The possibilities and limitations of institutional complementarities in explaining post-communist diversity[1]

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Abstract: Hall/Soskice 2001 argue in their Varieties of capitalism approach that the concept of institutional complementarity accounts for the persistence of diverse modes of coordination (liberal market economies and strategic market economies) which are reflected in distinct types of capitalism. This paper aims to answer the question whether the VoC approach and in particular the concept of institutional complementarities can explain institutional and economic diversity/performance of post-communist economies. I show that the concept of institutional complementarity alone is not sufficient to explain diversity and must be complemented by the concept of enforcement**.** I argue that the creation of new complementary institutions is only possible if these institutions are enforced as well. However, under conditions of transition (uncertainty, missing resources, multiple players) the design and enforcement of new complementarities is difficult. I provide evidence for diverse enforcement in different sub-sectors of the political economy of transition countries (South Eastern Europe, Commonwealth of Independent States and Central and Eastern Europe). Conceptually, I extend the Hall/Soskice's concept of institutional complementarity by distinguishing between negative and positive complementarities as well as between complementarities at different levels of analysis (intra-sectoral complementarities and inter-sectoral complementarities).

Draft version, June 2009

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Contents

1. Introduction

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

Research on institutional diversity is addressed by scholars of the VoC literature (Albert 1993; Whitley 1999; Hall/Soskice 2001; Amable 2003; Crouch 2005). The VoC approach, elaborated most prominently by Hall and Soskice 2001, sees institutional complementarities behind the persisting institutional and organizational diversity of developed Western countries. Hall/Soskice are mainly interested in complementarities between institutional subsystems of the political economy (education and vocational training, corporate governance, inter-company-relations, industrial relations). Complementarity between these spheres leads to limited clusters of capitalist systems. Political economies can be classified according the modes in which firms resolve coordination problems, namely via corporate hierarchies and market relationships (LMEs) or via non-market modes of coordination (CMEs), such as relational contracting, networks, associations and collaborative relationships and strategic interaction with other actors (Hall/ Soskice 2001, p. 8-10). Developed economies, which lie in between these two ideal poles of coordination, are identified as non-complementary, mixed systems. Hall/Soskice assume that in the long-run complementary institutions are more efficient than non-complementary ones and therefore advise that "nations with a particular type of coordination in one sphere of the economy should tend to develop complementary practices in other spheres as well" (Hall/Sockice 2001, p. 18).

The driving question behind this paper is whether the VoC approach (and in particular its concept of institutional complementarity) can help to explain the institutional divergence of post-communist economies? Although, the VoC approach has mainly been applied to explain differences of developed Western economies, recently several scholars have tried to use its insights to explain post-communist economic and institutional diversity (the type of emerging capitalism) (Hancke/Rhodes/Thatcher 2007; Lane/Myant 2007; Mykhnenko 2007; King 2007; Charman 2007; Christophe 2007; Myant 2007; Knell/Srholec 2007). The recent application of the VoC approach to post-communist countries seems to have only explanatory power for the most successful transition countries such as Slovenia and Estonia (Feldmann 2007; Buchen 2007) and most of this recent literature takes a critical view on the VoC approach in the transition context. Rather than by institutional complementarities, variety is explained as an outcome of historical factors (socialist legacy) and current factors (EU membership, policy choices, wars). Contrary to Hall/Soskice's claim there the institutional trajectories of post-communist countries do not confirm a correlation of economic success and the complementarity/purity of institutional system (e.g. Poland, Czech Republic, Hungary are mixed political economies with non-coherent institutions, which are also economically successful). Most authors, especially those in the edited volume by Lane/Myant 2007, conclude that the VoC approach does not capture the development of post-communist transition countries because of the peculiarities of the former socialist societies (path dependent informal institutions, diverse communist legacies). Scholars propose to extend the CME and LME typologies and introduce additionally some "mixed type" or "hybrids of capitalism" (e.g. Bartlett 2007; Charman 2007; Cernat 2006; Lane 2007a; King 2007). Scholars critically argue that the VoC approach concentrates too much on firms and neglects other actors such as the state, international organizations, political entrepreneurs. The VoC has been criticized also for neglecting power relations and bargaining over institutional reforms as well as different political systems (authoritarian or repressive state). To sum up, VoC literature on post-communist Europe claims that capitalist diversity cannot be explained solely by internal complementarities between institutional sub-systems and firms as the main actors. Instead, explaining capitalist diversity and institutional change must include diverse historical and future variables which can be internal (national state, national interest groups, structural legacy) or external (EU, international organizations).

While the above mentioned literature finds many factors which affect institutional and economic diversity of transition economies, the mechanisms which account for diversity are not well elaborated. At this place the paper provides a more conceptually and empirically grounded answer. The main argument of the paper is that the creation of new complementary formal institutions is only possible if these institutions are enforced as well. I argue that the creation of institutional complementarities is more difficult to achieve under conditions of transition (i.e. uncertain environmental conditions, changing power relations of diverse actors, capacity restrictions) than under conditions of stability, prevailing in developed economies or advanced transition economies. Such difficult transition conditions as well as persisting institutions from the past make the enforcement of new formal institutions difficult and require a cautious application of the VoC in those transition economies where law enforcement (legal effectiveness) is weak. Conceptually, it is argued that complementarities exist not only within sectors (i.e. intra-sectoral complementarities) but also between sectors (i.e. inter-sectoral complementarities between the state/polity and the economic sector). Furthermore, negative institutional complementarities are considered to account for negative self-enhancing phenomena, such as corruption, clientelism and particularism.

The outline of the paper is as follows. The next section gives an overview of the VoC approach, its critiques and some ideas of its extension. The third section elaborates the limits and possibilities of VoC approach to explain divergent transition outcomes. In this section I am trying to reveal whether the concept of institutional complementarity and that of pure types of coordination are helpful in the transition context. I argue that in general, the VoC approach can be useful as a framework of analysis but its application in the transition context has also certain limits. In particular, I identify three limitations (uncertainty resulting from a changing environment, diversity of actors, lack of resources) which restrict the *ex ante* design of a complementary institutional system. In the last section I conclude that although the VoC approach (and its concept of institutional complementarity) may partly be useful to explain institutional quality in more advanced transition countries, it is only restrictively applicable to the still evolving and less well implemented institutional systems of lagging post-communist countries.

2. The Varieties of capitalism approach and a tentative extension

2.1 The VoC approach by Hall/Soskice 2001

Institutional complementarities

Hall/Soskice's VoC approach is an actor centered[2] and rationalist approach with the main actor being the firm, which is the "*key agent of adjustment*" and whose strategies are conditioned on multiple interconnected institutions/actors from different economic sub-systems (Hall 2001, p. 6-7). Central to the approach are institutional interrelationships. The VoC approach focuses mainly on relationships between economic institutions/actors in different subsystems of the economy (education and vocational training, corporate governance, intercompany-relations, industrial relations). These sub-sector relationships are called institutional complementarities.[3] According to Hall and Soskice, institutions are complementary "*if the presence (or efficiency)*[4] *of one increases the returns from (or efficiency) of the other*" (Hall/Soskice 2001, p. 17). Note that Hall/Soskice's notion of institutions includes also organizations (Hall/Soskice, p. 9-10). Therefore, institutional complementarity should not be understood as a complementarity among rules only, but also among policies, relationships, strategies and skills. The main implication of institutional complementarities is that institutions are not only important alone, but also in their composition.

Institutional stability and change

Institutional complementarities have important consequences for institutional change and stability. The VoC approach argues that often overall systemic change is difficult because the benefits of introducing a new institution can often be realized only when complementary institutions are introduced as well (Hall Soskice 2001, p. 64; Hall/Thelen 2009, p. 11). Furthermore institutions are stable because they are *"collective constructs"* of multiple and diverse actors who not always find a consensus for reform (Hall/Thelen 2009, p. 12). Especially under conditions of uncertainty, the benefits of new institutions are not known and established institutions tend to persist. While "common knowledge" (shared cultural and historical derived understandings, habit) or the absence of alternatives play a role for stability, Hall/Thelen emphasize that institutional stability is not just a result of passive "institutional inertia", but is actively maintained by political and economic entrepreneurs which pursue their interests (Hall/Thelen 2009, p. 11). In this active reinforcement of existing institutions, power relations (negotiation and conflict) play a crucial role.

The original version of the VoC approach by Hall/Soskice 2001 concentrates on functional and less political means (political conflict, experimentation) of change. According to Hall/Soskice, nations experience external shocks (changes in technology, products and prices) which challenge the existing practices of firms. Firms respond to these shocks by adjusting their strategies and their relations with other firms or employees to sustain their competitive advantage/institutional comparative advantage (Hall/Soskice 2001, p. 63). Firms will try to restore their competitive advantage by appealing to already existing complementary institutional structures or the presence of a common-knowledge set of beliefs. They do so because they have made good experience with their institutions (or the underlying ideology) and be-

[2] The relevant actors in a political economy may be individuals, firms, producer groups and the government. Hall/Soskice concentrate on the interactions of firm-related actors such as employees, suppliers and clients, competitive firms, research consortia, labor unions, industry associations, banks and financial actors.

[3] The concept of institutional complementarity was debated in detail elsewhere (Boyer 2005; Deeg 2005; Amable 2003; Crouch et al. 2005; Streeck 2004; Höpner 2005).

[4] Hall/Soskice understand by efficiency the "*net returns to the use of an institution given its costs*" (Hall/Soskice 2001, p. 17).

cause they still trust in them. While Hall/Soskice partly acknowledge that economic shocks or liberalization activities can change existing institutions or practices (they see change to be more easy in LME's than CME's, because of the relative ease to establish market relations)[5] such change does not bring about meaningful change in the modes of coordination or corporate strategies (Hall 2006; Hall/Thelen 2009, p. 27).

In Hall/Thelen 2009, the hitherto neglected issue of institutional change is tackled more in detail by emphasizing three mechanisms of change: defection, reinterpretation and reform.[6] Defection occurs when actors stop following the practices prescribed by certain formal institutions, for instance by leaving certain organizations and thus weakening the bargaining power of such organizations who represent the interest of these institutions (e.g. German Metal sector association, see Thelen 2000). By reinterpretation, Hall/Thelen propose to see formal institutions independently from their meanings. It is argued that although formal institutions can change, "*the actors associated with an institution gradually change their interpretation of its rules, and thus its practices*" (Hall/Thelen 2009, p. 19). Such gradual reinterpretations without a change in formal rules, can be done by courts or the gradual acceptance of new practices and reflect the bargaining struggle between opposing groups. These reinterpretations result for instance from changing context conditions (e.g. increasing unemployment). Besides these piecemeal changes from below, the more visible institutional change from above is occurs through governmental reform, which is ultimately seen as a bargaining game among groups of social and political actors. Hall/Thelen emphasize that in this bargaining process hitherto established institutions from other sub-sectors matter for the effectiveness of the new introduced rules (complementarities matter) and support their claim by pointing to different outcomes of corporate governance reforms in France and Germany due to a different character of labor relations in both countries (see in detail Goyer 2007).

Economic performance (institutional efficiency)
The VoC approach argues that it is important to improve the coordination and hence the complementarity between the different spheres of the economy to increase efficiency. The VoC approach by Hall/Soskice takes enforcement issues for given and explains institutional and economic performance differences by different logics of coordination. According to the VoC approach, the complementary coordination of firms' activities with suppliers, customers, capital providers and workers explains economic success (competitive institutional advantage) of the firm which then aggregates to national economic performance (Hall/Soskice 2001, p. 6 and 37). Hall/Soskice assume that in the long-run complementary institutions (understood also as skills and activities) are more efficient (i.e. bring more comparative advantages) than non-complementary ones and therefore advise that "*nations with a particular type of coordination in one sphere of the economy should tend to develop complementary practices in other spheres as well*" (Hall/Soskice 2001, p. 18).[7] Inefficiency and enforcement aspects of economic institutions are not elaborated in the VoC approach by Hall/Soskice. However, Hall/Thelen acknowledge inefficiency in the diversity of coalition interest and a more elaborated account of formal institutional change as a "*process of continuous mutual adjustment inflected by distributive concerns*" (Hall/Thelen 2009, p. 20-21). Besides, they consider en-

[5] Establishing the liberal market model through liberalization and deregulation may be indeed easy and can lead to fast economic success. However, different national circumstances do not guarantee that the American model of coordination brings also sustainable institutional change and economic performance over a longer period of time in other countries. Recent examples of economic crisis and the beginning systemic change in Iceland, Ireland, Latvia and Hungary may be a proof of that.
[6] Note that Streeck/Thelen 2005 use other terms when referring to mechanisms of institutional change. They label defection as institutional 'displacement' and reinterpretation as 'conversion' (Streeck/Thelen 2005 p. 31).
[7] However, empirical studies show mixed results as regards the correlation of complementary institutions and economic growth in developed countries (see Hall/Gingerich 2004 and Kenworthy 2006).

forcement aspects in the mechanisms of reinterpretation and defection of institutions (Hall/Thelen 2009, p. 19- 20).

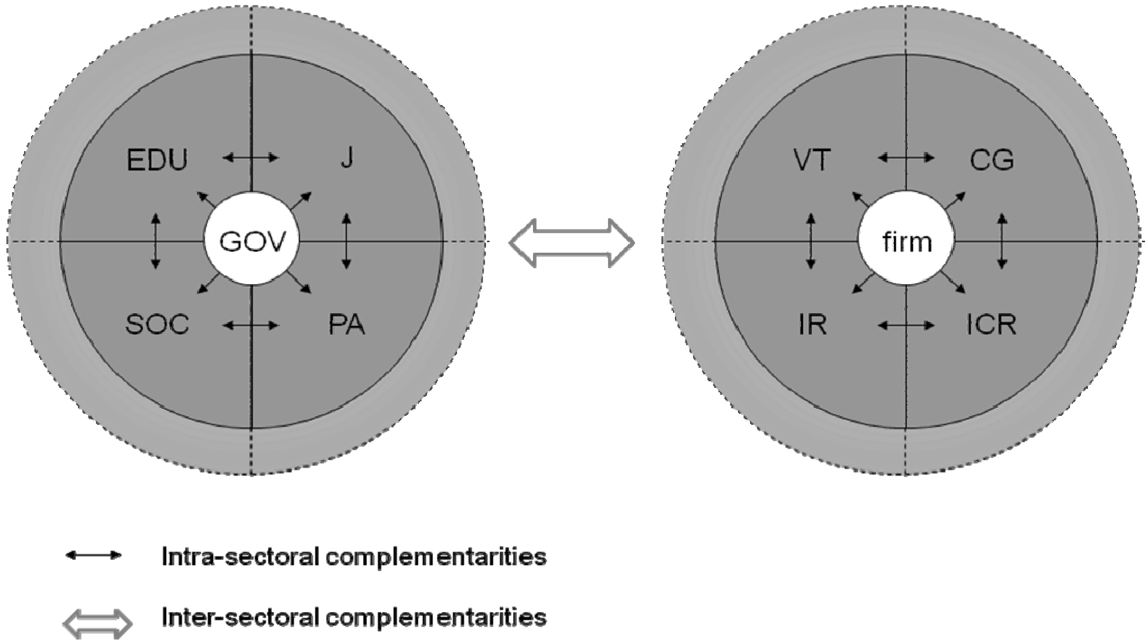
2.2 Towards an extension of the VoC approach

Institutional complementarities

Hall/Soskice's VoC approach has been criticized of neglecting the state as an important actor of the economy(Hanson/Teague 2007; Hancké/Thatcher/Rhodes 2007, p. 23; Schmidt 2002). In order to give consideration to the state, an extended version of the VoC approach has to include besides firm and firm-related actors also state(polity)-related actors (government, bureaucracy, judiciary, educational actors). Considering both state/political and business actors enables on the one hand to understand politico-economic relations and on the other hand intra-sectoral relations between firm-related actors (e.g. employees, suppliers and clients, competitive firms, etc.) or within the state/polity (e.g. bureaucracy, judiciary, government) or social/educational actors.

In this context, it is helpful to distinguish between relations at different levels of analysis, namely between intra-sectoral relations and inter-sectoral ones. Intra-sectoral relations are institutional or agency relationships between different economic sub-sectors (e. g. corporate governance, education and training, inter-company relations) or subsectors of the polity (e.g. judiciary, public administration, education, social/health sector) (see graph 1, p. 8). Inter-sectoral relations are reflected in government-business (polity-economy) relations. Such an extended view allows considering not only complementary effects between sub-sectors but between sectors as well. Why is it important to consider both levels of analysis? In general, because agency matters for institutional relations and institutional change. In particular, because both the firm (and firm-related actors) and the government (and government-related actors) are equally important actors of institutional change. The polity is important because it enforces the economic institutions of the economic/business sector. The economy is important because it impacts on state capacity and thus influences enforcement of economic institutions. One cannot without the other.

Because economic intra-sectoral complementarities were discussed in detail by Hall/Soskice I will shortly describe possible intra-sectoral complementarities of the polity. Similarly, as for the economic sub-sectors, political institutions (sub-sectors) can enhance each other. For instance, a management-oriented educational system guarantees that the judiciary and the bureaucracy are supplied with efficiency-oriented and management-skilled civil servants, magistrates and lawyers. A well functioning health and social system assures the state servants a stable provision of health services and pensions. Well-educated and socially protected bureaucrats and lawyers do not have to spend their salary on bribing teachers or doctors (or relying on bribes from the economic sector) and can redirect their activities to improve the impartial enforcement of social/health or economic institutions.



Graph 1: Intra and inter-sectoral complementarities of the political economy
Note: Intra-sectoral complementarities of the political sector exist between the sub-sectors of education (EDU), judiciary (J), social/health sector and the public administration (PA); intra-sectoral complementarities of the economic sector exist between the sub-sectors vocational training (VT), corporate governance (CG), industrial relations (IR) and inter-company relations (ICR). Inter-sectoral complementarities exist between the political and the economic sector (government-business relations).

Besides, coherent inter-sectoral relations (institutions, actions) can enhance each other and generate inter-sectoral complementarities between socio-political sub-sectors (judiciary and administration, social/health, education) and economic sub-sectors (training system, labor market, product market, financial system). On the one hand, a well functioning bureaucracy and judiciary can guarantee the enforcement of legislation (e.g. property rights, labor law, financial regulations), to guarantee quality standards, to reduce red tape for entrepreneurs and in general to provide the legal framework for enhanced economic. On the other hand, a flourishing economic sector can increase the financial situation of bureaucratic and judicial state agencies and thus enhances its enforcement capacity (government effectiveness). It also contributes (together with the increased state capacity of the administration and the judiciary) to the improvement of the social system (welfare, health, education), which then has a feedback on the functioning of the economic system.

It is also important to see, that both kinds of institutional interrelationships (intra-complementarities, inter-complementarities) can be based on dissimilar endowments of power and resources of actors. Especially, in developing or transition countries there is an imbalance of power between the political and the socio-economic sector. In these countries economic intra-sectoral complementarities which are related to function and efficiency are often less important than inter-sectoral complementarities (which are related to enforcement and political power). In less developed countries, a strong economic or social sector is absent and constraining political institutions are seldom in place. Political power is the principal means to economic enrichment and not the strive for economic power (efficient and productive methods). Consequently inter-sectoral complementarities should have more impact on institutional change than economic intra-sectoral complementarities in transition and developing countries. Due to the hierarchical superiority of the former, powerful political actors can even spill-over their dominant ideology (mode of organization) to the economic sector.

However, in the absence of a balanced complementary system, dominant political actors can become rent-seekers and profit from their unconstrained power in periods of instability and transition. Because the different types of complementarities (intra or inter-sectoral complementarities) can be based on different ideologies (e.g. communism vs. capitalism) or logics of organization (e.g. economic competition vs. absent political competition) the produced mismatch should lead to an overall incoherent hybrid system. In sum, to better account for institutional relationships, we have to consider both intra and inter-sectoral relationships and possible leverage differences between them (i.e. a hierarchy of complementarities).

Institutional stability and change
The VoC approach explains stability by emphasizing interdependencies (institutional complementarities), the interests of important actors (power balance) or the inertia of informal institutions. The implication of intra-sectoral complementarities for institutional stability is straightforward. The more interdependent the complementarities are the more stable are they. Institutions persist because the benefits of keeping the complementary sub-sectors together are higher than the costs of disrupting it. The disruption of a complementary sector is always a trade-off as those who benefit from the established mode of organization could be the losers of the new one. This functional argument is the key message of Hall/Soskice's approach. They explain persisting differences of political economies by drawing on intra-sectoral complementarities. Such an explanation is however not fully satisfactory as it neglects inter-sectoral complementarities between the political, the economic and the social systems.

Imagine that one of the systems is underdeveloped or was not transformed to modern standards, like in the case of post-communist countries. In many transition countries legal/ administrative reforms as well as reforms related to the welfare and health system were neglected during transition. Today we see that the welfare and health sector are among the most corrupt and least developed (see Transparency international or EBRD indicators). The delay of reforms in the social sector, the judiciary and bureaucracy mean that these countries which reformed the economic system have nowadays still mixed or hybrid systems which do not allow for the exploitation of inter-sectoral complementarities. The consideration of complementarities on different level of analysis has important implications for institutional stability and change. While the new created intra-sectoral complementarities are efficiency increasing for some new actors in the system (e.g. private firms) former inter-sectoral relations can persist and reduce overall systemic coherence. Such changes of relations within one sector and continuity of former relations between sectors happen often at the same time and are not easy to detect as they occur at different levels of formality. But how do we account for change within continuity? One solution to better understand such parallel processes can lie in a conceptual distinction between formal and informal practices. Another way would be to distinguish between actors-institutions relations and continuity and change at different levels of analysis

To better understand these diverse interrelations we have to disaggregate the dependent variable institutional change and analyze it at different levels of analysis. Institutional change takes place at four levels of analysis: the micro- level (intra-firm), the meso-level (intra-sectoral), the macro- level (inter-sectoral) and the international level (supranational). At each level of analysis institutions, institutional relationships and actors can be distinguished in terms of space (intra and inter-sectoral; national; international) and formality (formal, informal).[8] What distinguishes every level of analysis is the nature of institutions and actors (firm,

[8] The experience of post-communist transition countries but also that from Asia and Latin America underlines the importance of informal institutions, practices and networks which coexist next to formal legal structures. See for instance the parallel and informal structures described by Ahrens/Junneman 2007; Borocz 2000; Colignon

intra and inter-sectoral, national, supra-national) (see table 1). At every level of analysis different mechanisms (logics of organization) come into play which affect the relationship between actors and institutions. These mechanisms or logics can be for instance hierarchy (at the micro level), institutional complementarity (at the meso level), enforcement (at the macro level) or conditionality (at the supra-national level). On each of these levels of analysis a certain theoretical approach (often connected to a distinct governance mode) has advanced our understanding of institutions-actors interdependencies and institutional and economic change. Despite these separate theoretical advancements, the remaining challenge is to integrate the various levels of analysis into one coherent framework of institutional change.[9]

Table 1:Institutional change as a process of interrelationships at different levels of analysis

	Institutions	Actors	Governance concept	Theoretical approach
Micro level	Intra-firm/organizational (e.g. corporate law)	Intra-firm, intra-organizational	Corporate governance	Organizational theory
Meso level	Intra-sectoral (e.g. economic legislation, property rights)	Intra-sectoral, firm-related	Sectoral governance (economic, political, public)	VoC approach
Macro level	Inter-sectoral (e.g. national legislation)	Inter-sectoral (political, economic, social and others)	Intersectoral governance	NIEH
Supranational level	International (international conventions, supra-national legislation)	International (foreign states, EU, UN, NATO, IMF, World Bank)	Global governance, European governance	International Relations Theory, Europeanization

Leaving such a comprehensive integration between all levels aside, I focus on the link between the meso and macro level of analysis. The VoC approach acknowledge both external and internal sources of institutional change. As for external sources both approaches consider changes in the international environment (e.g. liberalization, external shocks, revolutions). As internal sources gradual changes in tastes or relative prices, power structures, informal institutions, or complementary economic relations are considered.

Nevertheless, the VoC approach argues that external sources of change play a minor role for meaningful institutional change and that existing institutions will move back to their former equilibrium after a period of adjustment. The Voc approach has the strong inclination to see institutional change as an incremental, unintended endogenous process of inertial internal factors. As shown above, an extended approach to institutional change has to be understood as a process which involves institutions, actors and relations both at the intra-sectoral level (meso) and at the inter-sectoral level (macro). This means that internally-driven institutional change can be either driven from above (reform by the polity) or from below (reinterpretation, defection, internal relative price changes) or by changes in tastes (from above or from below). Indeed, these internal drivers of change may account in most cases for the more or less gradual character of institutional change at the meso and macro level. They cannot however explain why externally-driven sources of change (revolutions, external relative prices changes, liberalization) have from time to time the capacity to induce fundamental and systemic

/Usui 2003; Easter 2000; Grzymala-Busse /Jones-Luong 2002; Collins 2002; Ledeneva 1998; Yang 1994. Such structures suggest certain non-official, informal complementarities between institutions or actors.

[9] Such a comprehensive integration should take into account shifting sources of institutional change (modes of organization) at different level of analysis: 1. Institutions-actors level, 2. Different levels of formal analysis (micro, meso, macro, supra-national) 3. Formality-informality level. Only with such a comprehensive approach hierarchical shifting links between the relevant relationships at different levels of analysis can be taken into account and significant change can be distinguished from shallow change.

change. Probably, a better integration of institutions and actors from the supra-national level would solve this puzzle.

Economic performance (institutional efficiency)

Finally, let me address the ambiguous implications of institutional complementarities for institutional and economic performance by distinguishing between positive and negative complementarities. Looking from an optimistic perspective, institutional complementarity is a self-enhancing mechanism of institutional and economic efficiency. Improving coherence of an already stable and successful system will make the system even more complementary. However, looking from a pessimistic perspective, the same mechanism can work in the opposite direction as well. More coherence of a system which values unproductive action will make the system more negative complementary.

This suggests the existence of inefficient or <u>negative institutional "complementarities"</u> (see Schneider/Karcher 2007). Negative complementarities increase efficiency for a particular group of actors and thus work in the opposite direction of (positive) complementarities which increase overall efficiency. Such inefficient and particularistic relationships are reflected in long-lasting vicious circles of institutional deterioration common in former Soviet-countries, South Eastern Europe or Latin America. Examples for negative complementarities would be state capture, systemic corruption, particularism or the absence of impartial rules (on these phenomena see for instance O'Donnell 1996; Mungiu-Pippdi 2006; Piattoni 2001). Negative complementarities evolve often at a more informal and less accessible level which makes them difficult to detect, to measure or to combat. But the experience of many Eastern European and Latin American countries suggests that such informal, parallel complementarities (e.g. informal power networks and practices from the communist system) can be equally important for the analysis of institutional change and performance. Institutional complementarity may be indeed the mechanism which increases efficiency. But this mechanism does not say anything about the direction and duration of efficiency and performance. Thus, institutional complementarity can explain socially efficient institutions as well as sub-optimal ones.

Institutional complementarity seems to drive performance in countries with a stable political and economic system. For instance, both consolidated democracies and authoritarian regimes can benefit from strongly enforced and coherent institutions which provide for a certain level of stability (i.e. absence of civil war), institutional quality (e.g. few corruption) or economic growth for decades.[10] Thus, both voluntary complementarity and non-voluntary complementarity (complementarity by force) can bring about economic growth. The question is only how sustainable and socially efficient are both systems in the long-term.

If we assume that complementary economic institutions are the key for the economic performance in the long-run then the central question is how to establish (positive) complementary institutions. The answer might not be simple as the transition from an authoritarian system to a consolidated democracy is related to feedback effects from economic performance and the distribution of power itself which in turn may depend on additional conditions.[11] Ex-

[10] Empirical evidence suggests a curvilinear relationship between democracy and corruption (Montinola/ Jackman 2002; Sung 2004) and between democracy and civil war (Hegre et al. 2001). Also, the relationship between democratic institutions and economic growth is ambiguous (Kurzman/Werum/Burkhart 2002; Przeworski/Limongi 1993; Przeworski et al 2000; Sirowy/Inkeles 1990).

[11] Inefficient institutional complementarities (absence of economic performance) are the effect of missing (or weakly enforced) impartial political institutions. But impartial political institutions are the effect of missing alternative economic feedbacks for those in power (e.g. increased tax revenue) and asymmetric power relations (see North/Weingast 1989, p. 817). This situation of circularity makes Adam Przeworski conclude that institutions are "*endogenous with regard to conditions*" (Przeworski 2004, p. 532).

amples from Latin America and Eastern Europe show that the introduction of one and same set of institutions can still lead to differences in economic performance. Sometimes, it even seems economically better to maintain former economic complementarities (as in the case of least reformed but economically performing Belarus) or political complementarities (as in the case of China).

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

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

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

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

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

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

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

3.2 The limits of institutional complementarities in the transition context

Why should institutional complementarities be so important for the functioning of institutional systems? Hall/Soskice's earlier mentioned emphasis of institutional complementarities is reflected in Gerard Roland's article. According to Roland, institutional systems are not "modular constructions" which are interchangeable. Institutions rather complement each other and "replacing one institution by another can in some cases dangerously disrupt this systemic consistency" (Roland 2004, p. 113).

Of course, disruptions of institutional coherence are not desirable if the system is performing well economically. However, if a country loses its institutional comparative advantage -for instance, due to changing environmental circumstances- institutional reforms are greatly required. Then complementary institutions become a burden because they are more resistant to change than non-complementary ones (Greif 1998, p. 82; Jackson/Deeg 2006, p. 37). Disrupting coherent but socially inefficient institutions is especially required when system complementarity is sustained by "brute force" (Mayntz 2007, p. 20) and provides sole benefits to a small predatory group (e.g. for the nomenklatura during the communism).

The 1990s fundamental institutional reforms, known as post-communist transition, were a rapid disruption of an inefficient but coherent communist system.[12] But did institutional complementarities play a role during this period of system transformation? I will try to answer this question by analyzing the extent of conscious *ex ante* design versus spontaneous, *ex-post* emergence of complementary institutions during transition. These two possibilities of conducting institutional reforms are grounded in two views about institutional change: institutions by design vs. institutions by bricolage.

According to the *"institutions by design"* view, which is reflected in rationalist theories, such as property rights theory or rational choice theory (see Williamson 1985; Demsetz 1967; Shepsle 1989; Calvert 1995), rational individuals construct and change institutions on the basis of cost-benefit calculations. This approach presupposes the existence of non-selfish designers[13] who are powerful enough to create efficient institutions. Transition scholars who follow the design approach believe that institutions and legacies from the past can be overcome by the adequate institutional and policy choices (Johnson 2003, p. 290). They assume that after getting rid of formal communist institutions (tabula rasa approach) and designing the new system on Western models a successful transition could be achieved. Therefore, they favor radical reforms, in form of "big bang" institutional change (Sachs 1993; Aslund 1991; Boycko 1992; Przeworski 1991; Lipton and Sachs 1990). These authors believe that "big bang reforms" (i. e. simultaneous liberalization, privatization and restructuring) are more effective than piecemeal gradual reforms as they benefit from complementarities between different policies and institutions. Partial reforms, instead, would eliminate the positive effects of complementarities (Murphy et al. 1992; Gates et al. 1993) and lead to rent-seeking and corruption (Havrylyshyn 2007, p. 3). The prevailing credo of the design view in the transition context is the introduction of market economy in one stroke.

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

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

According to the *"institutions by bricolage/(trial-error)"* view, which reflects the ideas of Austrian Scholars such as Menger or Hayek, social order is not as the outcome of conscious design, but of spontaneous and unintended human action (see Ahrens 2002, p.60; Poznanski 1996). According to this view, historical legacies can constrain rational institutional design and produce unintended outcomes (Goodin 1996, p. 28). Institutional change and institutional complementarity are endogenous, i.e. driven by internal dynamics. They are the results of experimentation, bricolage and learning under a constantly changing environment (Stark/Bruszt 1998; Mukand/Rodrik 2005, p. 375). Transition scholars, who adhere to the "bricolage view", stress the evolutionary and path-dependent nature of institutional change and support gradualist reforms (Portes 1990; McKinnon 1990; Murrell 1995; Poznanski 1996; Roland 2000). Gradualist reformers argue that in the presence of aggregate uncertainty gradual reforms are politically more acceptable because they have lower reversal costs, i.e. lower costs of trial and error (Dewatripoint/Roland 1995, p. 1209; Roland 2000). Therefore, this view stresses a sequenced design of reforms, i.e. to start with reforms which are socially less costly and provide constituencies for more difficult reforms. An example for sequenced reforms is to do privatization before painful restructuring (Zecchini 1997, p. 174-175).

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

However, supporters of radical reforms forgot that the degree of communist implementation differed among communist countries. Some states (Hungary, Poland, Yugoslavia) had already undertaken market-oriented reforms during the last decades of communism and had therefore better economic and institutional starting conditions (EBRD Transition Report 1999, p. 29) than states with more rigorously implemented communism (e.g. the Soviet Union, Romania, Bulgaria, Albania). Rather than designing institutions from scratch, CEECs had to redesign them, i.e. to recombine old institutions with new ones (Stark/Bruszt 1998). In some cases, new institutions substituted for old ones, in other cases, new institutions only supplemented old ones (Grzymala-Busse/Jones Luong 2002, p. 542). What is important to see is that institutional reforms were not done on a *tabula rasa*, and no matter which transition strategy was used (big-bang or gradualism), historical formal and informal legacies influenced the functioning of new institutions.[14]

One has to bear in mind that the good intention to design a complementary institutional system is always subject to hindering factors. Although in all post-communist countries institutional sub-systems were (re)designed, the relevant question is how strongly radical or gradual designers insisted on institutional complementarities (efficiency aspects) during post-communist transition and whether complementarities can explain post-communist institutional variety and performance. I will argue that the design of *ex ante* complementary institu-

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

tions was difficult due to three limitations: Changing environment, lack of resources/capacity for law enforcement and changing power relations of diverse actors.

Changing environment (uncertainty): Transition reformers faced a changing external environment and an uncertain future. These uncertain and changing conditions guarantee neither that the goal to build complementary institutions can be maintained, nor that initially complementary institutions will remain complementary in the future. As post-communist countries experienced a great deal of geopolitical and economic uncertainty, institutional adjustments and experimentation were strongly required during the transition period (McFaul 1999, p. 28). Initial variation in uncertainty among transition countries can be explained by different exit modes from communism. Whereas CEECs (e.g. in Hungary, Czech Republic, Poland) created competitive democracies in roundtable negotiations "in Bulgaria and Romania, for example, the collapse of incumbent regimes caused greater uncertainty than in than in the negotiated transitions of Central Europe…" (World Bank 2002, p. 108).

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

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

Post-communist transition involved both socio-economic and political reforms, which left relatively few time to conduct an analysis of the most efficient combination of institutions. As transition countries had to conduct reforms in different areas simultaneously (Elster/ Offe/Preuss 1998), they often did not have the time resources for long-term master plans of complementary institutional systems.[15] The simultaneity of reforms compelled actors to prioritize and to neglect some areas of reforms (McFaul 1999, p. 31). Whereas developed countries had built up democracy and market economy over a period of several decades, post-communist countries had to do so in only a few years (Grzymala-Busse/Jones Luong 2002, p. 535). Similarly, EU candidate countries were under time pressure and the adoption of EU legislation (*acquis communautaire*) was often carried out as a rapid legislation passing in the parliament without a correct implementation.[16] According to Sadurski "…the sheer volume of the *acquis* meant that parliaments had to adopt fast-track procedures for passing the related laws…" (Sadurski 2006, p. 34). Such hastened institutional reforms could not have produced complementary institutions.

Similarly, resource constraints (resulting from the past, from financial crises or wars) hindered the enforcement of institutions and did not give way for a complementary design of institutions. The leaders of economically instable countries had to postpone reforms, relied either on transitional institutions or even alternative solutions by half-legal private actors. Initially, informal and unofficial practices (black market) were a popular mean to resolve coordination problems in almost all transition states. However, there were strong regional differences in terms of informal practices. According to the estimations of Johnson et al., the average share of unofficial economy in CEE was at its peak with 21,3% in the year 1992 much lower than in former Soviet countries, which had its highest value with 36,2% in the year 1996 (See Johnson et al. p. 182-183).[17]

With progressive institutional reforms, some transition countries (e.g. Poland, Hungary, Slovenia, the Baltic States) overcame these initial problems of the shadow economy and were able to provide a stable business environment and to attract FDI. Why? Higher state capacity seems to be an important key to success. Better state capacity in CEE can be attributed to structural differences of the past[18] and to the absence of wars and financial crisis (World Bank 2002, p. 13 and p. 110). In contrast, reform laggard countries from SEE or CIS neither had the "beneficial legacies" nor the resources to train lawyers, bureaucrats and teachers to change quickly to capitalist mentality and to guarantee the enforcement of capitalist institutions. While transplanted formal institutions were often the same, enforcement and implementation were not. Otherwise, best practices (first-best institutions) would have had the same effect everywhere. The Worldwide Governance indicators from the World Bank provide some evidence that enforcement and legal quality differed. Rule of law[19] has been on average lower in CIS (Commonwealth of Independent States) and SEE than in CEB (Central Eastern Europe and the Baltic States) between 1996 and 2006. Whereas average scores on legal quality have been constantly high in CEC (around 70%), SEE had a considerably lower and fluctuating

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

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

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

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

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

development (score between 33% and 43%) and the CIS even a deterioration from about 24% to 19% (see table 2).

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

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

This general evidence on different quality of the institutional environment is reflected in more specific economic institutions. The EBRD's legal indicator survey[20] from the year 2005 provides some evidence that enforcement (legal effectiveness) of corporate governance laws differed among transition countries and that "even excellent laws can suffer from poor implementation" (see EBRD Report 2005, Annex 1.2.: Corporate governance, p. 30). EBRD survey data reveals on average a weaker legal effectiveness of corporate governance[21] in CIS and SEE than in Central Europe and the Baltic States (see table 3). Although some countries in SEE (e.g. Macedonia) and in the CIS (e.g. Armenia, Kazakhstan, Moldova) have high compliance with international standards and score high on legal extensiveness (quality of "laws on the books"), they only score poorly on legal effectiveness, i.e. the laws do not work well in practice. In contrast, the corporate governance legislation in most Central European and Baltic States is in most cases reasonable well implemented.

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

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

This implementation gap in SEE and former Soviet countries in contrast to CEECs recurs in other areas of legislation. The difference for these three groups of countries among extensiveness and effectiveness (implementation gap) is especially obvious in the area of commercial laws (see figures 2 and 3 in appendix), insolvency regulation (see figure 4 in appendix), con-

[20] The quality of legislation ("laws on the books") is based on the EBRD's annually conducted survey of legal experts from 27 transition countries. See legal annex of various EBRD Transition reports.
[21] By analyzing the effectiveness of corporate governance laws, the 2005 EBRD survey tries to reveal how well minority shareholders are protected in each transition country. Legal effectiveness is assessed in terms of information disclosure for minority shareholders and effective mechanisms to obtain redress (legal actions).

cession laws[22], securities markets legislation (see EBRD's legal indicator survey 2007) and labor market institutions.[23] Using survey data from three different sources,[24] Pistor et al. 2000 confirm a weak institutional environment and weak implementation of economic institutions in most countries from SEE and the CIS (see Pistor et al. 2000).

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

<u>Power relations (diversity of actors)</u>: Scholars stress the increasing importance of actors over institutions during transition and emphasize the role of the state for institutional reforms (Hanson/Teague 2007; Charman 2007; Schmidt 2008; Higley/Pakulski/Wesołowski 1998).[25] However, it has to be considered that institutions and institutional complementarities are not only created at the regime level alone, but are the outcome of many actors with diverse interests and power positions (Streeck 2004, p. 111). Institutions are often the result of a political compromise and not an optimal solution to a given problem or, as Amable puts in: "…institutions do not emerge as the result of a welfare-maximizing process. They are the outcomes of a political process" (Amable 2003, p. 63). Both Streeck and Amable remind us that the pursuit of political and economic power can limit rational design of complementary institutions. This is particularly true if there is no benevolent "dominant social block" (Callaghan 2008, p. 9) and when institutional reformers have opposing ideological backgrounds. But even when ideologically diverse reformers find a compromise, this compromise will not necessarily lead to the first best solution (complementary institutions).

The emerging post-communist state was not a unitary actor with uniform authority, but underwent a formation process which was characterized by "multiple actors, domestic as well as international" (Grzymala-Busse/Jones Luong 2002, p. 533). Let me first focus on domestic actors[26] and explain why so few complementary systems emerged during transition. A main reason can be found in opposing ideologies and changing power relations of these actors. After the demise of communism, old power structures changed and a battle for political and eco-

[22] See EBRD Concession assessment project report on the quality of concession legislation in early transition countries. http://www.ebrd.org/country/sector/law/etc/etccon.pdf.
[23] On the different degrees of enforcement regarding employment protection legislation in the CIS, SEE, and CEE, see Rutkowski/Scarpetta 2005, p. 37.
[24] Sources: Experts' assessment from the Central European Economic Review; EBRD legal indicator surveys; World Business Environment and Enterprise Performance (BEEPS) survey (see Pistor et al. 2000, p.341-342).
[25] This is particularly true in a rapidly changing environment, when new introduced rules are only forms without meaning. Then it is more plausible that the direction of influence goes mainly from actors to institutions.
[26] Internal actors are political parties with opposing ideologies (e.g. former communists, non-communists), oligarchs, business groups, trade unions and cultural or military elites.

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

Changing power relations and the redesign of institutional reforms were often the result of changing economic conditions, which differed among transition countries. In former Soviet Republics and SEE, prolonged economic decline and deteriorated living conditions made co-operation between domestic actors more difficult. Intense struggle among different domestic actors or ethnic groups, which produced also violence (e.g. in Yugoslavia), did not leave room for stability and a complementary institutional system. In war-torn countries (e.g. Azerbaijan, Georgia) and countries with high concentration of political power (e.g. Moldova, Russia, Ukraine, Kyrgyz Republic), domestic powerful groups actively influenced institutional reforms (see World Bank 2002, p. 106). Influence of such actors is nothing bad, as long as the state remains powerful enough and will not be captured by powerful internal business groups or oligarchs, who seek to extract rents from the state. The composite index of state capture[27] provides snapshot evidence that in the year 1999 the influence of firms on institutional and policy reforms was on average more pronounced in SEE and the CIS as compared to CEB (see table 4).

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

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

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

While dealing with institutional change and institutional complementarity during transition, external actors should be taken into account. Post-communist institutional building has been subject to pressure from Western consultants, international organizations (IMF, World Bank, USAID), multinational corporations and foreign banks. The EU was particularly important for institutional reforms.[28] Although international actors produced initially institutional and policy similarities (best practices), at the same time multiple conditionalities and interests hindered coherent institutional strategies, as well. Bartlett shows, for instance, that former Yugoslavian states became dependent on financial aid from external actors (IMF, EU, World Bank) who were able to impose their own diverse interests and thus hindered the creation of a complementary institutional system (Bartlett 2007). However, because of different geopolitical locations and economic resource bases, external pressure to adopt the same institutions was far from universal among post-communist states (Grzymala-Busse/Jones Luong 2002, p. 547).

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

The last puzzle which remains to be solved is why Slovenia and Estonia have created a coherent institutional system, while Hungary, Poland or the Czech Republic which had similar state capacities, beneficial historical legacies and the EU membership perspective did not. According to Feldmann, the mechanism behind coherent institutions in Slovenia and Estonia are economic networks between key economic actors (Feldmann 2007, p. 337). He argues that the combined effect of communist legacy (degree of centralization under communism) and policy choices during transition (privatization strategy, monetary policy, centralization of wage bargaining) encouraged network-promotion in Slovenia and network-disruption in Estonia and created two diverse but coherent systems. Although this may be an explanation for these two countries, Feldmann cautions: "The conditions necessary to promote or disrupt networks may be in fact quite stringent, and Estonia and Slovenia may be quite exceptional in terms of their combination of legacies and political preconditions for their reform paths" (Feldmann 2007, p. 348). Broader comparative analysis is required to clarify this remaining puzzle.

If we recapitulate the arguments on the design vs. spontaneous emergence of institutions, it is most reasonable to seek a reconciliation of both approaches. Particularly, if we conceive institutional change occurring simultaneously as a short-term change (e.g. agency design, external

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

shocks) and long-term change (e.g. structural change, enforcement, informal institutions) it makes sense to see both views as complementary rather than contradictory. Institutional change is an interplay between agency and structure. It is an interaction between the old structure (historical legacy), the current agency actions (policy and institutional choices) and future possibilities (e.g. EU membership or new opportunities due to scarcity of resources). In such an interdependent process, where in the short-run the causal direction can run from economic performance to institutions, institutional complementarities can be no more than one consideration among others to explain institutional divergence. I have mentioned some limitations of the complementarity concept to explain short-term institutional diversity in post-communist countries: a changing external environment and uncertainty, diversity of actors and power relations, weak enforcement of institutions due to lacking capacity. If such limitations are absent thanks to beneficial legacies, or become absent, for instance after economic and geopolitical stabilization, the design of complementary institutions could be easier. Generally, the argument of complementarity is more convincing in the evolutionary, long run emergence of institutions. Nevertheless, particular institutional or policy reform areas (e.g. policy complementarities[29] between macroeconomic stabilization and price liberalization), where fewer actors or resources (lower state capacity) for enforcement are required, may make complementarity relevant in the short-run. The transformation of an entire economic system, however, needs time and experimentation.

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

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

In my opinion, sustained mixed logics of coordination (second-best solution) are possible due to positive feedbacks resulting from increased enforcement, i.e. more effectiveness. Let me illustrate a more dynamic model of capitalist diversity (see figure 1) to explain the fundamental differences between developed economies (CMEs, LMEs) and transitional market economies (TMEs). In contrast to transition economies, developed economies have relatively strongly enforced and effective institutions. Developed economies have already reached a certain level of stable and settled market economy and possess a more mature form of capitalism than post-communist economies, which are still building up their economic and institutional systems. Nevertheless, enforcement and maturity of capitalism differs even among post-communist countries. On the one hand, very advanced frontrunners (Estonia, Slovenia) have already established clear and settled institutional structures and are classified in the Hall/Soskice framework as either LME's or CME's. On the other hand, laggards from South-

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

Eastern Europe, Central Asia and the Caucasus do not fit in this framework as they are still constructing and improving their institutional system and are considered transition economies.

While in developed economies the possibility to increase economic performance by increasing the quality/enforcement of institutions (effectiveness) is nearly exhausted, performance can still be improved by making institutions complementary (efficiency). Given that complementarity depends on external environment changes, developed countries can improve efficiency by adapting to external pressures by switching their logic of coordination (horizontal shifts between CMEs and LMEs).[30] These horizontal shifts tend to be slow, because of institutional complementarities, because of opposing powerful groups, because of path dependence and because certain reforms (e.g. better protection of minority shareholders, adopting international accounting standards) often do not have a major impact on other sub-systems or corporate strategies. Therefore, despite "liberalizing" reforms, switching of coordination modes should remain difficult in developed economies (Hall/Thelen 2005, p. 26 and p. 31).

While gradual institutional and economic development may be true for developed market economies, transition economies experience rapid formal institutional change. Due to the unfinished stage of capitalism (lower economic development) and high uncertainty (transition as an open-ended process), institutions in post-communist economies have initially a transitory character, i.e. they are only weakly enforced. Because of weak enforcement, formal institutional change is easier and at least in the short or middle-run there are more alternatives (the so-called third ways) for capitalist trajectories than in developed economies.[31]

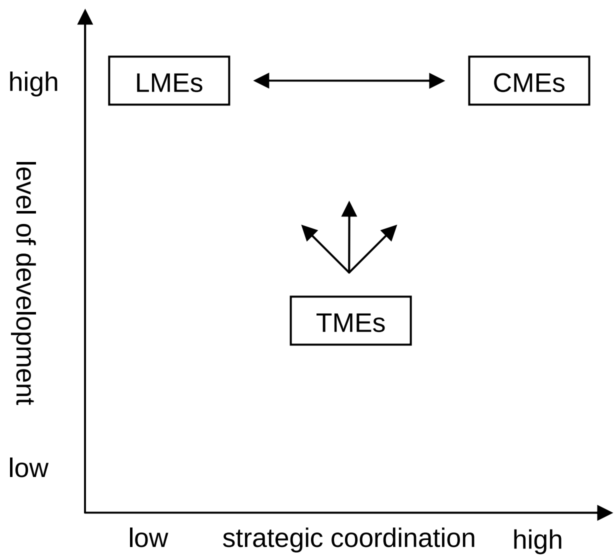


Figure 1: Modes of coordination under consideration of different development stages of capitalism
Source: Own elaboration

At a lower stage of development, TMEs can move vertically and diagonally. The paths of institutional and economic development are not fixed yet and can develop towards LME, CME or a mixed form of both. In the absence of positive feedbacks, development towards a

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

stronger role of the state and even less capitalism is possible (e.g. downward diagonal shift in Venezuela and Belarus). Such upward and downward diagonal and vertical shifts are reflected in capitalist reforms or reform reversals and are possible because political and economic institutions are enforced only weakly.[32]

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

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

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

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

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

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

The complementarity of institutions depends on changing environmental circumstances. This means that coherent institutions will be beneficial in the "good times" (i.e. when fundamental reforms are not required), but detrimental in the "bad times", when change is most needed. A good example for changing effects of the same institutional configuration comes from Japan and Germany. The Japanese and German institutional systems, which were praised as highly complementary and efficient in the second half of the 20th century, are regarded some decades later as hard to reform and inefficient. The explanation according to Streeck is that, with the technological change in form of micro-electronic revolution, the formerly complementary institutional systems, although remained coherent, became less complementary (Streeck 2004, p. 112).

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

Adaptive institutional complementarities are reflected in innovation-driven institutional or economic performance. This implies to stress learning, innovation and experimentation which are not always per se beneficial as these processes depend on complementary institutions of powerful actors which benefit from the old system. Thus in the short-run innovative and new ideas, ideologies or institutions can provide lower benefits than from established complementary ones. Changing the system pay-offs needs a long-lasting critical mass which enables higher benefits from the new system (Deeg 2005; Schmidt/Spindler 2002; Milgrom/Roberts 1995). However, reaching such a critical mass is often a costly and burdensome trade-off. The creation of adaptive institutional complementarities reflect the ability of political economies to destruct certain coherent but inefficient institutional interrelations and to recreate innovative complementary ones. Such innovation-driven increases of institutional efficiency and economic performance occur normally at the margins and only seldom lead to a creation of new complementarities (e.g. systemic transformation due to external shock). Adaptive institutional complementarities mean institutional innovation (trial-and-error process of learning through debate, experimentation, competition and contestation) at the periphery and institutional stability at the core of an impartial institutional framework. Adaptive institutional complementarities enable for a certain flexibility to transform unproductive and costly but coherent institutions into more complementary ones.

4. Conclusion

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

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

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

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

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

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

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Appendix

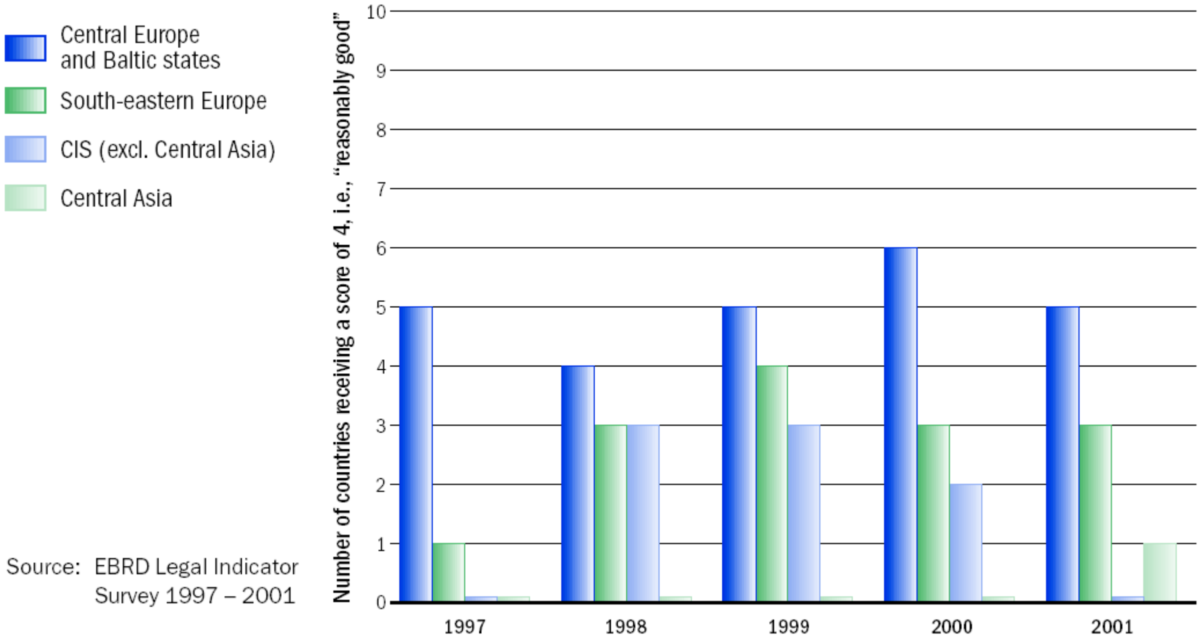

Figure 2: Perception of commercial law extensiveness over time
Source: Ramastry 2002 and EBRD Legal Indicator Survey 1997-2001.

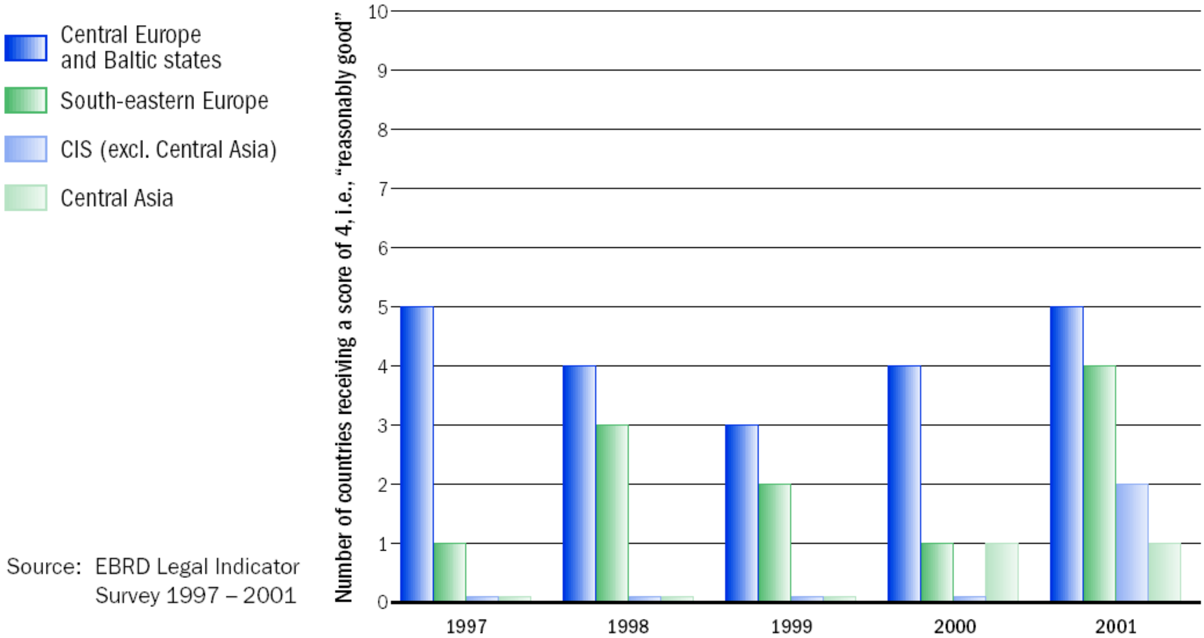

Figure 3: Perception of commercial law effectiveness over time
Source: Ramastry 2002 and EBRD Legal Indicator Survey 1997-2001.

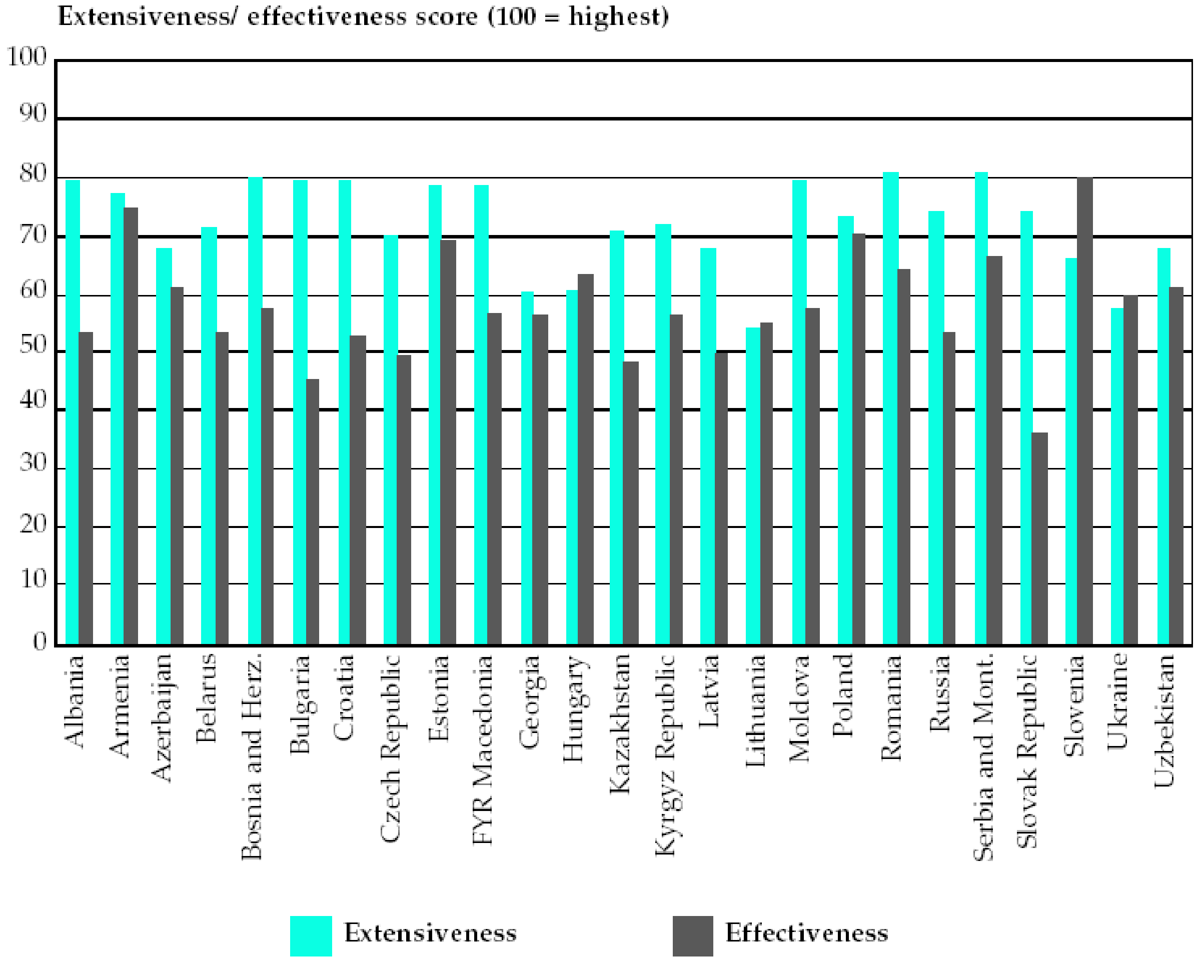

Figure 4: Extensiveness and effectiveness of insolvency legal regimes
Source: EBRD Legal Indicator Survey, 2004.

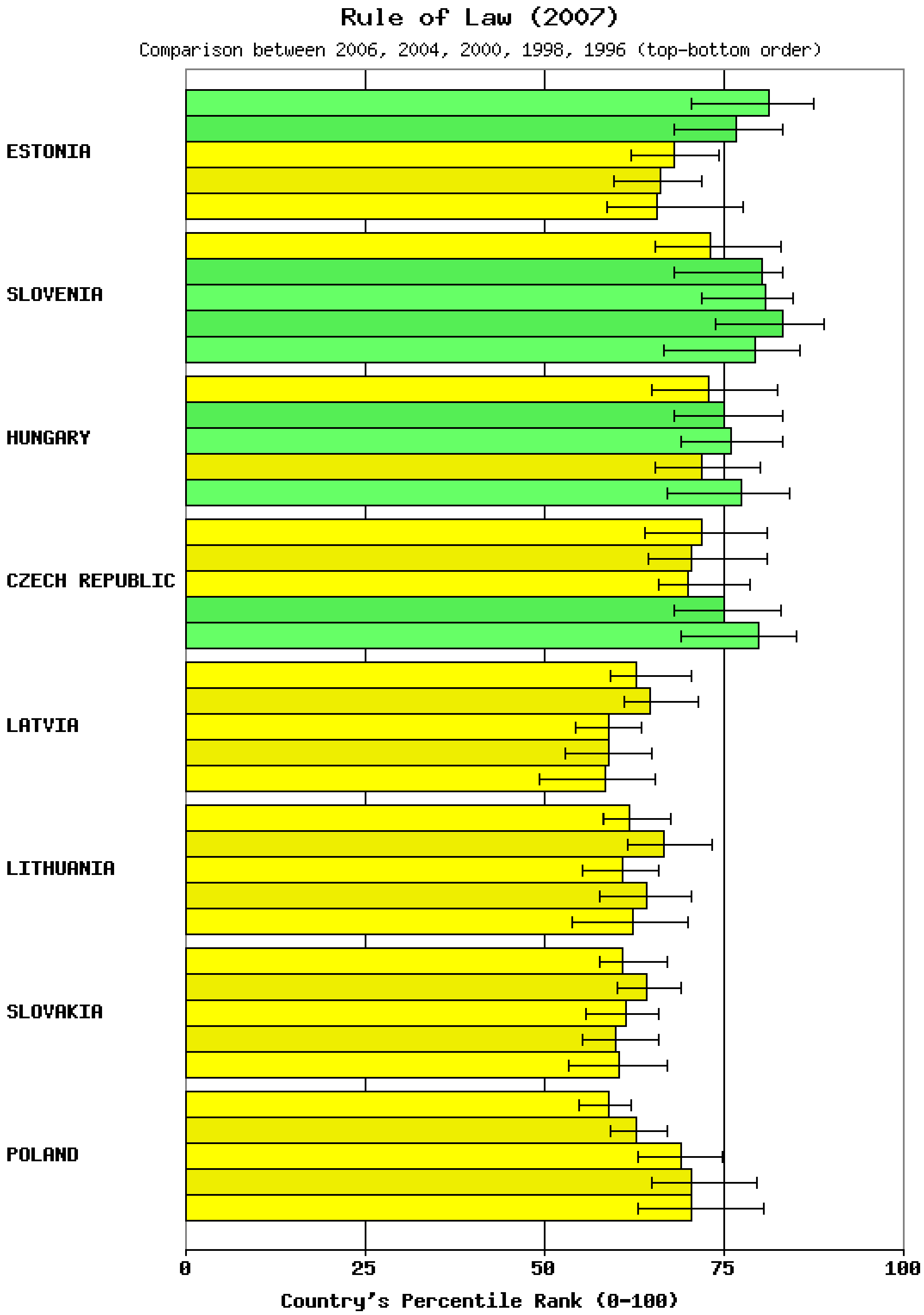

Figure 5: Rule of law in Central and Eastern Europe
Source: Kaufmann/Kraay/Mastruzzi 2008: Governance Matters VII: Governance Indicators for 1996-2007.