# Postcommunist Divergence: A Comparative Analysis of the Transition to Capitalism in Poland and Russia*

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This article critiques the dominant neoliberal transition paradigm. The implementation of neoliberal reforms in the postcommunist world has fostered the creation of two different types of capitalism. Rather than enabling a transition to Western European-style capitalism, these reforms have produced divergence within the postcommunist world. This article uses comparative firm-level case studies from Russia and Poland to construct a "neoclassical" sociological alternative to neoliberal theory that can explain this divergence. In this account, intra-dominant class structure (the pattern of alliances between the Party bureaucracy, the technocracy, and humanistic intellectuals) at the time of the transition produces different "paths to capitalism," or policy regimes, which, in turn, have different effects on the ability of firms to restructure. In Russia, this creates a system of "patrimonial capitalism" that will produce long-term economic stagnation. In Poland, a variety of modern rational capitalism emerges. This latter system is distinguished by its very high levels of dependence on capital imports in comparison to the advanced capitalist countries. As a result, this type of economy will be quite vulnerable to economic shocks.

Most would agree that the collapse of the Soviet empire and emergence of markets and elections throughout the former Soviet bloc constitutes the biggest change of the last half of the 20th century, causing a realignment of the global economic and political landscape and ushering in a massive transformation of the day-to-day life of more than 356 million people. Western economists, many associated with the World Bank, the IMF, and the European Bank for Reconstruction and Development, provided the theoretical and technical tools to manage the transition from "plan to market," as well as the dominant interpretation of economic change in this region. This approach can best be characterized as Smithian: If the state withdraws from the economy, markets

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and market activity will lead to capitalist development through voluntary exchanges in the pursuit of profit. In this world, there are only two types of economies—state dominated and the more "natural" market economy (Smith 1976).

This article critiques this view from a "neoclassical" sociological perspective (Eyal et al. 2001; Stark and Bruszt 1998). As Weber pointed out, Western-style capitalism was not a "natural" or "inevitable" result of the elimination of the state from interference with markets; rather, it emerged only under a very specific set of circumstances. This included a class structure of capitalists and free wage labor, the proper set of legal institutions, and the active involvement of strong bureaucratic nation states. Furthermore, Weber saw that there were several different kinds of capitalism. What Smith thought was the most "natural" economic outcome, Weber termed "modern rational capitalism," which he viewed as far from an historical inevitability (Weber 1978).

This article will argue that the application of a transition strategy premised on the Smithian logic led to the creation of capitalist economies, but not along the lines expected by the Smithians. Rather, two distinct forms of capitalism emerged throughout the postcommunist world: a system of patrimonial capitalism (as found in the former Soviet Union and Eastern Europe), which is reliant on the export of raw materials, and a sub-type of "liberal capitalism" or "modern rational capitalism," which I call "dependent capitalism," because accumulation is dependent on the import of capital and the export of manufactured products (as found in Central Eastern Europe and the Baltics). The former leads to capital flight rather than accumulation (what Burawoy [1996] calls "economic involution"), as well as a widening of the developmental gap with the West. The latter leads to modern capitalist growth. Because this accumulation is dependent on the import of capital and the export of manufactured products, this system will be very sensitive to external shocks and changes in the exchange rate. As a result, in the long run, this variety of capitalism *might* not close the gap with the West.

## The Neoliberal Theory of Transition

With the collapse of communism, neoliberals advocated moving to the "market" on all fronts, and as quickly as possible. Thus, they advocated the "Shock Therapy" of stabilization, liberalization, and privatization to create the conditions conducive to firm restructuring and convergence with the West. In a stable monetary environment, "Private ownership would ensure profit-oriented corporate governance, while liberalization of trade and prices would set free the competitive market forces that reward profitable activities. Firms would have therefore both internal and external incentives to restructure" (EBRD 1999: 16; see also Sachs 1991a: 3, 1996; Frydman, Gray, and Rapaczynski 1996; Kosolowski 1992; Lipton and Sachs 1990a; Fischer and Gelb 1991; Blanchard et al. 1991: 10-11; Carlin, Reenen, and Wolfe 1994: 72).

While there was some disagreement over the optimal speed and method of the most difficult transition policy (privatization), all of the leading Western neoliberal economists (and those most involved with policy formation) argued for a rapid privatization of large enterprises. Because there was no substantial

domestic ownership class, and foreign direct investment (FDI) was slow in coming, giving away the property (through a combination of voucher schemes and transfers to firm insiders) was deemed the best policy (Lipton and Sachs 1990b; Blanchard et al. 1991; Frydman and Rapaczynski 1994).

This transition had to be as rapid as possible, so that it could take advantage of the period of "exceptional politics," lest "partial reforms" created political constituencies with an interest in reversing or blocking further reforms (such as workers and managers in state-owned enterprises [SOEs], or citizens angry over the "temporary" falls in living standards) (see Balcerowicz, Blaszczyk, and Dabrowski 1997; Frydman, Rapaczynski, and Turkewitz 1997: 84; Blanchard et al. 1991: 57; Aslund 1991: 19; Lipton and Sachs 1990b). Indeed, as a result of these considerations, "The need to accelerate privatization is the paramount policy issue" (Sachs 1991b: 1). The emphasis was on destroying old communist institutions, and relying on the spontaneous generation of new institutions produced by market forces (see Sachs 1994: xii; Ericson 1991: 26).

These "radical reforms" would lead postcommunist countries on a linear path from "the plan" to "the market" (as found in the advanced market economies of Western Europe). This ontology is made explicit in the most frequently referenced source on the transition economies, the *Transition Reports* put out by the World Bank and the European Bank for Reconstruction and Development (EBRD). These reports rank countries on a number of reforms based on a linear movement from a planned to a market economy (with a "1" being "planned" and a "4" being "market," with a "4*" representing the situation "typical of the advanced industrial economies") (EBRD 1999: 12).

This Smithian transition strategy won the day: "the majority of countries in the former Soviet Union and in Central and Eastern Europe adopted what can best be described as shock therapy or the big bang approach…" (UNDP 1999: 30). This was "the most dramatic episode of economic liberalization in economic history" (Murrell 1996: 31), "a landslide victory of the neoliberal project" (Greskovits 1998: 22-23). It resulted in an unprecedented peacetime disaster. Throughout the region, the level of real GDP in 1999 was only 67 percent of its 1989 level (EBRD 2000: 4). Poverty skyrocketed from four percent of the population in 1988 to 32 percent in 1994 (UNDP 1999: 21). Far from Eastern Europe "catching up" with Western Europe, it lagged further behind. While an initial contraction was anticipated, the decline vastly exceeded expectations (Kornai 1993: 2).

The neoliberal explanation for the obvious failure of Russia and other postcommunist countries takes one of two forms: voluntaristic or fatalistic. The voluntaristic position is that it was a failure of political will that led to an inadequately implemented Shock Therapy package (Aslund, Boone, and Johnson 1996; Fisher, Sahay, and Vegh 1996; Sachs 1997; Sachs and Warner 1996; De Melo and Gelb 1996; Selowsky and Martin 1997). Because "leadership" is the only account given as to why various policies were adopted, readers interested in a structural account are left to supply their own. Implicitly, and at times explicitly, neoliberals and IFIs invoke a "corrupt" or "crony" capitalist analysis of the postcommunist economy (see Frye and Shleifer 1997; Johnson,

Kaufmann, and Shleifer 1997). These authors, operating with the old dichotomy of plan and market, are unable to conceptualize the economic system that has emerged in post-Soviet society. A default category, "crony capitalism," is invoked ad hoc, without any analysis of the structure or dynamics of "crony capitalist" society beyond the identification of high levels of "corruption." Indeed, the implicit model is that "crony capitalism" is identical to "normal capitalism," differing only in that the elites are either corrupt, or "myopic," or both. This is completely consistent with the neoliberal's exultation of choice and agency over structure (see Hacker-Cordon 2001).

The fatalistic response makes a "friendly amendment" to the original simple theory (that liberalization and privatization leads to successful transition). Postcommunist divergence can be explained by the "initial conditions" of the various countries when the transition began (EBRD 1999: 8). And yet, there is no attempt to use the lessons learned from the "initial conditions" to modify economic policy. The claim is either that, after controlling for initial conditions, radical reforms are still beneficial (De Melo et al. 2001), or, that policy decisions become completely irrelevant (Popov 2000). Either way, the implicit message is that the populations of postcommunist countries with the "wrong" initial conditions were doomed to suffer a massive fall in their standard of living and have little hope for a fundamental change.

## A Sociological Alternative

This article develops an alternative explanation for the success and failure of the transition process in postcommunist societies. This theory builds on the most prominent sociological analyses of postcommunist capitalism (Stark 1992, 1996; Stark and Bruszt 1998; Burawoy and Krotov 1992; Burawoy 1996; Eyal et al. 2001). These authors invoke state structures, the existing pattern of networks, and the political activity of various classes or groups (workers, managers, intellectuals, bureaucrats) to explain transition outcomes. This analysis is the first sociological attempt to account for the divergence between Central Eastern Europe and the former Soviet Union.

## Three Paths to Postcommunist Capitalism

This article holds with Stark (1992) that the outcome of the transition to capitalism is path-dependent. In particular, of crucial importance is the pattern of class and intra-class conflict and cooperation during the transition. This causal argument holds that the internal structure of the postcommunist dominant class determines how privatization is carried out, which greatly affects enterprise restructuring and firm behavior, which, in turn, determines the nature of the economy.

This article will present original case-study evidence on the link between privatization policy and firm restructuring and behavior. It will use this evidence to create models or "ideal types" of different varieties of postcommunist capitalism. While the differences in the class patterns in Russia and Poland will be described, the actual link between class structure and privatization policy and practice will not be demonstrated empirically, although the class back-

grounds of the actors involved in the case studies will be shown to be consistent with this interpretation.[1] Rather, this article pursues the more common comparative strategy of pointing out the covariation of the independent and dependent variables (class structure and type of capitalism), with the original data all focusing on the intermediary links in the argument (privatization and firm restructuring).

## The Tripartite Class Model of the Transition from Rational-Redistributive to Capitalist Economies

The state-socialist or "rational-redistributive" (Konrad and Szenlenyi 1979) economy was based on the collective control over property by the party/state. The party/state would centralize the surplus produced by socialist firms, and reallocate it according to the dictates of the official plan. Workers, who produced this surplus, were politically excluded and "negatively privileged" or "exploited." They also experienced alienation and identified various types of intellectuals as their class enemy (Haratsi 1977; Burawoy and Lukacs 1992). They were compelled to work, at times by force, but for the most part to obtain wages (often as piece rates), as well as scarce goods controlled by the party/state and distributed at the workplace. The bureaucratic estate, as well as technocrats and humanistic intellectuals, had superior levels of material consumption and opportunity.

Rational redistribution was effective in generating industrialization and modernization in agricultural societies. Over time, it created a working class out of the peasantry, and the enormous growth of an educated middle class of professionals, technicians, experts, and various humanistic intellectuals to fill the positions of a modernized economy.

As socialism matured, the technocratic and humanistic intellectuals came to share more power with the political bureaucracy. Over time, the upper class in mature socialism could be described as having three segments: the hegemonic political bureaucracy (or bureaucratic estate), the technocracy, and humanistic intellectuals (or producers of culture). All three groups benefited, relative to the workers, from state redistribution, and their career paths and lifestyles intertwined (Szelenyi 1978, 1982; Shlapentokh 1990). And all were ultimately legitimated by reference to their monopoly of teleological knowledge expressed in the exercise of socialist planning (Konrad and Szelenyi 1979). Of course, some of these intellectuals and technocrats expressed dissent, and were punished by the regime (such as Shokolov and Solzhenitsyn in Russia).

As communism began to collapse, the process of conflict and cooperation among these three segments would be decisive for the shape of the postcommunist economy and polity (see King 2001a; Eyal et al. 1998, 2001; King and Szelenyi 2001). When party bureaucrats abandon communism (as opposed to being pushed out of power by domestic opposition groups), they remake themselves politically as nationalists and economically as capitalists. This is accomplished through an alliance with managers (a fraction of the technocrats) to initiate "capitalism from above" in the form of Shock Therapy.[2] It comes "from above" because this is *where* the new owners come from (the top of the old party-state hierarchy).

This path describes most of the former Soviet Union and Eastern Europe (outside of Central Europe). The move to the market economy was attempted in one big push following the neoliberal Shock Therapy blueprint: stabilization, liberalization, and privatization. The last was accomplished extremely quickly, prior to restructuring and without regard for the property's selling price. Managers benefited from management and employee buyouts (MEBOs), which left them in control of their enterprises. Voucher privatization served both bureaucrats and managers, as the dispersal of ownership benefited manager-owners (because it allowed their concentrated shares to give them disproportionate control). It also benefited political insiders who used their connections to (and power over) agents in financial institutions to create investment funds that purchased vast amounts of these vouchers (see King 2001a, 2001b for this activity in the Czech Republic). State bureaucrats also benefited by giving property to clients through closed-door insider privatizations conducted as bogus auctions. This benefited bureaucrats through the construction of patron-client relationships with the new owners, who then helped them ensure their future political careers as well as accumulate personal wealth.

When technocrats aligned with dissidents against the bureaucracy, they ushered in "capitalism from without." This alliance was based on common interest. Politically, both wanted freedom from the bureaucratic estate (and to see their erstwhile master [and sometimes persecutor] vanquished). Economically, both believed they could do just as well in a capitalist system by becoming professionals and selling their relatively scarce labor power on the market and/or becoming entrepreneurs. A major factor in this was the possibility of working for some large multinational corporation. In this path technocrats and dissidents were able to block the self-transformation of the party bureaucracy into a grand bourgeoisie. This was largely because of the strength of civil society, and the maintenance of democratic institutions (which have primarily been weakened through manipulations by surviving members of the bureaucratic estate). In this path, the new owners came literally from outside the country: some were expatriates, but most were multinationals.

The historical path followed by Central Eastern Europe and the Baltics left the bureaucracy completely delegitimated and demoralized. Again, Shock Therapy was the first transition policy. Monetarism and neoliberalism served as ideologies uniting the technocrats and dissident intellectuals (Eyal et al. 1998; Eyal 2000). Monetarism provided a way to govern economic life without relying on the direct hand of the state (which was seen as the vehicle for communist oppression). Shock Therapy destroyed the old communist-era institutions—making the transition irreversible.

While there has been great progress in liberalizing the economy and in implementing stabilization measures, the privatization of large enterprises has proceeded in a different way. Instead of mass privatization, generalized MEBOs, and rigged auctions, large enterprises were sold in more or less transparent and fair auctions, especially to foreigners. Once the negative effects of stabilization and liberalization were felt, the democratic nature of their polities often resulted in an electoral backlash, and a modification of these policies (as happened in Hungary, Poland, and the Czech Republic).

In the postcommunist world, one of these two paths (understood as existing on a continuum) was followed. However, there existed a suppressed, or counterfactual, path to capitalism: "from below." Here, a private class of market-dependent actors could have grown up in the shadow of the socialist redistributive economy. This is what happened in Hungary after 1968, Poland during the later stages of martial law, and what is still occurring in China. This path is the outcome of a stalemate between technocrats and bureaucrats. The bureaucracy, rather than make political concessions to dissidents or technocrats, bolsters its legitimacy by allowing subordinate classes and sub-elites to engage in market activity. Thus, the new owners come from non-elite classes, "from below."

These "paths" out of socialism, led by different coalitions within the postcommunist elite, are, of course, merely ideal types. Concrete cases will combine elements of all three to different degrees. This article will argue that these different paths lead to different "destinations," that is, types of postcommunist capitalism.

## Methodological Issues

The economists make their case with cross-national time-series regression analysis using country-level macroeconomic data. These regressions are based on data with very poor reliability and validity (see Filer and Hanousek 2001). In addition, this method requires the unrealistic assumption of an independence of cases, and increases of the degrees of freedom in an unreliable way (by relying on an arbitrary division of time that corresponds to annual statistics, when restructuring processes obviously take much longer than a year) (see King 2001c for an expansion of these points). Sociologists, when not relying on individual-level survey data to engage in traditional stratification analysis, for the most part have used ethnographic case studies and traditional comparative methods (Stark 1992, 1996; Burawoy and Krotov 1992; Burawoy 1996; Burawoy and Verdery 1999). This article follows the lead of these sociologists and anthropologists.

This article will compare the transition experience of Russia and Poland, prime examples of capitalism "from above" and "from without," and of obvious intrinsic importance in their own right. While I seek to develop a theory that is generalizable throughout the postcommunist world, this cannot be tested in this article. However, since these cases constitute more than 50 percent of the population of the postcommunist world proper, any compelling theory must account for them.

This article, following the sociological tradition (Stark 1996; Stark and Bruszt 1998; Burawoy and Krotov 1992), supplements standard comparative sources with enterprise-level case studies. By studying firms, we can look directly for the causal mechanisms that are at issue (those affecting enterprise restructuring). This article matches firms in the two countries, making it possible to control for sector effects, since the ability of firms to restructure depends in important ways on their environment, which may well vary by industry.

The data for these case studies consists of interviews with a small number of top enterprise actors (owners, top management, union officials) as well as other locally published materials about the firm. This research design favors breadth of cases (47) at the cost of depth (in terms of time spent collecting data in a traditional ethnographic fashion). This trade-off is justified for two reasons. First, there is a grave danger of both overgeneralizing from atypical cases, and, conversely, missing important outliers. More cases give us a greater chance of getting both typical and atypical firms, providing much more material to generate a theory of enterprise change. Second, since the question here is not to ferret out what the transition *meant* to the actors (as in traditional ethnographies), but merely *what happened* to firms during the transition, such intensive research was not necessary.

Appendixes A and B describe the Russian and Polish case studies.

## The Russian and Polish Paths to Capitalism

Before discussing the case-study data, we need to set the context in terms of the theory of intra-class structure and struggle.

While the momentum of technocratic reforms and intellectual challenges in Central Eastern Europe in the late sixties might have been able to radically transform the power structure if not for Soviet military might, the bureaucratic estate in Russia was never seriously challenged. Indeed, the collapse of communism cannot be seen as a defeat of the Communist Party bureaucracy by outside forces. That is, the key players in this transition were members of the political bureaucracy itself (Linz and Stepan 1996; Garcelon 1997; Reddaway and Glinski 2001). The driving force of change was the party's growing recognition that it could not compete economically and militarily with Western capitalism (Szelenyi and B. Szelenyi 1995). Gorbachev should be seen as a technocratic reformer who opened up to intellectuals as ammunition against hardliners that he viewed as standing in the way of necessary reforms. At the same time, the perestroika reforms that legalized individual profitable activity and cooperatives (in 1986 and 1987) created vast opportunities for elites in managerial and ministerial positions to profit as middle-men—enabling them to accumulate personal wealth. This gave at least some partocrats the ability to see a future for themselves in a postcommunist world.

Gorbachev's move was initially successful, as he managed to replace much of the top Brezhnez-era elite whom he saw as corrupt and inefficient bureaucratic obstacles to reform (Hanley et al. 1995: 647). However, these reforms started to get out of control as activists in the Baltics and Armenia used Glasnost to espouse anti-Russian nationalism. Soon, the partocracy realized they could survive on the regional level, drawing their attention away from the center, and initiating the disintegration of the Soviet Union (Helf and Hahn 1992; Linz and Stepan 1996).

In the Russian Federation, 1988 saw the emergence of "civil society" in the form of Democratic Russia (DR). A full 80 percent of respondents in one survey of DR's Moscow activists were "specialists," holders of technical and professional degrees and skills (whereas 28 percent of those employed in the

Russian Republic fit this definition). While this movement mobilized the real discontent and grievances of the intelligentsia, it was nonetheless "launched from within the highest echelons of the Soviet-Party state. This movement against the party's political monopoly was part of, and contributed to, a struggle of technocratic reformers against party conservatives. This essentially split the party internally, creating two warring factions (the Democratic Platform and the Russian Communist Party)" (Garcelon 1997: 39, 47, 49).

When Gorbachev tried to use limited elections against party conservatives, his strategy backfired. Yeltsin rose to prominence through his control over the Moscow Association of Voters, which provided leadership for the mass-based DR movement. The fact that this was a section of the Communist Party coming to power (and not a non-communist elite, as in Poland) is clear. A full 86 percent of DR's deputies were party members, and Yeltsin himself had been a member of the Politburo (Garcelon 1997: 64).

In June the Russian Supreme Soviet declared its "sovereignty" from the USSR, and a dual-power structure emerged. After the failed coup of 1991, Yeltsin assumed full power over Russian territory. DR, having always been more of a top-down product of a section of the bureaucratic estate, soon withered into irrelevance. Yeltsin chose instead to align with enterprise managers and implement Shock Therapy from above. Indeed, a full 74 percent of Yeltsin's appointees were members of the nomenklatura (Garcelon 1997: 70).

In January 1992, the radical transformation of the Russian economy began. These reforms were led by Finance Minister Yegor Gaidar, the scion of a privileged intellectual family (both his grandfathers were well known writers, and his father a famous journalist). A member of the CPSU since college, and a head of the economic policy department of *Kommunist*, the main theoretical journal of the CPSU central committee, Gaidar was hand-picked by Burbulis, a former professor of Marxist philosophy and "scientific communism," and the unofficial number-two man in Yeltsin's first government (Medvedev 2000: 12-13). With the help of a team of Western economists headed by Jeffrey Sachs, "a radical reform package focusing on economic liberalization and privatization was adopted…." (EBRD 1996: 169; see Wedel 2001). This included a stabilization policy that is justly famous for radically reducing government spending and increasing interest rates (the real refinance rate got as high as 117 percent per annum [Aslund 1995: 187-188]). Liberalization of prices and trade was accomplished equally swiftly with most restrictions eliminated in one day (Aslund 1995: 140; EBRD 1999: 258).

Six months of this shock therapy led to unprecedented hyperinflation and a fall in living standards. To shore up support, Yeltsin incorporated into his regime representatives of enterprise directors, such as Chernomyrdin, chairman of the board of Gazprom, who was made vice premier of the fuel and energy sector, and later replaced Gaidar as Prime Minister when the public outcry against Shock Therapy forced his ouster (Reddaway and Glinski 2001). At the same time that Chernomyrdin joined the government, a privatization plan relying on a combination of citizen vouchers and giveaways to managers and employees was launched in June of 1992. This was easily the largest, most rapid transformation of ownership in world history. "By July of 1994, 15,052 me-

dium- and large-scale enterprises, employing more than 80 percent of the industrial workforce, had been privatized…" (EBRD 1996: 169). Thus, in Russia, a self-recreated bureaucratic estate, in coalition with elements of the technocracy in charge of large enterprises, unleashed "capitalism from above" via a full dose of Shock Therapy.

The Polish story was much different. In the summer of 1981, sudden price hikes precipitated strikes throughout the country, but particularly in the Baltic cities. In August, general strikes in Gdansk and Szezecin spread through the country, ending with government recognition of the right to form independent unions (Kramer 1995: 673). The working class entered into an alliance with a group of dissident intellectuals that had defended worker strikes in 1976 (Kennedy 1987; Bernhard 1993). The workers and intellectuals picked up the support of the disaffected technocrats and professionals, culminating in the 10 million-strong Solidarity Union (which was four times larger than the Communist Party, and ten times greater than the official trade unions [Ost 1990: 139-140]). From this movement an anti-communist political counter-elite was created, bent on abolishing the nomenklatura and wresting control from the bureaucratic estate (Wasilewski and Wnuk-Lipinski 1995: 674).

For the rest of 1981, Solidarity tried to negotiate the institutionalization of its power to determine and implement economic policy. Ultimately, the government would not agree to share its economy power. Massive strikes continued throughout the year, precipitating Jaruzelski's imposition of martial law, during which he outlawed Solidarity and arrested many of its leaders (Ost 1990: 113-148). The threat of Soviet intervention was crucial in this.

In an effort to restore some legitimacy, Jaruzelski sought to drive a wedge between intellectuals and workers, to make concessions to the Church, and even to open up to a small class of "socialist entrepreneurs" like in Hungary (Kennedy 1992: 55-56; Ost 1990: 155; Korbonski 1999: 146). While Solidarity was weakened by this, Jaruzelski never won any measure of legitimacy, and Poland continued to undergo serious economic problems and the build-up of international debt (Korbonski 1999: 143). Unable to garner support for his 1987 economic plan, and with the additional blow of the new Polish Pope (John Paul II) calling for the re-legalization of Solidarity, the party teetered near collapse. As a result of declining living standards, a new round of strikes started in Gdansk and Krakow in April of 1988. In August, strikes started in Silesia, and began to spread northward. That same month, Jaruzelski initiated the Round Table meeting with the opposition, which would lead, in short order, to the decisive defeat of the government in semi-free elections, ending Communist rule.

The first postcommunist government, headed by Mazowiecki, implemented a strong dose of Shock Therapy in terms of austerity and liberalization in late 1989 (Balcerowicz, Blaszczyk, and Dabrowski 1997: 138; EBRD 1996: 165-166). It is important to note that this coalition of technocrats and dissident intellectuals essentially rode the working class into power. With the fall of communism, the working class was without its symbolic enemy—leaving it vulnerable to the intellectuals' leadership (and the leadership of intellectual advisors to actual working class leaders, like Walesa). The biggest immediate

victim of Shock Therapy was the working class. As inflation leaped, unemployment steadily grew, and production fell dramatically. Solidarity's leadership declared a "moratorium on all forms of social protest," and even Walesa personally participated in putting down a railway worker's strike in May 1990 (Levitsky and Way 1998: 174).

Only a year later, political backlash from the hyperinflation (555 percent) and economic contraction (11.6 percent of real GDP) that followed liberalization and stabilization led to a change of government, and a softening of the neoliberal approach. In the summer of 1990 "fiscal and monetary policy were considerably loosened" (Murrell 1993: 129). State credits again flowed to enterprises, and began to "approach…old levels" (Murrell 1993: 129). By the next summer, the average tariff went from five percent to 18 percent, and "selective protection was endorsed" (Murrell 1993: 129). Plans for microeconomic interventions by the government on a firm-by-firm basis were also being drawn up and executed. This case-by-case approach to firm restructuring was expanded in 1993 with the implementation of the *Law on Financial Restructuring of Banks and Enterprises.* As the head of the Agency for Industrial Development said, the Polish transition was "not absolute liberalism, but controlled liberalism" (Interviews with Bochniarz 2001; Krezel 2001).

While shock liberalization and stabilization were significantly modified, mass privatization never got off the ground. For the first few years privatization proceeded mostly in small and medium-sized enterprises. While plans for rapid large-scale privatizations had been drawn up, they were not enacted because of political pressure (by workers and the public) and the victory of a left-wing government (Kramer 1995: 654; Poznanski 1996: 279; EBRD 1996: 165).[3] Eventually, a mass-privatization bill was passed in 1995. However, it was very limited, and included mostly medium sized enterprises that amounted to only 10 percent of the productive potential of SOEs (Baltowski and Mickanwicz 2000: 437).

Thus, Poland's ruling alliance of technocrats and intellectuals held the workers in check, and implemented stabilization and liberalization programs, but never rapid, large-scale privatization. The neoliberal reforms were softened within a year, and the active state involvement in the economy increased after voter backlash against Shock Therapy put the former communists back in power in 1993. The private economy came to dominate the state sector through the growth of FDI (both greenfields and privatizations) and new domestic businesses. Privatization of large SOEs occurred after substantial restructuring, and was carried out by strategic investors (i.e., with investment capital and expertise). As a result, there are still over 1,000 large state-owned enterprises (Krezel 2001). In this sense, Poland "grew out of the plan," like China (Naughton 1995).

The comparative argument holds that, in Poland, technocrats, humanistic intelligentsia, and the working class allied against the bureaucratic estate, thus ending communism. Rather than the big bourgeoisie coming from the bureaucracy and top managers of giant enterprises, it came from "outside," in the form of expatriate capitalists and multinationals. The technocracy and humanistic intellectuals primarily transformed themselves into Western-style profes-

sionals (including managers of foreign-owned firms) and the owners of small and medium-sized businesses. Transformed into capitalist labor, by 1993 workers suffered from a 16.4 percent unemployment rate. In Russia, the bureaucratic estate was not pushed out of power. Having lost self-confidence in the confrontation with the military and the economic challenge from the West, elements of the bureaucracy led the transition, attempting to transform themselves into a patriotic-nationalist political class, and to convert their political connections into financial assets. Indeed, the big bourgeoisie came to consist of former members of the bureaucratic estate and their clients. The working class increasingly merged with the means of subsistence, becoming bound to the enterprise for their very survival.

While a brief review of the historiography sketched earlier is consistent with this interpretation, very good empirical data exists to back up this claim. Ivan Szelenyi and Donald Treiman conducted a survey of elites in six postcommunist countries in 1993, including Poland and Russia. This gives us some comparative data to support the contention that the bureaucratic estate was far more successful after the transition in Russia than in Poland. These figures and levels of FDI are presented in Table 1. More than twice as many former members of the nomenklatura made up the 1993 political and economic elite in Russia as compared to Poland, and there was less than one-tenth the level of FDI per capita.

With the political and economic contexts established, let us now take a closer look at the effects of these programs on the respective manufacturing sectors.

## Case Study Data

All cases discussed in this article are taken from the manufacturing sector, where, if modern rational capitalism is established, it will have to dominate. In addition, the constant revolutionizing of the means of production, which is the hallmark of modern rational capitalism, should be most apparent in the part of the economy that uses the most machinery. A variety of sectors in high-tech and low-tech industries, in producer and consumer markets, were selected. Twenty-five case studies were carried out in Russia in the summer of 2000, and 23 case studies were carried out in Poland in the summer of 2001. Fourteen of these more or less matched the Russian cases.

**Table 1**
**Evidence on the Structure of the Postcommunist Dominant Class**

| | Russia | Poland |
|---|---|---|
| Percent 1988 nomenklatura in 1993 Political Elite | 67.7 percent | 27.5 percent |
| Percent 1988 nomenklatura in 1993 Economic Elite | 51.0 percent | 22.7 percent |
| Cumulative FDI 1989-2000 (per capita) | $9,998 million ($69) | $29,052 million ($751) |

Source: Szelenyi and Szelenyi 1995: 629; EBRD 2001: 68.

First, I will examine two typical Russian firms and their matching Polish firms, followed by the Russian and Polish exceptions.

*Russian Television Producer*

The Russian firm Recorder produced radio equipment and TVs. In 1992, competition from low-wage Eastern producers, and the fall in demand that accompanied Shock Therapy, created an immediate crisis in the firm. In 1993 the company was privatized by insiders. The most important effect of this ownership transformation was completely left out of Smithian transition theory: the new owners had absolutely no resources to restructure their enterprise.

After privatization, massive looting of the factory took place. Production literally ground to a halt after parts of the conveyer belt, as well as other equipment and tools, were stolen. The firm was further impeded because of the fiscal crisis and the institutional breakdown of the Russian state. It is crucial to realize that this was in large measure a consequence of similar financial crises at other privatized firms, which were unable to pay taxes. Thus, the firm experienced a major shock when the state stopped paying for its orders of radio equipment. Then the local state bank which had underwritten a restructuring loan for the firm went bankrupt. Another supply shock occurred when the upstream producer of cathode ray tubes was privatized, and turned into a beer factory. The only appropriate tubes were made in Germany, and were far more expensive than the old Russian ones.

As a result of these direct and indirect effects of rapid privatization, the factory went into a tailspin. By 1996-1997 it had stopped paying workers, who began to sell their shares to outsiders for almost nothing. Of 12,000 workers, 5,000 were laid off, and 5,000 more abandoned their jobs. The only new hires were guards. Indeed, many large, hardy young men, armed and in military fatigues, were observable in this (and other) Russian firms (while none were observable in their Polish equivalents).

Recorder responded to the opening of the market and privatization by *withdrawing from the market and downgrading technologically*. Like many other Russian firms, it engaged in barter, had large accounts receivable and payable, and engaged in periodic debt-swaps. Firms also withdrew from the capitalist labor market, ensuring the survival of their employees outside the market by providing garden plots (and later collective potato farms). Thus, firms responded in ways unanticipated by the neoliberals, as they survived without the market. Merely eliminating “soft-budget constraints” does not make a firm market-dependent. Contra Sachs, markets do not “spring up as soon as communist bureaucrats vacate the field” (Sachs 1994: xii).

While Recorder partially withdrew from the market to survive, it also continued to operate on the market on a much lower level of technological production. Where the firm used to be an integrated TV producer, creating great value added by making most of the parts for TVs, it now only serves as an assembly platform (and the state doesn’t even receive a tariff on these imported parts, which are produced in Korea and smuggled into Russia!).

Finally, it was quite clear that this enterprise was firmly embedded in an environment that was rife with “political capitalism”—the political distribu-

tion of property to clients. The new director, brought in by the creditors after the company declared bankruptcy, was charged with reclaiming property stolen from the enterprise. It all started during the bankruptcy proceeding when, according to the current director: “the former director of Record factory violated laws governing Russian property—he used the property of the factory for his own ends” (Interview [anon.], Vladimir Oblast, Russia, 2000). The director, a rough-looking man dressed in a Nike warm-up suit, explained his approach to conflict resolution with the old manager. “We [the management team] are taking the civilized route and want to make an agreement with normal civilized relations. Already there have been six attempted assassinations over this, and people’s cars have been stolen. We could break legs, but what for? We want to use normal methods” (Interview [anon.], Vladimir Oblast, Russia, 2000). Indeed, the implication is that although they may *want* to use “normal civilized” methods, this might not be possible.

Furthermore, according to the upper management, “this is not just an argument between stockholders and [the old manager] but there is a third corner: the large criminal empire run by the number two guy in the Oblast,” the local state official in charge of the economy and industry (Interview [anon.], Vladimir Oblast, Russia 2000). According to the director, “he is the matron of the apartment and decides who gets into the kitchen to cook dinner”—that is, he is the real power behind many businesses in the Oblast. He doesn’t own the factory directly, according to the director, but exerts power through clientelistic relationships with straw men (Interview [anon.], Vladimir Oblast, Russia 2000). The consequences of Shock Therapy devastated Recorder, and firmly embedded it in a non-market environment. The other TV company I studied in Russia had a near-identical outcome (case study 20).

*Polish TV producer*

The contrast between Recorder and the Polish TV producer Philips could not be greater. The emergence of this multinational reflects Poland’s mix of “capitalism from without” with “capitalism from below.” This multinational actually began in 1987 as a consequence of two engineers’ decision to launch a small domestic start-up to service Western consumer electronics. One workshop in Warsaw grew and expanded to other cities. When importing became legal later that year, they started importing Philips and other major brands of electronics appliances for retail.

Eventually, they decided to build an assembly plant in Poland to avoid tariffs. They grew by contracting with a Philips subsidiary to produce Philips TVs for the Polish market. A manager from a state-owned TV company was hired to build a new factory, bringing many of his colleagues with him. The company expanded its contracts with other subsidiaries to produce VCRs, TV tuners, and PCB boards. The Western partners supplied the technology (typically they “loaned” it to them). By 1995 the company employed 800 people, and was steadily growing.

At this point, Philips bought them out, having became interested in the strong Polish market. Low labor costs induced them to shift all their European pro-

duction to Poland. By 2001 they employed 2000 people, and produced 3.3 million TVs, exporting 90 percent of their output (70 percent to Western Europe), making them the number-one player with 21-22 percent of the market. They also had 30 percent of the Polish market, and 10 percent of the rest of Eastern Europe. They made, in addition, 11 million tuners and 4.3 million PCB boards a year. They also brought a slew of suppliers with them, who employed another 2500 workers. They produced many inputs locally; however, by value they were 60 percent to 70 percent imported. According to the interviewee, Philips had plans to produce the major components (tubes) at a subsidiary in the Czech Republic. The other major TV producer was a French MNC (case 22)—which had a very similar story (except it was producing tubes for its entire European empire).

Thus, where the TV firms in Russia had disinvested and partially withdrawn from the market economy, this TV producer in Poland started as a small greenfield, literally grew into a joint venture, and then became incorporated into a multinational corporation that transferred technology and provided investment capital and access to coveted Western markets. This was the most advanced form of capitalist property—but it definitely made Poland dependent on the investment decisions of a Western European multinational, the level of Western European demand, and imported inputs. This type of development enhanced Poland's ability to catch up with Western Europe, but at the price of increasing Poland's vulnerability to an externally induced economic crisis.

Critics might suggest that the Polish and Russian TV case studies are not comparable, since one was a start-up and the other a privatized SOE. However, the point is that, in Poland, resources did indeed "reallocate"—the interviewee, a top manager in charge of production, was an employee of one of the three large Polish SOEs that had dominated the market before the system change. Those firms split up and either went out of business or switched to other markets. The manager, in turn, hired many of his former colleagues, thus shifting human capital to the new (foreign) firm. Moreover, this FDI was only drawn into the country by the entrepreneurial activity of a firm started "from below" and as a result of the Polish economic boom (which, I argue, would not have existed had they pursued rapid large-scale privatization like Russia).

The histories of these firms reflect the differential development of the Russian and Polish class structure. In Russia, we see firm managers and a patron-client relationship between a manager/owner and a regional administrative elite. In Poland, we see engineers become entrepreneurs, who, along with former managers of SOEs, come to work as highly paid professionals for a Western multinational.

*Russian Textile Producer*

Most of the Russian cases displayed roughly the same pattern of change as Recorder. We can see this in a textile company, Crystal, which was also located in Vladamir Oblast. The company was privatized in 1991 when all shares were transferred to the worker collective. However, as was the pattern in 18 of

the 25 Russian firms, the work collective lost control of the firm to outside groups. A Moscow-based investment group ended up with a majority of shares.

These owners failed to provide any investment capital, and Crystal suffered the same fate as Recorder. In addition, because state funding dried up for the polytechnic institute that traditionally supplied their technicians, they increasingly had trouble finding skilled manpower.

They responded in all of the same ways that Recorder did: asset stripping, barter, inter-enterprise arrears, non-payments (of wages and taxes), debt-swaps, and securing access to the means of subsistence for their employees. This firm also ended up producing a less technologically sophisticated product on a much smaller scale of production.

### *Polish Textile Producer*

In capitalism from below, a SOE sector that is increasingly marketized and restructured continues to exist. Optex, although still under state ownership in the summer of 2001, was more market dependent, and pursued more restructuring, than the privatized Russian textile firm. Thus, we can call this property form "state capitalism."

In 1989, on the heels of the Tiannamen Square massacre, Polish firms were no longer allowed to trade with China. This cost the firm 60 percent of its market. Shock Therapy also created a crisis, causing firms to lose all subsidies as well as their source of investment credits. They had a huge productive capacity, an unknown trademark, and many employees. Moreover, most of their suppliers went bankrupt, leaving one domestic monopolist.

The director of Optex, who had been deputy director for a long time prior to the transition, was forced to restructure and reorient production in order to survive. This was made slightly easier, however, by a loan provided by the Ministry of Light Fabric after a change of government. To the neoliberals, this loan would be considered anathema, the continuation of "soft-budget constraints" that would guarantee a company would not restructure. The contrast with the Russian firm, utterly starved of investment capital, could not be more stark.

Optex was able to modernize all machines with labor-saving technology purchased from the crisis ridden Western European textile sector. They reoriented to the local market, decreased employment from 1600 to 1100, and paid all of their taxes. They managed to make constant investments in the production process to keep up with trends in world prices. Indeed, they spent three to five percent of their $25 million (U.S.) turnover on research and development—which, in addition to making their own designs, was spent on figuring out how to incorporate new technology into their factory. Like Philips, however, this firm had become extremely dependent on Western Europe—not for their market (they now export only 10 percent of their output), but for their inputs (80 percent of which are now imported).

Thus, this state-owned enterprise, far from blocking the transition to capitalism (as Sachs and the neoliberals warned), helped make the Polish transition possible. After restructuring was initiated with a loan from the state, it

supplied the state with revenue, even as it constantly upgraded and successfully competed in a liberalized market. In the Russian textile firm, as with most in Russia, the fiscal crisis meant a cessation of tax revenues, and thus a weakening of the state, contributing to the subsequent failure of the manufacturing sector.

Again, we can see the macrohistorical story of differential class formation on the micro level. In Russia, rapid privatization created a manager-dominated firm without any resources. As this firm was unable to respond to the severe challenges it faced, workers were forced to sell their shares in an effort to survive. These shares were purchased by a politically connected financial-industrial group, which was only interested in extracting as much money from the firm as possible. In Poland, where privatization was delayed and the state funded restructuring, the outcome was vastly different.

These four firms in Russia and Poland are indeed quite representative of their respective countries' transitions to capitalism. In Russia, capitalism was made "from above," with the rapid privatization of large state-owned firms by owners without any resources, exacerbating other problems caused by liberalization and austerity, and leading to asset stripping, the adoption of extremely inefficient non-market survival mechanisms, and technology downgrading. In Poland, capitalism was both "made from below" and "from without"—in which new owners emerged from the private sector and Western capital eventually purchased much of the major means of production. Large SOEs were not rapidly privatized, but were first restructured and made market dependent before being sold to strategic investors. These firms were able to successfully restructure to be competitive on the world market, although at the cost of increased dependence on the West.

I will now check this theory by examining the outliers, the two most successful restructurers in Russia (only three to four cases can be seen as even partial success stories), and the Polish firm that most resembled the Russian pattern. In this way, I can see what sets these cases apart and whether I have to qualify the claim about the importance of rapid privatization for firm restructuring.

### *Russian Heavy Engineering (Mining Supplier)*

Founded in 1948 as a state-owned enterprise, this company produced rock bits for gas and oil drilling. The company was privatized in January of 1994 in fairly typical fashion: 51 percent of shares were given to the labor collective, and 49 percent remained with the state ministry of property. The state ministry subsequently sold this stock through an auction.

When this firm experienced a crisis, workers were forced to sell their shares to a group of managers. The new management/ownership team modernized production with retained earnings, so that they were competitive on the world market. When the devaluation of 1998 effectively eliminated foreign competitors, they were able to totally dominate the domestic market.

The distinguishing feature of this firm was its close connection to the privileged sector of the Russian economy: the energy sector accounted for more

than 50 percent of all profits in the country (Vorobyov and Zhukov 2000: 18). Because of its privileged sectoral location, the firm was able to build on its very high levels of inherited human capital to make high-quality, high-tech goods, and eventually restore its financial stability. Because it was wealthy, insiders never sold out, and the ultra-parasitic outside "financial investment companies" never took over the firm. This company is thus the exception that proved the rule: it managed to restructure because of its attachment to the dominant sector in the Russian economy.

*Polish Heavy Engineering (Mining Supplier)*

This company was not a perfect match with the Russian company, since it was only involved in supplying coal-mining operations. However, its inclusion is important because it was one of the only Polish firms that engaged in the various types of "market withdrawal" that typified Russian industry. This firm therefore shows that barter, inter-enterprise arrears, and debt-swaps are not some uniquely "Russian" path of transition, but a response to financial crisis available to all postcommunist firms.

The company was privatized in 1994 under Poland's "Mass Privatization" program. Thirty-three percent of their shares were transferred to Fund Number 11 of the state sanctioned investment funds. Twenty-two percent went to other investment funds, 25 percent stayed with the state treasury, four percent went to employees, and the rest were sold to individual investors. As with three of the four cases in Poland privatized in this way, the Investment Fund was described as a disaster (and a threat) by management. The fund made no investments in the firm, and did not even guarantee their credit, so that they could obtain loans. As a result of this mass privatization, "six or seven years were lost to the firm," leaving the management with only the hope of one day acquiring a strategic investor (Interview [anon.], Nowy Sacz, Poland 2001).

According to the director, the firm was forced from the market after "Sachs' draconian reforms" (Interview [anon.], Nowy Sacz, Poland 2001). The coal companies could not pay in cash, so they paid in coal. This, in turn, meant that the firm had to pay their suppliers in coal. They were also forced to accept non-payments from their customers, as banks stopped providing credits. They began to periodically arrange chains of debt-swaps. They initially paid employees in coal as well, but this was eliminated as gas became the prevalent form of home heating.

As with the Russian case just discussed, this was an exception that proved the rule. This firm exhibited a Russian response, and actually experienced a dose of Russian-style "privatization from above."

*Russian Paper Producer*

This successful Russian firm was a paper producer located outside St. Petersburg. It was the only firm among the 25 Russian cases to increase its employment in the postcommunist period, growing from 1070 in 1990 to 1900 by the summer of 2000.

This firm followed the typical pattern: privatization to the worker collective, consequent shocks and financial crisis, which then induced asset-stripping and all varieties of market withdrawal. The worker collective eventually was forced to sell their shares to outsiders. The firm is now a three-company joint venture—the biggest owner a German paper multinational. Primarily because of this German capital, the firm was able to modernize, and gained significant market share. In their first year of ownership, they spent $18 million (U.S.) to modernize their equipment.[4] They made constant investments, and salaries have increased yearly by 25 to 30 percent. They planned to start exporting once they further upgraded the quality of their product.

The difference between this firm and others was clearly having both a source of investment capital and experienced and knowledgeable owners. The incentive for this FDI, however, was undoubtedly access to extremely cheap raw materials (Russian wood is among the cheapest in the world). Despite the advantages of foreign ownership, this firm was still embedded in a domestic market that had been hobbled by mass privatization, leading to some problems as a result. They still engaged in barter, despite its expense and inefficiency. Their biggest problem, like many of the firms in the sample, was a shortage of young specialists. Undoubtedly, this shortage hampered their ability to raise quality enough to capture shares of the Western European market. The firm responded to this problem by educating young specialists, and making contracts with polytechnic universities and other institutes and universities to fund higher education for specialists.

### *Polish Paper Producer*

This paper company was located hours from Warsaw, the biggest company in the town of Swiecie. Like the Polish textile firm, it underwent a long period under state ownership, during which it received significant state funds for restructuring (a total of $150 million [U.S.]). In 1990 they exported 20 percent of their product to Western Europe. By 1995, exports had grown to more than 50 percent. The company was privatized in 1997 by a German paper multinational, which invested another $170 million (U.S.), allowing further expansion to Western Europe.

Thus, in comparison to the Russian firm, the Polish firm had significantly more investment, and was able to become deeply integrated into the world economy—emerging as a major player on the West European market. However, the Russian firm had a comparative advantage over the Polish producer. They were both in an excellent location for exporting to Western Europe, but the Russian firm had access to substantially cheaper wood ($9 per cubic meter, compared to $25 in Poland). In spite of this, the Polish firm was much more successful.

## Discussion

What we see from the case studies is that the different paths to capitalism in Poland and Russia produced overlapping forms of property and integration in both countries. However, the difference in quantity translates into a difference

in quality. In Russia, capitalism was very much made "from above," resulting in serious problems. Rather than Russia's radical reforms resulting in a transition to a "4*" economy ("advanced industrial"), it moved in another trajectory, towards a system that can be described as "patrimonial capitalism." Similarly, in Poland, because rapid large-scale privatization was never implemented on a massive scale, and the state took a more active role in restructuring enterprises, capitalism was made "from without" and, to a lesser extent, "from below." Thus, Polish firms avoided many of the ownership problems that crippled the Russian firms' ability to restructure. As a result, the patrimonial elements that dominated the Russian economy were far less prevalent in Poland. Indeed, because they violated neoliberal theory by not pursuing mass privatization but instead actively restructuring their SOEs, Poland indeed moved closer to the EBRD's idealized "4*" economy. Thus, it can be classified as a sub-type of "liberal capitalism." Still, the Polish economy differs, if in a less dramatic fashion, from the core "advanced capitalist countries" because of its greater dependence on imported investment goods and capital.[5]

We can now abstract from these case studies to fully specify: (1) the economic consequences of each path, and (2) the resulting structures of the different systems.

## The Economic Consequences of Divergent Paths

"Capitalism from above" makes it very difficult for privatized companies to successfully restructure. The biggest liability is a new owner without any investment capital. These firms are faced with depression-like conditions following the collapse of established patterns of international trade (by the politically administered destruction of the CMEA trading organization), the drying up of credit and state subsidies as a result of stabilization programs, and a crisis from competition with more advanced or cheaper competitors ensuing from liberalization.

Except those firms with privileged access to raw materials sectors, most enterprises will be unlikely to survive on the domestic market, let alone manage to restructure to be competitive on world markets. These firms won't be able to behave like rational capitalist firms are supposed to, by maximizing the price:cost ratio. In this situation, it is often the case that both "principals" and "agents" find it completely rational to strip the firm's assets. Since there is no collective solution under the new rules of the game, short-term, self-interested behavior becomes quite attractive.

Eventually, those associated with the firm will face a severe challenge to their very existence. Since almost all firms are at least near technical bankruptcy, they engage in non-modern (or non-market) capitalist economic activity. In this case, firm managers respond by withdrawing from the market, and activating old (or creating new) patron-client ties (between the state and enterprises, and between managers and workers) and horizontal networks with the managers of other enterprises (see Burawoy 1996; Stark 1996). Much as under socialism, firms engage in barter, and tolerate payment arrears. Unable to earn money, they initially pay their workers in-kind. Eventually, they provide for

access to the means of subsistence, by providing garden plots and facilitating production, as well as by organizing collective potato cultivation (and occasionally other foodstuffs).

This withdrawal of the firm from the monetary economy, as well as the overall economic decline, leads to a radical curtailment of government revenues. This leads to a decrease in the state's effectiveness or "infrastructural" power (Mann 1986). This weakening also facilitates the permeation of the state by new or reactivated patron-client ties between "clientelistic capitalists" (King 2001a, 2001b) and their bureaucrat patrons. As state capacity declines, the state can no longer supply the public goods necessary for modern rational capitalist activity, leading to more firm withdrawal from the liberalized market economy. To the extent that firms stay in the market, they typically do so after massive disinvestment and technological downgrading. Unable to compete on capital intensive markets, some firms are able to switch their production profile to take advantage of cheap labor costs. This process leads to a vicious circle of decreasing state capacity and market withdrawal and technological downgrading, leading to what Burawoy calls "economic involution."

Over time, the politically constituted ownership groups will spread throughout the economy—swallowing up the shares of insider-dominated firms that can be stripped of their assets in one way or the other. The compromise between the bureaucratic estate and enterprise managers will not result in equal gains for both segments of the former elite in the long run. In the Russian case studies, the eventual takeover of insider-owned firms by Moscow-based financial groups, who then typically failed to make any investment into restructuring the enterprise, was the norm.

This pattern of "negative" restructuring among the large formerly state-owned enterprises creates a big problem for the new private sector. Entrepreneurs suffer from a general decline in demand for both consumer and producer goods. In addition, the clientelistic allocation of bank capital to firms with personal connections deprives the new start-ups of investment funds. The withdrawal of state support for regulatory and legal infrastructures, or the inability of the state to provide these functions, is also deadly for the development of the new private sector. Eventually, mafias will arise to fulfill some of the tasks of the state—only they are likely to significantly "over-tax" for their services, disproportionately hurting entrepreneurial start-ups.

These processes lock in stagnation and impoverishment. They give rise to an economy dominated by rent seekers from the natural resource sectors, and those exploiting their connections to political elites and their insider status for purposes of financial manipulation and speculation.

In contrast to Russian "capitalism from above," Poland combined "capitalism from without" with elements of "capitalism from below." FDI partially compensates for the problems created by shock liberalization and stabilization, as it leads to reindustrialization. Multinationals provide capital and technology, expertise, and access to world markets. This allows more firms in non-resource-based manufacturing to restructure to enable their survival on the market—and to export to Western Europe without massive technological downgrading. Taxes from these restructuring privatized firms, as well as con-

tinued revenues from large SOEs and their domestic suppliers, allow the economy to avoid the vicious circle of declining state capacity and market withdrawal that follows from "capitalism from above."

The new private economy will be strengthened, as large greenfields, as well as small joint ventures, emerge. Domestically owned small and medium-sized businesses, however, are likely to suffer in at least the short and medium term because of foreign competition in consumer markets, and the replacement of industrial input producers with the suppliers from elsewhere in the global empires of MNCs. Basically, there will be capitalist growth, but it will depend on the investment strategy of particular MNCs, and the ability to import industrial inputs and capital from, and export manufactured goods to, the core of the capitalist world economy.

## Two Varieties of Postcommunist Capitalism

We can now move up a level of abstraction from the case studies, and describe the differences between the patrimonial-style of capitalism that has developed in Russia, and the dependent variety of liberal capitalism that has developed in Poland. Table 2 describes these differences.

**Table 2**
**Varieties of Postcommunist Capitalism**

| | Patrimonial Capitalism (Russia) | Dependent Capitalism (Poland) |
|---|---|---|
| Dominant Class Formation | Clientelistic capitalists; Parasitic financial groups | Multinationals; Domestic capitalists |
| Working Class Formation | Very low formation; Merged with the means of subsistence | Medium level of formation; separated from the means of subsistence |
| Firm Integration | Markets plus non-market horizontal coordination (barter and non-payments reciprocity) | Markets with low levels of non-market horizontal coordination (barter and non-payments reciprocity) |
| State-Private Interaction | State does not provide adequate public goods (such as the stock of human capital); Personalistic enforcement of laws by patrons provides profits for clients; Tax revenue crisis; Huge informal sector | State provides adequate public goods (such as the stock of human capital); SOEs continue to provide revenues and demand; Some informal sector |
| Leading Sector | Raw material exports | Manufacturing exports |
| Dynamic of Accumulation | Political accumulation; Capital flight; Technological downgrading | Importing capital; Economic accumulation; Technological upgrading; Financial fragility |

For Weber, capitalism was "the provision of human needs by enterprise, which is to say, by private businesses seeking profit. It is exchange carried out for positive gain, rather than forced contributions or traditionally fixed gifts or trades" (Collins 1980: 927; see also Schluchter 1989: 281-314; Weber 1978, 1988). Capitalist activity, in its most generic sense, cannot by itself create the conditions for dynamic economic growth as found in "modern rational capitalism." Indeed, Weber details how the structure of ancient capitalism in Rome led to the collapse of the Roman Empire, and how capitalist organization in Spain, India, and China failed to produce explosive economic growth.

Only the type of capitalism that emerged in Western Europe in the mid-19th century qualifies as modern rational capitalism. According to Brubaker, this system is "defined by the rational (deliberate and systematic) pursuit of profit through the rational (systematic and calculable) organization of formally free labor and through the rational (impersonal, purely instrumental) exchange on the market, guided by rational (exact, purely quantitative) accounting procedures and guaranteed by rational (rule-governed, predictable) legal and political systems" (1984: 1-2). Modern capitalism also requires the rule-governed, non-personalistic (bureaucratic) state to provide certain public goods, such as the stock of human capital (skilled and knowledge-based labor) necessary for modern economic production.

The economy that has emerged in Poland can indeed be characterized by these conditions. Private businesses pursue profit through market exchanges utilizing free wage labor, in a rule-governed legal and political environment, with a state that provides adequate public goods. While there were some enterprises that engaged in barter and inter-enterprise arrears, this activity was not pervasive.

The Polish class structure also strongly resembles what can be found in many advanced capitalist counties. The capitalist class consists of multinational corporate owners as well as new private domestic capitalists that have expanded (often through privatizations) until they become members of the grand bourgeoisie. The working class is also typical of advanced economies. They are "doubly free" in the Marxian sense of the term: they are free to move from employer to employer, and are "free from" direct access to the means of subsistence (and thus compelled to work for a monetary wage). Such free wage laborers will join unions to pursue their common interest. The Polish working class is organized in unions, which, in turn, are active politically. Indeed, the Polish working class is more organized than the American working class, if possibly less organized than their German or French counterparts.

A functioning bureaucratic state, combined with the market-dependent private actors employing free wage labor, creates the conditions for "modern rational capitalist" reproduction, as described by the classical sociologists as well as Adam Smith: the systematic reinvestment of profit into the means of production, leading to innovation, specialization, and accumulation. In Poland, this "modern rational capitalism" has been integrated into the global capitalist economy through FDI and manufacturing exports to the global market (mostly Western Europe). Compared to modern capitalism in Western Europe, Japan,

and the U.S., it is a capitalism that is more dependent on external investment capital, the importing of investment goods, and exports to Western markets.

As a result, it will be vulnerable to economic shocks because of its liberalized exchange rate regime and open capital market. It may experience balance of payment problems due to a reliance on foreign inputs. It may also experience problems because inflation is higher than in advanced capitalist countries, leading to real exchange rate overvaluation. At the same time, as short-term portfolio capital flows in to take advantage of the high interest rates necessary to attract capital to cover the payment gap, the currency will be further pushed up. This will lead to an overvaluation, which will make exports to the West, upon which the economy has become totally dependent, even more difficult. The purchase of these inputs may also lead to an increase in foreign debt, producing a debt-trap. This will set the country up for a rapid withdrawal of foreign funds if key investors lose confidence in the ability of the government to handle these problems, provoking a classic mass "herd-like" exodus of portfolio investors. This, in turn, will lead to a default and/or devaluation, with a massive loss of purchasing power for the population. This will restore domestic manufacturing somewhat, only to set the cycle in motion once again.

Thus, it is far from clear that this "capital import dependent" version of capitalism will allow postcommunist countries to converge with the levels of development found in Western Europe. However, if there is enough investment and technology transfer, leading to enough capture of world market share, it is not out of the question that, in the long run, such countries can experience convergence with the core. The probable ascension of Poland (and other Central European countries) to the European Union makes this latter scenario even more likely.

The economic system emerging in Russia is also capitalist by the Weberian definition, but certainly not of the "modern rational" or "liberal" variety. First, modern economic capitalism requires the full commodification of the economy. Only the production of goods for sale for money allows the "exact, purely quantitative" calculation, which is the hallmark of modern capitalist rationality. In addition, the production of goods for barter, and not sale, obviously reduces the overall efficiency of the economy. Thus, the pervasiveness of barter and inter-enterprise arrears among Russian firms distinguishes them from their Polish counterparts in ways that reduce the overall efficiency and dynamism of the system.

Second, modern economic capitalism requires the creation of "free wage labor," or the separation of the enterprise from the "household." In Russian industrial firms, this is often not the case. The workers became dependent on the enterprise for directly providing for their access to the means of subsistence. Lack of separation between the household and the enterprise characterizes economies dominated by subsistence peasants or labor-repressive landlords—not modern rational capitalism.

The inadequate separation of household and enterprise makes it impossible to use formally free labor in an instrumentally rational way. What this means is that firms are able to survive even though they cannot compete with other firms on the market by maximizing the price:cost ratio of their commodities. Inefficient businesses will not automatically "lose" their formally free labor if

they are not receiving at least the average level of return on their investments. Such businesses will not be forced to exit the market, and their resources will not "reallocate" to more efficient/profitable lines of production.

The third dimension upon which Weber distinguished modern rational capitalism is the relative separation of the economy from politics. That is, in modern rational capitalism it is quite possible to be involved in the economy, but not involved in politics. In at least one of the Russian case studies (Recorder), but certainly in many large Russian firms, "ownership" of private assets is allocated by individual political elites in a personalistic manner. This is an example of what Weber called "political capitalism."

Weber's explanation of why political capitalism creates less economic dynamism is simple. There is no rational reason to reinvest profits into improving production techniques. Rather, economic actors have a larger incentive to devote time and economic resources to establishing and cultivating those network ties to state elites that make political capitalism possible. Thus, there is a political rather than an economic logic to accumulation (See Brenner [1976] for a description of "political accumulation" under feudalism).

In addition, a system in which political capitalism dominates will have a less bureaucratic state by definition, which, in turn, decreases the conditions necessary for the emergence of modern rational capitalist activity. Russian firms must make do without the effective bureaucratic states that characterize liberal capitalism, and thus suffer from inadequate public goods, and the intrusion of mafias and corrupt officials.

Indeed, under these conditions any profit made from capitalist activity is very unlikely to be reinvested into the means of production. It is far more rational for owners to channel this profit out of the economy into some hard currency or foreign assets. This is particularly true of clients of political elites (political capitalists), who risk having all their property confiscated if the elite loses their political/administrative position or they lose favor with their patron.

Thus, firms in Russia are distinct from modern rational capitalist firms in these three dimensions. Taken together, Russian capitalism is distinctively patrimonial—permeated by personalistic ties that are anterior to market activity. Of course, not all firms in Russia can be categorized as part of this patrimonial economy. Firms in the energy and metal sectors (raw material exports), and the firms that supply them, are far more privileged, and thus have not all been pushed into non-market survival strategies. However, precisely because they are based on scarce raw materials, these firms are especially attractive for political capitalism, since they can be run into the ground but still generate huge profits. The history of the Russian metals, gas, and oil sectors and their appropriation in the infamous "loans for shares" privatization (consisting of rigged auctions) attests to this fact (see Klebnikov 2000).

For all these reasons, in the long run, patrimonial capitalism is bound to vastly underperform its liberal capitalist cousin.

## Conclusion

This article shows that the neoliberal assumption that there is a linear path from "plan" to "market" is incorrect. There is not just one "market" economy, but several varieties of capitalism. Two forms of capitalism have emerged in postcommunist society: a patrimonial variety dependent on raw materials exports which produces "involution," and a liberal variety that is dependent on capital imports and manufactured exports, and that leads to some development, but not necessarily the unambiguous "catch-up" with the West predicted by the neoliberals.

Furthermore, the more closely the neoliberal privatization strategy is followed, the greater the chance of creating patrimonial capitalism. The case studies reveal that the single biggest error was the neoliberal call to rapid mass privatization. In contrast, the Polish strategy of delaying privatization while the enterprise is marketized and restructured until a strategic investor can be found, is a far better solution to the problem of "making" capitalists in postcommunist society. Furthermore, the experience of Poland refutes the neoliberals' theory that delaying large-scale privatization will lead to the emergence of a politically powerful coalition among either firm actors or the general public that will reverse the transition to capitalism.

Of course, FDI was also shown to be crucial for firm restructuring. However, there is no evidence that a neoliberal transition policy can guarantee such investment. Russia was at least as neoliberal as Poland at the beginning of the transition, but FDI was not forthcoming. The fact that China, which is the furthest from the ideal state from a neoliberal perspective, is the largest recipient of FDI in the developing world, further supports this claim. Generally, attracting FDI cannot substitute for a development strategy. Relying on FDI to develop your economy, as some advocate, is a classic example of "many are called, few are chosen." Clearly, there was not, nor was there any realistic reason to think there would be, enough foreign direct investment to go around. Indeed, to the extent that FDI is pulled in by strong domestic growth and political stability, the inflation and recession that follow neoliberal Shock Therapy should make large inward flows unlikely.

## Notes

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1. One could seek to demonstrate a link between class and policy decisions by marshalling biographical and financial information that link various organizations and political actors in the policy making process (see Domhoff 1978, 1990).
2. This should not be confused with Moore's (1966) use of the phrase. In that sense, all paths are "from above," since the state implements some "transition strategy" resulting in capitalism.
3. It is important to note that the most prominent neoliberals recognized this difference between Russia and Poland, and judged the latter harshly for its deviation from the neoliberal blueprint.

According to Aslund, slow, case-by-case privatization, as carried out in Britain, did not work, and "consequently, large-scale privatization in Poland failed. The foreign technical assistance provided to Russian privatization is likely to stand out as some of the most effective Western aid in support of post-communist economic transition" (Aslund 1995: 248). For a review of this rather extensive "assistance," see Wedel 2001. Similarly, Sachs and Lipton approvingly noted that "The Gaidar economic team has moved swiftly to prepare for privatization, recognizing how delays in privatization in Poland and elsewhere have undermined stabilization efforts and forestalled structural adjustment" (1992: 8 [online version]).

4. They modernized, but could not have replaced, all of their equipment for this amount. They had two lines of production, each centered around a giant paper machine. According to interviews at paper multinationals, these machines were perfectly fine for producing at Western European quality levels, and cost about $150 million (U.S.) to replace.
5. For example, the vast majority (77.5 percent) of Polish banking stocks are held by foreigners, compared to four percent in Germany, three percent in Italy, ten percent in Spain, and 13 percent in Austria (Staniskzkis 2001: 5).

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# Appendix A
## Russian Case Study Basic Information

**Description of Cases**

| Case | Location | Size (employees) | Main Activity |
|---|---|---|---|
| 1 | Moscow Oblast | 1030 | Clothes production |
| 2 | Moscow Oblast | 5100 | Airplane parts production |
| 3 | Vladimir Oblast | 2000 | TV/Radio production |
| 4 | Vladimir Oblast | 1200 | Textile production |
| 5 | Vladimir Oblast | 5000 | Tractor production |
| 6 | Vladimir Oblast | 600 | Machine tools production |
| 7 | Vladimir Oblast | 1040 | Textile production |
| 8 | Vladimir Oblast | 575 | Radio parts production |
| 9 | Moscow Oblast | 1000 | Scrap aluminum production |
| 10 | Moscow Oblast | 3000 | Harvester production |
| 11 | Moscow Oblast | 2200 | Furniture production |
| 12 | Moscow | 500 | Paint production |
| 13 | St. Petersburg | 600 | Brick production |
| 14 | St. Petersburg | 700 | Ceramic Basin production |
| 15 | Leningrad Oblast | 1200 | Machinery production |
| 16 | Leningrad Oblast | 550 | Ceramic Tile production |
| 17 | Leningrad Oblast | 250 | Bus production |
| 18 | St. Petersburg | 1900 | Cardboard and Paper production |
| 19 | Samara | 7500 | Mechanical Car parts production |
| 20 | Samara | 1,800 | TV production |
| 21 | Samara | 900 | Valve production |
| 22 | Samara | 400 | Clothing production |
| 23 | Samara | 600 | Machinery production |
| 24 | Samara | 2900 | Oil drill bits production |
| 25 | Samara | 150 | Machinery production |

# Appendix B
## Polish Case Study Basic Information

| Case | Location | Size | Main Activity |
|---|---|---|---|
| 1 | Warsaw | 700 | Pharmaceuticals |
| 2 | Opoczno | 1100 | Textiles |
| 3 | Ostroleka | 1700 | Paper |
| 4 | Gdansk | 700 | Apparel |
| 5 | Warsaw | 900 | Basins |
| 6 | Gdansk | 20 | Roofing material |
| 7 | Warsaw | 23 | Pharmaceutical |
| 8 | Swiecie | 1400 | Paper |
| 9 | Wroclaw | 700 | Bandages |
| 10 | Katowice | 240 | Mining equipt. |
| 11 | Dabrowa Gornicza | 900 | Steel construction |
| 12 | Dabrowa Gornicza | 200 | Machine tools |
| 13 | Nowy Sacz | 408 | Mining equipt. |
| 14 | Poznan | 3800 | Ship engines |
| 15 | Warsaw | 1800 | Pharmaceutical |
| 16 | Ostrów Mazowiecka | 4000 | Furniture |
| 17 | Grodzisk Mazowieki | 1100 | Pharmaceutical |
| 18 | Lodz | 219 | Car parts |
| 19 | Kwidzyn | 2000 | TVs |
| 20 | Wadowice | 420 | Machine tools |
| 21 | Andrychów | 257 | Machine tools |
| 22 | Warsaw | 4200 | TVs |
| 23 | Lodz | 200 | Apparel |

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