerful insiders would impede restructuring or even seek to stall reform. Concern about the political sustainability of reform was one of the motivations behind a lively literature about the appropriate speed of economic reform (Fischer and Gelb 1991: 104). Those who worried about a popular backlash and the sustainability of reform and saw benefits to a piecemeal approach viewed a gradual set of policy reforms as the best way to transform the state socialist economies into dynamic market economies (Portes 1990; Roland 1991; McMillan and Naughton 1992: 141; Dewatripont and Roland 1992a: 292; Aghion and Blanchard 1994; Dewatripont and Roland 1995). Those who feared bureaucrats and insider interests would try to block reform viewed rapid reform or "shock therapy" as a way to kick-start market economies (Lipton and Sachs 1990a; Frydman and Rapaczynski 1994; Sachs 1994; Åslund 1995; Hellman 1998).[8]

Even the brief comparison of Bulgaria, Romania, and Poland brings into question the standard explanations for differences in developmental trajectory

[8] As Dewatripoint and Roland point out, some authors took a mixed position, seeing the need for a shock approach on some dimensions and a gradual approach in others. For example, most economists agreed that measures to bring about macroeconomic stabilization should be adopted rapidly but diverged on liberalization, privatization, and the pace of firm restructuring (Dewatripont and Roland 1995).