

**THE POLITICAL ECONOMY OF POST-COMMUNISM:  
THE DONBAS AND UPPER SILESIA IN TRANSITION (1980S –EARLY 2000S)**

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*To Aisté*

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## Introduction

### RESEARCH AGENDA

By the end of the 1980s, state socialism had lost its appeal as a form of social organisation and as a doctrine of accelerated development in most of the countries, previously dominated by Marxist-Leninist ideology. The majority of the former state socialist societies soon entered a new – post-communist – historical period. Under post-communism, the countries of Central and Eastern Europe, and the former Soviet republics were to undergo a *transformation*: a period of an intended fundamental change in the form, appearance, and nature of their systems of social and economic organisation. The post-communist transformation was to involve the entire triangle of polity, economy, and society, as well as relations with the outside world. Many authors have contended that the early post-communist governing elites as well as their foreign advisors were guided by a vision of a relatively fast transition to a Western type of society characterised by wealth, markets, private property, democracy, and liberal civil society (Pickles and Smith 1998; Lane 2002b).

After the first decade of transformation, when I began to work on the book in October 1999, the post-communist world seemed to be divided more than ever between those countries that had ‘made it’ and those that had failed. The group of ‘transition leaders’, that is, those countries which were said to have accomplished successfully their transition towards democracy and the market, was then headed by Poland. In the 1990s, Poland had been the best performing post-communist country. ‘An East European tiger’ and ‘a soaring eagle’ were amongst the most popular descriptions used by the Western international commentators and mass-media to portray Poland’s post-communist success. Besides Poland’s historically strong anti-Russian and anti-communist sentiments that facilitated the country’s extrication from Soviet-style state socialism, Poland’s success was typically attributed to radical and rapid free market reforms initiated very early in 1990 by the nation’s committed leadership. Far-reaching political and economic liberalisation was believed to be the key factor behind the Polish success story. By striking contrast, Ukraine – Poland’s largest post-communist relative and neighbour – was described as a ‘transition laggard’, a country that had opted for a ‘go-slow’ reform approach which inevitably resulted in ‘one of the deepest recessions experienced by any of the transition economies not affected by war’ (EIU 1998). The most negative consequences of post-communism – rapid growth of corruption, shadow economy, extreme poverty and income inequality – were usually attributed to transition laggards,

Ukraine in particular. Ukraine's perceived transition failure was explained as a result of the nation's vague economic policies, constant changes in the direction of reforms, pervasive government intervention and involvement in the economy, huge business constraints, and the overall hostility to the private sector and the market in general.

According to the transition paradigm of the post-communist transformation, in addition to extensive state ownership of productive assets and all-encompassing government control over important aspects of economic activity, another fundamental challenge the post-communist countries faced was 'over-industrialisation'. Over-industrialisation referred to centrally planned economies' heavy emphasis on industry, the encouragement of the production of capital and military goods, with underdeveloped consumer goods and service sectors. It was said that policy makers in centrally planned economies used their power over prices and resource allocation to favour heavy industries with cheap energy, cheap access to foreign exchange for their imports, and huge money-financed subsidies to cover wages, losses and other costs. The advent of market forces was to result in the closure of subsidised industries and politically-motivated production. Heavily industrialised areas were supposed to be hit hardest.

Born and raised in one of those heavily industrialised areas of Eastern Ukraine, I felt then there was a pressing need to study the Polish experience in supposedly applying the free market economics to treat the 'Soviet over-industrialisation syndrome' and to release the natural comparative advantages of my home region. My original intention had been, therefore, to make a comparative study of two hypothetically depressed old industrial areas in transition, in which one of the regions was successfully transformed and hence could have been used as an example for the other failed post-communist region. Three major studies on the future of old industrial areas in Poland, Ukraine, and Eastern Europe published with the assistance of foreign donors around the time I was contemplating my Ph.D. plans (Wódz 1994; Wódz 1998; Liakh and Pańków 1998), seemed to be fully supporting my initial research design as well as my choice of the Polish Upper Silesia and the Ukrainian Donbas as a comparative case.

In the course of several data-gathering stages of this research project in 2000-2001 and in 2003, when I spent over fifteen months in total on the field-work in the Donbas and Upper Silesia and visited a dozen small coal-mining towns and large industrial cities, I came to realise that the conventional story did not hold. There were manifest transformation failures in Upper Silesia as well as apparent transformation successes in the Donbas. Moreover, none of the two 'over-industrialised' regions had been depressed; the macroeconomic performance and developmental outcomes of post-communism in both Upper Silesia and the Donbas were far superior to Poland's

and Ukraine's averages respectively.<sup>1</sup> The orthodox transition theory that views the post-communist transformation as a process of continuous liberalisation could not provide a probable explanation for the apparent paradox. As a result, I recognised that a new conceptual vision of post-communism, a new paradigm of the post-communist transformation, was needed to broaden our academic research horizons and to enhance our explanatory and interpretative potential. For the lack of available alternatives, I had to rely on my own conceptual constructions.

The present study shares with critics of the mainstream 'transitology' paradigm the conviction that post-communism can neither be analysed nor should it be judged in terms of a transition towards one pure system of liberal competitive capitalism. Instead, the post-communist phenomena can be approached in terms of a political economy of the emerging diversity of capitalism in transition. Hence this study responds to the call made by a number of critics of the neo-liberal orthodoxy, both from the field of Western political economy (the 'varieties of capitalism' approach) and from post-communist studies (the school of path-dependence), for a comparative institutional analysis of 'really existing' capitalisms. I will argue that post-communist capitalism is characterised by a high degree of institutional variety, and by path-dependent and interconnected developments in the economy and in the polity, which can neither be reduced to liberalisation as a general trend, nor interpreted as simple obstacles and time-lags to this direction. What determines the eventual outcome of economic transformation is not so much the legacy of the communist (and pre-communist) past nor the extent of multiple liberalisation under post-communism, but the success that a post-communist society has in moulding major institutional forms – both inherited from state socialism and those copied from modern capitalist economies – in a complementary, reciprocally sustaining manner. As there is no one best (liberal market) way of organising and co-ordinating industrially advanced modern economies in the West, there is no one best way of providing coherence to newly-emerging capitalist systems in the post-communist East. There are alternatives.

In this endeavour, the present study seeks to tie together three stories. There is an internal empirical story of the post-communist transformation of Poland's and Ukraine's industrial strongholds (Upper Silesia and the Donbas respectively), of the regions' post-communist economic performance and developmental outcomes. And, closely connected, there is also an external theoretical story about the evolution of the orthodox neo-liberal causal explanatory model of post-communism. As the repeated attempts of mainstream scholars of transition to provide an adequate explanation for the divergent pathways of post-communism (in the two regions) have so far failed,

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<sup>1</sup> 'Depressed area' is usually defined as a geographical area or region within a country which experiences a significantly poorer economic performance than the country as a whole (Macmillan 1992: 103).

one has to resort to alternative conceptual frameworks. Hence I introduce a third external theoretical story of comparative political economy and its ‘varieties of capitalism’ school.

## **PURPOSE AND LIMITS**

The book aims to show that by adjusting and applying contemporary conceptual frameworks and institutional theories developed for the study of modern Western capitalism to the post-communist world, one can offer an understanding of transformation which is both systemically multi-causal and coherent. As an empirical study, the book has neither been conceived nor designed as a test capable of falsifying the orthodox neo-liberal model of transition. Nonetheless, as a comparative study of two regions in transition, the book can indicate the insufficiency of the currently dominant approach and certify the necessity of having conceptual alternatives.

This study claims to give a better understanding of the post-communist phenomena than is usually offered by conventional neo-liberal accounts. The book has been conceived to serve three further purposes. First, it can serve as a supplement to more general introductions to the challenges of economic transformation under post-communism. Second, it aims to show the importance of theorising for post-communist studies and, in particular, of theorising in terms of the political economy of complementary institutional change. Third, since theories are considered tools that ‘provide the (often) causal links which should allow us to explain phenomena and, in a practical science like politics, to think of the most appropriate policy options’ (Guzzini 1998: xi), the final goal of this research is practical. In such a policy-relevant discipline as post-communist studies, one is particularly interested in theories for their instrumental value. Therefore, the study aims to identify probable faults and drawbacks in the institutional design of the two economies in transition that are responsible for heavy social ‘transition costs’ which have appeared under post-communism in both regions.

The volume has a limited focus on the political economy of capitalist institution-building in two old industrial regions of Eastern Europe, and thus cannot aspire to offer many practical solutions to other regions in economic transition. Neither can it offer a lot of theoretical solutions to the field of post-communist political studies – mainly a democratisation discipline in deep crisis that some describe as being ‘ten years later, twenty years behind’ (Kubicek 2000).<sup>2</sup> The existence of

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<sup>2</sup> As Paul Kubicek critically argued in 2000: ‘Although we certainly know more about Eastern European and former Soviet states and societies than we did in 1989-1991 when communism collapsed in the region, it is debatable whether we are saying much new about the broader study of politics or employing the most useful approaches to our work. One might wonder if the momentous collapse of communism and the ostensibly unique challenges of post-communist transformation give rise to any novel, surprising, or provocative

transformation processes involving social, cultural and geographical change, gender and feminism issues, the emergence of civil society, nation-building, the problems of ‘geo-politics’ and ‘geo-economics’, security and military defence, issues concerning ‘Europeanisation’ (i.e. EU enlargement proceedings) and many others are fully acknowledged as other important aspects of post-communism. Yet, they are not this study’s concern and will not be discussed in any particular detail.

## **METHODOLOGY**

### **Research strategy**

On the whole, this book adopts the pivotal ontological and epistemological assumptions of the *scientific approach* that human behaviour and social phenomena can be explained in terms of direct and systemic observation and recording of the phenomenon of interest. My study is based upon the prevalent understanding of social research as the process aimed at constructing representations of social life through what is typically called a dialogue of ideas (‘theory’) and evidence (‘data’) (Ragin 1994). The search for order and regularity in the complexity of social life is, thus, recognised here as the most fundamental purpose of social research. This book accepts the notion that in order to decipher complex social phenomena, social research must pursue several more specific, multiple and sometimes contradictory goals by asking and answering three types of research questions: ‘what’, ‘why’, and ‘how’ (Blaikie 2000). The major particular social research objectives identified in the literature include:

- a) Identifying general patterns and relationships; this research objective concerns description and involves the use of ‘what’ questions.
- b) Testing and refuting theories; this objective concerns explanation and involves the use of ‘why’ questions.
- c) Making predictions; this objective is related to prediction and involves the use of ‘what’ questions.
- d) Interpreting culturally or historically significant phenomena; this research goal concerns understanding or explanation and involves the use of ‘why’ questions.
- e) Exploring diversity; this goal is related to exploration and involves the use of ‘what’ questions.



- f) Giving voice (e.g. to marginal or deviant groups); this goal concerns understanding and involves the use of ‘why’ questions.
- g) Advancing new theories; this research objective is related to explanation and involves the use of ‘why’ questions.
- h) Assessing change (intervention); this goal concerns evaluation and impact assessment and involves the use of ‘how’, ‘what’, and ‘why’ questions (Ragin 1994: Chapter 2; Blaikie 2000: Chapters 3 and 4).

The above-mentioned variety of competing and at times overlapping goals of social research has fostered the evolution of different research strategies. The traditional methodological and indeed philosophical divide is usually drawn between qualitative and quantitative styles of social inquiry. In essence, qualitative research strategy is suggested to be employed to study the commonalities which exist across a very small number of cases, whereas quantitative research is said to be focused on the correspondence between two or more attributes across a large number of cases (Ragin 1994: Chapter 2). According to some critical commentators on research methods (see Bryman 1988), quantitative research is typically taken to be exemplified by the ‘objective’ experimental investigation, structured social survey and statistics, as well as by some tenets of logical positivism and empiricism and a broad commitment to imitating the natural sciences. In turn, qualitative research tends to be associated with participant observation and unstructured, in-depth interviewing, as well as with the ‘subjective’ interpretation of personal accounts, inadequate generalisation and insufficient theoretical reasoning.

The highlighted dichotomy of social research strategies has led some authors to argue ‘that there is no such thing as *the* scientific method, that there is a variety of logics of enquiry available in the social sciences, and that, in order to conduct social research, it is necessary to choose from among them’ (Blaikie 2000: 8). Nevertheless, the core of this variety of research logics evolves around the formulation and testing of hypotheses through the logical processes of *induction* and *deduction*, and of the interaction between the two termed *retroduction*.<sup>3</sup> Therefore, in this study I have generally followed the standard social research design described in the methods literature, which dictates that researchers pursue specific scientific procedure by (i) studying the relevant literature; (ii) formulating a hypothesis; (iii) developing a research design; (iv) collecting data; and (v) analysing

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<sup>3</sup> The concept of retroduction is associated with the work of Norwood Russell Hanson. According to Charles Ragin, retroduction means the interplay of induction and deduction and is central to the procedure of scientific discovery, since the process of constructing representations from the interaction between analytic frames and images involves retroduction (1994: 47, 191). In his studies of social research methods, Norman Blaikie (1993) has identified four research strategies: the inductive, deductive, retroductive and abductive. Besides the more typical processes of induction and deduction (and retroduction), the abductive social research strategy uses the method of abduction that refers to the process of producing social scientific accounts from social actors’ accounts and deriving technical concepts and theories from lay concepts and interpretations of social life (see Blaikie 2000: 114).

the data in a way dictated by the hypothesis (see Chadwick, Bahr and Albrecht 1984; Judd, Smith and Kidder 1991; Sedlak and Stanley 1992; King, Keohane and Verba 1994; Kumar 1999; Neuman 2000).

### **Comparative method**

The present research into the post-communist transformation of Upper Silesia and the Donbas is conducted by employing comparative methods (see Przeworski and Teune 1970; Lijphart 1971; Ragin 1987; Peters 1998). Comparative objectives and methods – the third social research strategy – are typically positioned between the two basic styles of quantitative and qualitative social inquiry:

There is a trade-off between the *number of cases* and the *number of features of cases* social researchers typically can study and then represent. At one extreme is most qualitative research: few cases, many features. At the other extreme is most quantitative research: many cases, few features. In between these two extremes is comparative research. The comparative study of diversity across a moderate range of cases strikes a balance between in-depth knowledge of cases and broad knowledge of relations among variables. It is the best strategy when there are too many cases for close, detailed investigation of each case, but too few for quantitative analysis [...] The emphases of comparative research on diversity (especially, the different patterns that may exist within a specific set of cases) and on familiarity with each case make this approach especially well suited for the goals of exploring diversity, interpreting cultural or historical significance, and advancing theory (Ragin 1994: 78, 108).

The comparative perspective is chosen here as a basis for examining patterns of similarities and differences because of my particular interest (a) in the diversity of institutional or ‘macro-social’ factors behind the transformation of different post-communist societies; (b) in the development of capitalism as a specific phenomenon under post-communism to be analysed comparatively across different political economies of Eastern Europe; and (c) in the advancement of post-communist transformation theory. A number of inherited structural similarities between Upper Silesia and the Donbas such as, for example, the high concentration of coal, steel and other heavy industries, a relatively similar level of social and economic development under state socialism, and the ethno-cultural borderland nature of both regions, determine the need in conducting the research via the ‘most similar systems’ design (Przeworski and Teune 1970: Chapter 2; Pennings, Keman and Kleinnijenhuis 1999: Chapter 2).

According to comparative methodologists, the assumption in the ‘most similar systems’ design is that ‘a number of theoretically significant differences will be found among similar systems and that these differences can be used in explanation’ (Przeworski and Teune 1970: 39).<sup>4</sup> Thus,

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<sup>4</sup> The alternative strategy developed by Przeworski and Teune is the ‘most different systems’ design. The starting point here is that the variation of the observed behaviour resides at a lower, sub-systemic, usually

extraneous variance questions are dealt with by the selection of the cases. If a relationship between an independent variable X and a dependent variable Y is discovered, then the factors which are held constant through the selection of cases cannot be argued to be alternative sources of that relationship. On the other hand, any variable that does differentiate the systems is likely to be the source of the observed variation among them (see Peters 1998: 36-41). The ‘most similar systems’ design allows us to exploit the diversity of the post-communist pathways by implying that common factors of the post-communist transformation are to be conceived as controlled variables, whilst dissimilar factors that determine the outcomes of post-communism in the two regions can be considered independent explanatory variables. A number of comparative methodologists have argued that the ‘most similar systems’ design can suffer from the procedural problem of over-determination, since the method could fail to eliminate many rival explanations: there may be a hypothesis being tested, but there can be a large number of other competitors which would be equally plausible (Peters 1998: 36-41; see also Collier 1993). However, it is believed that such problems may occur in the context of almost any research design (see Fleron 1996).

The application of the scientific approach in social sciences – typically associated with quantitative research – has attracted a host of criticisms over many decades and is characterised by several ontological, epistemological, methodological and cultural limitations. The fundamental notions of reality, objectivity, rationality, natural science methods, and open-minded discovery have long been questioned by a number of sociologists, historians, geographers, linguists, and philosophers of science (see e.g. Gillispie 1960; Kuhn 1970; Gouldner 1971; Scheffler 1982; Bauer 1992; Flyvbjerg 1998, 2001). The scientific approach has also been criticised for its Western Eurocentric cultural predisposition (Harding 1993). Last but not least, the scientific method is claimed to be based upon a ‘reductionist’, analytical approach to social complexity, which some feminist authors see as being unavoidably masculine and lacking holistic or integrative understanding of the human behaviour (Shepherd 1993). With some reservations, the keynote of the overwhelming majority of scholars who choose to follow an ‘anti-scientific’ or anti-positivist approach is analogous to the main aim of qualitative research, that is to see and interpret social reality through the eyes of the people studied (Bryman 1988: Chapter 3).

I fully recognise the methodological restrictions involved in applying the scientific (albeit comparative) methods to study social phenomena. I accept the criticism that complete value-freedom or scientific objectivity are hardly attainable, as we are subjective human beings and most of the (middle-class white male) social researchers are guided in their work by a particular set of inner assumptions and beliefs. Nevertheless, it is contended that both the scientific and anti-

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individual level; ‘systemic factors are not given any special place among the possible predictors of behaviour’ (Przeworski and Teune 1970: 34).

scientific approaches to human behaviour and social phenomena have been logically justified and effectively used in the past and in the present, and that many of the fundamental assumptions and concepts of both approaches will remain a subject of unsettled controversy for many decades to come.<sup>5</sup> Hence the choice of a research method can still be regarded as an expression of personal preference based on tradition and the familiarity with the procedure.

The second reason for the use of the scientific comparative approach is more technical and related to the subject of my inquiry since – putting the ontological and epistemological differences aside – different research approaches are better suited to different research questions. According to most of research methodologists, quantitative and comparative research is likely to be preferred when there is a concern to establish cause-and-effect relationships as:

Qualitative researchers are not interested in causes, in that they are frequently concerned to establish how flows of events connect and mesh with each other in the social contexts they investigate, or how their subjects perceive the connections between facets of their environment. [In contrast], survey and experimental researchers tend to be much more concerned with the precise delineation of a causal factor, relative to other potential causes (Bryman 1988: 102).

Yet another crucial reason behind my decision to adopt the scientific methodology has been the character of the discipline itself. The field of post-communist studies, especially politics and economics of post-communist transformation, has been occupied almost exclusively by scholars of the scientific tradition. The dominant neo-liberal paradigm of the political economy of post-communism is firmly rooted in neo-classical economics and rational choice theory – arguably the most natural science-like systems of knowledge in the study of social relations. Therefore, I consider the scientific method to be a more appropriate and effective means of testing and refuting the post-communist transition orthodoxy.

## **Evidence**

The secondary sources of ideas, data and information used in this study will be introduced and discussed subsequently in the following chapters of the book. This section will describe the primary sources only. The primary data sources that have been originally compiled for the research purposes of this book in the course of my Ph.D. studies as well as the data which were collected by other researchers and used in this book can be assigned to the seven following major categories:

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<sup>5</sup> Moreover, according to Bryman, ‘there are a number of ways in which the posited connection between epistemology and data collection can be questioned: participant observation (and indeed unstructured interviewing) is not without positivist leanings; survey researchers frequently claim to be looking at the social world from their respondents’ perspectives; and participant observation can be deployed within a theory testing framework with which the epistemological basis of quantitative research is conventionally associated’ (1988: 123).

- 1) Official statistics: comprehensive numerical data collected and published by the governments of the European Communities (*Eurostat* publications), Poland and relevant provincial authorities (*GUS* and National Bank of Poland publications), Ukraine and relevant provincial authorities (*Derzhkomstat* and National Bank of Ukraine publications); United Kingdom (*ONS* publications); USSR (*Goskomstat* publications).
- 2) Non-official statistics: numerical data collected and published by a variety of public and private organisations, including the European Bank for Reconstruction and Development; International Labour Organisation; International Monetary Fund; l'Observatoire des Sciences et des Techniques (France); Organisation for Economic Co-operation and Development; Polish Information & Investment Agency; United Nations Conference on Trade and Development; United Nations Development Programme; United Nations Economic Commission for Europe; United Nations Educational, Scientific and Cultural Organisation; United Nations Statistical Division; United States Agency for International Development; University of Groningen Growth and Development Centre (Netherlands); World Bank; World Health Organisation; World Trade Organisation.
- 3) National legislation and regulatory framework: laws, directives, instructions, agreements and decrees issued or adopted by the legislative and executive branches of the Ukrainian government used in the construction of missing numerical indicators (e.g. on regulatory framework) for comparative purposes.
- 4) Non-official reports and surveys: verbal as well as numerical data collected and published by a variety of public and non-governmental organisations, think-tanks and advocacy groups, including the Economist Intelligence Unit; European Bank for Reconstruction and Development; Freedom House (USA); Fraser Institute (Canada); Heritage Foundation (USA); National Academy of Sciences of Ukraine.
- 5) Industrial business performance indicators: numerical data on company accounts collected and published by the Polish national *Rzeczpospolita* daily and the Ukrainian business *Investment Gazette* weekly.
- 6) Political programmes and speeches: verbal data prepared and published by Ukrainian and Polish political parties; official government addresses to the parliament; transcripts of televised electoral debates.
- 7) Electoral results: numerical data prepared and published by Poland's and Ukraine's national electoral authorities concerning the official outcomes of parliamentary and presidential elections.

The usage of data collected and published by government agencies has a large number of strengths and applications. Amongst the major recognised advantages of official data analysis are availability; limited cost and time constraints involved in gathering the data; high quality (comprehensively representative and rigorous sampling procedures, good procedures for non-response, experience); a possibility of examining trends and changes over time (longitudinal analysis); inter- and sub-group analysis; cross-cultural comparisons; and ‘before’ and ‘after’ studies (evaluations of intervention impact). On the other hand, the usage of official statistics has a number of well-known weaknesses and limitations, which include, among others, the lack of familiarity with complex data; the problem of definitions and categorisation (i.e. changing official concepts of crucial indicators); a partial picture of reality (i.e. statistical data may only represent a ‘snapshot’ of social interaction); and the lack of control over the purpose of official statistics that may be deeply affected by government’s political and economic considerations or may be different from the social researcher’s purpose. In addition, as far as cross-cultural comparative studies are concerned, there may be inconsistencies between (a) the sub-national and national samples and data sets, as well as between (b) different national traditions and procedures.

It should be emphasised that official statistics have been approached with very great caution in this book. Collecting and getting myself familiar with the regional and national data was the major task accomplished during my fieldwork in Poland and Ukraine. In most cases, I have cross-checked and verified the official data by using alternative measurements or non-official statistics. For example, with regard to unemployment statistics, both the official registered unemployment rate and the labour force survey-based figures have been used and presented; in evaluating the regional macroeconomic performance under post-communism, both formal and informal economy shares have been considered.

Besides the seven primary sources of evidence by which my argumentation in this book has been supported, another major source of knowledge, impression, and the notion of reality was participant and ‘pure’ observation.<sup>6</sup> To complement the partial picture of reality constructed on the basis of official statistics and other types of numerical data, I have invested over a year in pure as well as participant observation of the processes and outcomes of the post-communist transformation in a large number of places in Poland, including Łódź, Warsaw and the Upper Silesian cities and towns of Gliwice, Katowice, Pszczyna, and Sosnowiec; whereas my fieldwork trips and stays in Ukraine covered Kyiv and the Donbas cities and towns of Donetsk, Khartsyzsk, Makiivka,

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<sup>6</sup> According to Bryman, ‘pure’ observation should not be confused with participant observation (e.g. in-depth, unstructured interviewing) as the former technique ‘involves the researcher observing others, but with no participation. Many participants observers use pure observation some of the time, but the relative absence of involvement with the subjects of the research has meant that pure observation is rarely used alone by qualitative researchers because it is unlikely to allow access to the world-views of those being studied’ (1988: 71).

Mariupol, Novoazovsk, and Novohrodivka. Given my interest in ‘macro-social’, macroeconomic, systemic and institutional factors, as well as my leaning towards comparative and quantitative research strategies, the qualitative techniques of participant observation applied during my fieldwork in the two countries have not been geared towards primary data collection or ‘giving voice’, but were meant to be an additional source of personal impressionistic evidence. Therefore, interview material is not included into the book as I have had no intention to use it in such a form. Together with pure observation, semi-structured interviews and informal talks I have had with state officials, entrepreneurs and industrialists, political and trade-union activists, industrial and public service workers, research and development personnel, and ordinary citizens have served as a major ‘reality check’ needed to balance images formed under the influence of numerical and non-oral verbal data collected.

In order to examine the central research question of the book, that is, why two similar old industrial regions of neighbouring East European countries have been generating different patterns of post-communist transformation, one would need to establish concepts that could confine the field to analysing different political economic systems. First, how can one evaluate the impact of post-communism on the two regions and what indicators should one use? Second, what independent variables are to be compared and why are they considered to be explanatory? Third, how can one assure (in a qualitative study) that different factors are not incidentally related but that there exists some causal links and relationships? The answers to these questions are reflected in the basic structure of the book.

## **STRUCTURE**

Part One will present the research problem of the study. Part Two will consider potentially available explanations provided by the neo-liberal transition paradigm of post-communism and critically examine the applicability of the orthodox explanatory model to this comparative study of two old industrial regions in transition. Part Three will develop an alternative political economic approach towards the post-communist transformation of Upper Silesia and the Donbas and, consequently, apply it to resolve the study’s major research question. The concluding Part Four will analyse both the empirical findings of the book as well as their theoretical and practical implications. Part Four will tie together the entire book to ascertain the determinants of post-communist social and economic developments in Upper Silesia and the Donbas.

In Part One, the first chapter lays the foundations of the ‘most similar systems design’ of the book by introducing Upper Silesia and the Donbas and examining a number of essential similarities possessed by both regions before the beginning of transformation. It is argued that the major inherited similarities between Upper Silesia and the Donbas include the borderland culture of the two regions, their analogous economic, industrial, and settlement structures, as well as the economic institutions of state socialism. In turn, Chapters 2 and 3 examine the different economic performance trajectories and varied developmental outcomes produced by Upper Silesia and the Donbas between the late 1980s and early 2000s. Chapter 2 focuses on growth and stability indicators to assess the impact of post-communism on the two regions, whereas Chapter 3 covers economic, social, and human development. By discovering both differences and similarities between the post-communist outcomes in Upper Silesia and the Donbas, Part One thus poses the research question of the book, namely, why have the two structurally similar regions generated different patterns of transformation?

In Part Two, Chapter 4 describes the assumptions and deduced explanations of the orthodox liberal post-communist transition theory and critically evaluates the causal model developed by mainstream theorists. Chapter 5 attempts to apply the conventional neo-liberal model to the comparative study of Upper Silesia and the Donbas in transition. Part Two concludes that there is a need to search for an alternative, more adequate approach towards the varied outcomes of the post-communist transformation in two structurally similar old industrial regions.

In Part Three, Chapter 6 presents a new conceptual framework of the post-communist transformation that is based upon the theory of institutional complementarity and the related ‘varieties of capitalism’ approach recently elaborated by Peter A. Hall and David Soskice (2001a), and Bruno Amable (2003). Institutions of modern capitalism and politics of post-communism are identified as the major independent variables to account for the divergence of the post-communist pathways followed by Upper Silesia and the Donbas. Chapter 7 applies this newly-developed theoretical framework to the comparative study of the two regions. It shows that the research problem of the study can be solved by analysing two different types of post-communist capitalism<sup>7</sup> that emerged in Upper Silesia and the Donbas. Consequently, Chapter 8 shows why post-communist capitalism in Upper Silesia (and in Poland generally) is characterised by heavy regulation, a considerable government involvement in the economy, and a generous welfare system, whereas post-communist capitalism in the Donbas (and in Ukraine generally) is relatively of a much more liberal yet neo-corporatist kind. To support the ‘diversity of capitalism’ hypothesis concerning the macroeconomic and structural dynamics of each model of modern capitalism, Chapter 8 also

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<sup>7</sup> I use the terms ‘post-communist capitalism’ and ‘capitalism in transition’ to indicate the unfinished formation of capitalism in the post-communist countries.



examines whether the two different models of economic organisation and co-ordination generate different comparative institutional advantages by specialising in certain industries and technologies. In addition to providing an assessment of the positive developments produced by the two models of post-communist capitalism, Part Three concludes by identifying several main weaknesses in-built into their institutional designs.

In Part Four, Chapter 9 defines the determinants of the post-communist transformation in Upper Silesia and the Donbas. Chapter 9 also considers the major findings of this study and evaluates their theoretical implications. It is contended that the dissimilarity between the initial post-communist macroeconomic performance trajectories of Upper Silesia and the Donbas ought to be attributed to specific differences between the regions' inherited conditions and the velocity of systemic change. On the other hand, the similarly positive economic performance trends that the two regions have been generating since the second half of the 1990s are claimed to be caused by specific institutional complementarities developed within each parallel, that is, non-converging type of post-communist capitalism. In turn, the varied outcomes of the post-communist transformation in Upper Silesia and the Donbas are attributed to the continuance of certain intra-systemic incongruity between several major institutional domains of post-communist capitalism in the two regions. Consequently, Part Four discusses a number of potential practical measures that can be implemented in order to develop new and to enhance the existing institutional complementarities of the two East European political economies. The book ends with a wider speculation on the future of capitalism in the post-communist world and on the necessity of further research endeavours in this regard.

## **Part One**

*Upper Silesia and the Donbas –  
Similar Regions, Varied Trajectories*

## **Inherited Similarities: Upper Silesia and the Donbas at the Outset of Post-Communism**

This comparative study of the post-communist transformation of Poland and Ukraine has a particular empirical focus. It considers the determinants of social, economic, and human development progress achieved under post-communism by Upper Silesia and the Donbas – the industrial heartlands of the two countries respectively. In the following three chapters of Part One, I will establish the puzzle of this book, namely that two structurally similar, old industrial regions of two neighbouring East European countries have generated different performance trajectories and followed divergent transformation patterns. I define this as the ‘paradox of transformation’. In this chapter I will outline the major inherited similarities between Upper Silesia and the Donbas at the outset of post-communism. In the next chapter I will turn to examine the divergent economic performance of the two regions during the transformation. And in Chapter 3, I will consider the varied developmental outcomes registered in Upper Silesia and the Donbas at the beginning of the 21<sup>st</sup> century (up to 2004). Hence Part One will frame the book’s research question: what determines the post-communist transformation in two inherently similar East European regions, and, in particular, why have the outcomes of economic transformation in Upper Silesia and the Donbas varied? This chapter examines three aspects of the inherited similarities of Upper Silesia and the Donbas. First, following a short geographical profile of Upper Silesia and the Donbas, I consider historical and cultural traditions of the two borderlands. Second, I examine the economic, industrial, and settlement structures of the two regions. Finally, I consider the institutional features that characterised the two regions under state socialism.

### **GEOGRAPHICAL PROFILE**

#### **Upper Silesia**

Silesia is the geographical and historic area in central Europe that lies on both sides of the Oder River, and extends from near the source of the river north-westward for nearly 250 miles to

the borders of Brandenburg (Pounds 1958: 1). The Polish form of the name is *Śląsk* [Shlons'k], the German is *Schlesien*, and the Czech is *Slezsko*. Since the Middle Ages, Silesia has been historically divided into two main parts, Lower and Upper Silesia. Lower Silesia (*Dolny Śląsk* in Polish) lies in the northwest, with Wrocław (German Breslau) and Legnica (Liegnitz) as its main cities. The remainder of Lower Silesia now forms part of Brandenburg and Saxony *Länder* (states) of Germany. Upper Silesia (*Górny Śląsk* in Polish) is in the southeast, and its most important cities are Opole (German Oppeln), Katowice (Kattowitz) and the Katowice conurbation. A small part of Upper Silesia outside Poland forms Moravian Silesia *kraj* (region) of Czechia. Map 1.1 locates Upper Silesia in the European geographical context.

Map 1.1 Upper Silesia and the Donbas in the European geographical context



The borderland nature of Silesia and its complex history have resulted in frequent shifts in the region's official boundaries. After the Second World War, the borders of Silesia have been rearranged four times alone. During the last territorial reform in the Polish People's Republic in 1975, Silesia was divided between 9 *voivodships* (provinces). In particular, Upper Silesia was divided between Opole, Katowice, Bielsko, and Częstochowa provinces.

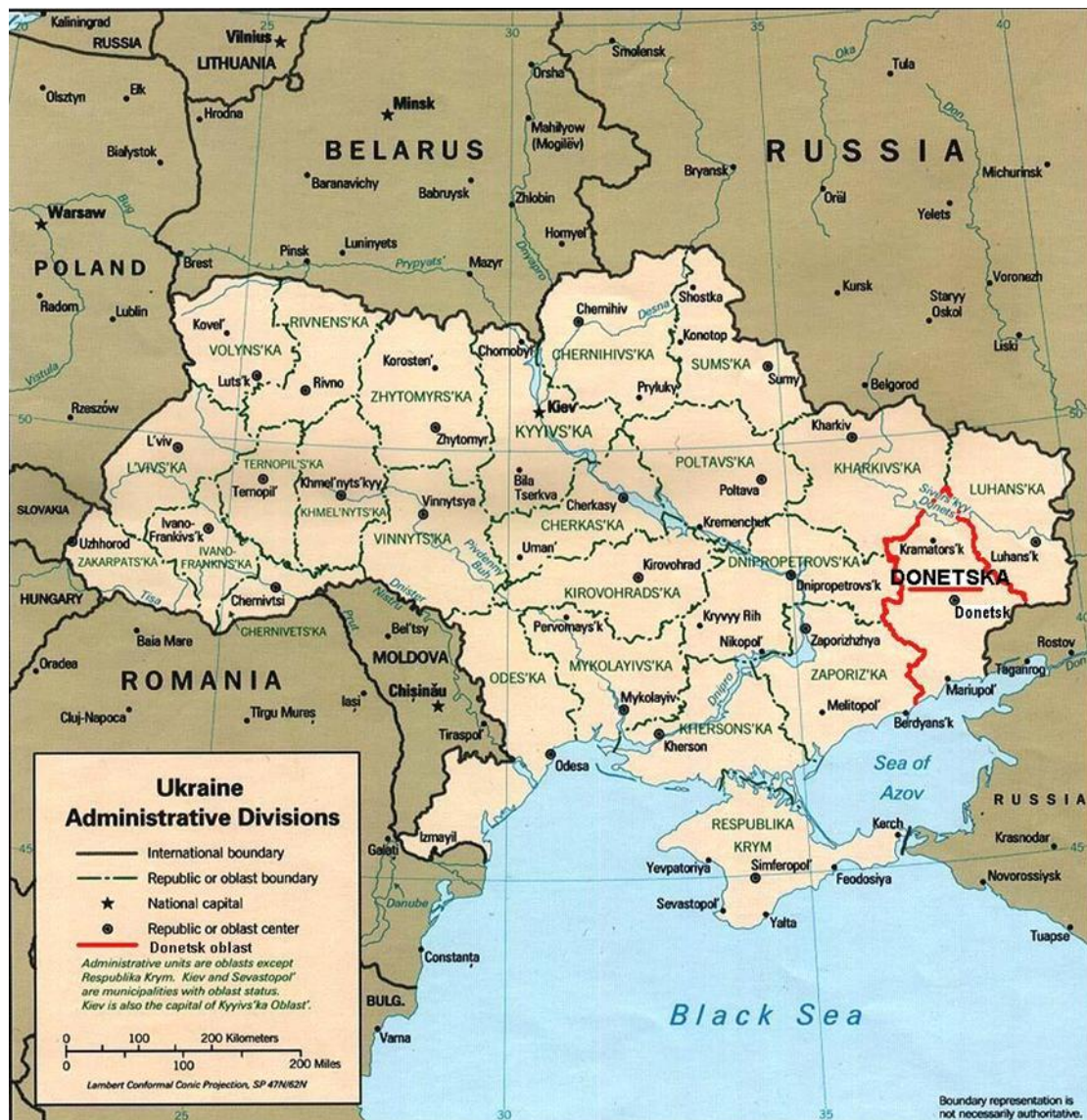
Map 1.2 Poland: administrative divisions after the 1999 territorial reform



In the course of the 1999 administrative reform, the Upper Silesian region has been re-grouped into two larger provinces with administrative centres at Katowice (*województwo Śląskie* or Silesian voivodship) and Opole (*województwo Opolskie* or Opole voivodship). As the focus of this book is on the post-communist transformation of the most heavily industrialised coal-mining eastern part of the region, the term ‘Upper Silesia’ is used here to cover primarily the territory of Silesian voivodship, including the Dąbrowa Górnicza Basin. To make statistical time-series consistent and data fully comparable, I have had to reconstruct and re-arrange data outputs for Silesian voivodship on the basis of data inputs of pre-1999 Katowice, Bielsko and Częstochowa voivodships, since most of the territory of those three provinces made up the enlarged Silesian voivodship. Map 1.2 highlights the first subject area of the present comparative study. The book,

thus, does not cover the processes of the post-communist transformation in Opole voivodship – the second Upper Silesian province according to Poland’s current administrative divisions. The author fully recognises, however, that some parts of present-day Silesian voivodship (e.g. the Dąbrowa coal basin or the Częstochowa area) are not ‘Upper Silesian’ from a purely historical point of view, since they belonged, before the First World War, to the Russian Empire and not to Germany or Austria-Hungary, as Upper Silesia proper did.

Map 1.3 Ukraine: administrative divisions



## Donbas

The Donets Coal Basin is a large historical and mining region at the southern end of Eastern Europe. It stretches from the Donets Hills in the north towards the Don River, and in the south across the low Azov Upland and the coastal plain to the Sea of Azov. The Donets Basin is thus

surrounded by the middle and lower Donets River (a tributary of the Don River) and the Sea of Azov (see map 1.1). The Ukrainian form of the name is *Donets'kyi Basein* [Донецький басейн]; the Russian is *Donetskii Bassein* [Донецкий бассейн], by name the Donbas or Donbass respectively. Similar to Upper Silesia, the Donbas region has never constituted a single administrative-territorial entity. The principal area of the greater Donets coal field is usually referred to as the 'Old Donbas'. This old part of the greater Donbas forms present-day Donets and Luhans provinces in eastern Ukraine (*Donets'ka* and *Luhans'ka* oblasts)<sup>8</sup>. Westward, the greater Donets Basin extends to Ukraine's Dnipropetrovsk province. Eastward, the Donbas extends to western and northern districts of Russia's Rostov province. The major city of the Donbas is Donetsk – the administrative centre of Donets oblast. As in the case of Upper Silesia, our examination of the post-communist transformation of the Donbas is focused on the most heavily industrialised part of the region. Since Donets oblast (similar to the case of Silesian voivodship and Upper Silesia) covers the heartland of the Old Donbas and is considered to be the economic, political and cultural centre of the Donbas region, Donets oblast is the second subject-area of the present comparative study. Hence the term 'Donbas' is used here primarily to cover the territory of the province as highlighted in Map 1.3. All other Donbas areas are not covered in this book.

## **TWO BORDERLAND CULTURES**

The first inherited similarity between Upper Silesia and the Donbas is their borderland location. Both Upper Silesia and the Donbas are frontier regions, i.e. areas – usually in a peripheral location – that are characterised by a tangible feeling of local individuality based upon a long lasting mutual permeation of several cultures and traditions of varied provenance (Szczepański 1993b). The cultural and geographical borderland nature has been the common feature of Upper Silesia and the Donbas throughout their history, both before and during the post-communist transformation.

### **Upper Silesia**

From a historic perspective, originally populated by West Slavonic tribes, around the year 1000 Silesia was ruled by the Polish dynasty of the Piasts as one of their main six provinces. During

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<sup>8</sup> Typically, the two Donbas provinces are translated into the English language as *Donetsk* and *Luhansk* oblasti, instead of the correct Donets and Luhans versions. This stems from a wide-spread misconception of the origin of these names, as most of the Ukrainian provinces are named after their capital cities (i.e. Poltava – Poltavska oblast, Odesa – Odeska, etc). Yet in the case of the Donbas, the administrative capital cities – Donetsk and Luhansk – themselves have taken their names from the names of the two provinces, which in turn designate the river basins of the Donets and the Luhans respectively.

the 14<sup>th</sup> century Silesia became a possession of the Bohemian crown. In 1526, along with Bohemia and Moravia (the Czech Lands), Silesia was passed to the Austrian Habsburgs, and was consequently seized by Prussia in 1742. In the aftermath of the First World War, in 1921, south-eastern part of Upper Silesia was awarded by the Council of the League of Nations to the newly established independent Polish Republic, whilst the remainder was left to Germany. In 1939, following the German occupation of Czechoslovakia and Poland, the Polish and Czech parts of Silesia were annexed by the Third Reich. In 1945, the territory of Silesia was redistributed and nearly the entire region acceded to Poland (Dzięłowski *et al.* 1995: 450-52). These changes in state authority and control over the region led to frequent contacts and conflicts between various political and economic systems (for the history of Upper Silesia, see also Popiołek 1972 and Bahlcke 2001).

Map 1.4 Upper Silesia and the Donbas in the European cultural context



A large number of researchers have stressed how, over many centuries, Upper Silesia has been subjected to strong cultural, social, political, and economic influences emanating from Poland,



the Czech Lands, Austria, Prussia and later Germany (Błaszczak-Wałowik, Błasiak and Nawrocki 1990; Szczepański 1993; Szczepański 1994; Szczepański 1998b; Jałowicki 1998). In addition, since 1815 and until the beginning of the First World War in 1914, the northern and east-central parts of contemporary Silesian voivodship (Częstochowa area and the Dąbrowa coal basin) belonged to the Russian Empire which also left strong cultural and economic traces in the region (see Pounds 1958). Yet, as Map 1.4 shows, throughout its history, Upper Silesia has mostly been a junction of the West Slavonic and German cultures, the borderland of clashing Polish, German, and Czech national identities.

Map 1.5 The approximate distribution of ethnic minorities in Upper Silesia and Poland



Source: Author’s reconstruction on the basis of Szczepański 1997b: 10.

Since the end of the Second World War, the Polish state has been pursuing in Upper Silesia the policy of en-nationalisation<sup>9</sup> aimed at *Polonising* the region and homogenising the country’s various regionalist differences (on ethnic cleansing and en-nationalisation in Upper Silesia, see Kamusella 1999a, 2002). Nonetheless, even after some 60 years of en-nationalisation, Upper Silesia has retained its cultural difference from the rest of ethnically homogenous Poland (see Map 1.5).

<sup>9</sup> ‘Ennationalising’ is a policy pressure exerted by an established nation-state upon a particular (minority) ethnic group to assimilate and/or to transform that group into one nation.

From the general population census conducted in Poland in 2002, it appears that the Silesian voivodship is home to over 40 per cent of all the ‘non-Polish’ population in the country. About 92 per cent of the Silesian voivodship’s population declared themselves as Poles, 3.1 per cent as Silesians, about 1 per cent as Germans, and the rest were registered as Roma/Gypsies, Ukrainians, and Russians (SOK 2003a: 36)<sup>10</sup>.

Nevertheless, according to local sociologists, even within the largest population group in Upper Silesia (i.e. those who declared themselves Polish) there also exist several fundamental cultural and social cleavages. The major identity-dividing lines amongst Polish Upper Silesians run between ‘native Upper Silesians’ and ‘new-comers’, i.e. Polish post-WWII migrants to the region, and between the inhabitants of the formerly German and Russian parts of the province (Nawrocki 1990; Szczepański 1993; Szczepański 1997; Łukowski and Nawrocki 1997; Wódz 1997; Jacher 1997; Kamusella 1999b, 2001). In addition, in predominantly Roman Catholic Poland, Upper Silesia is the place of residence of Poland’s largest Protestant minority.

### **Donbas**

The Donbas lies in the western part of the Eurasian Steppe – a belt of open grassland that extends from Hungary in the west through Ukraine and Central Asia to Manchuria in the east. From prehistoric times, this open steppe – called by the Eastern Slavs the ‘wild field’ – formed a natural gateway to Europe for successive waves of nomadic horseman from Central Asia. From the early 13<sup>th</sup> century and until the late 18<sup>th</sup> century, the south of what later became known as the Donbas and the adjoining steppe was under the rule of the Tartar Golden Horde and its successor state – the Crimean khanate. The central areas of the Donets Basin were under control of the Ukrainian and Russian Cossack communes – the Zaporozhian Sich and the Don Cossack Host respectively. With the full annexation of Ukraine and the Crimean khanate to the Russian Empire in the 18th century, the sparsely settled Donbas lands were colonised by migrants from other parts of Ukraine, Greeks and Tatars from the Crimea, as well as smaller numbers from Russia, Belarus, the Balkans, and Germany. Thus, as Map 1.4 illustrates, over many centuries the Donbas has been the borderland between the East Slavonic, Ponto-Caspian Turko-Tatar, and Balkan (Greek) cultures. It has also been a place of ethnic coexistence and, at times, ethnic conflict between the Ukrainians, Russians, and various Balkan, Transcaucasian, and Western Asian peoples (see Kuromiya 1998: Chapter 2). The long-standing characteristics of the Donbas as a border region have survived the turmoil of the 20<sup>th</sup> century. According to the general population census conducted in Ukraine in 2001, 56.9 per cent of the Donets oblast’s population declared themselves as Ukrainians, 38.2 per cent as Russians,

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<sup>10</sup> Poland’s 2002 general population census was the first one since 1931 in which the question about the respondent’s ethnic origin (*narodowość*) was asked. Therefore, it is impossible to assess the ethnic diversity and national identity of Upper Silesians at the outset of transformation.

1.6 per cent as Greeks, 0.9 per cent as Belarusians, 0.4 per cent as Tatars, and the rest as Armenians, Jews, Azerbaijani, and others (USSC 2004b).<sup>11</sup>

## ECONOMIC AND SETTLEMENT PATTERNS

### Economy

The second common distinguishing feature of Upper Silesia and the Donbas at the outset of post-communism was their regional economic structures based upon heavy industry. After the discovery of coal in Upper Silesia and the Donbas in the first half of the 18<sup>th</sup> century, within some fifty years the two regions were transformed into major locomotives of the late Industrial Revolution in the Prussian and Russian empires respectively. In 1913, Upper Silesia produced 43.4 million tonnes of coal and nearly 1 million tonnes of pig-iron, whilst the Donbas's production figures stood at 25.3 and 3.1 million tonnes respectively. During the 20<sup>th</sup> century, the coal and steel industries were supplemented in both regions by a number of other heavy industries. By the end of state socialism, Katowice and Donetsk were amongst Europe's largest manufacturing hubs; whilst Upper Silesia and the Donbas were the largest coal-mining areas on the continent as well as one of the world's largest centres of heavy industry (for a full account of Upper Silesia's industrialisation, see Popiołek 1972 and Bahlcke 2001; for the history of the industrialisation of the Donbas, see Friedgut 1989, Wynn 1992, and Mykhnenko 2003b).

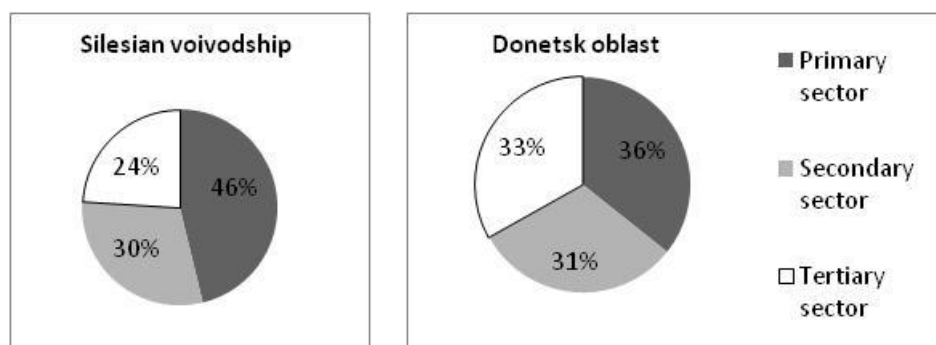


Figure 1.1 Total employment by sector, Upper Silesia and the Donbas, 1985

*Note:* Primary sector covers agriculture, forestry, and fishing; mining and quarrying; energy, and water. Secondary sector includes manufacturing and construction. Tertiary sector covers education and health; distributive trades; real estate, housing and municipal services; transport, storage, and communication; banking, finance, and insurance; public services; and other services.

<sup>11</sup> The last Soviet general population census conducted in 1989 registered the following figures for Donetsk oblast: Ukrainians – 50.7 per cent, Russians – 43.6 per cent, Greeks – 1.6 per cent, Belarusians – 1.4 per cent, Jews – 0.5 per cent, Tatars – 0.5 per cent, etc. (USSC 2004b).

Source: Author's calculations on the basis of DOSO (1987, 1991a, 1991b); VSO (1986, 1989, 1992, 1994, 1996, 1998); PCSO (2002), SOK (2003a). Some data inputs are estimates based on regression.

In the 1980s, the largest share of the workforce in both Upper Silesia and the Donbas was employed in the primary sector, chiefly in coal-mining, energy, and agriculture. Figure 1.1 shows that in 1985 about one-third of the workforce in both regions was employed in secondary industries (manufacturing and construction), whilst the remainder worked in services. In addition to the analogous employment structure of the overall economy, Upper Silesia and the Donbas were also characterised by a very similar industrial structure. As Figure 1.2 indicates, in 1985, about 80 per cent of all industrial workers in Upper Silesia and the Donbas were employed in coal mines, steel works, and engineering plants.

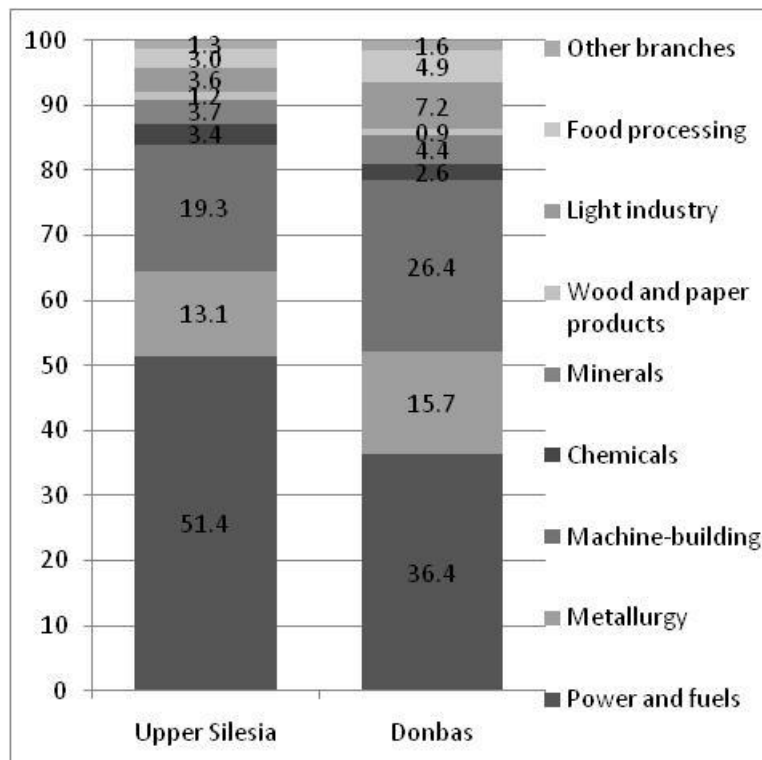


Figure 1.2 Industrial employment by branch, Upper Silesia and the Donbas, 1985

Source: Author's calculations on the basis of DOSO (1987, 1991a, 1991b); VSO (1986).

The overall economic structure of the two regional economies was thus almost entirely built upon coal-mining and manufacturing, though the Donbas had a slightly more diverse industrial structure. In 1985, manufacturing and construction alone accounted for about 55 per cent of total output in the Donbas and for 48 per cent of total output in Upper Silesia. Together with mining and quarrying, the share of total industrial output in the Donbas's gross regional product in 1985 was

around 67 per cent, whilst in Upper Silesia the share of industry was as high as 77 per cent. In addition to the similar inherited economic structure, at the outset of post-communism, Upper Silesia and the Donbas were also characterised by analogous positive growth rates. Between 1985 and 1988, on average, industrial production had been increasing annually by 2.7 and 2.8 per cent in the Polish and the Ukrainian region respectively (author's calculation on the basis of DOSO 1987, 1991a; VSO 1989).

### Population

The expansion and later concentration of mines, plants and factories in Upper Silesia and the Donbas inevitably brought with it a steady increase in population (Pounds 1990: 421-26). In the first half of the 19th century, the population of Upper Silesia had doubled, reaching one million by 1850. By 1890 this had increased to 1.58 million and in 1910 to 2.2 million (Pounds 1985: 403). In the Donbas, between 1850 and 1900, population had increased from 0.7 to 1.5 million (Antonenko 1994: Chapter 2). The two world wars had a detrimental effect on the demographic growth of both regions. Nonetheless, the post World War II reconstruction brought a steady and massive in-flow of new-comers to Upper Silesia and the Donbas (see Runge 1996, 1999; Mykhnenko 2003b). By the end of state socialism, the population of Silesian voivodship had grown to 4.9 million and the population of Donetsk oblast to 5.3 million (DOSO 1991a: 16; SOK 2003b: 19). The steady growth of population was accompanied by rapid urbanisation and increasing population density. About 88 and 90 per cent of the population in Upper Silesia and the Donbas respectively lived in urban areas. As a result, the Katowice and Donetsk conurbations, and Upper Silesia and the Donbas generally, became two of the most densely populated areas in Europe.

*Table 1.1.* The balance sheet of the inherited economic structure

	<i>Upper Silesia</i>	<i>Donbas</i>
Industrial output per capita (US\$, official exchange rate, 1985)	3615	5860
Average annual industrial growth (1985-1988)	2.6%	2.7%
Distribution of GDP (current prices, 1985)		
- industry	77.0%	67.2%
- agriculture	6.0%	14.8%
- services	17.0%	18.0%
Urbanisation (share of total population, 1985)	88%	90%
Natural resource endowment	moderate	moderate

*Source:* Author's calculations on the basis of DOSO (1987, 1991a, 1991b); VSO (1986, 1989, 1992, 1994, 1996, 1998); PCSO (2002); SOK (2003a, 2003b, 2003c); UN (2004); OECD (2004a, 2004g). Some GDP data inputs are estimates based on regression.

Table 1.1 summarises the key structural similarities inherited by Upper Silesia and the Donbas from state socialism. It shows that both regions had possessed a number of essential corresponding features such as the degree of industrialisation and urbanisation, positive economic performance, and inherited natural resources. Given that on a comparative classification scale only those post-communist countries which possessed oil and gas deposits have been considered to be richly endowed with natural resources (see De Melo et al. 1997), one should put coal-rich Upper Silesia and the Donbas into the ‘moderate’ category.

## INSTITUTIONS OF STATE SOCIALISM

In addition to the two regions’ commonalities in cultural, economic, and demographic spheres, by the mid-1980s Upper Silesia and the Donbas had also acquired several fundamental systemic institutional similarities.<sup>12</sup> Until the beginning of *perestroika* in the USSR in 1985 and subsequent revolutionary changes of the late 1980s – early 1990s, there were sixteen core communist countries in the world. Upper Silesia, as a Polish province, had become a part of the ‘world socialist camp’ (as the official Soviet terminology defined it), soon after the end of the Second World War. The history of state socialism in the Donbas was thirty years older, as the region had joined the Bolshevik revolution in Russia in October 1917. Notwithstanding a number of internal complexities and distinctions that existed amongst different communist countries, all of them were founded and functioned according to the generic organising principles of ‘a state-owned, more or less centrally planned economy, controlled by a dominant communist party which, seeks, on the basis of Marxism-Leninism and through the agency of the state, to mobilize the population to reach a classless society’ (Lane 1996: 5).

There are a large number of studies which provide a detailed description of the bases of the state socialist system in both its ‘classical’ and ‘reformed’ versions (Lavigne 1974; Kornai 1980, 1992a; Lane 1985, 1996; Nove 1987; Campbell 1991; Bornstein 1994; Brabant 1998). It would be beside the purpose of this book to review the complexity of the socialist project and of the evolution of state socialism. Generally following the established literature, in this section I only briefly examine five basic principles which defined the foundations of the system and the operation of socialist economies in the following domains: information and co-ordination mechanisms; labour relations, employment and wages; money and price arrangements; the welfare system; and the education and training sector. We will return to these five institutional domains in Part Three.

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<sup>12</sup> The theoretical discussion on the definition and nature of institutions will follow in Chapter 6.

Since 1917 in the case of the Donbas and 1945-1946 in the case of Upper Silesia, and until the mid-1980s, almost all production in the two regions had been in state hands. As the socialist state owned virtually all productive resources and assets and controlled prices and international trade, government planners were able to allocate capital and other factors of production according to the economy's central plan, which set production targets for all different sectors of the economy and determined the supply of different commodities. The bulk of agriculture and some small retail and craft activities remained non-socialised in Poland, whilst private agricultural plots also existed in the Soviet Union. However, even taking into account all private economic activities, the Polish socialist state owned and controlled in 1985 about 93 per cent of the production of goods and services in Upper Silesia. In the Donbas, the Soviet state owned and controlled over 91 per cent of production.<sup>13</sup>

A limited autonomy of decision-making existed in both Upper Silesia and the Donbas at the level of the so-called large socialist corporations – ‘big economic organisations’ (WOG - *wielka organizacja gospodarcza*) in Poland and ‘production associations’ (PO - *proizvodstvennoe ob'edinenie*) in the USSR, which were created as the key to modernisation and increased efficiency during the economic reforms of the 1970s in both countries (see Slay 1994: Chapter 1; Nove 1992: Chapter 13). With time, the mandatory – directive – character of the central plan was relaxed and party control over enterprises loosed. Yet, as most authors agree, the reforms of state socialism shared similar features and direction in all the countries (see Kornai 1992a; Lavigne 1999: Chapter 3). Thus, centralised planning as a mechanism for the co-ordination of the economy and the provision of information to economic agents was the first similar institutional feature which both Upper Silesia and the Donbas possessed by the end of state socialism.

The second common institutional feature of Upper Silesia and the Donbas at the outset of transformation was an extremely high level of employment protection, job stability, the centralisation and strong co-ordination of wage-setting arrangements, and high labour unionisation. In centrally planned economies, workers were assigned jobs according to plan. Since the end of the Second World War, labour movements were no longer directly constrained. Instead, workers were indirectly controlled through the regulation and the subsidisation of housing, and other various social security benefits that were distributed at the firm level and managed by branch trade unions. In most communist states, and in Poland and the USSR particularly, all labour (outside non-state-owned agriculture) was comprehensively unionised and organised through the official trade unions. In addition to guaranteeing job security and safety standards, managing social security and

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<sup>13</sup> These production figures are based on private-public employment patterns in agriculture, industry, and services and the share of the respective sector in the gross regional product. The assumption is that private production in agriculture and services was at least as efficient as the state-owned one. The entire industrial production had been in state hands in both Upper Silesia and the Donbas by the mid-1980s.

providing a large number of welfare benefits to their members, the most significant function of the official trade unions was to take part in a centralised and co-ordinated process of wage- and employment-bargaining with the government and party bodies.

During Poland's political crisis of the early 1980s, a large part of the Polish workforce left the official labour organisations and joined the unofficial opposition trade union *Solidarność*. Nonetheless, labour unionisation in Poland remained very high. In 1986, over 45 per cent of the Polish workforce belonged to the official All-Poland Alliance of Trade Unions. Together with members of unofficial trade-unions, about 80 per cent of Poland's total workforce was organised (Gardawski *et al.* 1999; Gardawski 2002). Given the overly industrialised character of Upper Silesia and relatively small share of agricultural employment, one can estimate that the degree of labour unionisation in the region was even higher than the nation's average. In the Donbas, and Ukraine generally, unofficial organisations were suppressed. However, membership in the official trade unions was close to 100 per cent of the total workforce (ITUFR 2000).

The socialist money and price system was the third similarity between Upper Silesia and the Donbas under state socialism. Money did not play an active role in the economy: central government planners set prices administratively for both goods and resources, whilst the survival of enterprises did not really depend on its profits but on its ability to negotiate the plan targets with the political authority and to attain additional 'soft' credits and direct subsidies from the particular ministerial bureaucracy. The soft budget constraint faced by a socialist firm was sponsored by the single state-owned Central Bank, which issued money as well as supplied loans and subsidies. Thus, besides performing the customary functions of a central bank and a state treasury under capitalism, this 'mono-bank' also performed the functions of capitalist commercial banks, handling personal savings accounts and issuing credits to firms. However, cash and non-cash money circulated separately: individuals were paid wages in cash and could only use cash in banknotes and coins for their payments. On the other hand, each state-owned enterprise was obliged to keep all its monetary funds in an account at the central bank, divided into several 'sub-accounts' for the payment of wages, purchase of inputs, capital investment, etc. The central bank governed how the firm could use the money, co-ordinated the entire non-cash flows of capital, and monitored the firm's performance. In addition to the extensive money finance of public expenditures and tight capital controls, the central bank exercised heavy exchange controls and maintained highly artificial fixed exchange rates. With minor revisions, this mono-bank financial system of state socialism survived in both Poland and the USSR until the very end of the 1980s, when it began to be replaced with a two-tier banking system, i.e. with a separate Central Bank and independent (state-owned) commercial banks (Kornai 1992a: Chapters 8 and 23; Jezierski and Leszczyńska 1999: Chapter 11.9; Lavigne 1999: Chapter 1).



The fourth institutional similarity between Upper Silesia and the Donbas was the system of social protection and public welfare, which was one of the main pillars of state socialism. The welfare sector in Poland, the USSR, and other industrially developed communist countries was huge, generous, and universal, 'from the cradle to the grave'. Even the most ardent critics of state socialism admitted that there was a welfare net to catch everyone (Kornai 1992a: 312). There was full employment. The health service was free to all citizens. There was a centralised, comprehensive public pension system. (In Poland there were some public welfare limitations for private farmers). The provision of housing was also at a very low non-market cost. The maintenance of housing, public transport and other municipal services were heavily subsidised. Prices for food and other necessities were subsidised as well. Wage differentials were exceptionally low and most state socialist countries were egalitarian societies, as far as money income was concerned. Public security was tight and crime was low. Additionally, on the enterprise level, all trade union members were entitled to free or subsidised vacations at health resorts and sanatoria, children summer camps, gardening plots, etc. In 1985, 12 per cent of the average household income in the Donbas was comprised of various welfare payments and social security benefits. In total, over 21 per cent of the regional population were dependent on the public social security system (i.e. public pensions, stipends, allowances, and other welfare benefits) for living (DOSO 1991a: 44-51). In Upper Silesia, the role of the socialist welfare system was even higher. Even excluding non-employed households (i.e. farmers, pensioners, disabled),<sup>14</sup> which relied more heavily on social security, almost 10 per cent of the average working household income was comprised of social security payments (VSO 1986, 1989).

The final pre-transformational institutional similarity between Upper Silesia and the Donbas under consideration was the education and training sector. Under state socialism, primary, secondary, and tertiary education was provided by public (state) institutions free of charge. Substantial financial support and scholarships were provided for undergraduate and graduate students, who were admitted to universities and other institutions of higher education on a selective and highly competitive basis. Besides a small number of Church-related higher educational establishments, which functioned in both Poland and the USSR, the importance of the state in the public-funded and highly centralised system of education was paramount. The nature of the public education systems in both countries was utilitarian, scientific, and secular. The state bodies maintained a very high degree of curricula standardisation. Furthermore, the education sector was characterised by the high differentiation between 'general' (primary, lower secondary, and general

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<sup>14</sup> Available Upper Silesian household surveys of the 1980s excluded 'non-working' households from the published sample.

secondary education) and ‘vocational’ programmes (technical and vocational education). Although vocational training was mainly school-based, potential employers were institutionally linked to vocational schools for industry- or trade-specific training of pupils on the shop floor level. In addition, similar to the French system of public education, differentiation was also extended to higher education, where there were specialist subject oriented institutions of higher education (e.g. engineering, foreign languages, health care, polytechnics). Given the economic structure of Upper Silesia and the Donbas, the importance of vocational and technical education was especially high (see Szczepański 1996; Sarzhan 1999: Chapters 2.6 and 3.5).

## **CONCLUSION**

I have argued that at the outset of post-communism, in the mid-1980s, Upper Silesia and the Donbas possessed four fundamental cultural, structural and institutional similarities. First, both regions were geographical and historical multi-cultural borderlands characterised by particular regionalist identities, distinctive from the rest of Poland and Ukraine respectively. Second, both Upper Silesia and the Donbas were highly and heavily industrialised economies. Coal-mining, iron and steel, and heavy engineering were major sources of income for the two regions. Thirdly, the two East European regions were amongst the most urbanised and densely populated areas on the continent. Finally, after decades of state socialism in Poland and the USSR, both regions had acquired a number of analogous institutional characteristics: a system of centralised planning and management of the economy; highly unionised labour, co-ordinated wage-setting and centralised trade unions; a communist mono-bank financial sector; an exceptionally high degree of social protection and a large universal public welfare system; and a public education system with special emphasis on standardisation, vocational training, science and technology. Thus, following the logic of the comparative method, in this chapter I have established the initial base for our comparative inquiry by identifying a large number of characteristics (variables) shared by Upper Silesia and the Donbas at the outset of the post-communist transformation. All these variables will be treated as constants for the initial stages of post-communism. The cultural and demographic variables, which are not subject to substantial change, will remain as controlled variables for the entire period under scrutiny. It is contended the institutional and economic variables will be affected by the consequent stages of the transformation and, thus, will become a part of the explanation. In the following two chapters I complete this book’s methodological construction by identifying divergent transformation patterns and outcomes produced by two similar post-communist regions.

## **Different Trajectories: the Economic Performance of the Two Regions during the Transformation**

Having sketched the major features of the two largest industrial regions of Eastern Europe at the outset of transformation, the book turns to the outcomes of post-communism in Upper Silesia and the Donbas. The post-communist enterprise was inaugurated in the late 1980s with the aim of catching up with industrially advanced nations of the West. It was then conceived, at least in Eastern Europe, as a ‘transition’ towards capitalism or the free market economy, which was widely regarded as the most efficient system of social organisation capable of generating a higher level of economic development and assuring a better quality of life than those produced under state socialism. Therefore, by ‘outcomes’ of the post-communist transformation I mean, firstly, the economic performance of Upper Silesia and the Donbas under post-communism, and, secondly, the level of economic, social, and human development achieved in Upper Silesia and the Donbas as a result. How have Upper Silesia and the Donbas performed under post-communism? What impact, both short and long term, has post-communism had on the social and developmental prospects of the two old industrial regions? How similar or different were the transformation trajectories followed by each region? I will explore these issues in the following two chapters.

The primary concern of this chapter is the economic performance of Upper Silesia and the Donbas between the second half of the 1980s and the early 2000s. First, I propose and examine indicators of industrial production and economic growth for the two regions. Second, the macroeconomic, employment, and welfare stability of Upper Silesia and the Donbas under post-communism are considered. Third, I discuss the timing of the two regional performance trajectories. It is contended that the post-communist transformation is multi-stage. I will argue that there is a basic similarity between the two transitional regions. This similarity lies in the general direction of macroeconomic stabilisation processes in the two regions and of their economic and output growth paths – from decline to recovery, followed by late expansion. Nevertheless, the post-communist performance of the two old industrial regions has varied considerably. A number of crucial indicators are different and show no signs of potential convergence.

## GROWTH

### Industrial output

We begin by examining the evolution of the Upper Silesian and Donbas regional industrial output since the beginning of *perestroika* in the USSR in 1985 and subsequent structural reforms in Eastern Europe. Figure 2.1 shows the annual change in industrial output of the two regions between 1985 and 2004. It also provides approximated output trend lines for Upper Silesia and the Donbas within the period covered.

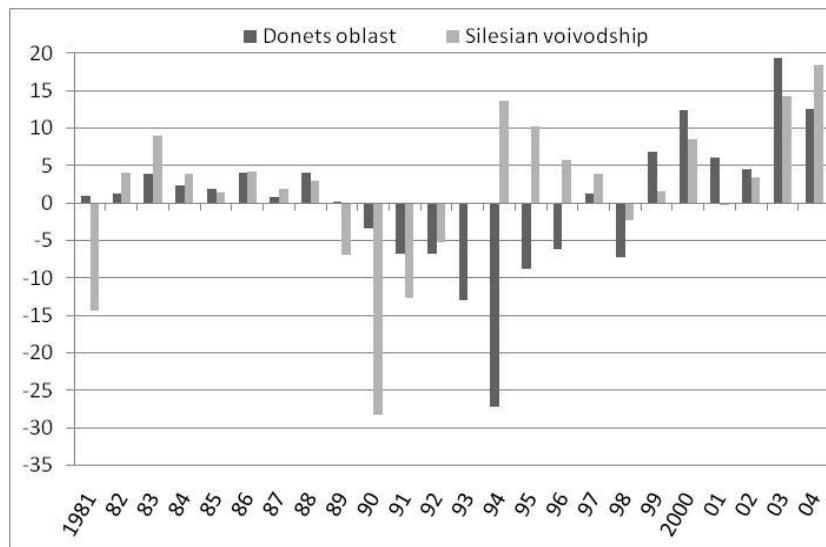


Figure 2.1. Industrial production growth in Upper Silesia and the Donbas, annual percentage change, 1985-2004

Source: Author's calculations on the basis of VSO (1989, 1991, 1992, 1994, 1996, 1997, 1998); SOK (1999, 2000, 2001, 2002a, 2004a, 2004d); DOSO (1991a, 1992a, 1993, 1994, 1995, 2000, 2002, 2003); DOCSO (2004a, 2004b).

Figure 2.1 indicates that both regions first experienced decline in industrial output in 1989. However, whilst Upper Silesian industries returned to growth in 1994, in the Donbas the industrial recovery arrived three years later in 1997. Thus, it appears that while Upper Silesia experienced five consecutive years of industrial production decline, the corresponding figure for the Donbas was eight years. Figure 2.1 also shows that the growth trend lines of the two regions have not coincided. Upper Silesia experienced the largest output collapse within the first three years of transformation in the early 1990s. By contrast, in 1990-1992, the Donbas experienced a comparatively modest decline in industrial production, while the output sharply collapsed afterwards. 1994 was the best year for the Upper Silesian industries in the 1990s and, conversely, the worst year for the Donbas

industrial production. Yet how deep was the output collapse and how fast was the recovery that followed?

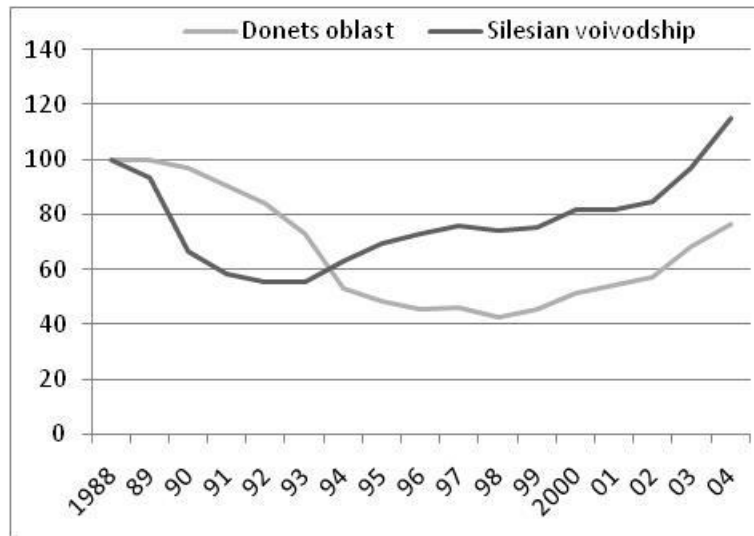


Figure 2.2. Post-communist industrial output trajectories, Upper Silesia and the Donbas, volume indices, 1988-2004 (1988 = 100)

Source: Author's calculations on the basis of VSO (1989, 1991, 1992, 1994, 1996, 1997, 1998); SOK (1999, 2000, 2001, 2002a, 2004a, 2004d); DOSO (1991a, 1992a, 1993, 1994, 1995, 2000, 2002, 2003); DOCSO (2004a, 2004b).

To avoid using the 1990 or 1991 output level as a comparative transition performance yardstick, I have recombined the regional growth figures into volume indices, using 1988 – the last year of growth in both of the regions – as the zero year for Upper Silesia and the Donbas. Figure 2.2 demonstrates the basic similarity in the output performance of Upper Silesia and the Donbas under post-communism: both regions had experienced a very deep output fall, followed by a robust recovery. Between 1988 and 2004, in total, there had been seven and eight years of registered industrial production decline in Upper Silesia and the Donbas respectively. During this transitional recession, or what was more appropriately labelled as the ‘Great Transitional Depression’ (Kołodko 2000a), Upper Silesia’s cumulative industrial output decline amounted to 45 per cent. The industrial decline in the post-communist Donbas resulted in the loss of 57 per cent of its initial level of measured output. It is also evident from Figure 2.2 that, given the length of the Donbas output decline, the regional industries have not yet fully recovered. Yet, the industrial output almost doubled since 1998. According to the output volume index, in 2004 the Donbas industrial production already stood at 80 per cent of its pre-transformation level. The Upper Silesian industries fully recovered from the detrimental effects of the post-communist depression at the beginning of 2004. In 2004, the region’s industrial production expanded to 120 per cent of its 1988

level. Similar to the data presented in Figure 2.1, Figure 2.2 also indicates the existence of a four- or five-year-long time lag between the Silesian and Donbas industrial output trajectories. I shall return to this issue in the concluding sections of the chapter.

*Table 2.1.* Three transformation periods in Upper Silesia and the Donbas, average industrial growth per period, 1989-2004

	<i>1989-93</i>	<i>1994-98</i>	<b>1999-2004</b>
	<i>Average annual % growth</i>		
Upper Silesian industrial output	-9.0	6.9	10.2
Donbas industrial output	-5.4	-8.3	14.4

*Source:* Author's calculations on the basis of VSO (1989, 1991, 1992, 1994, 1996, 1997, 1998); SOK (1999, 2000a, 2001, 2002a, 2004a, 2004d); DOSO (1991a, 1992a, 1993, 1994, 1995, 2000, 2002, 2003); DOCSO (2004a, 2004b).

Another feature of the post-communist transformation in Upper Silesia and the Donbas has been its multi-stage character. Different phases have produced several major fluctuations in growth rates. Table 2.1 aggregates the post-communist business cycles into three basic periods. During the initial stage of the post-communist transformation in 1989-1993, the Upper Silesian industry was contracting by 9 per cent annually; in the second phase of 1994-1998, it returned to growth at the pace of nearly 7 per cent per year; and in the final phase of 1999-2004, the Upper Silesian industry has been growing at 10 per cent a year, on average. The Donbas industrial output was declining during the first phase at the average speed of 5.4 per cent annually, before collapsing in the second phase by an annual average of 8.3 per cent. During the final transformation phase of 1999-2004, the Donbas industry was rapidly recovering at 14.4 per cent a year on average. If such growth tempo is sustained, the Donbas industry would regain its pre-transformation level of output by the second half of 2005.

### **Overall economy**

In addition to industrial production, the most essential, yet more statistically complicated, criterion of the post-communist performance is the growth of the overall economy (i.e. of industry as well as agriculture and services) assessed through gross domestic product. A number of researchers have questioned the quality of transitional statistics for their disregard of a prospering shadow economy, i.e. unreported and illegal economic activities (Dobozi and Pohl 1995; Friedman, Johnson, Kaufmann, and Zoido-Lobatón 2000; Åslund 2001a, 2001b). De Broek and Koen (2000), in their detailed comparative analysis of the shadow economy accounts, have argued that the extent

of the industrial collapse during the initial phases of transformation can hardly be disputed.<sup>15</sup> Nevertheless, most authors agree that during the 1990s a large share of economic activities in agriculture and, especially, in the service sector have not been properly accounted for. According to a research database compiled by Friedman and others, the share of the shadow economy in Poland on the electricity-consumption basis reached as high as 20.3 per cent of the official GDP in the early 1990s, dropping to 12.6 per cent by 1995 (cf. Smejda 1996). The shadow economy share in Ukraine, according to these researchers, in the early 1990s was 28.4 per cent of the official GDP, growing to 49 per cent by 1995 (cf. Kaufmann 1997). There have been a large number of other contradictory estimates of the informal economy as well (for a summary, see IMF 2003a). Table 2.2 provides a more coherent picture. No separate data on either Upper Silesia or the Donbas are available, however.<sup>16</sup>

*Table 2.2.* A comparison of the shadow economy estimates relative to official GDP in Poland and Ukraine, percentage, 1990-2002

	1990-93	1995	1997	1998	1999	2000	2001	2002
Poland	20.3	12.6	n/d	n/d	n/d	n/d	n/d	n/d
Ukraine	28.4	48.9	43.6	42.7	40.4	37.3	35.6	34.7

*Source:* Friedman *et al* (2000); IMF (2003a: 17-23).

Since the late 1990s, both the Polish and Ukrainian central and local statistical agencies have been tackling the issue of including the ‘shadow economy’ estimates into official GDP statistics. Official statistical yearbooks published in Poland and Ukraine (and, consequently, in Upper Silesia and the Donbas) since the late 1990s cover the ‘hidden economy’ to a greater extent. While the coverage of the shadow economy by the Polish Central Statistical Office is believed to be within the Western standard, i.e. it includes most of the informal economy into the official statistics (see PCSO 2002: 538-39), almost one half of the Ukrainian shadow economy is said to be still unaccounted. According to the IMF, about 50 billion hryvnia, or 23 per cent of Ukraine’s official GDP in 2002

<sup>15</sup> These claims that the output collapse was just an illusion were recently investigated by de Broek and Koen. The two researchers have applied electricity consumption, freight transportation, and postal deliveries as alternative proxies for actual GDP. De Broek and Koen have also compared the economic performance of the transition countries with that of Finland, where the quality of the national accounts data was believed to be far superior to any post-communist state. Their conclusion was that even in advanced market economies the three alternative economic activity indicators do not typically correlate with actual GDP; yet, ‘even so, the sharp falls in electricity use, freight and mail observed in the Baltic and CIS countries support the view that the magnitude of the economic contraction was indeed extreme’ (De Broek and Koen 2000: Appendix II).

<sup>16</sup> The latest World Bank estimates of the informal economy (as percentage of gross national income in 2003) in Poland and Ukraine are 27.6% and 52.2% respectively, or almost twice as high as the ones reported in Table 2.2 (see World Bank 2005). Nevertheless, for alternative GDP calculations I have used the IMF estimates of the shadow economy, as they appear to be more consistent and complete.

was excluded from the official data (IMF 2003a: 22). In 2003, according to the Ukrainian State Tax Administration authorities, the total economic activity not captured in the official statistics was over 70 billion hryvnia (*LIGA Business Inform Newswire*, 9 February 2004), or 27 per cent of the official GDP that year (i.e. UAH 263.228 billion).

On the basis of the improved official national and international statistics and taking into account the data presented in Table 2.2, I have constructed a number of GDP time series for Upper Silesia and the Donbas. To account for some missing data inputs, e.g. the sub-national power purchasing parity (PPP) exchange rates needed to convert Silesian and Donbas gross domestic product figures in Polish złoty and Ukrainian hryvnia into US dollars, I have had to use the corresponding national purchasing power parity exchange rates provided by a number of international economic organisations. Most importantly, given the territorial changes that affected Silesia in the course of the 1999 administrative reform (most of the data on the newly-formed administrative-territorial entities are available from 1995 on-wards), I have had to construct the 1988-1994 gross regional product statistics for the post-1999 Silesian voivodship. This task was accomplished, firstly, via ‘bottom-up’ regression-based analysis by using the necessary data for Katowice, Częstochowa, and Bielsko voivodships (e.g. the GDP per head and population ratios of those voivodships in currently existing Silesian voivodship) to arrive at combined pre-1995 indicators. On the other hand, to assure that such data comparisons are viable over time, I have also constructed ‘top-down’ gross regional products figures for Silesian voivodship from 1988 to 1994 by using the available statistics on the voivodship’s population and its share in the national GDP from 1995 to 2001 and making necessary regression calculations back to 1988. All my calculations were again cross-checked against the relevant data provided by various World Bank, United Nations, IMF and OECD data sets, as well as by the Polish, Ukrainian, Upper Silesian and Donbas statistical agencies.

Figure 2.3 illustrates a complex picture of the post-communist economic performance of Upper Silesia and the Donbas. There are two main findings here. Similar to the industrial production trends, both regions experienced an initial decline in their gross regional products, which was later followed by recovery. The economic decline in Upper Silesia was also not as deep as in the Donbas. In current market prices, the Upper Silesian economy contracted by 23 per cent in the early 1990s. By 1993, the Donbas economy contracted by over 47 per cent of its 1988 level according to the official statistics, or by 37 per cent, including the informal economy share. There is also a substantial difference in assessing the regional economic performance in US dollars at current market prices and at the purchasing power parity rate. At current market prices, the Silesian GDP per capita in 1988 stood at \$3816, dropping to \$2945 in 1990, and rising to \$7438 in 2004. In the Donbas, the GDP per capita amounted in 1988 to \$1298, falling to \$807 in 1992, and reaching



\$1826 in 2003 (or only 25 per cent of Upper Silesia's GDP). At PPP, the Silesian GDP per capita declined from \$8463 in 1988 to \$7886 in 1991, rising continuously afterwards to \$14,266 in 2004. In the case of the Donbas, the GDP per capita at PPP fell from \$6212 in 1988 to \$2805 in 1998, expanding later to \$7003 in 2004.

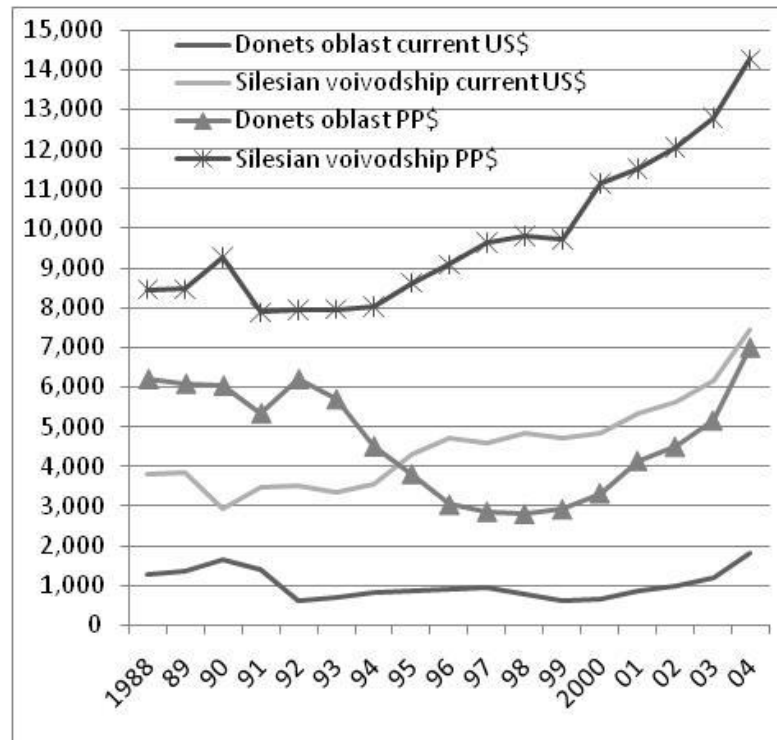


Figure 2.3. Economic growth under post-communism, GDP per capita, Silesian voivodship and Donets oblast, 1988-2004, US\$

Source: Author's calculations on the basis of UkrSSR SSC (1987, 1988); DOSO (1991a, 1992a; 1993; 1994, 1995, 2000, 2002); DOCSO (2004a, 2004b); USSC (2000, 2002, 2003, 2004a); PCSO (2000, 2001, 2003, 2004a); VSO (1989, 1991, 1992, 1994, 1995, 1996, 1998); SOK (2000, 2001, 2002a, 2003a, 2003b, 2004a); Szczepański (1998a: 43); World Bank (1991, 1996, 1999, 2000c, 2001, 2003a, 2003b); UNDP (1996, 1999, 2002a, 2002b, 2002c, 2003, 2004); Easterly and Sewadeh (2001); UN (2003); IMF (2003a); OECD (2004a, 2004g); some data inputs are estimates based on regression.

Thus, although the level of industrial production in the two regions has only recently approached full recovery, Figure 2.3 clearly indicates that by 2005 both of the overall regional economies not only fully recovered to their pre-transformation levels but also expanded substantially beyond. The common upward growth trend becomes even more apparent when the remaining estimated shadow economy share is added to the one already included in the official statistics: the data presented in Figure 2.3 show that the overall size of the Upper Silesian economy

in 2004 was 195 per cent of its 1988 level at current market prices and 169 per cent at purchasing power parity prices. In the Donbas, the corresponding figures were 141 per cent and 113 per cent respectively. The phase of recovery and economic expansion in Upper Silesia has begun much earlier than in the Donbas. Yet, as Figure 2.3 shows (similar to the industrial output trajectories), after a period of diverging economic performance, since the late 1990s both regions have been following a similar ascendant growth trajectory.

### STABILITY: PRICES, EQUALITY, EMPLOYMENT

Post-communism has generated several major fluctuations in economic and industrial growth rates. Yet, the transformation has brought a much more unstable macroeconomic environment. Prices have risen dramatically. The regional statistical agencies do not provide consistent time-series data on retail price inflation or producer price indices in Upper Silesia or the Donbas during transition. However, the nation-wide inflation indicators in Poland and Ukraine are only marginally different from the sub-national ones. The data are shown in Figure 2.4.

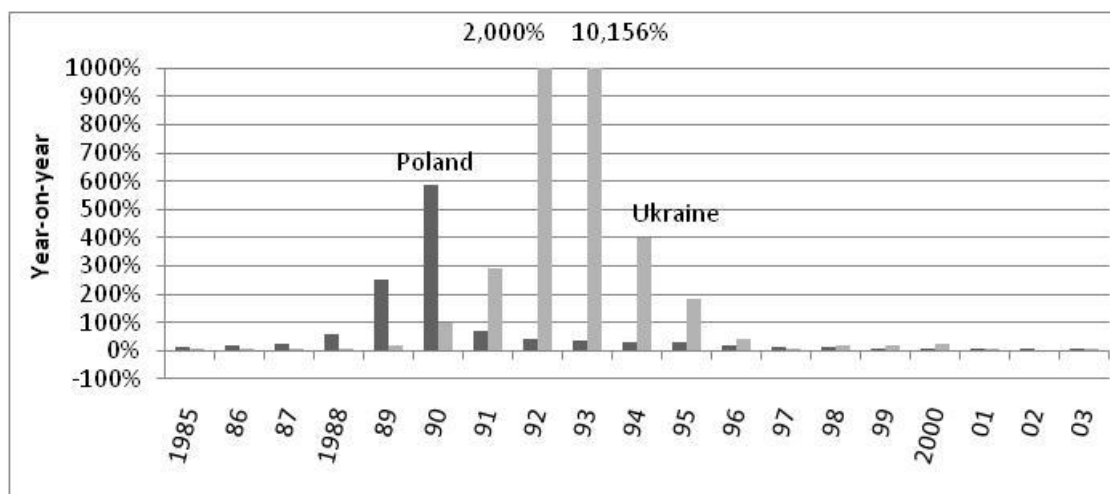


Figure 2.4. Retail price inflation rates, Poland and Ukraine, 1985-2003, annual percentage change  
 Source: USSC (2000, 2002, 2004a); PCSO (2004).

It indicates that both Polish and Ukrainian regions suffered from very high inflation in the first half of the 1990s, albeit within different time frames. After a relatively short period of hyperinflation experienced by Poland in 1989 and 1990, the price levels stabilised soon afterwards. In Ukraine, however, inflation rates of over 100 per cent per year lasted for five years, while in 1992 and 1993 the price levels rose even more dramatically, growing by 2000 per cent and 10156 per cent respectively. On the overall comparative scale, an item that was priced at 1 rouble in the

Soviet Donbas in 1985 would cost today around 950,820 roubles (i.e. 95 Ukrainian hryvnia). In Upper Silesia, the corresponding ratio is much less dramatic: from 1 złoty in 1985 to 623.9 złoty in 2003 (i.e. 0.00623 new Polish złoty) (author's calculations on the basis of USSC 2000, 2002, 2004a; PCSO 2004a). Since the mid-1990s, both post-communist regions have been enjoying a period of low inflation.

In addition to price instability, post-communism has also resulted in a great disparity in income, wealth, and consumption (for a detailed discussion, see World Bank 2000a). While examining the economic growth in the two transitional regions, I have discovered that under post-communism Upper Silesia's gross regional product per capita grew by 49 per cent in purchasing power terms, whilst in the Donbas that figure increased by 28 per cent. The relative similarity in the economic expansion notwithstanding, the question of this sub-section is how has that growth been distributed? It appears that wealth and income distribution is a sphere that was fundamentally but asymmetrically destabilised by post-communist changes in the two regions.

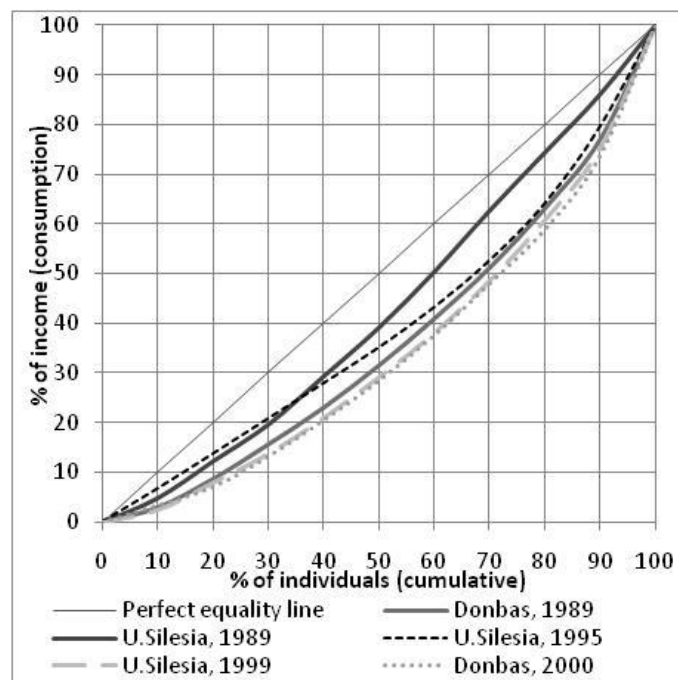


Figure 2.5. Lorenz curves of wealth distribution, Upper Silesia and the Donbas, 1989-2000

Note: (i) *Donbas 1989* curve is based upon a comprehensive Donets oblast households income distribution survey data; (ii) *Upper Silesia 1989* curve is based upon a Katowice voivodship working households income distribution survey data; (iii) *Upper Silesia 1995* curve is based upon a Katowice voivodship full-time employment gross wage and salary distribution data; (iv) *Upper Silesia 1999* curve is based upon a Silesian voivodship full-time employment gross wage and salary distribution data; (v) *Donbas 2000* curve is based upon a comprehensive Donets oblast households expenditure distribution survey data.

*Source:* Author's calculations on the basis of household survey data from DOSO (1991a, 2002); VSO (1989); Szpor (1996); SOK (2000a); PSCO (2001).

Figure 2.5 provides a graphical representation of Lorenz curves which indicate the degree of income inequality in the pre- and post-transformational Donbas and Upper Silesia. I have constructed the appropriate Lorenz curves on the basis of several Donbas and Upper Silesian regional household and wage surveys conducted between 1988 and 2000. The two Lorenz curves for the Donbas that are shown in Figure 2.5 are fully comparable over time, since they are based on two comprehensive household income and consumption surveys conducted in 1989 and 2000 respectively. Given that an analogous complete household income survey for Upper Silesia has never been made widely accessible,<sup>17</sup> I have had to rely on other types of income distribution-related statistics to assess the magnitude of the change in inequality in the Polish region under post-communism. Upper Silesia's Lorenz curve for 1989 is based upon a survey of income distribution amongst working households, i.e. one or two-person employed households; thus, the 1989 survey excluded self-employed farming, unemployed, and retired households. To a certain extent, it can be compared to the Donbas's pre-transformational indicator. The other two Lorenz curves for Upper Silesia are only comparable between each other, as they are constructed on the basis of full-time gross wage and salary distribution data, which are only partially representative of the average wealth distribution pattern in the region.

These differences in the presented data notwithstanding, Figure 2.5 indicates that under state socialism the Upper Silesian society was characterised by a much more equal income distribution pattern than the one in the Donbas. However, under post-communism inequality in Upper Silesia has increased considerably. Figure 2.5 shows that the latest available Lorenz curves for the Donbas and Upper Silesia have virtually converged. Yet, the average wage and salary patterns are typically characterised by a more equal income distribution than the overall distributive picture in the society, as they exclude the aged, sick, and unemployed. Given that the inequality indicator for the post-communist Donbas is inclusive and comprehensive, whereas the respective Upper Silesia's curve line is partially representative, one can suggest that in the course of the post-communist transformation the level of income inequality in Upper Silesia has not only grown to a larger extent, but it has considerably overreached the Donbas's inequality level. Figure 2.5 shows that, in contrast to Upper Silesia, income inequality in the Donbas has only marginally increased under post-communism.

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<sup>17</sup> The Polish Central Statistical Office regularly publishes only nation-wide household surveys.

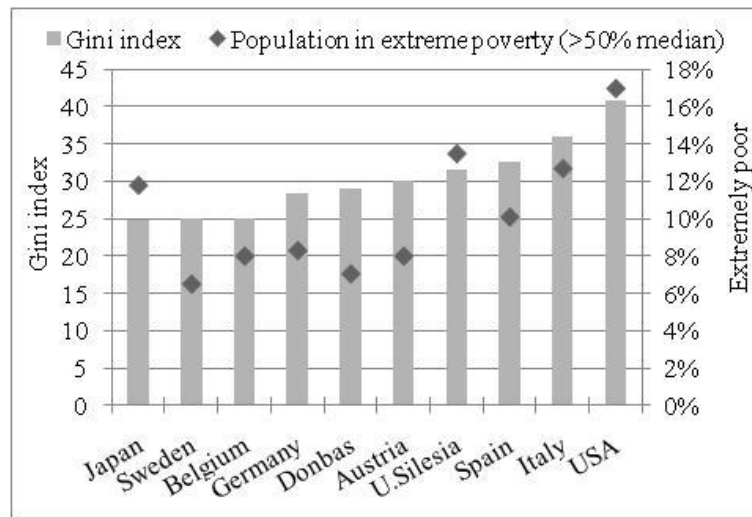


Figure 2.6. Income inequality and poverty in Upper Silesia and the Donbas under post-communism, international comparison, 1999-2000

Note: Gini coefficient index: 0 = perfect equality, 100 = perfect inequality. Extreme poverty rate: percentage of population below 50% of national median income or consumption. Gini coefficient indices of Upper Silesia and the Donbas are national averages for per capita consumption; the remainder are for per capita income.

Source: Author's calculations on the basis of World Bank (2000a, 2000b); UNDP (2004); SOK (2000a); PSCO (2001, 2004b).

Although inequality increased in both regions, on a wider comparative scale, the distribution of income and household consumption patterns in the Ukrainian region remained fairly egalitarian. The Gini coefficient (which is the most often-used inequality index) for per capita consumption rose across Ukraine from 24.0 in 1987 to 29.0 in 1999, whereas in Poland the increase was more acute, from 25.8 to 31.6 respectively (Deininger and Squire 1996; World Bank 2000a, 2000b; UNDP 2004). Figure 2.6 shows that, in addition to the modest rise in income and consumption inequality, the process of transformation in the Donbas has also been characterised by a slight increase in relative impoverishment. There are a number of ways of defining income poverty lines. According to one of the standard household survey methodologies used in this chapter, a relative poverty line of 75 per cent of the median adjusted disposable household expenditures (or income) is usually chosen as a criterion for poor households, 60 per cent of median expenditures (or income) is used as a criterion for very poor households, and 50 per cent of median expenditures as a criterion for extremely poor households (see World Bank 2000b). On its right scale, Figure 2.6 shows the percentages of the population living in extreme relative poverty in Upper Silesia and the Donbas and in some high-income OECD member states. Figure 2.6 indicates that the share of the Donbas population living in extreme relative poverty in 1999-2000 (7.1 per cent of the entire population)

were on par with those registered in some of the most egalitarian societies of Continental Europe (e.g. see Belgium, Germany, Austria), and far below the relative poverty levels observed in Upper Silesia (13.5 per cent) or elsewhere (e.g. see Spain, Italy, Japan, the United States). Thus, by the beginning of the twenty-first century, Upper Silesia reached a relatively high degree of income inequality and extreme poverty, analogous to that of Southern European countries, whereas the Donbas experienced a moderate rise in both consumption inequality and extreme poverty levels, analogous to those of Continental Europe.

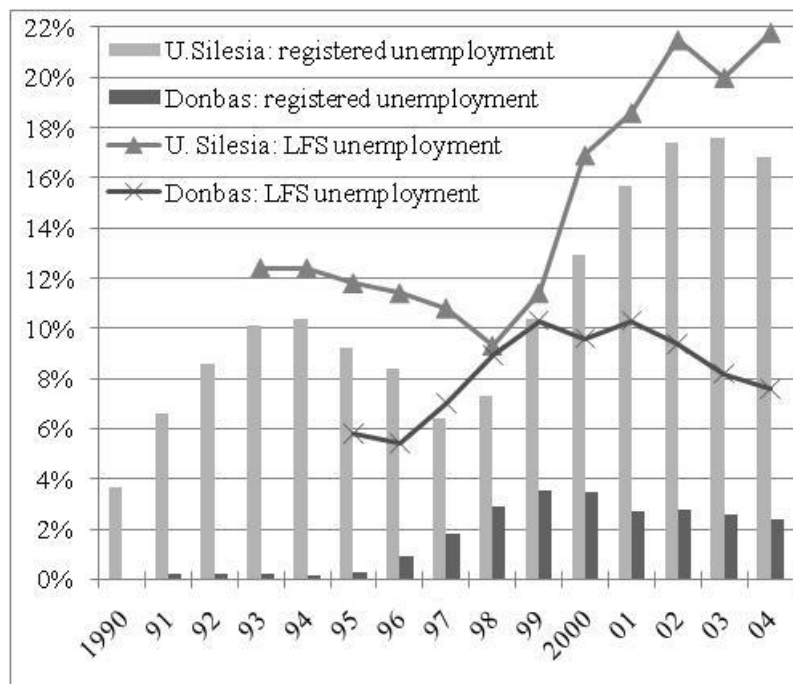


Figure 2.7. Unemployment in Upper Silesia and the Donbas, 1990-2004, annual percentage rates, end of year (registered unemployment) and the first quarter of each year (labour force survey unemployment)

Source: Author's calculations on the basis of DOSO (2000, 2002, 2003); DOCSO (2004a, 2004b); USSC (2000, 2002, 2003, 2004c); VSO (1995, 1996, 1998); SOK (2000a, 2002b, 2003a, 2003c, 2003d, 2003e, 2004a, 2004b, 2004c); IMF (2003b).

In addition to prices and income distribution, stability of employment was another casualty of the post-communist transformation in both regions. Contrary to its more stable growth and price level patterns, Upper Silesia has been much less successful in utilising its labour resources. Figure 2.7 combines Upper Silesia's and Donbas's rates of officially registered unemployed people as well as labour force survey-based unemployment rates, compiled according to the International Labour Organisation methodology (i.e. the so-called real unemployment rates). As Figure 2.7 shows, during the post-communist transformation unemployment has risen in both Upper Silesia and the Donbas.

However, in the Donbas the number of jobless people has been smaller. The officially registered unemployment rate in the region has never moved beyond a 4 per cent threshold. The ‘real’ unemployment rate, which peaked in the Donbas at 10.3 per cent in 1999, has been twice as low in the Ukrainian region as in Upper Silesia throughout the entire transformation period. In turn, in Upper Silesia, unemployment has been extremely high most of the time, reaching its maximum level of 21.8 per cent of the economically active labour force by the second quarter of 2004. Thus, one can conclude that with the average registered unemployment rate of 11 per cent between December 1990 and September 2004, the persistent lack of jobs has turned into a chronic socio-economic problem in Upper Silesia. The average rate of registered unemployment in the Donbas during the same period was 6 times lower.

### TRANSFORMATION TIME LAG?

I have established that the multi-stage post-communist performance trajectories of Upper Silesia and the Donbas do not easily coincide. Therefore, besides examining the regional performance trends in a conventional time-consistent way, one has also to examine them with some time-lagging. In the following time-lagged figures, which are based on the data already presented in this chapter, I have taken 1989 as the Year 0 for Upper Silesia and 1993 as the Year 0 for the Donbas.

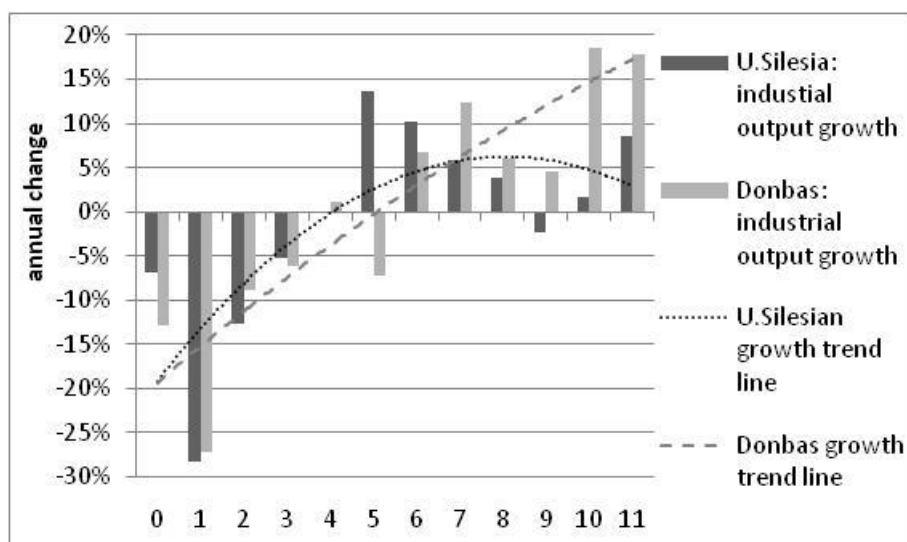


Figure 2.8. Industrial production growth in Upper Silesia and the Donbas, annual percentage change, time-lagged scale

Note: Year 0 = 1989 for Upper Silesia and 1993 for the Donbas.

This would take account of the fact that Upper Silesia and Poland generally were the first in the post-communist bloc to start full-scale market-oriented reforms (the ‘shock therapy’ strategy designed by Jeffrey Sachs and Leszek Balcerowicz) on 1<sup>st</sup> January 1990. By contrast, the radical neo-liberal economic programme was initiated in Ukraine in late October 1994, after the presidential election of Leonid Kuchma. Firstly, Figure 2.8 presents time-adjusted annual percentage changes in industrial production. It shows that the industrial output growth trends of Upper Silesia and the Donbas have indeed been rather similar, especially at the early stages of the economic transformation and before exogenous factors came into play. Year 5 for the Donbas and Year 9 for Upper Silesia in Figure 2.8 are the year 1998, when a financial crisis damaged South East Asia’s and Russia’s import capacities and, consequently, interrupted the recovery of industrial output in transitional countries, and particularly in the Donbas.

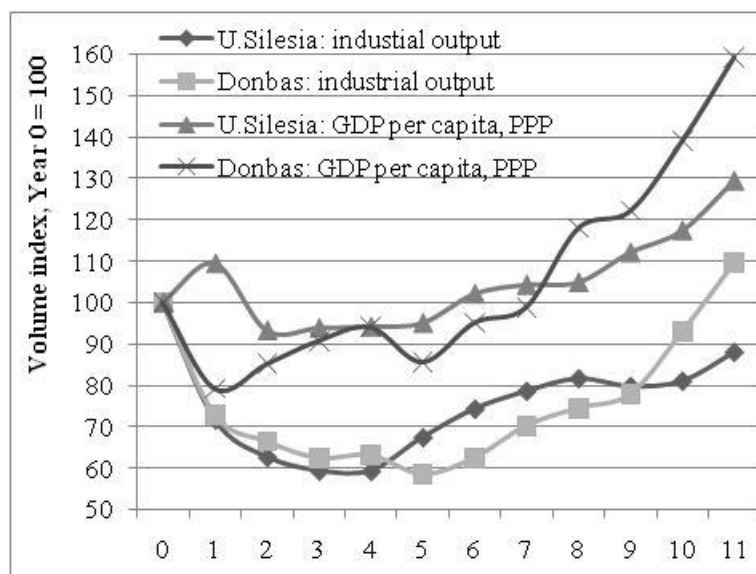


Figure 2.9. Industrial output and GDP growth trajectories in Upper Silesia and the Donbas, volume indices, time-lagged scale, year 0 = 100

Note: Year 0 = 1989 for Upper Silesia and 1993 for the Donbas.

Secondly, a certain similarity between the transformation growth trajectories of Upper Silesia and the Donbas becomes more evident in Figure 2.9, which shows the volume indices of growth in industrial output and GDP. It indicates that, with a time-lag, both Upper Silesia and the Donbas have generated relatively similar responses as regards the industrial and general economic performance. Moreover, the Donbas’s economic recovery appears to be much more rapid. The difference in the GDP curves produced in Year 1 of the transformation should be attributed to the initial appreciation of domestic currency at the purchasing power parity exchange rate, which was experienced by Poland in 1990 (i.e. the Year 1) during the introduction of the ‘shock therapy’. In



Ukraine, changes in the monetary sphere occurred in 1992 as a result of the collapse of the Soviet Union and abolition of its former currency (i.e. the Year -1).

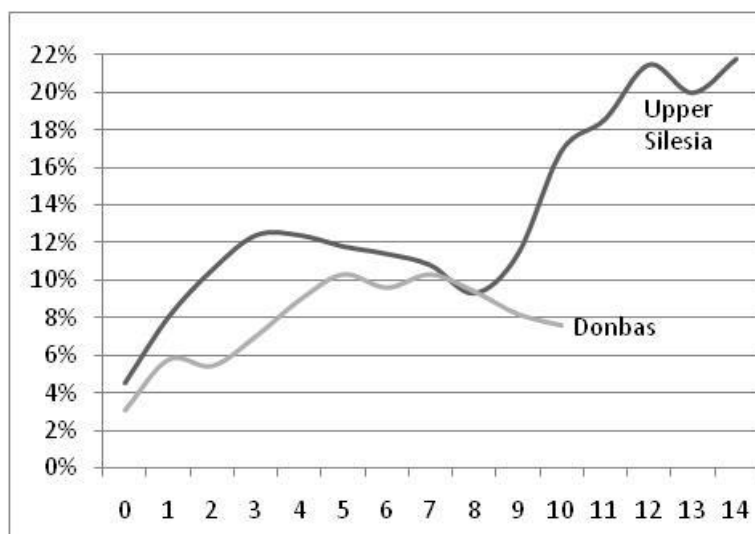


Figure 2.10. Unemployment in Silesian voivodship and Donets oblast, annual percentage rates, end of year, ILO methodology, time-lagged scale

Note: Year 0 = 1990 for Upper Silesia and 1994 for the Donbas

Some similarity in the post-communist transformation performances of Upper Silesia and the Donbas can also be observed in Figure 2.10, which contrasts the two regional unemployment trends. While comparing the unemployment growth trajectories, I have moved the time scale one year further to take into consideration certain structural inertia which is believed to characterise labour markets. Thus, the Year 0 for Upper Silesia in Figure 2.10 is 1990, and it is 1994 for the Donbas. Figure 2.10 shows that the implementation of radical market-oriented reforms was accompanied by growing unemployment in both Upper Silesia and the Donbas. By the end of the first transformation decade, unemployment began to subside in both regions. However, whilst in the Donbas unemployment continued to decline steadily afterwards, sinking below 8 per cent of the labour force, in Upper Silesia unemployment began to rise once again, doubling within the following three years. This finding casts a strong doubt over the simple evolutionary argument that, with time, the post-communist trajectories of the two regions ought to converge. The remarkable dissimilarity in the regional labour markets' behaviour as well as the different poverty and inequality trends observed under post-communism in Upper Silesia and the Donbas, suggest that besides the timing of the general market-oriented reforms, there must have been a number of other intervening independent variables at work. We shall return to this issue in Part Four.

## CONCLUSION

I have argued that post-communist transformation is a multi-stage process. It has been contended that within different stages there are a number of similarities in the post-communist economic performance of Upper Silesia and the Donbas. Firstly, the general direction of the two regional output trajectories as well as of their macroeconomic stabilisation patterns has been very similar. I have identified three different and distinctive phases of post-communism as experienced by Upper Silesia and the Donbas: the initial transformation period of the late 1980s – first half of the 1990s; the intermediate period of economic trough and stabilisation; and the posterior period of recovery and expansion. During the initial phase output fell sharply; industry shrank; the macroeconomic situation was highly unstable; large social costs were incurred, principally in terms of worsening income inequality and rising unemployment. Thus, the impact of post-communism on the economic performance of Upper Silesia and the Donbas has appeared to support basic stylised facts of transformation in general (for a discussion about conventionalised transition outcomes, see Campos and Coricelli 2002). In the second period, most of these negative tendencies were stopped and stabilised. The third transformation period was that of a speedy industrial recovery and overall economic expansion, rising income levels, and macroeconomic stability. By the end of 2003, the Upper Silesian industry had fully reclaimed lost output and expanded further beyond its pre-transition level. The Donbas industry is expected to follow this lead by 2006.

I have also established that the first two most negative transformation phases appear to last a short period of time in Upper Silesia. By contrast, they were much more protracted in the Donbas. Nonetheless, the overall economic performance of the Polish region, on average, and especially in terms of growth and macroeconomic stabilisation, has only been marginally superior to that of the Ukrainian region. In 2004, the Upper Silesian economy was one and a half times larger than its original size in 1988. At the current market exchange rate, it was 195 per cent of its pre-transitional level, whilst the evaluation at purchasing power parity prices revealed a 169 per cent volume. In the Donbas the two indicators varied from 141 to 113 per cent respectively. As the political transition in Poland and Ukraine did not start simultaneously, I have exploited this transformation time lag by adjusting data correspondingly. As a result, it appears that the two regional post-communist growth trajectories roughly coincide. Moreover, the economic recovery in the Donbas appears to be more robust, while some of the initial social costs of transformation in the region have been substantially smaller in the Ukrainian region than in Upper Silesia. Since the late 1990s, the Donbas economy has been catching up with Upper Silesia and steadily closing the income gap between the two regions.

Notwithstanding the recognized difference in time frames between the transformation phases in the two regions, I have identified fundamental differences in the post-communist performance of Upper Silesia and the Donbas, which do not fade away with time. They concern inequality, extreme poverty, and employment stability patterns. The rise in income and consumption inequality under post-communism has been significant in Upper Silesia and at least twice as rapid compared with the Donbas. By the beginning of the 21<sup>st</sup> century, Upper Silesia reached a relatively high degree of inequality and extreme relative poverty. By contrast, the deterioration of consumption equality and the rise in relative extreme poverty in the Donbas have been very modest. Furthermore, the level of unemployment in Poland's industrial stronghold has been almost the double of the Donbas's unemployment level. Similar to the income distribution situation, the labour markets in the two regions have also followed rather divergent trajectories. Whilst the jobless rate in the Donbas has been recently in steady decline, Upper Silesia has been suffering from chronically high unemployment. It has appeared that, contrary to parallel economic and industrial growth patterns, the welfare and employment trends set by Upper Silesia and the Donbas show no sign of convergence.

## **Varied Outcomes: the Development of Upper Silesia and the Donbas under Post-Communism**

In its first *Transition Report*, the European Bank for Reconstruction emphasised that the systemic changes taking place in the formerly socialist societies were a transition from a lower to higher level of development, understood broadly as raising the living standards of individuals in those countries (1994). Later on, the international financial institutions have maintained that this transition is to be regarded as successful in the sense that it helps to promote development of the post-communist societies (EBRD 1996: 10; for a similar position, see also World Bank 1996: introduction; EBRD 1999: Chapter 1; World Bank 2002a: overview). While all these accounts take countries as the unit of analysis, in this book we focus on two comparable sub-national areas of Poland and Ukraine. In this concluding chapter of Part One, I consider the levels of economic, social, and human development, which Upper Silesia and the Donbas have achieved in the course of the post-communist transformation. The following sections consequently measure and compare the Upper Silesian and the Donbas developmental achievements against a number of well-established criteria, including income, the quality of life and environment, human survival and development.

As with the preceding examination of the post-communist economic performance, the major objective of this chapter is to establish a sound empirical basis for later discussions. It is contended that the multi-stage nature of the post-communist transformation has had its immediate effect on the developmental outcomes in both Upper Silesia and the Donbas. As the result of particularly poor economic performance at the initial stage of transformation, the two post-communist regions fell out of their international developmental clusters for the entire 1990s. Nonetheless, since the mid-1990s, general economic, social, and human development indicators have been registering positive gains in both regions. Moreover, in a number of specific spheres, Upper Silesia and the Donbas have not only recovered to the pre-transformation levels, but they have also managed to move further up the developmental ladder. Yet, most recent developmental gains of post-communism have not been shared equally within the two regions. The deleterious effects of the initial economic

and industrial collapse on the social and human development and survival in the Donbas have not been negated. Violent criminality and *felones-de-se* in Upper Silesia have had a significant increase.

## ECONOMIC DEVELOPMENT

At the end of state socialism, Upper Silesia and the Donbas were both middle-income regions. However, they belonged to different international development classification sub-groups. With an average per capita GDP at current market prices of US\$ 3816, Upper Silesia was in 1988 in the upper-middle-income area category and firmly above the upper-middle-income average of \$3150. The Donbas, on the other hand, with a \$1298 GDP per head level was an average lower-middle-income territory.

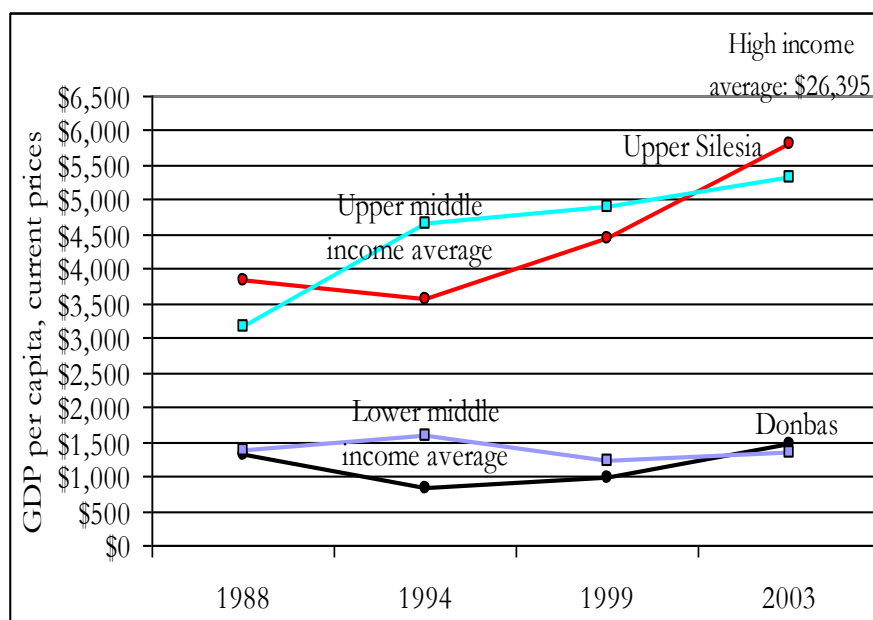


Figure 3.1. Income growth trajectories of Upper Silesia and the Donbas, international comparison, 1988-2003, US\$, current market prices

Source: Author's calculations on the basis of DOSO (1991a, 2000, 2003); DOSCO (2004a); USSC (2003, 2004a); PSCO (2003a, 2003b, 2004a); VSO (1989, 1991, 1996); SOK (2000a, 2001, 2002a, 2003a, 2003b, 2004a); Szczepański (1998a: 43); World Bank (1991, 1996, 1999, 2001, 2003a, 2003b); UNDP (2003, 2004); Easterly and Sewadeh (2001); UN (2004); OECD (2004a). Some data inputs are based on regression estimates.

Figure 3.1 shows the GDP per capita growth trajectories of Upper Silesia and the Donbas under post-communism. The data presented are in current US dollars. It appears that with the

beginning of transformation both Upper Silesia and the Donbas underwent a period of visible developmental decline in the first half of the 1990s. By the turn of the century, the Donbas had firmly restored and moved above its initial average lower-middle-income area position. In turn, Upper Silesia has also managed to increase its lead in monetary terms. However, if one considers the world's upper-middle-income average as a 'moving' developmental target, both regions have not yet regained their previous positions on the international development scale. Between 1988 and 2003, the difference between the upper-middle-income group's average and Upper Silesia's GDP per capita shrank by 12 per cent. In the case of the Donbas, the Ukrainian region's standing worsened by 14 per cent.

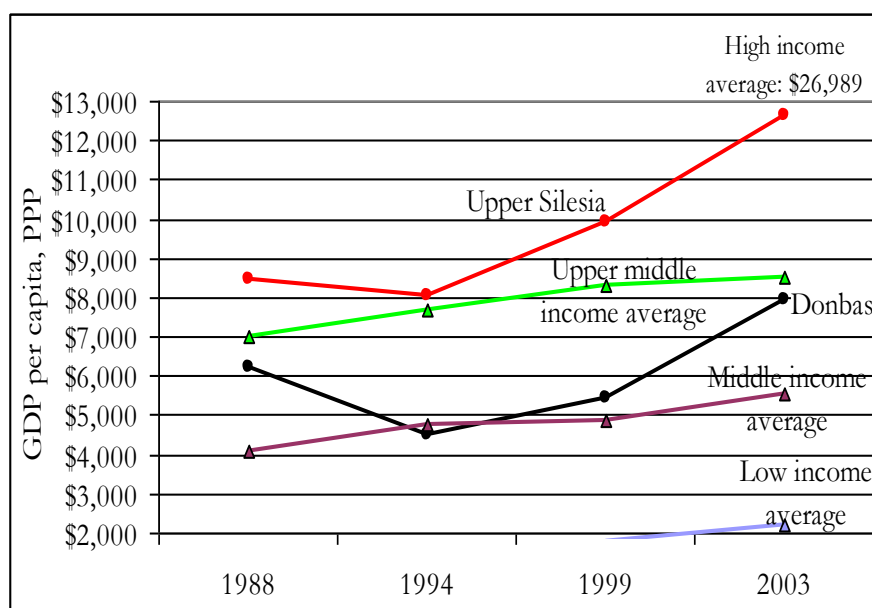


Figure 3.2. Income growth trajectories of Upper Silesia and the Donbas, international comparison, 1988-2003, US\$, purchasing power parity

Source: see Figure 3.1.

The assessment provided in Figure 3.1 does not present the full picture, as the Polish and Ukrainian currencies are believed to be significantly under-valued. Therefore, one ought to examine the regional economic development on the basis of the purchasing power parity exchange rates in addition to the evaluation in current market prices. Figure 3.2 demonstrates that in accordance with the PPP figures, including the respective shadow economy shares, Upper Silesia and the Donbas entered post-communism as upper-middle-income areas. It also shows that the developmental decline of the early 1990s was indeed substantial in both Upper Silesia and the Donbas. Nevertheless, Figure 3.2 indicates a much more dynamic recovery and a considerable improvement in the relative developmental position of the two regions on the international comparative scale

achieved by the early 2000s. In real income value terms, between 1988 and 2003, Upper Silesia moved upwards within the upper middle income group, building up its lead over the group's average by 28 per cent. The Donbas performed positively as well, closing its gap with the upper-middle-income group's average income by over 4 per cent. Yet, as indicated in Figure 3.2, given the two regions' rather low starting position, catching-up with the West still remains an extremely remote possibility for Upper Silesia and the Donbas (for a discussion on possibilities for post-communist countries to catch-up with industrial advanced nations, see Kołodko 2000b). According to my calculations, at the existing high growth pace, other things being equal, Upper Silesia could reach the current high-income countries' average of \$26,989 within the next three decades by 2035. In turn, it would take more than half a century or up to 2061 for the Donbas to reach the current richest nations' average per capita income level.

## **SOCIAL DEVELOPMENT AND ENVIRONMENT**

What effects have the post-communist economic development had on social conditions and environmental quality in the two regions? We begin with the quality of life indicators that should allow us to evaluate whether the post-communist transformation has brought a qualitative improvement in living standards of the average inhabitant of Upper Silesia and the Donbas. The first essential criterion is the structure of the household budget. According to the World Bank data, in the late 1980s, the average monthly household expenditure per capita on the most basic item categories (i.e. food, drink and tobacco) amounted to 15 per cent of the total household expenditures in high-income countries, to 30 per cent in the upper-middle-income countries, to 36 per cent in lower-middle-income countries, and to over 50 per cent in low-income countries (World Bank 1991: Table 10). In the Donbas, the average household per capita expenditure on food, drink and tobacco in 1989 amounted to 34 per cent (DOSO 1991a: 15), which was within the lower-middle-income area category. At the same time, Upper Silesia also found itself in a similar position within the lower-middle-income category, since around 40 per cent of the average per capita household budget in the region were spent on food, alcoholic drinks, and tobacco products (VSO 1989: 417-19).

During the post-communist transformation, household budget expenditure structures in the two regions have drifted apart. Figure 3.3 demonstrates the most recent data on the composition of average monthly expenditures in Upper Silesia and the Donbas, as well as in some European Union member states before the 2004 enlargement. It indicates that, by the turn of the century, the expenditure patterns in Upper Silesia have shown some improvement, though they are still far from

approaching a high-income country level. According to its basic consumption expenditures (33.6 per cent of the total household budget in 2001), the average Upper Silesian household has moved from the lowed-middle-income category to the upper-middle-income category.

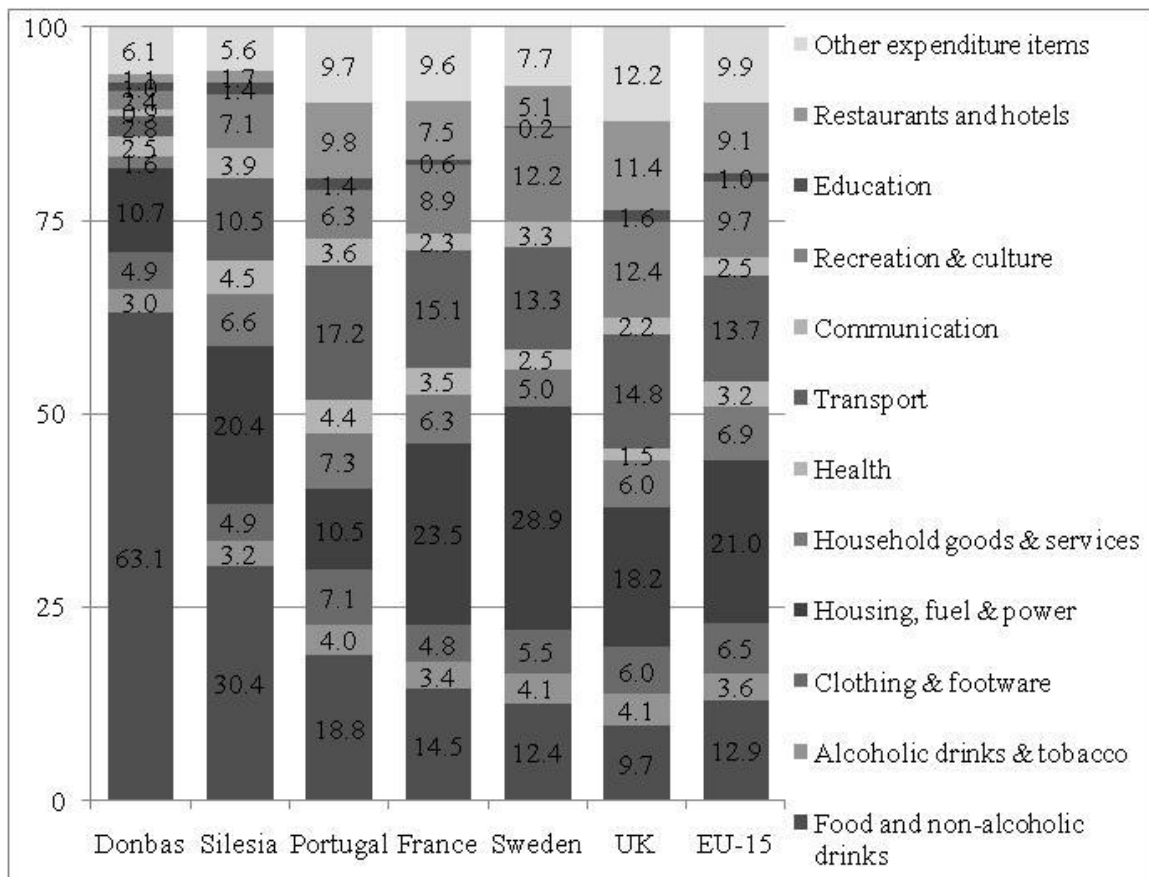


Figure 3.3. Average monthly household expenditures, percentage of disposable income expenditure in Silesian voivodship and Donets oblast, international comparison, 2001-2002

Source: Author's calculations on the basis of DOSO (2002, 2003); SOK (2002a); UKONS (2003); EUROSTAT (2004a, 2004b).

On the other hand, the quality of life for the average Donbas household has vastly deteriorated; it has been spending under post-communism most of its monetary income on food: twice as much from the late state socialist period. With the bulk of the average household budget allocated to cover for the most basic needs (66.1 per cent in 2002), the Donbas people have clearly experienced a downward movement to the low-income consumption group. The apparent upward trends in the Donbas's economic development identified previously have not yet had any significant effect on the quality of life of the average household in the region, if assessed through its consumption patterns.

Other quality of life indicators portray a more diverse picture. Table 3.1 shows that under post-communism households in both Upper Silesia and the Donbas have become to be much more



saturated with domestic electric appliances and other consumer durable goods, which were either unavailable or in a short supply previously. Between 1990 and 2001, the years when detailed household surveys were conducted in the Donbas, the region's households on unweighted average increased the amount of durable goods possession by 52 per cent. The comfort of urban dwellings in the Donbas was raised as well. Given its initially higher income status and better supply system under communism, Upper Silesians have generally owned more durable consumer goods and motor-cars.

*Table 3.1. Selected durable goods and house comfort installations, 2000-2001*

	<i>Donbas</i>	<i>Upper Silesia</i>	United Kingdom
	in % of total households		
Colour television sets	79	98	100
Satellite TV equipments	0.2	54	40
Video tape recorders	14	64	87
Hi-fi stereo music system	5	38	77
Washing machine	89	87	92
Refrigerator	97	99	95
Microwave oven	1	21	84
Wire telephone main connections	52	82	93
Personal computers	1.2	14	44
Passenger car	13	48	72
	in % of urban inhabited dwellings		
Water-line system	76	99	100
Central heating	68	75	91
Sewerage system	74	80	100
Bathroom	70	88	100

*Source:* Author's calculations on the basis of DOSO (1991a, 2001, 2002); VSO (1989); SOK (2002a); USSC (2002); USSR SSC (1993a); PSCO (2003a); UKONS (2003).

Upper Silesia's higher base notwithstanding, the level of household durable goods saturation increased in the region during the 1990s by a considerable 40 per cent. However, Table 3.1 also demonstrates that even after the elimination of shortages, the two regions have still been falling behind Western Europe as regards the possession of motor-cars, durable goods, and accomplished house installations. In turn, as the result of its lower income status, the Donbas has been falling behind Upper Silesia.

The third set of quality of life indicators concerns the natural environment. Environmental degradation has been widely claimed to be one of the main failures of central planning. Under late state socialism, ecological movements and environmental non-governmental organisations were amongst the most vocal members of the anti-communist opposition. Has the environment received more protection during the transition to capitalism?

Table 3.2. The pollution of natural resources under post-communism, Silesian voivodship and Donets oblast, 1985-2002

	<i>Upper Silesia</i>			<i>Donbas</i>		
	1985	2000	%	1985	2002	%
	<i>(per capita)</i>					
Fresh water withdrawals, cubic metres	290	138	-52	703	332	-53
Discharge of industrial and municipal sewage water into surface waters or earth, in cubic metres	263	91.8	-65	534	335	-37
Discharge of untreated industrial and municipal sewage water into surface waters or earth, thousand cubic metres	101	10.7	-89	5.6	22.3	+298
Emission of industrial air pollutants (carbon dioxide excluded), kilograms	509	132	-74	741	370	-50
Annual generation of toxic wastes, tons	23	9.7	-58	10	4.9	-51

Source: Author's calculations on the basis of VSO (1985, 1989, 1992); DOSO (1991a, 2002, 2003); USSC (2000, 2002); SOK (2002a); PSCO (2000, 2001, 2003b).

Table 3.2 summarises the major environmental indicators. It appears that the industrial decline experienced by the two regions in the 1990s has been accompanied by a sharp decrease in the overall level of pollution in Upper Silesia, and by a large number of environmentally positive changes in the Donbas. As Table 3.2 demonstrates, during the transformation, more fresh water was saved, less toxic wastes were generated, and less air pollutants were discharged by factories in both regions. However, in the Donbas, most of this environmental protection was produced by the industrial contraction and not by investments into new technical safety facilities and protection equipment. The percentage decline in the overall pollution levels generally corresponds to the Donbas's industrial output collapse: a 43 per cent contraction of industrial output in 2002 to the pre-transitional level.

During the 1990s, the capital investment into the protection of natural environment virtually ceased to exist in the Donbas. As the Donbas sewage treatment facilities were in a dire state already in the late 1980s, the lack of investment under post-communism resulted in a vast increase (by three times) of untreated sewage water being discharged into the region's surface waters or earth. By contrast, the positive environmental developments in Upper Silesia were achieved through safety measures and protection equipment investment. As the Upper Silesian industrial output almost recovered to its pre-transitional level in 2002 (-15 per cent), the simultaneous decrease of industrial air pollution in the region by 74 per cent and of water pollution by 89 per cent is notable. One should mention, however, that all the improvements notwithstanding, Upper Silesia and the Donbas have remained to be the most polluted regions of Poland and Ukraine respectively, and two of the most industrially polluted territories in the world.

## HUMAN DEVELOPMENT AND SURVIVAL

Although Upper Silesian and Donbas inhabitants, on average, have experienced a number of quality of life improvements, the post-communist transition appears to put a very heavy strain on the social fabric of local communities and on mental health of their inhabitants. The overall level of criminal behaviour has increased under post-communism in both regions.

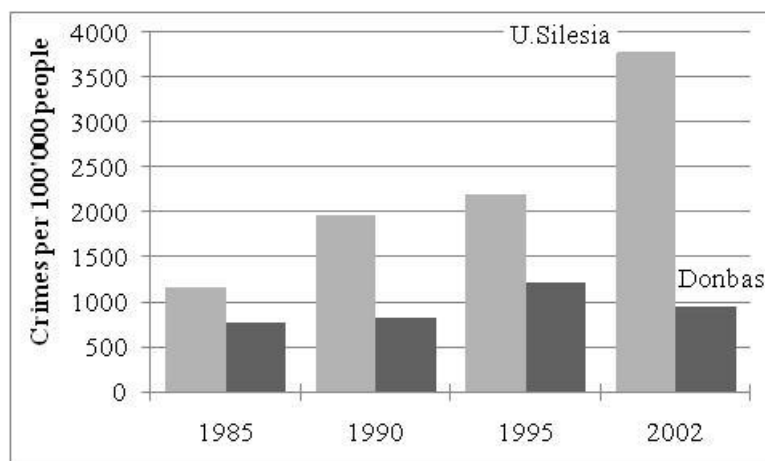


Figure 3.4. Crime rates in transition, Silesian voivodship and Donets oblast, registered crimes per 100,000 people

Source: Author's calculations on the basis of DOSO (1991a, 2000, 2001, 2003); VSO 1989); SOK (2000a, 2001, 2003c); PCSO (2003b).

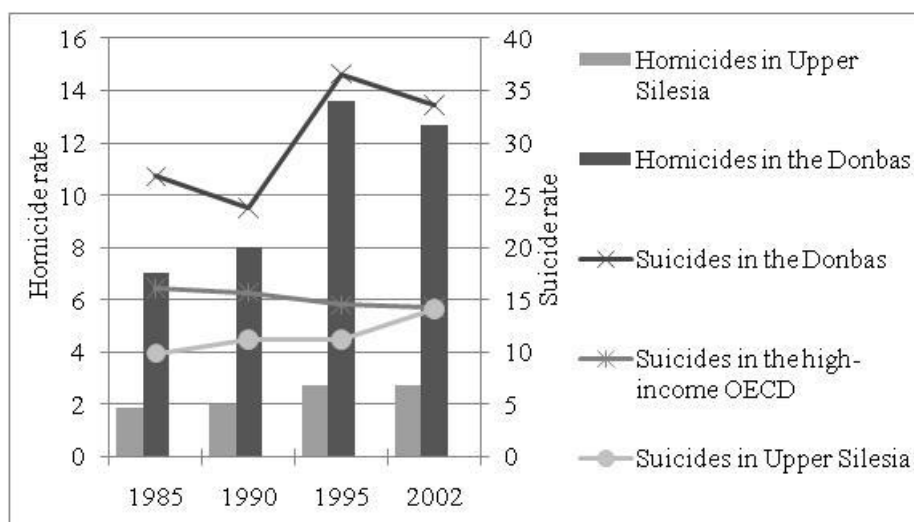


Figure 3.5. Suicide and homicide rates in transition, Silesian voivodship and Donets oblast, registered cases per 100,000 people

Source: Author's calculations on the basis of DOSO (1991a, 2000, 2001, 2003); VSO 1989); SOK (2000a, 2001, 2003c); PCSO (2003a, 2003b); WHO (2003).

Figure 3.4 indicates, however, that in the Donbas the crime rate had grown in the first half of the 1990s, whilst it has been falling steadily afterwards, registering an overall increase of 23 per cent between 1985 and 2002. By contrast, the Upper Silesian crime rate – which was already much higher under state socialism than in the Donbas – has been constantly rising. Between 1985 and 2002, criminality increased in Upper Silesia by nearly three and half times. In 2002, a serious breach of the public law was committed, on average, four times as often in Upper Silesia than in the Donbas.

The number of mental disorders and suicides has also increased in both of the regions. As the result of the post-communist transformation, the Upper Silesian and Donbas societies have become much more violent. However, in this regard, the Donbas has increased its lead. Figure 3.5 shows that homicides are nearly five times as common in the Donbas as in Upper Silesia. In addition, suicides are more than twice as likely to be committed in the Ukrainian region. Yet, Figures 3.4 and 3.5 also point towards another difference in the post-communist crime developments between the two regions, namely their divergent criminality trajectories. In Upper Silesia, the level of criminality and antisocial behaviour has been steadily and constantly rising since the mid-1980s. By contrast, in the Donbas, the rise in crime and *felones-de-se* had been happening only in the early 1990s. Since the mid-1990s, the level of criminality in the Donbas has been subsiding.

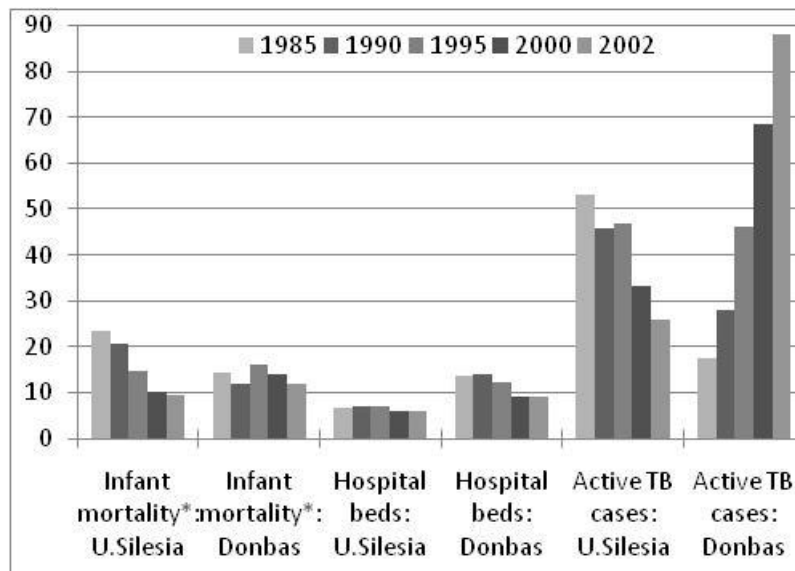


Figure 3.6. Infant mortality, hospital beds, and active tuberculosis cases in Silesian voivodship and Donets oblast, per 100,000 people, 1985-2002

Note: \*Infant mortality per 1000 live births.

*Source:* Author's calculations on the basis of DOSO (1991a, 2000, 2001, 2003); VSO (1989, 1991, 1996); SOK (2000a, 2001, 2003c, 2004d); PCSO (2003a, 2003b).

The health care systems in both of the regions in transition have experienced capacity downsizing. Official data indicate that hospital closures under post-communism were much more frequent in the Donbas. Although the overall per capita availability of doctors and hospital beds remained to be higher in the Donbas than in Upper Silesia, public health developments in the two regions have been contrasting, especially in the early 1990s. Figure 3.6 shows that Upper Silesia has undergone some serious improvements with regard to infant mortality and tuberculosis – the major indicators of public health and welfare. By contrast, the Donbas has been witnessing an enormous increase in active tuberculosis cases. Infant mortality increased in the Donbas between 1990 and 1995 as well. Since the mid-1990s, some of the Donbas's health care indicators have been improved: infant mortality has begun to decline, going lower the pre-transformation level. Yet, the TB epidemic in the Donbas has been escalating even further.

*Table 3.3.* Human survival indicators, Upper Silesia and the Donbas, international comparison, 2001-2002

	<i>Life expectancy at birth, total (years), 2001</i>	<i>Infant mortality per 1'000 live births, 2002</i>
Donets oblast	66.9	11.8
Silesian voivodship	73.8	9.3
Lower-middle income countries	69.2	30.7
Middle income countries	69.4	28.8
Upper-middle income countries	73.2	18.8
High income countries	78.1	5.4

*Source:* Author's calculations on the basis of DOSO (2002, 2003); SOK (2000, 2003c); World Bank (2003b), UNDP (2003).

The post-communist crime and health-related changes in the two regions have had a significant effect on human development and survival. Table 3.3 indicates that, by 2002, average life expectancy and infant mortality indicators reached in Upper Silesia the levels of upper-middle-income countries and high-income countries respectively. Between 1990 and 2002, life expectancy at birth rose in Upper Silesia by 3.8 years, while infant mortality dropped between 1985 and 2002 by 60 per cent. In the Donbas, the level of infant mortality declined between 1985 and 2002 by 17 per cent. Yet, due to the very high level of homicides, suicides and life-threatening infectious diseases, life expectancy in the Donbas declined by 3.1 years. As Table 3.3 shows, according to its life expectancy and infant mortality indicators, at the beginning of the 21<sup>st</sup> century, the Donbas

appeared to belong to the lower-middle-income and upper-middle-income country categories respectively. Thus, the Ukrainian region has lagged one class behind Upper Silesia.

To have a clear meaning of the impact of post-communist transformation on the development of Upper Silesia and the Donbas, one should try to summarise various indicators into some comprehensive measurement. In the 1980s, the United Nations Development Programme introduced the Human Development Index (HDI) as a synthetic measure developed on the basis of a uniform methodology, which would describe the level of human development in a given country in comparison with others. This final measure which I apply covers three major aspects of human development – a long and healthy life, knowledge, and a decent standard of living – by evaluating (1) life expectancy at birth, (2) adult literacy rate, (3) combined gross primary, secondary and tertiary education enrolment ratio, and (4) GDP per capita in PPP US\$.

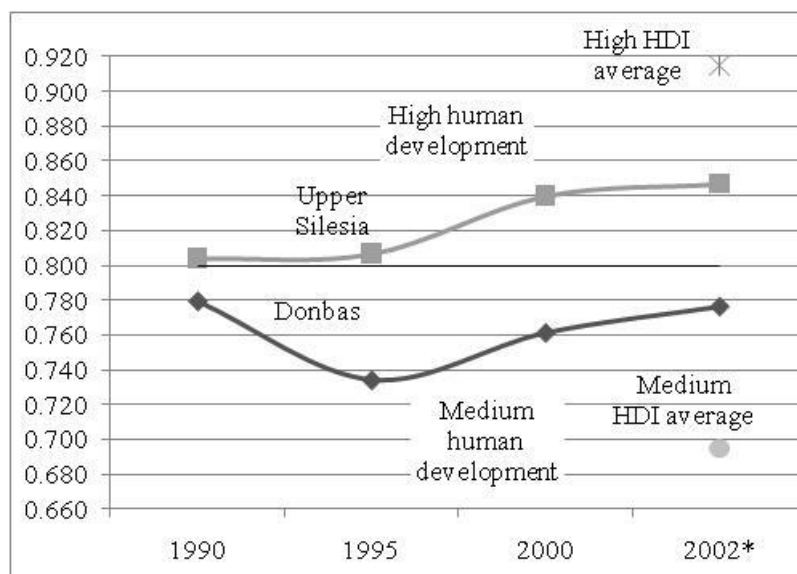


Figure 3.7. Human development under post-communism, Silesian voivodship and Donets oblast, 1990-2002

Note: (i) 0 – 0.5 = a poor human development country; 0.501 – 0.8 = a medium human development country; 0.801 – 1.0 = a high human development country; (ii) Upper Silesian and Donbas HDI indicators for 2002 are estimates based on respective nation-wide HDI figures.

Source: Author's calculations on the basis of DOSO (1991a, 1992a, 2000, 2002, 2003); VSO (1989, 1992, 1996, 1998); SOK (2000, 2003a, 2003b, 2003c); USSC (2000, 2003); World Bank (1999, 2001, 2003a, 2003b); Easterly and Sewadeh (2001), UNDP (1996, 1999, 2002a, 2002b, 2002c, 2003, 2004).

Although in the 1990s the HDI formula had gone through a number of adjustments, it remained the single best indicator used to determine the gap in human development between the

poorest and the richest countries, or between the developing and the developed ones (UNDP 1990; 2002a; 2003). The national UNDP offices occasionally prepare and publish sub-national human development indices. I have calculated the HDI values for both Upper Silesia and the Donbas, using the HDI calculation methodology and the available statistical data for the four above-mentioned indicators. I have also cross-checked my HDI values with a number of UNDP-endorsed HDI indicators for Donets oblast (available for 1999), Katowice, Częstochowa, and Bielsko voivodships (available for 1992 and 1995) as well as with those for Poland and Ukraine (for the HDI calculation methodology, see UNDP 2002a: 252-59; 2002b: 139-140; 2002c: 91-94). It is believed that the HDI values presented in Figure 3.7 are of better quality than those available elsewhere.

Figure 3.7 shows that the two regions have entered the post-communist era with different developmental legacies. Upper Silesia passed the boundary between the medium and high levels of human development already in the late communist period. In 1990, the Donbas was still in the medium human development area. In the early 1990s, human development marginally deteriorated in Upper Silesia, later recovering and overcoming its pre-transformation level already in 1995. In 2002, the HDI value of Silesian voivodship reached 0.847 from the 1990 level of 0.804. The human development decline suffered by the Donbas in the first half of the 1990s was much more profound: from the 1990 level of 0.779 to 0.734 in 1995. Figure 3.7 indicates that since the mid-1990s, the Donbas HDI has been recovering, reaching the value of 0.776 in 2002. Notwithstanding its fast recovery, the Donbas has not closed the human development gap with Upper Silesia. Life expectancy appears to be the single largest constituent indicator behind the persistent HDI disparity between the two regions.

## CONCLUSION

I have argued that there have been a number of similarities between Upper Silesia and the Donbas with regard to the impact of the multi-stage post-communist transformation on the regional developmental patterns. Firstly, as an immediate outcome of the two regions' poor economic performance at the initial stage of post-communism, both Upper Silesia and the Donbas temporarily fell out of their respective international developmental classification categories. The relative economic decline of the first half of the 1990s has resulted in the deterioration of social and human development conditions. In both Upper Silesia and the Donbas, the early 1990s were a period of rising poverty and infant mortality, growing crime, deteriorating physical and mental health, and declining human development indicators. On the other hand, as the natural result of industrial collapse, environmental pollution has decreased as well.

Correspondingly, since the mid-1990s, general economic, social, and human development indicators have been registering positive gains in both regions. Moreover, in a number of specific spheres both Upper Silesia (e.g. real income, quality of life, environmental protection, physical health, human development) and the Donbas (e.g. real income, household durables and home comfort installations, infant mortality) have not only recovered to the pre-transformation levels, but they have also managed to move further up the developmental ladder. Thus, when I assessed the regional developmental outcomes via such broad indicators as the level of economic or human development, I found out that similar to the regional economic trajectories, there have been several basic developmental phases as well – from decline to recovery, followed by expansion.

Nevertheless, a large number of specific developmental criteria examined have shown a much more divergent picture. Despite its constantly rising crime level and steadily deteriorating mental health of the inhabitants, the Polish region has managed to recuperate fully and progressed substantially under post-communism in almost every developmental sphere. In contrast to Upper Silesia, the developmental outcomes of post-communism in the Donbas have been very mixed, ranging from beneficial to devastating. Despite its rapid tempo of economic growth and industrial recovery, the macroeconomic gains in the Donbas have not been translated into viable development or environmental improvements. Some crucial developmental achievements of state socialism in the Donbas, such as the middle-income level of living standards, human health, development and survival status, have yet to be recovered. As the direct result of health deterioration and frequent homicides and suicides, life expectancy in the Donbas declined by 3.1 years between 1990 and 2001. By contrast, it grew in Upper Silesia by 3.8 years. Since 1995, the comprehensive UNDP human development index has been registering substantial advances in both Upper Silesia and the Donbas. Yet, even taking into account the existing transformation time-lag, the detrimental effects of the initial economic collapse on the social and human development in the Donbas have not been completely negated. A number of social and human development characteristics, which deteriorated in the Donbas during the initial stages of post-communism, have shown no signs of sequential improvement.

## **PART ONE SUMMARY: SIMILAR POST-COMMUNIST REGIONS, VARIED TRANSFORMATION OUTCOMES**

In Part One, I have put forward the research question of this book. I have also established a sound empirical basis for the following discussion concerning possible determinants of the post-communist transformation in Upper Silesia and the Donbas. Chapter 1 demonstrated that, at the outset of post-communism, Upper Silesia and the Donbas had possessed four fundamental cultural,



structural and institutional similarities. Both regions were geographical and multi-cultural borderlands. Correspondingly, Upper Silesia and the Donbas were amongst the most urbanised and densely populated areas on the continent. Thirdly, they were highly and heavily industrialised economies. Coal, steel, and heavy engineering were the major sources of income for both regions. Finally, both Upper Silesia and the Donbas inherited from state socialism a large number of analogous institutional characteristics: a system of centralised planning; highly co-ordinated and centralised labour relations; a mono-bank financial sector; an extensive universal public welfare system; and a standardised and diversified public education system with institutionalised role of employers in vocational training.

Chapters 2 and 3 have completed the construction of the ‘most similar systems design’ methodology of this book by identifying the divergent transformation patterns and developmental outcomes produced by two similar post-communist regions. I argued that, according to a large number of performance indicators, both Upper Silesia and the Donbas had followed almost parallel trajectories from the initial deep decline towards the consequent fast recovery and growth. Moreover, taking into account the considerable time-lag between the collapses of state socialism in Poland and Ukraine, I established that the economic and industrial recovery in the Donbas had been even more robust than in its Polish counterpart. Since the late 1990s, the Donbas economy and society have been catching up with Upper Silesia and steadily lessening the income and human development disparity, which had earlier widened between the two regions. In a great number of economic, social, environmental, quality of life, and human development spheres, both Upper Silesia and the Donbas had already exceeded benchmarks and targets that were previously established under state socialism.

I have argued consequently that despite the fundamental similarity between the macroeconomic performances of Upper Silesia and the Donbas, both within the specific transitional stages and throughout the entire period under examination, there are a number of considerable differences with regard to the outcomes of the post-communist transformation in the two regions. Besides various natural as well as contingent quantitative differences in economic, social, and human development indicators observed between the post-communist Donbas and Upper Silesia, there have appeared to be several dissimilarities of a systemic nature. In striking contrast with the Donbas, Upper Silesia’s post-communist transformation has been characterised by a dramatic, continuous increase in inequality and relative extreme poverty, a depressed labour market and extremely high levels of chronic unemployment, and by an ever-raising intensity of criminal and self-destructive behaviour. On the other hand, in contrast to the situation in Upper Silesia, the Donbas population has experienced under post-communism a steep decline in living and health standards, as well as a deterioration of human survival and developmental conditions.

Whilst the quantitative discrepancies in the post-communist performance of the two regions could potentially fade away with time as the direct result of the two regions' converging growth trajectories, the most negative outcomes of post-communism, which have appeared at the earliest stages of transformation, indicate no signs of sequential improvement. Hence why have two structurally similar, old industrial regions of neighbouring East European countries generated different outcomes of the post-communist transformation? On the other hand, what could account for the observed similarities in the economic and industrial performance of Upper Silesia and the Donbas? Finally, why did not similar macroeconomic trajectories of the two regions result in analogous social welfare and human development achievements?

In the following Part Two, I will critically examine a set of explanations developed by the orthodox transition paradigm to account for the divergence of transformation outcomes, before moving further to apply the established independent variables to the comparative study of Upper Silesia and the Donbas. Consequently, I will identify a number of deficiencies in the available explanations. An alternative concept and explanatory model of transformation will be offered and applied in Part Three of the book. In turn, the research questions of this study will be resolved in the concluding part of the book.

## **Part Two**

*Post-Communism as Multiple Liberalisation:  
Examining the Orthodox Transition Paradigm*

## **Assumptions and Deduced Explanations of the Transition Paradigm**

Inspired by the ongoing process of the political, economic, and social change of the former Communist societies, the world-wide academic community has been theorising about the patterns, outcomes, and determinants of the transformation process. What solution can post-communist transition theory offer us to resolve this book's major paradox? In Part Two, I will critically examine the orthodox transition paradigm in post-communist studies and evaluate the explanatory power of its theory. In Chapter 4, I will consider the main postulations, deductions, and explanations for the divergent outcomes of post-communism provided by the mainstream approach. Subsequently, in Chapter 5, I will apply the available set of causal or explanatory variables to our comparative study of the post-communist transformation of Upper Silesia and the Donbas. I will argue that the orthodox transition approach – an heir to liberal philosophy and neoclassical economics, and a direct extension of the economic approach to politics – is characterised by normative and ideologically motivated theory-building. The analytical model of transition as multiple liberalisation, developed by liberal theorists of post-communism in tune with the dominant Western policy orientation, fails to provide an adequate account for the diversity of the post-communist pathways in the two regions concerned. It is contended that a new comparative political economy of the post-communist change is needed to resolve this book's major research question, i.e. why have two structurally similar old industrial regions in transition produced divergent post-communist outcomes?

The leading position on the study of post-communist transformations and societies is neither a distinct methodology nor a particular theory, but rather a perspective or a paradigm.<sup>18</sup> Thomas S. Kuhn (1970) defined his concept of paradigm as a conceptual world-view or a general way of seeing the world, which consists of formal theories, traditional experiments, and reliable methods, and dictates what kind of scientific work should be done, what kind of questions should be asked,

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<sup>18</sup> While recognising the definitive differences between such terms as theory, paradigm, and approach, I will, nevertheless, use them interchangeably, when referring to the liberal school of thought in post-communist studies. My view of the orthodox transition theory is that of Kuhn's paradigm, i.e. of a conceptual world-outlook.

and what kinds of theory are acceptable. It is contended that the orthodox paradigm of post-communist studies – the perspective from which a large number of academic observers and the overwhelming majority of practitioners and mass-media commentators view post-communism – has been constructed in terms of discourses of liberalisation, practices of the New Right, and policies of neo-liberalism.<sup>19</sup>

One important caveat ought to be made, however, prior to any further investigation into the (neo-)liberal transition paradigm. In the case of transformation in the East European countries, the economic theory of neo-liberalism and the political theory of democratisation became the major assumptions of the policy change, which was advocated and put into effect in the 1990s. Hence within the entire field of post-communist studies and, especially, with regard to the literature on the political economy of transformation, the actual process of change is often conflated into the theory of how change should take place. In some of the literature, it is impossible to distinguish between policy prescription and academic interpretation. Therefore, while presenting the core assumptions and explanatory variables of the orthodox transition paradigm, this chapter unavoidably will have to combine policy advice and retroactive explanation. In the following, I outline the major constituent parts of neo-liberalism, which guided the principal advisers' policy. The extent to which these policy prescriptions were adopted as well as their results are considered separate issues, which are subsequently discussed in different chapters of the book (see Chapters 5, 7 and 8).

### **AN UNABASHED VICTORY OF LIBERALISM – THE BASIC PREMISE OF THE ORTHODOX TRANSITION THEORY**

A number of political developments in the last quarter of the twentieth century in various regions of the world, and, in particular, the collapse of Soviet power and the end of the Cold War in 1989-1991, led a number of observers, most notably Francis Fukuyama, then Professor of Political Science at George Mason University (Virginia, USA), to declare that history, as it had been known before, ended by the unabashed victory of liberalism over all of its ideological contenders:

The twentieth century saw the developed world descend into a paroxysm of ideological violence, as liberalism contended first with the remnants of absolutism, then bolshevism and fascism, and finally an up-dated Marxism that threatened to lead to the ultimate apocalypse of nuclear war. But the century that began full of self-confidence in the ultimate triumph of Western liberal democracy seems at its close to be returning full circle to where it started: not to an 'end of ideology' or a convergence between

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<sup>19</sup> For a recent review of contemporary liberal and conservative political ideologies, see Bellamy (1999) and O'Sullivan (1999). My critique is limited to the post-communist transition approach which deals directly with former communist countries of Eastern Europe and ex-USSR. I do not examine any theorising as regards the transformation of China, Vietnam or any other country outside Europe and Central Asia.

capitalism and socialism, as earlier predicted, but to an unabashed victory of economic and political liberalism. The triumph of the West, of the Western *idea*, is evident first of all in the total exhaustion of viable systemic alternatives to Western liberalism ... What we may be witnessing is not just the end of the Cold War, or the passing of a particular period of postwar history, but the end of history as such: that is, the end point of mankind's ideological evolution and the universalization of Western liberal democracy as the final form of human government ... The victory of liberalism has occurred primarily in the realm of ideas or consciousness and is yet incomplete in the real or material world. But there are powerful reasons for believing that it is the ideal that will govern the material world *in the long run* ([1989] 1997: 1-2; italics in original).

Given the prevalence of liberal ideas and ideational constructs at the time of its conception, the transition paradigm has been based from the very beginning on the principle of individual freedom, the pursuit of which is considered to be the ultimate goal of a society according to the liberal doctrine.<sup>20</sup> The analytical transition model has been inspired by the classical liberal theory of the nineteenth century and by the school of neo-classical economics based upon it. At its core, neoclassical economics sees the market as an institution allowing maximum scope for voluntary exchange between utility-maximising individuals and hence for the efficient allocation of scarce resources. It emphasises the role of rational expectations (i.e. competitive maximizing behaviour) in decision-making and the natural rate of unemployment in equilibrium growth. Neoclassical economic theory postulates that no state demand-management intervention is effective, whilst other types of state intervention into economy should be strictly limited. The limits of the market reduce the range of choice which enhances social welfare, that is, the sum of individual preferences.

According to monetarist and supply-side supplements to neoclassical economics, growth can and should only be enhanced by influencing supply and removing market restrictions of all sorts, for example, by restricting the growth of money supply to control inflation and improve economic stability, cutting taxes and welfare benefits to boost incentives, or diminishing the ability of trade unions to obstruct the workings of a free labour market. In a detailed survey of neoclassical political economy, Caporaso and Levine (1992: Chapter 4) have demonstrated that, in the neoclassical ideal, politics is subsidiary to the efficient exchange within markets, as it becomes an alternative instrument to achieve what the market fails to efficiently achieve. The state enters the stage only to fix market failures. It is allowed to correct market deficiencies (i.e. non-priced 'externalities'),

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<sup>20</sup> In his critique of the transition to democracy paradigm, Thomas Carothers has argued that 'transitology' was brought about by evident liberalising trends in seven different regions such as: '1) the fall of right-wing authoritarian regimes in Southern Europe in the mid-1970s; 2) the replacement of military dictatorships by elected civilian governments across Latin America from the late 1970s through the late 1980s; 3) the decline of authoritarian rule in parts of East and South Asia starting in the mid-1980s; 4) the collapse of communist regimes in Eastern Europe at the end of the 1980s; 5) the break-up of the Soviet Union and the establishment of 15 post-Soviet republics in 1991; 6) the decline of one-party regimes in many parts of sub-Saharan Africa in the first half of the 1990s; and 7) a weak but recognizable liberalizing trend in some Middle Eastern countries in the 1990s' (2002: 5).

provide public goods (e.g. roads, primary education, property rights, and courts of justice), and guarantee competition (e.g. break up monopolies).

In addition to neoclassical political economy, the conventional transition paradigm draws its core assumptions from a range of twentieth-century conservative and libertarian theorists. It is especially indebted to the writings of Ludwig von Mises, Friedrich von Hayek and the Austrian school of political economy, to the free market ideas of Milton Friedman and the Chicago school, as well as to the Virginia school of public choice theory founded in the 1960s by J. M. Buchanan and Gordon Tullock, two libertarian right-wing academics deeply suspicious of the state and ‘over-supplied’ government bureaucracy. Thus, orthodox post-communist theorists, commentators, and policy advisers typically stress the efficacy of the free market for economic and political freedom and the significance of competitive polyarchy (or liberal/pluralistic/multi-party/parliamentary democracy) for protecting the rights and liberties of individuals (for a variety of arguments in favour of marketisation and democratisation in the post-communist world, see Kornai 1990, 1998; Lipton and Sachs 1990; Blanchard *et al.* 1991; Gelb and Gray 1991; Fischer and Gelb 1991; Garber and Bjornlund 1992; Murphy, Shleifer, and Vishny 1992; Blanchard *et al.* 1993; Sachs 1993; Balcerowicz 1995; Boycko, Shleifer, and Vishny 1995; Åslund 1995, 2001a; Crawford 1995b; Rose 1995, 1998; Linz and Stepan 1996; World Bank 1996, 2002; Dawisha and Parrott 1997; Klaus 1997; Rose, Mishler, and Haerpfer 1998; USAID 1998; EBRD 1999; Dąbrowski, Gomułka, and Rostowski 2000).<sup>21</sup>

## **UNHINDERED COMPETITION FOR BUYERS AND VOTERS: A PAIRED HYPOTHESIS OF THE LIBERAL TRANSITION APPROACH**

In the orthodox view of transformation, which Michael Burawoy (1992) has labelled ‘transitology’, and David Lane (2000b) has called ‘the system transfer approach’, the former Communist societies are said to replace – in abrupt, sweeping moves – the command economy with the free market, communist dictatorship with liberal democracy, and, thus, to accomplish a radical and swift *transition* away from totalitarianism to a pluralist society. A complete and rapid system change is required to correct the pathological shortcomings of state socialism. In the words of a critic, the dominant Western policy orientation concerning post-communist societies presumes that the legacy of state socialism can be neutralised relatively quickly and that a transition to market and

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<sup>21</sup> In addition to scholarly work, the orthodox transition paradigm has been popularised by the Western mass-media. Amongst the most influential Western periodical publications that embrace the tenets of neo-liberalism and which have been widely referred to in post-communist countries are the British conservative weekly *The Economist*, the London *Financial Times*, the US *Time* magazine, and *The Wall Street Journal*.

democracy can be ensured through the introduction of the appropriate institutional forms copied from Western practice and pushed through by positive political leadership (Lane 2002b: 8).

The application of economic methodology to the study of politics combined with some empirical observations of the totalitarian anti-ideology has led the orthodox post-communist transition theory to the assumption of double resemblance. All communist societies are assumed to be remarkably alike and by pursuing a uniform liberation strategy they should follow a roughly similar course of maximising economic and political efficiency. As Valerie Bunce has put it: ‘the homogeneity of the socialist past and the homogeneity of the contemporary international political economy pointed in unison to the same prediction: postsocialist regimes would resemble one another in form and functioning’ (1999: 757-58). Beverly Crawford’s *Political Economy of Post-Communist Transformation* could serve as one of the best exemplars of the orthodox transition paradigm. Deriving her assumptions from public choice theory and the philosophy of liberalism, she claims that logically simultaneous economic and political liberalisation is possible in post-communist regimes. In fact, post-communism is a political economy *per se*, as the process of transformation involves the entire triangle of polity, economy, and society:

After the revolutions of 1989 in Eastern Europe and the last gasp of the Communist party’s power in Russia, most post-communist regimes embarked on a course of self-proclaimed economic and democratic shock therapy to transform their societies, economies, and political systems. These new regimes’ immediate external and internal mandate was the simultaneous introduction of markets and democracy and the dismantling of the discredited socialist state (Crawford 1995b:3).

The normative value judgment of the theory is usually downplayed by emphasising that economic, political and social liberalisation of the post-communist world is a self-proclaimed and self-imposed goal. This line of logical reasoning leads the orthodox transition paradigm towards a paired hypothesis of liberal market economy and liberal pluralistic polity:

Economic and political liberalization have at their root the drive for individual freedom ... Two institutions are crucial in this quest for freedom: markets and liberal democracy. Economic liberalization means the creation of labour markets, capital markets, and financial markets and the removal of barriers to the creation of those markets in order to efficiently allocate scarce resources in the hope of achieving economic growth ... The creation of markets does not ensure growth and does mean that inequalities in income and wealth are likely to characterize social relations. Inequality, however, is tolerated in private economic relations because growth that should ensue from the efficient allocation of resources will make everyone better off than they would have been in the absence of markets, and economic inequality is offset by equality of citizenship and representation in the political process. [In turn] liberalizing politics in new democracies involves the creation of institutions that ensure representative government and universal citizenship ... Political liberalization demands that new rules of political contestation be



formulated and implemented to remove the *certainty* of power for any one political elite and to permit new contenders for political power to enter competition (Crawford 1995b: 6-7; italics in original).

Although some transition theorists regularly express doubts as to whether markets and democracy can be introduced simultaneously (e.g. Przeworski 1991; Bresser Pereira, Maravall, and Przeworski, 1993), the majority believe such a scenario would be optimal and the most desirable.

### **The free enterprise economy hypothesis**

The first hypothesis of the liberal post-communist transition approach argues that, in order to approach the Western level of prosperity, post-communist countries must adopt the economic model of the free enterprise economy epitomised in the Anglo-American system of competitive capitalism and limited government intervention (the following presentation of the two core theses of the transition paradigm is based on Åslund 1995, 2001a; Crawford 1995b; Balcerowicz 1995; World Bank 1996, 2002; Fish 1998; Bunce 1999; EBRD 1999, 2003; Hellman 1998; Hellman, Jones, and Kaufmann 2000; Ekiert 2000; Dąbrowski and Gortat 2002). As we have seen from the extensive quotations above, transitology explicitly refer to some general Western model of society to be copied. Nonetheless, in the economic branch of the transition paradigm it is the US economic system and other similarly free market economies which are the destination point for the nations in transit.<sup>22</sup>

Assuming that most of the deficiencies of state socialism as well as of any other non-Western economy stem from pervasive government involvement and control over all important aspects of economic activity, prices, and international trade, and from extensive government ownership of productive assets, the fundamental solution prescribed by the dominant Western policy orientation is two combined market-oriented reforms – macroeconomic stabilization and structural adjustment. The first reform that post-communist countries are set to introduce in order to achieve macroeconomic stability includes cutting public spending and reducing excessive money growth. The second policy reform involves changes in the basic structure of the economy to be achieved by providing stronger incentives for productive economic activities and international trade based on comparative advantage. The most important element in the structural adjustment stage is a reduction in the extent of government involvement in the economy and an increase in the role of markets. Both policy reforms are regarded as integral in fostering the self-organizing system of the market: macroeconomic instability is believed to be caused by excessive fiscal spending and money

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<sup>22</sup> Characteristically, whilst emphasising the great difficulty of a ‘double transition’, Crawford has argued that the only successful simultaneous introduction of markets and democracy had occurred under benevolent occupation in post-World War II Germany and Japan. Yet, as she adds, experts disagree as to just how ‘liberal’ these countries really are (1995b: 3).

growth, which follows directly from the state ownership and control over the economy; and to reduce state involvement in the economy one has to engage in structural reforms (for this textbook example of the orthodox transition package, see Yarbrough and Yarbrough 1997: Chapter 21).

The combination of macroeconomic stabilization and structural adjustment are said to result in the unleashing of markets – ‘the basic enabling reform from which all the potential benefits of transition follow’ (World Bank 1996: 7). In the words of Milton Friedman:

The transition to freedom in Eastern Europe cannot be accomplished overnight. The formerly totalitarian societies have developed institutions, public attitudes and vested interests that are wholly antithetical to the rapid creation of the basic economic requisites for freedom and prosperity. These requisites are easy to state, but far from easy to achieve ... The one thing that is common to all of them is a drastic reduction in the size and role of the government ... Government must be narrowly limited to its essential functions of maintaining law and order, including enforcing private contracts; of providing a judicial system to adjudicate differences in the interpretation of contracts, and to assure that laws against theft, murder, and the like are applied justly; of establishing the rules of the game, including the definition of private property. Such a reduction threatens almost every powerful vested interest in the current society ... However, the talk about ‘the enormous costs of moving to a free-market economy’ is much too gloomy. There is no reason why total output cannot start expanding rapidly almost immediately after the totalitarian restrictions on people’s activities are removed (1990: 6-7).

Operationally, the standard model that has stimulated the orthodox transition policy was the structural adjustment package (often called stabilisation programme or SAP) of the International Monetary Fund (IMF) and its sister organization – the International Bank for Reconstruction and Development (the World Bank), that had been tried first in underdeveloped Latin American countries in the 1980s.<sup>23</sup> The SAP model has been redesigned in the late 1980s – early 1990s as a set of key policy measures aimed at shifting non-market societies towards liberal capitalism. Dubbed the ‘Washington consensus’ because of the location of the two international financial institutions in the U.S. capital city (Williamson 1990), the orthodox transition approach has called for ten policy reforms, which stated in a more detailed manner how to achieve macroeconomic stabilization and structural adjustment through deregulation, privatization, sectoral restructuring, price liberalization, fiscal consolidation, and financial and trade integration with the world. The Washington consensus policy measures have become a general prescriptive mechanism to ensure the transition towards what international financial institutions see as a standard free market economy. According to John Williamson, the author of the concept, the orthodox reform package

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<sup>23</sup> In turn, the structural adjustment programmes themselves go back to the monetarist theory of Milton Friedman and, more specifically, to ‘monetarist’ economic policies of ruthless cuts in government spending, social security, and real wages, instituted in Chile after the military coup d’etat in 1973 by the dictatorship of General Pinochet. For a review of SAPs, see Killick (1982) and Ghai (1991).

could be considered a generally applicable ‘universal convergence programme’ that summarized ‘the common core of wisdom embraced by all serious economists’ (1993: 1334).

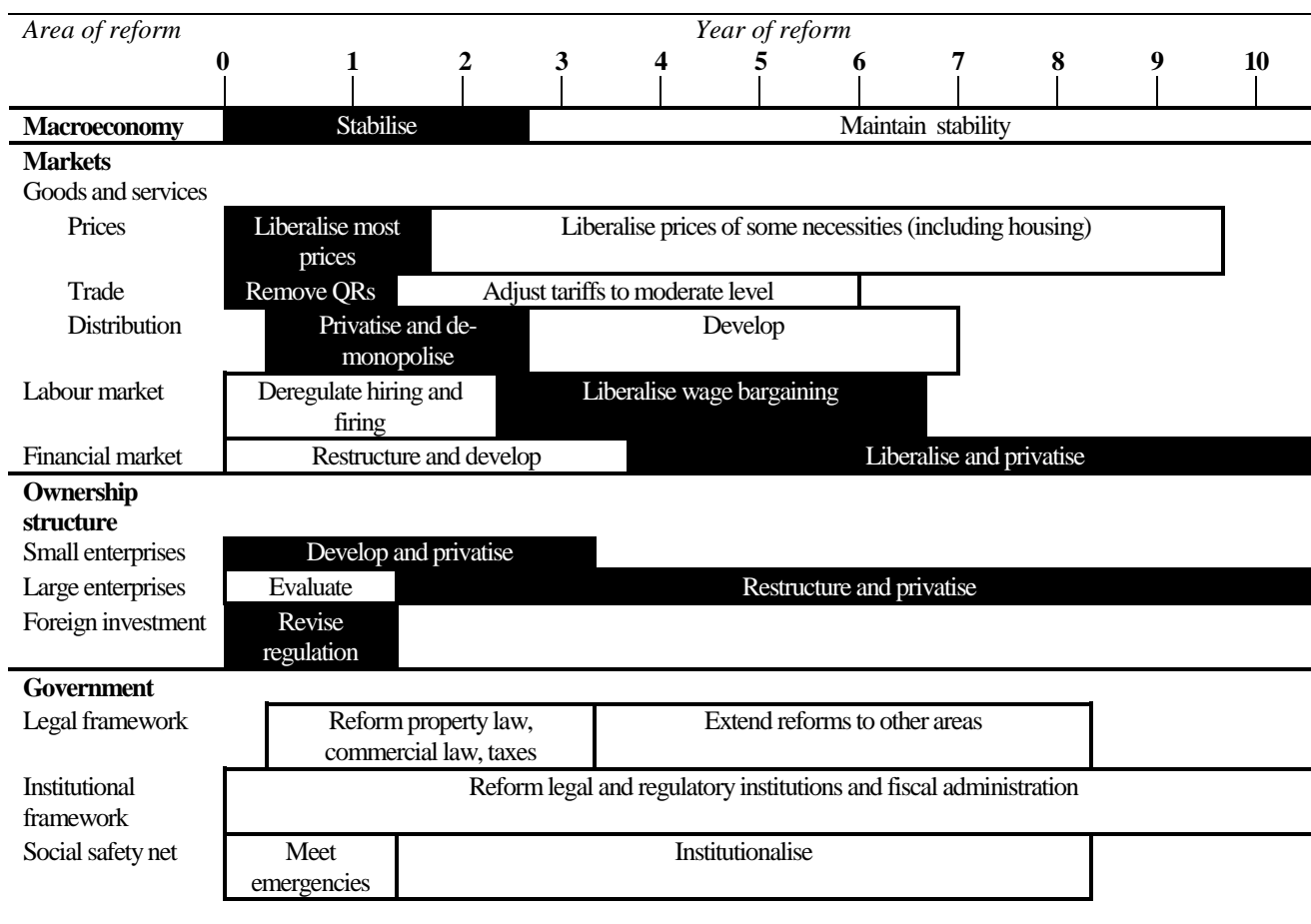


Figure 4.1. The phasing of reform: building blocks of the orthodox transition package

Note: Shading indicates intensive action. QRs = quantitative restrictions.

Source: Author’s reconstruction on the basis of Gelb and Gray (1991b: 9).

On the basis of the Washington consensus, in 1990, the IMF and the World Bank developed a more detailed set of policy reforms, which highlighted the importance of stabilisation-cum-liberalisation measures.<sup>24</sup> Figure 4.1 presents this original IMF-World Bank transition plan for the

<sup>24</sup> The original ‘Washington consensus’ has included the following measures: (1) fiscal discipline should be imposed to minimise the overall budget deficit (including, in addition to the central government deficit, also those of the local governments, of state enterprises, and of the central bank) of about 2 per cent of GDP; (2) priorities in public expenditures should be redirected from politically sensitive areas (i.e. administration, defence and subsidies) towards primary education and health, and basic infrastructure; (3) tax reform should be implemented, lowering the tax burden, broadening the tax base and simplifying tax administration; (4) financial liberalisation should be aimed at market-determined but moderately positive interest rates; (5) the exchange rate should be unified and market-determined; (6) trade should be liberalised and outward oriented, and import tariffs should be reduced to a uniform low tariff of no more than 10 per cent; (7) foreign direct investment should not be restricted and foreign firms should be allowed to enter freely and compete with domestic firms on equal terms; (8) state-owned enterprises should be privatised; (9) government regulation of economic activities should be abolished and maintained only to ensure safety and environmental

post-communist world. According to the neo-liberal blueprint, market-oriented reforms have to be introduced in a rapid and simultaneous manner (see Gelb and Gray 1991a). The most intensive action is concentrated on liberalising prices, internal and external trade, the labour market, the financial system and foreign investment; privatising state-owned firms; and stabilising the macro-economy. The creation of an appropriate legal framework and institutional environment for the market to operate within and the construction of an adequate social protection system are believed to be the issues of the last concern.

The state is considered of marginal policy relevance by neo-liberal reformers and, as Figure 4.1 shows, the government-related area of reform has been left without shading. As the post-communist state liberalises the economy in transition, it is forced to undergo a radical process of ‘slimming down’ and ‘shrinking’. The World Bank’s report *From Plan to Market* published in 1996 is a good example of the orthodox neo-liberal policy advice concerning the role of the state under post-communism:

The transition from plan to market calls for a whole-sale reinvention of government. The state has to move from doing many things badly to doing its fewer core tasks well. This means government must at once shrink and change its nature ... First, the role of government in producing and distributing goods and services must shrink dramatically. Public provision must become the exception rather than the rule. state intervention is justified only where markets fail – in such areas as defense, primary education, rural roads, and some social insurance – and then only to the extent that it improves upon the market. Second, government must stop restricting and directly controlling private commercial activity and extricate itself from intimate involvement in the financial sector, focusing instead on promoting macroeconomic stability and providing a legal and institutional environment that supports private sector development and competition. Finally, instead of providing generous guarantees to secure adequate living standard for all, governments need to foster greater personal responsibility for income and welfare (110).

Following a public choice theory argument that politicians are not less ‘rational’ or selfish than entrepreneurs and that the polity is, like the economy, driven by self-interested individual actions (e.g. see Downs 1957; cf. Niskanen 1971; Buchanan and Tollison 1972), the World Bank also called for the restraint of government powers and tight control over public spending and bureaucracy: ‘In a market economy the burden of proof regarding public intervention lies with the government’ (1996: 111). Notwithstanding the lack of conclusive evidence to suggest the existence of some systemic relationship between changes in government size and economic reforms, one of the world’s most powerful economic organizations alleged that in the post-communist context the smaller the size of government is, the better the transition performance ought to be:

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protection; (10) property rights should be secured without excessive costs, and made available to the informal sector (Williamson 1993, 1994).

General empirical studies relating levels of government spending to economic growth yield few robust conclusions. In transition economies, however, there are stronger grounds for thinking that large governments will hurt economic performance: government spending, especially at high levels, tends to be quite inefficient and, as a result, to contribute less to growth than in market economies; also, financing government programs is costlier and poses a greater risk of inflation (World Bank 1996: 113).

It is very symptomatic in this regard that in most of the post-communist world the Washington consensus project of transition through deregulation, marketisation, and privatization was understood and designated from the very beginning as a programme of ‘de-statisation’, i.e. the withdrawal of the state (e.g. *rasgosudarstvenie* in Russia; *rozderzhavlennia* in Ukraine).

The free enterprise economy hypothesis of the liberal transition model claims that the success or failure of the process depends solely on the ability of determined reformist policy-makers to adopt this ‘all-out’ approach and to free the markets. The gradual adoption of market-oriented policies, or a ‘go-slow’ approach, should inevitably fail.<sup>25</sup> The preservation of central planning is another non-starter. The role of the initial conditions of geography, history, macroeconomic distortions, and exogenous economic shocks is acknowledged, when accounting for the initial period of output decline (see de Melo *et al.* 1996, 1997). Nevertheless, the Washington consensus policies of liberalisation and structural adjustment or ‘discipline and encouragement’ reforms in their most recent presentation (see World Bank 2002) are said to matter the most throughout the full period of transformation (De Melo and Gelb 1996; World Bank 1996; Hernandez-Cata 1997; Selowsky and Martin 1998; Berg *at al.* 1999; Havrylyshyn and Van Rooden 1999; World Bank 2002). In the words of Stanley Fischer (First Deputy Director at the International Monetary Fund in the 1990s) and his IMF colleagues, ‘while not all transition economies are equally well placed, the starting conditions are favourable in most countries. Policies will make all the difference’ (Fischer, Sahay, and Végh 1998: 34).

### **The liberal democracy hypothesis**

The second hypothesis of the liberal transition paradigm argues that there exists a very strong positive correlation between the progress in economic and political reforms, that is, between economic and political liberalisation. The ‘unusually capitalist’ and ‘unusually economically

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<sup>25</sup> The advice of Rudiger Dornbusch, an academic colleague of Stanley Fischer, on priorities of the post-communist economic reform is as a good example of such an approach: ‘A quick transition to a market economy is the most effective strategy... At the very start, governments must provide a legal framework for a market system, including the right of private property and full economic freedom... The most suitable way of handling this issue is to adopt the entire civil code, including corporate law, of a well-functioning legal system, say from the Netherlands. There is absolutely no merit in trying to create a new one; time is too short (*Transition*, February 1991: 1-3).

robust' post-communist countries are also those that are 'unusually democratic' (Bunce 1999). According to this liberal democracy hypothesis, successfully functioning and constantly growing post-communist market economies are enclosed within a consolidated, stable and competitive democratic environment, underpinned by widespread political rights to participate in multiparty elections and an extensive range of civil liberties. In contrast, limitations on rights to participate in elections and constraints on civil liberties concentrate political power and produce a corrupt and deficient 'oligarchic' capitalism. This defunct capitalism is deeply authoritarian and, perhaps, 'normally undemocratic'. A number of transition theorists have claimed that the relationship between the transition to the market and to democracy is so strong as to suggest the existence of a causal relation. Notwithstanding the classic idea of economic democracy producing political democracy, the direction of causation under post-communism is said to be from political choices to economic choices. Political factors are believed to be firmly behind economic performance (Fish 1998; Bunce 1999; EBRD 1999: Chapter 5; World Bank 2002: Part III).

More precisely, the key factor that emerges from the conventional transition story to explain different post-communist trajectories is the balance of power between the liberal democratic opposition and the communists – a balance that determined the outcome of the first competitive election and that shaped in turn the radicalness of the initial economic reform, the political struggles, institutional modifications, and public policies that followed (Fish 1998). Looking at the role of the political system, the advantage of parliamentary or parliamentary-presidential systems governed by multiparty coalitions is underlined. Competitive, parliamentary democracies are said to have high political contestability and high government turnover, which help to build a transparent and relatively stable system of political parties. In contrast, authoritarian political regimes are, almost entirely, presidential or presidential-parliamentary systems. They tend to concentrate political power in the executive branch of government; curtail or constrain political and civil liberties; have low political contestability and government turnover; and generally contribute to party fragmentation, irresponsible legislature, and the state capture by powerful interest groups (oligarchs and insiders). Such a monopolisation of political power consequently brings a monopolisation of the economy, hampers the successful functioning of the markets, and, eventually, hinders development (Dąbrowski and Gortat 2002).

One has to mention that earlier, in the first half of the 1990s, the logic behind the mainstream transition approach was that most successful market reforms occurred in countries where exceptional political leaders came to power and pushed through decisive reforms via a strong executive agency (e.g. see Sachs 1993; Williamson 1994; Haggard and Kaufmann 1995; Balcerowicz 1995). One of the World Bank's first transition reports has concluded that most decisive reforms reflects the vision of one leader or a small and committed group (1996: 11). By the

late 1990s, however, both the international financial institutions and academic transitology have rejected this view. According to the 1999 *Transition Report* by the EBRD, the experience of the post-communist societies runs counter to the conventional wisdom that the successful construction of capitalism requires strong political executives (i.e. presidents or prime ministers) with the power to act swiftly and decisively against the opponents of market-oriented reforms. Consequently, the presidential system has been declared as the one that is responsible for co-opting powerful vested interests of the old nomenklatura and young oligarchy prone to state capture, and, thus, for derailing further liberalisation and ultimately imposing heavy costs on the society. For the third set of most extreme cases, where presidential powers are virtually limitless (e.g. in Belarus and the countries of Central Asia), the transition paradigm's argument runs as follows: the opposition forces were weak and, as a result, the ex-communist won a decisive victory. In this case, both economic and political reforms were rejected. The outcome of post-communism according to the third scenario is continuity in dictatorial politics (one-man rule) and socialist economics, which generate reasonably, though unexceptionally, good economic performance (Bunce 1999; Dąbrowski and Gortat 2002; Freedom House 2003b, 2004b).

## **THE CAUSAL CHAIN OF THE POST-COMMUNIST TRANSFORMATION**

Following the logic of liberal transition theorists, neo-liberal policy advisers, and popular conservative commentators, one can construct a fully-fledged causal chain that is usually held to account for the divergence in the outcomes of post-communism. The explanatory scheme offered by the orthodox approach is presented in Figure 4.2. The liberal transition model is based on a triad of the paradigm's paired theses and as such it has inevitably coalesced Western policy recommendations with *ex post facto* academic explanations. In good behaviouralist manner, the liberal transition model distinguishes between different types of post-communist societies, according to the distribution of freedom. It appears to be possible, relying on differential calculus, to predict the behaviour of the post-communist systems. Here 'inputs' are the two freedoms (political and economic) and 'outputs' are the outcome of transition, which is variously defined.<sup>26</sup>

According to the liberal transition model, the complete economic and political liberalisation of a post-communist society should lead towards the establishment and consolidation of liberal democracy and free market economy and ensure the successful outcome of transition. Empirically, the first scenario is modelled on Poland, Hungary, the Czech Republic, Slovenia, and the Baltic

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<sup>26</sup> Some orthodox theorists subscribe to the view of transition's success or failure in a 'full-package' way presented in Figure 4.2; while others define success only as the achievement of stable economic growth under polyarchy.

states. In contrast, the absence of liberalisation in both spheres should lead to the continuation of the previous system (albeit without the Communist party hegemony) of despotic rule and a command economy.

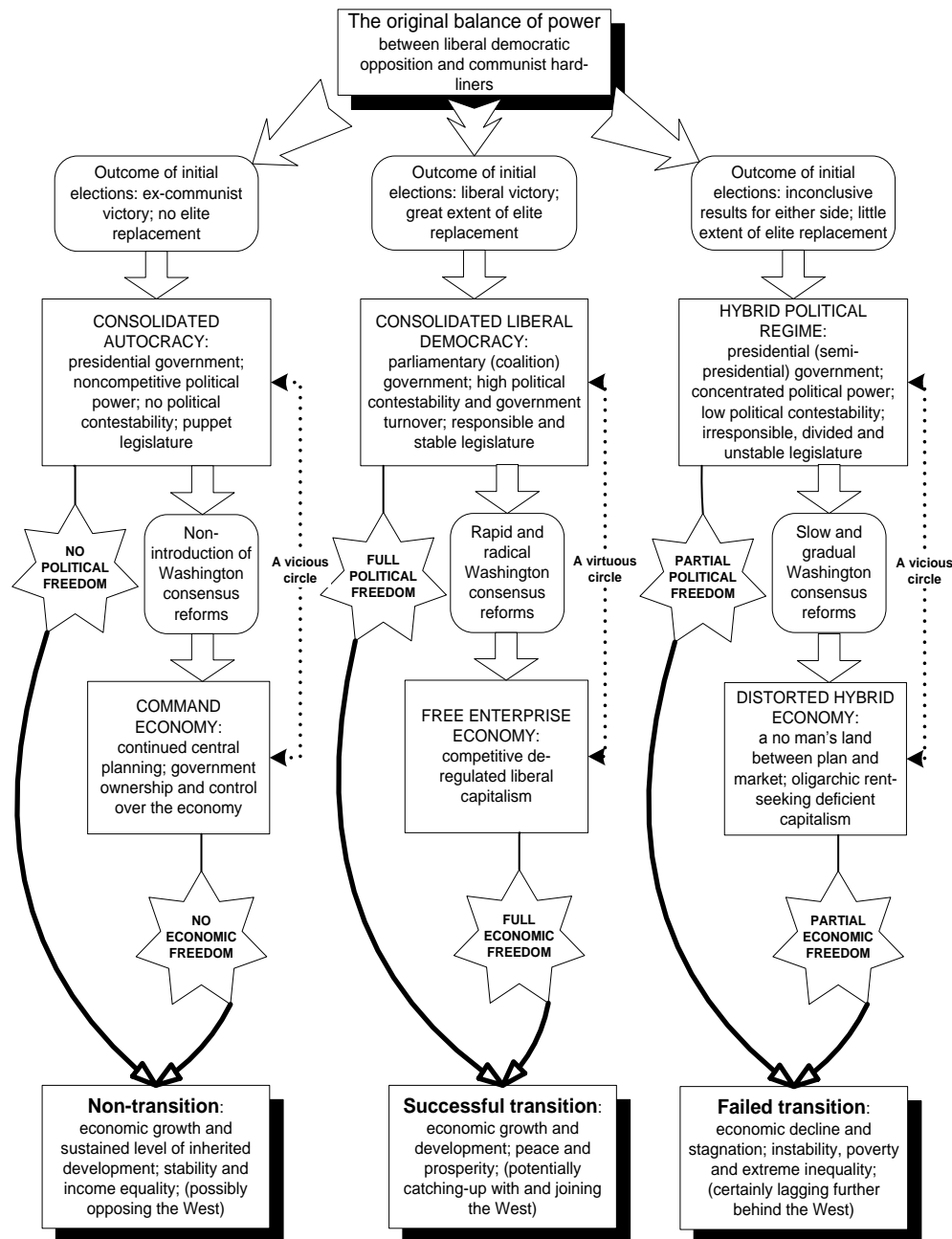


Figure 4.2. The conventional model of transition: three basic scenarios

Thus, the second scenario is of non-transition modelled on Belarus, Turkmenistan, and Uzbekistan. In turn, partial liberalisation should result in the creation of a hybrid transitional political regime (between liberal democracy and autocracy) and heavily distorted economies, mired in a no man’s land between plan and market. This eventually leads to a total national transition



failure. The third scenario is modelled on Ukraine, Russia, Moldova, Armenia and Georgia. In the words of a leading theorist of transitology:

Thus, just as the most stable regimes in the region are either fully democratic or fully authoritarian, so those countries with the strongest economic performance feature either substantial and sustained economic reforms or a failure to introduce, let alone implement, such reforms. The most unstable countries and the ones with the weakest economic performance, therefore, are hybrid regimes – in the first instance political and in the second economic. These are the regimes that are perched precariously between democracy and authoritarianism and between state socialist and capitalist economics. This would seem to point to one obvious implication. The most successful postsocialist pathways (with success defined narrowly here as stable polities and growing economies) are those involving either a sharp break with the past in terms of economic and political regime form, or those that feature significant continuity with the past. Between these two extremes (and extremes are, again, extreme) lies ‘ambivalent’ postsocialism – a hybrid form of politics and economics that appears to produce the highest costs and the fewest benefits ... While economic performance varies in these cases, all the worst performers are in this ‘neither here nor there’ group (Bunce 1999: 786, 788).

Figure 4.2 indicates that the explanatory model of the liberal transition paradigm also envisages the existence of an in-built self-sustaining and self-perfecting mechanism of virtuous and vicious circles: democratisation and marketisation coalesce to form a virtuous circle of progress, whereas a transitional political regime couples together with a distorted hybrid economic system to generate a vicious circle of regress and decline. To summarise, theorists of the liberal transition paradigm emphasise that to be successful a post-communist country must guarantee the virtuous circle of full freedom. They claim there is an exceptionally high positive correlation between democratisation and economic reform.<sup>27</sup> Therefore, full-scale liberalisation should be carried out in *both* polity and economy; partial liberalisation would inevitably fail; the rejection of liberalisation is the rejection of transition. Yet these choices are preconditioned and the outcomes are predetermined: the electoral loss of freedom-seekers in the founding elections triggers the inevitable course of unfortunate events. The outcomes of transition are usually treated as static (for the most recent theoretical developments in transitology, see Bunce 1999; EBRD 1999; Wyplocz 1999; Ekiert 2000; Fischer and Sahay 2000; UNECE 2000; Dąbrowski and Gortat 2002; Dubrovskiy and Ivaschenko 2002; World Bank 2002; Freedom House 2002b, 2003b, 2004b; EBRD 2003).

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<sup>27</sup> Similar to the position of Beverly Crawford quoted earlier, Valerie Bunce explains the logic behind the two circles: ‘democracy and capitalism are based on precisely the same principles, albeit applied to different arenas of human activity: uncertain results combined with certain procedures. Just as democracy is based on the notion of competition within well-specified rules of the game, so capitalism is premised in competition in a context of secure property rights. In both realms, moreover, the state bears primary responsibility for ensuring the desired mix of competition and constraint’ (1999: 780).

## THE ORTHODOX TRANSITION MODEL GETS BLURRED

At first, it might appear rather surprising that, as late as 2004, the majority of transition theorists still described the three scenarios of post-communism as given and did not alter the explanatory model to provide for some sort of feedback loop between the system's output and the polity that influences it. However, from the logical point of view of the transition paradigm, there can hardly be a reason for any change. In the first case of liberal democracies and market economies the feedback mechanism is self-evident, as democracy is said to provide all the necessary mechanisms for accountability. In the second scenario of repressed 'post-totalitarian' regimes there can be no feedback mechanism by definition. In the third scenario of concentrated polities and 'oligarchic' economies a feedback loop from the masses to the elites cannot function, as those societies are not democratic and are stuck in 'a partial reform equilibrium trap', where early transition winners 'take all' and prevent any further political and economic liberalisation, since it could undermine their corruption and super-rent-seeking opportunities (see Hellman 1998; UNECE 2000; World Bank 2002: Part III). The causal chain developed within the liberal transition paradigm, thus, seems to be immune. As Marie Lavigne has argued in a review of economic transitology, despite the dire criticism of the orthodox transition paradigm and, especially, of the standard policy applied in the post-communist countries, 'the Washington consensus is alive and well, with some cosmetic changes' (2000: 481). Its major tenets have re-emerged unchallenged as 'the main card in the hands of the orthodox school is indeed the fact that growth has resumed in Central and Eastern Europe (except Romania, but it is easy to point out that this is a special case of Balkan-type bad politics and foul economic management)' (Lavigne 2000: 480).

Nevertheless, it has appeared that the liberal explanatory model got stuck in its own trap.<sup>28</sup> The major trouble of the system transfer approach is that some countries from the third 'trapped' and 'partially reformed' group has been growing since the late 1990s and rapidly catching up with the first group of declared transition winners. Yet the data on which the liberal paradigm is based – various freedom ratings and rankings produced by North American conservative advocacies – are time-lagged and have been unable to show evidently that those growing economies, including

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<sup>28</sup> It has to be emphasised that, although the transition paradigm and neo-liberal economic philosophy have acquired and retained a hegemonic status inside the international financial institutions and within the Western policy community at large, the liberal transition paradigm has not enjoyed the same treatment in other arenas. The orthodox transition model has attracted a host of criticism from a large and very diverse group of academic scholars, public officials, non-governmental activists, and publicists, for being both an inadequate political blueprint and a false and deficient economic strategy. For example, see Galbraith (1990), Nove (1990, 1993), Stark (1992), Przeworski (1992), Lane (1992, 1995, 2002a), Murell (1993), Amsden, Kochanowicz, Taylor (1994), Buzgalin (1994), Glasman (1996), Gowan (1995, 1996), Poznański (1995, 1996, 2001), von Beyme (1996), Goldman (1996), Offe (1996), Pickles and Smith (1998), Greskovits (1998), Stark and Bruszt (1998, 2001), Kołodko (1998, 1999, 2000a, 2000b), Stiglitz (1999, 2002; 2003); Cohen (2000), Reddaway and Glinski (2001), Burawoy (2001), Kennedy (2002).

Ukraine, have moved into the first category of liberal democracies. Without such a shift, the model appears to be problematic, since it stresses the in-built virtuous circle of *multiple* liberalisation, that is, the simultaneous liberalisation of both the polity and the economy leading to success. Given this theoretically impossible condition, most orthodox transition observers have ignored the discrepancy in the third scenario and maintained the model unchanged. Yet, a smaller group of writers working within the liberal transition paradigm have decided to accommodate the statistical outliers and to revise the model.

Anders Åslund, Andrei Shleifer and Daniel Treisman have recently claimed that the model's assumptions and definitions have to be somewhat relaxed to take into account that: (a) the third transition scenario might not lead to an ultimate failure since the 'de-coupling' of political from economic liberalisation (in the favour of the latter) can work; and (b) most of the economic depression, poverty, and social problems were not caused primarily by partial liberalisation, as the original model postulated, but mostly by exogenous shocks and exceptionally detrimental initial conditions of the third group of countries. These 'revisionist' transition scholars also argue that, if one applies less strict procedural definitions of democracy and of the (free) market economy, the process of transition to capitalism and democracy could be declared as being successfully accomplished not only by the first group, but by the second formerly 'ambivalent' group of post-communist countries as well. Moreover, the argument goes, the change from a communist dictatorship to a multiparty democracy in which officials are chosen in regular elections, and the transformation of the Soviet command economy into a capitalist order based on markets and private property, accomplished by Russia and other parts of 'what was an Evil Empire as little as 15 years ago', have all been much more remarkable and extraordinary than elsewhere (see Shleifer and Treisman 2000, 2004). Not only the initial conditions for a successful transition have been much worse in the former USSR, but the overwhelmingly negative assessments of economic growth, macroeconomic stability, social progress, income inequality, and corporate finances in the CIS major countries are said to be widely exaggerated by various partisan opportunists and leftist extremists. The neo-liberal revisionists go further to claim that the post-Soviet countries, especially Ukraine, Kazakhstan, and Russia, have actually been outperforming the new EU member states from Central Europe and the Baltics:

Meanwhile, in a development that has gotten little notice amid the EU expansion hoopla, the post-Soviet countries further to the east have been booming since 1999. The nine market economies in the former Soviet Union (Russia, Ukraine, Kazakhstan, Moldova, Georgia, Armenia, Azerbaijan, Kyrgyzstan and Tajikistan) have on average grown annually by no less than 7 percent for the last five years. The new tigers are Kazakhstan, Russia and Ukraine – far more so than Poland, Hungary or the Czech

Republic. The three Baltic countries are doing significantly better than the Central Europeans, but not as well as their eastern neighbors (Åslund 2004b; cf. Åslund 2004a).

One should emphasise, however, that the ideological terms of the transition-as-liberalisation paradigm have not experienced a major alteration since the late 1980s. The basic adjustments have appeared to involve blurring the model's terminology of democracy and transition success and shifting the geographical direction of the paradigm's search for a particular post-communist country (or a group of countries) that would resemble most the ideal type of a free enterprise economy or liberal capitalism. Accordingly, the revisionist neo-liberal commentators attribute the new economic and social dynamism of the three largest post-Soviet countries to their liberal economic model, which is described as the one based on open markets, home-grown entrepreneurial talent, deregulation, limited state intervention, low public expenditures, very low personal and corporate taxation, and privatised 'Chilean-style' social security systems.

On the other hand, Poland and other post-communist EU member states – former models of transition success – are now alleged to be constructing a deviant, pathological, and degenerate form of capitalism. As some conservative critics of the transition paradigm argue, under the newly emerged foreign-dominated property structure, Central Europe and the Baltics have been left without a basic source of wealth, because profits are claimed now by foreign owners of banks and factories (Poznański 2001; King 2002; cf. King 2001). Moreover, under the harmful influence of the 'petrifying EU model', the countries of Central Europe and the Baltics are said to be building 'premature welfare states'<sup>29</sup> with unsustainable public deficits, fiscal profligacy, high taxes, and stiff market regulations (Åslund 2004a, 2004b). With regard to the political economy of post-communism, the splinter group of the system transfer approach returns, though implicitly, to the orthodox IMF policy reform strategy (which was quietly dropped from the agenda by the late 1990s) of the politically detached and committed reformist leader. In the revised transition model, it is economic liberalisation (once again) that starts first and initiates the virtuous circle of multiple liberalisation. In the next chapter, I will examine the applicability of the liberal transition model (both in original and revised versions) to our research problem of the two old industrial regions.

## CONCLUSION

I have claimed that the orthodox transition paradigm – a conceptual view from which a large number of scholars and practitioners see the post-communist phenomena – is based on the

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<sup>29</sup> The invention of this term is attributed to Kornai (1992b).

philosophical premises of liberalism and constructed within the methodological frameworks of neoclassical political economy and the economic approaches to politics. Empirically, the transition-as-liberalisation theory draws its assumptions from the anti-totalitarian tradition. I have established that the orthodox transition paradigm has one paired liberalisation hypothesis, which is used concurrently both as a normative prescription by most of the policy advisers and as an explanation by a large number of academic scholars. The neo-liberal transition theory postulates that the liberalisation of the economy should be combined simultaneously with the liberalisation of the polity. The first part of the system transfer hypothesis argues for the need to replace the system of centrally planned economy with the free market, that is, a competitive de-regulated liberal economy of the Anglo-American model. This should be achieved through the rapid and radical implementation of the Washington consensus set of stabilisation and structural reforms. The second part of the system transfer hypothesis argues for the need to establish and consolidate liberal democracy, preferably with a parliamentary multiparty coalition government and dispersed power centres. Only the workings of multiple liberalisation and the construction of a social formation based upon the virtuous circle of economic and political freedoms, guaranteeing unhindered economic and political competition, would be sufficient to ensure a successful transformation. A combination of partly-liberalised polity and partly-reformed economy is said only to generate a transition failure. The absence of any liberalisation means a non-transition, that is, some form of continuity of the old regime.

The causal model derived from the system transfer approach puts its primary emphasis on the political situation in the post-communist world at the beginning of transition; more specifically, on the balance of power between communist hard-liners and liberal democratic opposition, and on the results of the 'founding' elections. The victory of anti-communist opposition results in political liberalisation and the introduction of liberal democracy, which is the first logical step towards the free enterprise economy and, thus, towards the ultimate success in transformation. The victory of ex-communists and the old elite results in the rejection of any liberalisation. The indecisive outcome of the initial elections stalls political liberalisation and leads towards authoritarianism. An authoritarian presidential regime fails to reform the economy fully and establishes a deficient corrupt economic system, which eventually generates economic decline, social regress, political instability, thus, leading to a failed transition. Within the liberal transition paradigm, the three resultant outcome scenarios (successful, nonexistent, and failed transitions) are treated usually as given. In the early 2000s, a revised version of the conventional transition model has been proposed. In it, economic liberalisation has been assigned the priority. The revised model postulates that even under the conditions of an (allegedly) semi-liberalised polity, a committed reformist leader can push

through the Washington-consensus reforms and set the economy on the right track towards the free market.

It is contended that the orthodox transition paradigm is – for the most part – a highly normative system. As such it can hardly be challenged through scientific argumentation. Nonetheless, the orthodox analytical model of three transition scenarios is of descriptive and explanatory value. In the next chapter, I will apply the liberal model of transition as to whether it can account for the varied patterns of post-communism in Upper Silesia and the Donbas. Being empirical in nature, this study cannot present a test capable of falsifying a theory. As it has often been suggested, empirical analyses are not scientific laboratories. However, as any empirical study, this book can substantiate the necessity of having more than one theoretical model available, if the model at hand proves to be insufficient to explain or interpret the observed phenomena.

## Two Post-Communist Regions and the Explanatory Model of Multiple Liberalisation

In Chapter 4, I have examined the assumptions and explanatory variables developed within the liberal paradigm of post-communist studies. In this chapter I will consider the applicability of the transitology model to the comparative study of the two old industrial regions in transition. I will argue that the orthodox transition paradigm (particularly with respect to my research agenda) is incapacitated by a number of fundamental problems. Firstly, there is a problem with treating post-communist politics as essentially a ‘black box’. Secondly, the original neo-liberal model’s emphasis on the ‘right policies’ contravenes the subsequent revision of the theory by a number of scholars, who prioritise different initial macroeconomic conditions and distortions as the major determinant of post-communist countries’ performance. Thirdly, there is a problem with the belated interpretation of transitional results within the traditional approach. What can qualify as a successful transition outcome today? Fourthly, there is a conceptually unresolved issue of the virtuous circle of multiple liberalisation (i.e. simultaneous political and economic liberalisation) contrasted with non-failed but ‘de-coupled’ transition cases. On the other hand, if a post-communist country liberalised in either polity or economy does generate sustainable economic growth, how should one treat the enduring social and human development problems? Finally, there is a problem with the empirical evidence of liberalisation and its authorised presentation. Can one rely on various cross-national rankings of freedom that are produced by advocacy groups and quasi non-governmental organisations and based on outside expert opinion? If this is the case, can economic and/or political liberalisation be considered *the* independent variable that accounts for the divergent post-communist pathways and varied transformation outcomes? As we have discovered earlier, the orthodox transition paradigm aspires to produce a theoretical model in terms of testable propositions. It is contended that for the liberal transition paradigm to offer such a theoretical model, it has to undergo a major adjustment. I will claim that – for the research purposes of this book – the explanatory power of the orthodox transition model has a limited appeal.

## PROBLEM ONE: THE BLACK BOX OF POST-COMMUNIST POLITICS

The orthodox model, as presented in Chapter 4, tends to put most of its emphasis on the outcome of the ‘founding’ elections and to negate the potential existence of a feedback loop between economic outcomes and the political process in any other society but liberal democracy. Generally, it treats the post-communist polity and politics as a black box, that is, something which has unknown internal functions, hidden and impenetrable. The conventional story concerning the post-communist transformation of Upper Silesia and the Donbas goes as follows. The initial political conditions in Upper Silesia and Poland favoured the anti-communist opposition grouped around the underground Solidarity movement. During the semi-free parliamentary elections in Poland in June 1989, anti-communist candidates won in all contested races. Soon afterwards, the communist majority in the Polish diet – the *Sejm* – disintegrated; in August 1989 Tadeusz Mazowiecki, a dissident conservative journalist, was called to form the first Solidarity-led government which initiated the Washington consensus package of rapid and radical market-oriented reforms. In December 1990, the process of Poland’s successful extrication from state socialism had been accomplished during the presidential election, which was won decisively by the long-standing Solidarity leader Lech Wałęsa. By contrast, in the Donbas and Ukraine, the founding presidential elections in December 1991 were won not by a former nationalist dissident (Levko Luk’ianenko) or a liberal human-rights advocate (Viacheslav Chornovil), but by Leonid Kravchuk, a ‘repainted but scarcely reconstructed former Communist party leader, who did not oppose the [reactionary] August 1991 putsch’ (Fish 1998: 50).

According to the transition paradigm, political effects of the initial elections in the Central European countries included a rapid reformation of communists and a rapid emergence of non-communist politicians, which quickly opened space for the formation of a vibrant civil society, non-state sources of economic power, especially private businesses and their associations. Since in Ukraine (as well as in Belarus, Bulgaria, Kazakhstan, Moldova, Mongolia, Romania, Tajikistan, Turkmenistan and Uzbekistan) the victory had been claimed by the ‘custodians of the old regime’, communists were neither marginalised nor rapidly reformed, and no new non-communist elite had emerged (Fish 1998; see also Bunce 1999; Ekiert 2000).

Besides missing the fact that the Communist party was banned in Ukraine in the aftermath of the declaration of independence in August 1991 and until early 1993 – the critical period for the emergence of new non-communist politicians, including Kravchuk’s presidential successor Leonid Kuchma – the orthodox model seems to be ill-equipped to interpret the following crucial development. The most decisive factor that emerges from the liberal explanatory model is the balance of power between the opposition and the communists – a balance that determined the



outcome of the first competitive election and that shaped in turn the entire course of the post-communist history. Yet, how have then Ukraine or some other countries from the group of transition ‘laggards’ and ‘drop-outs’ managed to transit to, at least, ‘hybrid’ polities or ‘directed democracies’? It appears that the neo-liberal transition theory leaves such questions unanswered (for a literature review of Ukraine’s contemporary political system, see Wilson 2004).

## **PROBLEM TWO: POLICIES V. INITIAL CONDITIONS**

The orthodox school of transition studies usually stresses the importance of following the neo-liberal policy agenda under post-communism. There is a widespread assumption that the policies of macroeconomic stabilisation and structural adjustment matter the most; numerous working documents published by the World Bank and the International Monetary Fund usually emphasise the existence of positive correlation between the Washington consensus reforms and economic performance (see Chapter 4). Nevertheless, as I have established earlier, a number of transition scholars have been recently changing the emphasis from such policies to the particularly detrimental impact of inherited characteristics on the process and outcomes of the post-communist transformations in the former Soviet republics. They have reinstated the initial conditions as one of the crucial transition variables.

De Melo, Denizer, Gelb and Tenev (1996, 1997) were amongst the first policy analysts to scrutinise and compare initial conditions of the post-communist world. In assessing the influence of initial conditions on the economic performance of transition economies, de Melo *et al.* have aggregated the inherited conditions into three categories: ‘structure’, ‘distortions’, and ‘institutions’. With some minor changes, this set of inherited economic conditions has been widely applied elsewhere in explaining variation in output performance (for example, see World Bank 1996, 2002). A large number of variables which are claimed to influence the economic performance of transition economies such as the degree of ‘over-industrialisation’, the level of urbanisation, the richness of the natural resource endowment, the initial level of development, the degree of economic stagnation prior to the transition, cultural or ethnic heterogeneity, have already been examined in Part One of this book, where I have described the basis for the ‘most similar system design’ comparative methodology adopted. As I have argued, those initial structural conditions ought to be considered controlled variables in our case, since they were analogous in both Upper Silesia and the Donbas at the beginning of transformation. Therefore, in this section I examine in detail other initial variables proposed by the transition theory that may have affected economic performance of Upper Silesia and the Donbas over the past decade. It is contended that, notwithstanding the dissimilarity between

macroeconomic policy reforms pursued by the Polish and Ukrainian governments in the early 1990s, the inherited structural liabilities alone can provide an adequate explanation for the difference in the magnitude of the initial output collapse experienced by the two regions.

### **Inherited distortions and institutions**

The analysis of the remaining set of characteristics of the two regions at the beginning of transformation, and of the shocks emanating from the collapse of central planning and of the USSR, indicate that Upper Silesia had inherited less macroeconomic and organisational distortions, had possessed better institutional conditions, and had been less affected by external exogenous shocks than the Donbas. Firstly, being a province of an old independent state, the Upper Silesian economy operated in a stable environment of Poland's established public institutions. On the other hand, Ukraine had little experience as an independent nation-state and did not inherit strong political institutions. In contrast with the situation in Upper Silesia, during the last years of state socialism, the Donbas economic agents had to operate in difficult circumstances of an increasingly hostile 'war of laws and sovereignties' between the Ukrainian authorities in Kyiv and the federal government in Moscow. The imminent collapse of the Soviet state and of the institutional and technological links of the integral centrally planned economy was to pose much more severe troubles for Donbas enterprises. Furthermore, following the disintegration of the USSR, Donbas economic agents had to adjust to a new and unaccustomed financial and monetary system.

*Table 5.1.* The balance sheet of inherited distortions and institutions

	<i>Upper Silesia</i>	<i>Donbas</i>
Export dependence (exports to GDP ratio, 1990)	16.9%	65.6%
Repressed inflation, World Bank's methodology (the difference between increase in wages and economic growth, average figure, 1985-1988)	-0.4%	0.2%
Repressed inflation, author's methodology (deposit bank savings to retail trade turnover ratio, average share, 1985-1988)	25%	91%
Statehood (region as part of an independent state)	old	new

*Source:* Author's calculations on the basis of DOSO (1987, 1991a); USSC (1999, 2003); VSO (1986, 1989, 1996, 1997); Szczepański (1998a); World Bank (1999); Easterly and Sewadeh (2001); PCSO (2002); SOK (2003); UN (2004); OECD (2004a, 2004g). Some GDP data inputs are estimates based on regression.

Secondly, as most other communist economies, both Upper Silesia and the Donbas had repressed inflation. However, the degree of inherited macroeconomic distortions had been different. According to the World Bank's methodology, the level of repressed inflation is measured as the

difference between the increase in real wages and real GDP. As there are no reliable data on Upper Silesia's and Donbas's GDP performance before 1988, I have measured the degree of repressed inflation, first, as the difference between the average industrial wage growth and industrial production growth. Table 5.1 shows that this 1985-1988 index was very low for Upper Silesia (-0.4%), indeed indicating some deflationary pressure. The Donbas had also been characterised by low repressed inflation (0.2%). Alternatively, I have measured the level of repressed inflation as the difference between the amount of individual bank deposit savings and annual retail trade turnover. This measurement shows the degree of forced saving (by the shortage of consumer goods) and the overall vulnerability of the macroeconomic situation, provided that people would rapidly decide to turn their cash savings into real goods and services. I believe that such an assessment could be more accurate for forecasting potential inflation pressures in the post-communist context. As Table 5.1 indicates, the second repressed inflation index was very high for the Donbas and almost four times lower in Upper Silesia: 91 and 25 per cent respectively.

The final observed difference between the two regions refers to their trade dependence, at the outset of transformation, on other countries and on inter-republic flows in the USSR. According to my own calculations, the degree of foreign trade dependence (including the intra-USSR trade) was much higher in the Donbas than in Upper Silesia. Whilst in the latter, in 1990, the merchandise exports amounted to 17 per cent of GDP; in the former the figure was as high as 66 per cent (including sales of goods and services to other Soviet republics). Thus, Upper Silesia had been significantly less dependent on foreign markets and distant suppliers than the Donbas, and, therefore, the Polish industrial stronghold was much less prone to be adversely affected by probable exogenous shocks.

### **Disorganisation**

The problem of external economic shocks emanating from the collapse of foreign trade as well as of the entire system of centralised planning deserves additional attention. The transformation of ownership and the re-distribution of property was an essential mechanism behind the broader processes of economic transformation described by Blanchard (1997) as *re-allocation* (from old to new activities, from existing to new firms) and *restructuring* (of the existing enterprises). According to Blanchard, the initial output decline experienced by all the post-communist economies was caused by price liberalisation and the removal of state subsidies which triggered a collapse of state firms, while growth in the new private sector was simply insufficient to take up the slack. However, Blanchard has emphasised that the decrease in the economic activity in the first stage of transformation was due not so much to macroeconomic policies, but rather to the chaotic nature of reallocation:

When central planning ended, production in the state sector was organised around bilateral relations between state firms. Typically, firms had or knew of only one supplier for each input, of one buyer for each output. Such a structure can easily lead to large disruptions in production: if, for any reason, this supplier does not deliver, production may come to a stop. Under central planning, the presence of the central planner was enough to avoid most of these problems; through threats and bribes, the planner could induce firms to deliver most goods most of the time. Once the central planner disappeared, these problems came to the fore. The result was a set of disruptions in production and trade, or what can be thought of quite generally as *disorganization* (1997: 36).

Blanchard and Kremer (1997) have argued further that the cost of losing the co-ordination function of central planning in the absence of institutional arrangements common in the West is higher in sectors with the most complex production processes, which have also suffered the most dramatic output losses. Providing some preliminary evidence, they have shown that, despite price liberalisation, many firms (most in sectors with the complex production processes) were reporting shortages of inputs as the direct result of the collapse of trade between the former republics of the Soviet Union.<sup>30</sup>

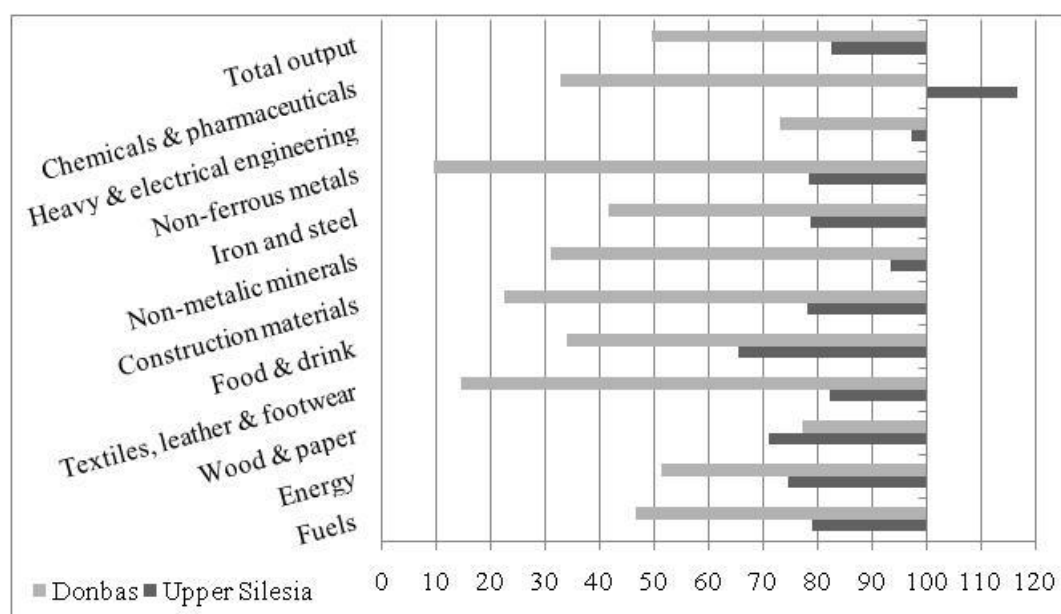


Figure 5.1. Output decline by industrial branch, Upper Silesia (1985-1991) and the Donbas (1990-1995), volume index, 1985 =100 for Silesia and 1990 =100 for Donbas

Source: Author's calculations on the basis of VSO (1989, 1992); DOSO (1992, 2000).

<sup>30</sup> The theory of disorganisation has been supported by other researchers as well. Roland and Verdier (1997), and Bezemer, Dulleck and Frijters (2003) have also found disorganisation to be one crucial explanation for the decline in output. They have emphasised the costs of searching for new trading partners and establishing of new contacts subsequent to the end of central planning and the introduction of price liberalisation. These authors argue that the fall in investment and output during the transformation should be associated with such a search.

It is difficult to estimate the net effect of disorganisation on the overall economic breakdown during the initially ‘chaotic’ transition period. Figure 5.1 shows the damaging impact of the first post-communist years on industrial production in Upper Silesia and the Donbas by the type of industrial production. The degree of industrial decline is measured between 1985 and 1991 in the case of Upper Silesia to cover the moment of economic disorganisation during the breakdown of state socialism and the introduction of the market. In the case of the Donbas, I measure the degree of industrial collapse between 1990 and 1995 – the period of the Soviet Union’s disintegration and initial years of the independent Ukraine. Figure 5.1 demonstrates that the loss of the co-ordination function of the centrally planned economy has been much more pronounced in the Donbas. Moreover, in the Ukrainian region, disorganisation had had a particularly detrimental impact on the production of most technologically-sophisticated products, including chemicals, pharmaceuticals, electric and transport machinery, equipment, instruments, optical and precision apparatus. By contrast, Upper Silesia’s heavy and electrical engineering had been almost unaffected, whereas the output of chemicals and pharmaceuticals had even increased.

### **Trade implosion**

The initial period of the post-communist transformation was also associated with the increasingly high adjustment costs of adverse supply shocks and the related exogenous impact of the collapse of the CMEA trade (Portes 1991). Calvo and Coricelli (1993) used the term ‘trade implosion’ to describe the phenomenon of the break-up of the old centrally planned system of exchange. As one of the structural features of the Donbas economy under state socialism was the high reliance on intra-USSR trade and exports overseas, the phenomenon of disorganisation as a disruption of trade links had the most severe impact on the Ukrainian region, while it left Upper Silesia almost untouched. The foreign-trade-implosion part of the transformational disorganisation appears to be one of the crucial variables behind the drastic collapse of output experienced by the Donbas in the first half of the 1990s. Since there are no reliable provincial-level export and import data for the late 1980s - early 1990s, one is unable to assess directly the effects of trade implosion on the regional economies of Upper Silesia and the Donbas. Given that both of the old industrial regions have always been amongst those most integrated into external markets, I have used the available national balance of payments data to evaluate the export growth trends at the start of the post-communist transformation.

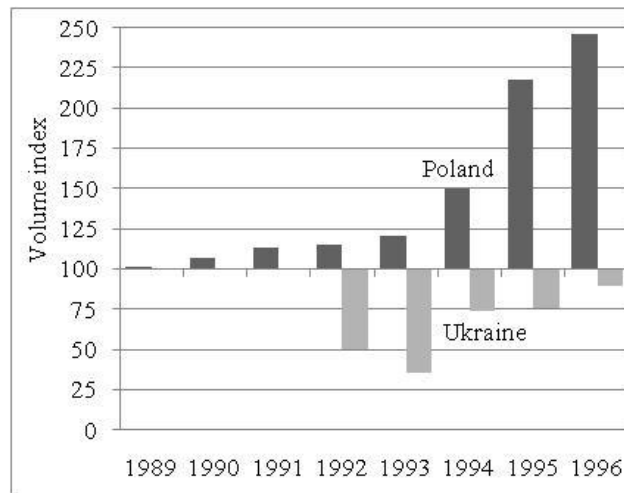


Figure 5.2. Total foreign trade growth, Poland and Ukraine, exports and imports of goods and services, volume indices (1988 = 100 for Poland; 1991 = 100 for Ukraine), balance of payment data, 1989-1996

Source: Author's calculations on the basis of World Bank (1999); Easterly and Sewadeh (2001); NBU (2000); NBP (2003).

Although the necessary time-series data available for Poland's foreign trade flows is available, the first year of reliable foreign trade statistics for Ukraine is 1991; therefore, I use 1991 as the base year for Ukraine and 1988 as the base year for Poland. Figure 5.2 shows the magnitude of the trade implosion phenomenon by providing combined volume indices of exports and imports of goods and services. It demonstrates that Poland was uninfluenced by the trade implosion phenomenon as the country's foreign trade volume has been steadily growing since 1988. By contrast, during the first year of independence in 1992, Ukraine's foreign trade flows contracted by 51 per cent, to be followed by a 65 per cent contraction during the following year.

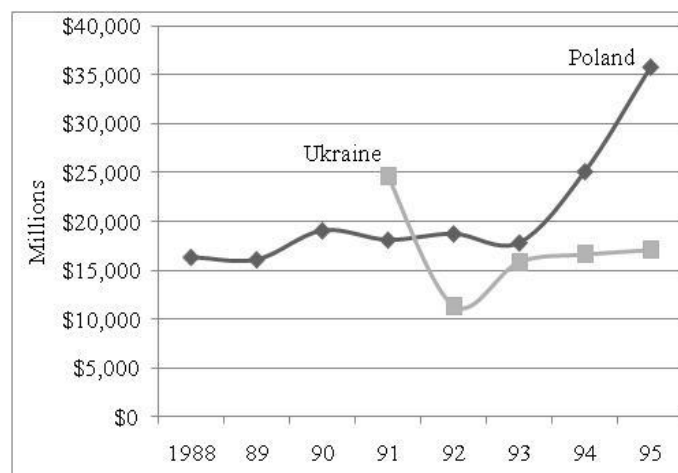


Figure 5.3. Exports of goods and services in Poland and Ukraine, US\$ million, balance of payment data, 1988-1995

*Source: Source: Author's calculations on the basis of World Bank (1999); Easterly and Sewadeh (2001); NBU (2000); NBP (2003).*

In the Ukrainian case it was the collapse of imports (especially of energy), which propelled the trade implosion process after Russia lifted its price caps on oil and gas in 1993. Figure 5.3 shows that in absolute terms, the effect of exports trade implosion was almost invisible in the case of Poland, which experienced a decline of export revenues from US\$ 16.3 billion in 1988 to US\$ 16.1 billion in 1989. However, the exogenous shock emanating from the collapse of external markets for Ukraine, which had been fully integrated into the Soviet and CMEA trade systems, was dramatic: the exports of Ukrainian goods and services fell from US\$ 24.7 billion in 1991 to US\$ 11.4 billion in 1992. In 1993, although Ukraine's exports grew, the overall amount of foreign trade contracted. For the Donbas, with its oil- and gas-consumption intensive heavy industries (e.g. iron and steel, petrochemicals, electricity generation, heavy engineering), the collapse of energy imports should have been even more detrimental than for the country as a whole. Thus, the disorganisation of trade, which was almost not existent in Upper Silesia and Poland, was one of the most serious factors influencing the output collapse in the Donbas and Ukraine in general in the early 1990s.

The above discussion concerning the inherited distortions and exogenous shocks suggests that the renewed emphasis by a number of transition scholars on initial conditions as the most important factors in explaining the differences across countries during the initial period of output decline in 1990-1994 can be shared and well applied to the comparative study of Upper Silesia and the Donbas. However, this hypothesis is contrary to the orthodox transition model, which prioritises 'wrong policies' (i.e. the lack of economic and political liberalisation and 'muddling-through' reforms) as the most crucial explanation for the economic depression suffered by the majority of post-communist countries in the first half of the 1990s.

### **PROBLEM THREE: THE TRANSITION MODEL AND TRANSITION OUTCOMES**

Another problem one encounters whilst trying to apply the orthodox transition model to the comparative case of Upper Silesia and the Donbas concerns the dynamic nature of transformation outcomes and their rather static treatment by the theory. In Part One, I have established that since the mid-1990s onwards both Upper Silesia and the Donbas have been showing signs of rapid recovery and strong economic and industrial growth. Moreover, by 2004, both regional economies had fully recovered and expanded further from their pre-transitional levels. Thus, following the orthodox transition model, in particular, the more restricted definition of successful transition (or

non-transition) associated with sustainable growth and economic development, Upper Silesia and the Donbas could both qualify to be included into the successful group (or into the non-transition group). As it has been mentioned in Chapter 4, a number of commentators (e.g. Åslund, Shleifer and Treisman) have claimed that several major post-Soviet cases could also qualify for inclusion into the first group of transition success stories, as those countries are rapidly growing and competitive market economies.

In Part One, we have established that the major difference in the outcomes of post-communism between Upper Silesia and the Donbas lies in the sphere of social welfare and human development. In contrast to the Donbas, post-communism in Upper Silesia has been associated with chronically high unemployment and crime levels as well as with a relatively high degree of inequality and extreme poverty. On the other hand, among the major negative post-communist outcomes in the Donbas have been poor health indicators and a general decline in human development standards. These social developments clearly distinguish Upper Silesia and the Donbas from the non-transition post-communist category, since the countries in non-transit are supposed to be characterised by the overall preservation of the communist equality and employment achievements (see Figure 4.2 in Chapter 4). Furthermore, as a number of transition theorists have emphasised, one can only hope that economic transition and the instalment of the free market economy would make everyone better off; if this is not the case, one has to tolerate inequality and unemployment as they are to be eventually compensated by equality of citizenship and wider representation in the political system. Hence there is nothing theoretically wrong in including both Upper Silesia and the Donbas, despite some evident social problems, into one group of eventual success stories characterised by economic growth and stability. Yet, this would contradict the major assumption of the entire paradigm, namely, that only the post-communist cases that are characterised by the simultaneous introduction of economic and political liberalisation can generate positive macroeconomic performance. For the orthodox transition paradigm asserts that the Donbas, Ukraine, and the CIS in general are only partly liberalised, at best (for a typical treatment of the post-communist Donbas and Ukraine by the orthodox tradition, see van Zon 2000, 2001, 2003).

#### **PROBLEM FOUR: THE VIRTUOUS CIRCLE OF (MUTUALLY PARTIAL) LIBERALISATION?**

The fourth dilemma posed by the orthodox transition theory concerns the explanatory power of the liberal model as applied to the two post-communist regions. As a number of commentators have pointed out, there exists a contradiction between the concept of multiple (i.e. simultaneous



political and economic) liberalisation and economic growth. If one situates both Upper Silesia and the Donbas into the group of successful transition cases, both regions are supposed to be enjoying the virtuous circle of liberalisation, that is, economic freedom and political freedom must go hand in hand in both regions to assure sustainable economic development. Partial or ‘de-coupled’ kinds of liberalisation must inevitable fail. Yet, the data on which the liberal transition paradigm is based are contradictory in this regard and could be subject to various speculations. This can be demonstrated by considering a number of most widely quoted ratings of political liberties and economic freedom.

We will start with the analysis of two ‘freedom ratings’, which are regularly produced by the Freedom House (a Washington-based quasi-nongovernmental political advocacy sponsored by the US Congress), and by the Heritage Foundation (a Washington-based conservative think tank closely linked to the US Republican Party). The ratings of political and economic freedom developed by these organisations have been widely used in the construction of the orthodox transition paradigm (for example, see Dethier, Ghanem, and Zoli 1999; Havrylyshyn and Van Rooden 2000; Ekiert 2000). The two organisations usually construct their data-sets on the basis of outside expert opinion concerning formal political and economic institutions (legislation) and informal activities (practices) in the world. As both Poland and Ukraine are unitary states, and Upper Silesia and the Donbas are non-autonomous provinces with limited government rights, one could assume that the constitutional rights and civic liberties are enjoyed in the two provinces on the average national level. Therefore, one can use the published nation-wide data to roughly evaluate the degree of political and economic freedom in particular regions within the respective countries.

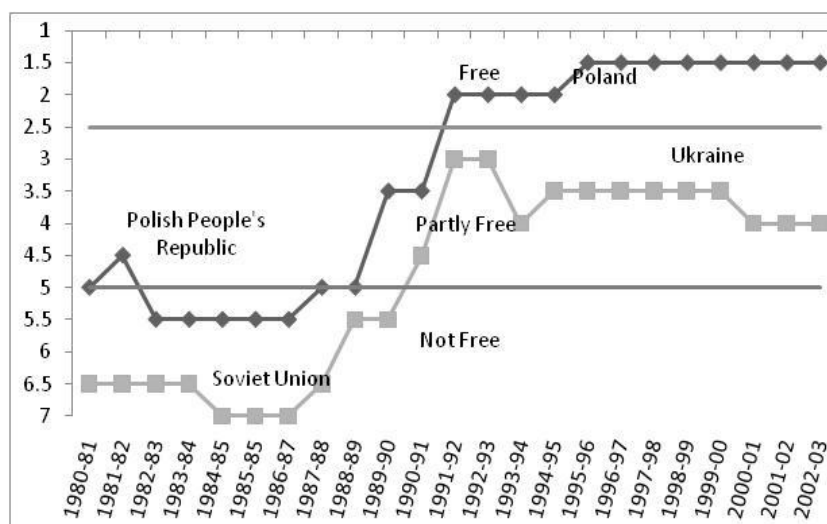


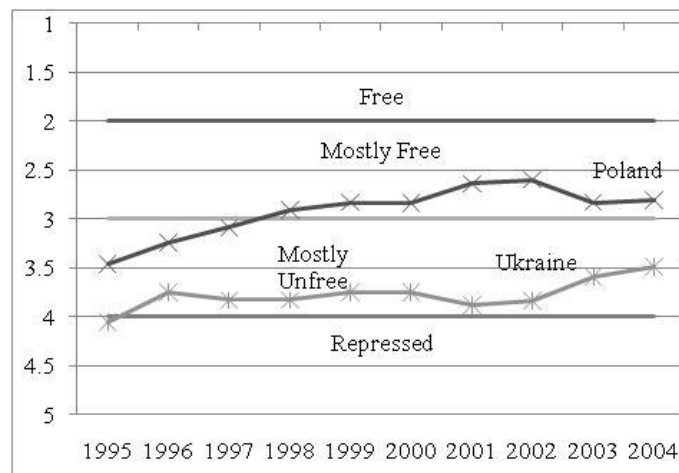
Figure 5.4. Political freedom ratings by the Freedom House, Poland and Ukraine, 1980-2003

Note: The freedom score points are combined average of the respective nation’s annual scores for political rights and civil liberties as defined by the Freedom House. Each of the first two is measured on a one-to-seven scale, with one representing the highest degree of freedom and seven

the lowest. Countries whose combined averages for political rights and for civil liberties fall between 1.0 and 2.5 are designated ‘free’; between 3.0 and 5.5. ‘partly free’; and between 5.5 and 7.0 ‘not free’.

*Source:* Author’s calculations on the basis of Freedom House (2002a, 2003a, 2004a).

Figure 5.4 illustrates the evolution of political liberalisation in Poland and Ukraine over the last two decades. It shows that, according to the Freedom House experts, since the beginning of the 1990s, Polish citizens have been living in a politically free country with the full set of civic liberties. By contrast, over the same period, Ukraine has been drifting into the opposite direction, whilst remaining a ‘partly free’ polity, that is, in the middle of the road between totalitarianism and a free society. Assuming that political conditions in Upper Silesia and the Donbas are analogous or, at least, comparable to those reported by the Freedom House for Poland and Ukraine, Figure 5.4 could indicate that in contrast to the Polish region, the post-communist transformation in the Ukrainian region did not proceed under the conditions of significant political liberalisation.



*Figure 5.5.* Economic freedom ratings by The Heritage Foundation / Wall Street Journal, Poland and Ukraine, 1995-2004

*Note:* The freedom score points are combined average of the respective nation’s annual scores for the degree of economic freedom in the following categories: trade policy, fiscal burden of government, government intervention into the economy, monetary policy, capital flows and foreign investment, banking and finance, wages and prices, property rights, regulation, and informal market activity, as defined by the Heritage Foundation and *The Wall Street Journal*. Each score is measured on a one-to-five scale, with one representing the highest degree of economic freedom and five the lowest. Countries whose combined averages for economic freedom fall between 1.0 and 1.99 are designated ‘free’; between 2.0 and 2.99 ‘mostly free’; between 3.0 and 3.99 ‘mostly unfree’; and between 4.0 and 5.0 ‘repressed’.

Source: Miles, Feulner, and O'Grady (2004).

The rating of economic freedom produced collectively by the Heritage Foundation and *The Wall Street Journal* questions, however, whether Ukraine have been liberalised even in the economic sphere. The Heritage Foundation's index casts a serious doubt about Poland's alleged free market status as well. Figure 5.5 shows that the Ukrainian economy (its institutional arrangements) has been classified as 'mostly unfree' since 1995; before that Ukraine was classified as a country which repressed economic freedom. Therefore, on the basis of the reported level of economic and political freedom in Ukraine, one has to shift the Donbas from the category of successful transition cases (which are characterised by high economic growth) to the third group of partially liberalised, failed transition cases. However, such a move would contradict the economic outcome of post-communism in the region, which, according to the orthodox model, should have been characterised by economic decline, extreme inequality, poverty, and creeping stagnation. On the other hand, Poland reportedly became a 'mostly free' economy around 1998 and remained in that category ever since. Yet, as Figure 5.5 indicates, Poland's ranking has been far below that of free market economies, signifying the country's only partial economic liberalisation.<sup>31</sup> On this basis, the orthodox transition approach's hypothesis of multiple liberalisation can hardly be applied to the Polish case of post-communist transformation as well. Thus, to the extent that the explanatory and predictive power of the liberal transition theory is concerned, it fails to provide us with a tool either for understanding the determinants of the post-communist transformation in the two East European regions or for interpreting its outcomes.

## **PROBLEM FIVE: FREEDOM, GROWTH, AND OFFICIAL RATINGS**

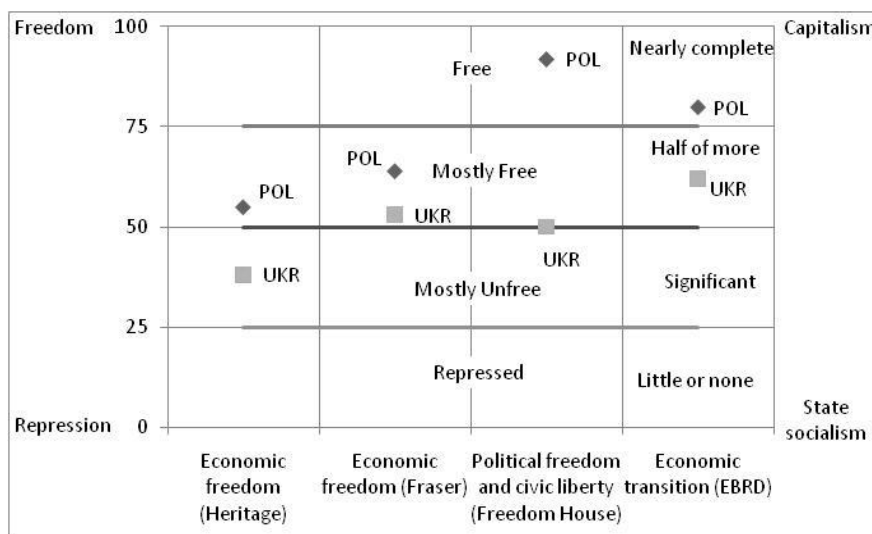
The possession of different degrees of freedom ('full' versus 'partial') by two similarly performing post-communist regions presents a serious problem for the potential applicability of the orthodox model to this particular comparative case. Furthermore, it brings out a fundamental discrepancy. What degree of political and economic freedom, if quantified, could be sufficient for economic growth? For any observer or practitioner of post-communism outside the orthodox neo-liberal paradigm this question could appear doctrinaire. For a paradigm based upon the concept of

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<sup>31</sup> According to the latest Heritage Foundation's *Index of Economic Freedom in the World*, the group of totally 'free' economies include all the countries that are traditionally characterised by the Anglo-Saxon liberal competitive capitalism such as New Zealand, the United Kingdom, the United States, Australia, and Canada. The only post-communist country that has appeared amongst the economically 'free' is Estonia (see Miles, Feulner, and O'Grady 2004).

harmonising liberties and scientific quantitative methodology, to answer the question could be indispensable. Such an ambitious enterprise should inevitable fail, however, if applied to the present study of Upper Silesia and the Donbas (and of Poland and Ukraine in general). Leaving aside the normative aspect of the transition-as-liberalisation theory, the major problem lies in the most basic issue, that is, the widely acclaimed causal link between freedom and growth. The mere existence of causality in this case cannot even be established, if one relies upon the empirical evidence presented in various authorised ratings of freedom.

In Figure 5.6 below, I have combined four freedom and transition ratings, which are most frequently used by neo-liberal theorists of post-communism. The first two are ratings of economic freedom prepared by the Heritage Foundation / *The Wall Street Journal*, and by the Fraser Institute (a libertarian think tank based in Vancouver, Canada). The third rating of political freedom and civic liberties was produced by the Freedom House. The fourth rating was developed by the European Bank for Reconstruction and Development to measure progress made in economic transition, that is, how far a particular post-communist country stands in its move from a standard centrally planned economy to a standard free market economy. I have re-arranged the four different rating systems to produce a comparable data-set.



*Figure 5.6.* Four ratings of liberties and transition progress, Poland and Ukraine, 2003-2004 scores  
*Note:* The four different rating systems were adjusted and respective scores re-defined on a 0 to 100 scale. For the three freedom ratings, ‘0’ means total repression and ‘100’ means total freedom. For the fourth rating of economic transition, ‘0’ means an unreformed state socialist economy and ‘100’ means a standard market economy of industrially advanced Western countries. Four additional subdivisions run respectively at each one-fourth of the scale.

*Source:* Author’s calculations and adjustments on the basis of Miles, Feulner, and O’Grady (2004); Gwartney and Lawson (2004); Freedom House (2002a, 2003a, 2004a); EBRD (2003).

Figure 5.6 illustrates the respective rating scores for 2003-2004, when both Upper Silesia and the Donbas have achieved a full economic recovery from the initial transitional depression. Figure 5.6 indicates that, according to the first and the third indicators (i.e. the Heritage Foundation's and Freedom House's indices), during its growth stage the Donbas has been functioning within restricted and mostly unfree economic and political systems. In turn, Upper Silesia has been part of a mostly free economy and a totally free polity. Based solely on the first and the third indicators, one could, perhaps, argue that both the region and Ukraine in general should be analysed within the 'non-transition' scenario rather than the 'failed' transition scenario of the liberal model. The EBRD rating brings discord into this line of logic, however. It shows that, although still far from total completion, the Ukrainian economy has accomplished more than half of its free market transition tasks, as defined by the Bank itself. Moreover, if one disregards the first and the third indicators and focuses exclusively on the remaining two, including the EBRD's transition rating and the Fraser Institute's freedom index, one could claim that by the beginning of the twenty-first century Ukraine moved both politically and economically very close to the 'mostly free' status. The discrepancies between several freedom and transition indicators show how vulnerable the neo-liberal paradigm might be to the reliability of the data based upon different methodologies of 'freedom'. This further weakens the explanatory power of the transition model, when applied to the comparative study of the Polish and Ukrainian transformation experiences.

### **IS THE ORTHODOX TRANSITION MODEL APPLICABLE?**

Being of an empirical nature, my discussion has been neither designed nor aimed at falsifying the entire orthodox transition theory. Its main goal is to assess the explanatory power and, thus, the potential applicability of the transition-as-liberalisation model for the research purposes of this book. It appears that to a certain extent orthodox transitology is of limited application. I argue further that liberalisation itself – the major independent variable of the transition paradigm – is problematic as an explanatory factor, which could account for the varied transformation outcomes. My critique proceeds along the main lines of the transition agenda that consists of two central reforms: macroeconomic stabilisation and structural adjustment.

Extensive state ownership and control, price controls, money finance of fiscal expenditures have long been considered amongst the fundamental deficiencies of state socialism. Therefore, according to the neo-liberal economic reform strategy, price liberalisation, fiscal consolidation, and privatisation should be initiated and implemented as soon as possible to free the economy from the

excessive government burden and to stabilise it afterwards. The virtuous circle of liberalisation is supposed to work within the economy itself.

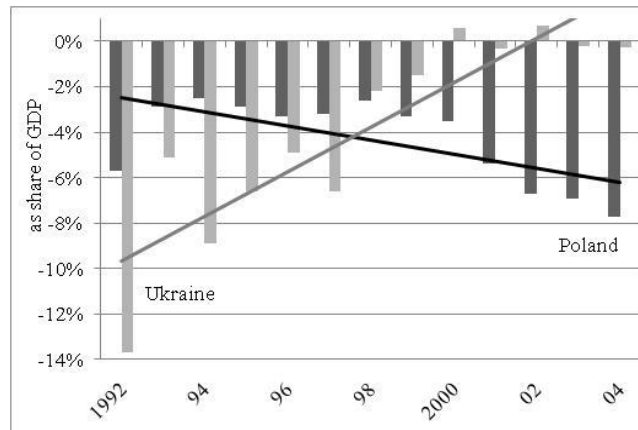


Figure 5.7. The general government sector expenditure balance (budget deficit) as share of GDP, Ukraine and Poland, annual percentages and trends, 1992-2004

Source: Author's calculations on the basis USSC (2000, 2002, 2003, 2004a); PSCO (1996, 2000, 2002, 2003, 2004a); Easterly and Sewadeh (2001); NBU (2004); OECD (2004a).

Figure 5.7 presents data on public expenditure balances in Poland and Ukraine between 1992 and 2004. It shows the divergent trajectories of fiscal consolidation in the two countries. Whilst economic growth in the Donbas has been highly negatively correlated with misbalanced public finances (in line with monetarism), Upper Silesia appears to be able to achieve sound economic performance as well as a higher level of social and human development under a much loosened, deficit-financed budget policy.

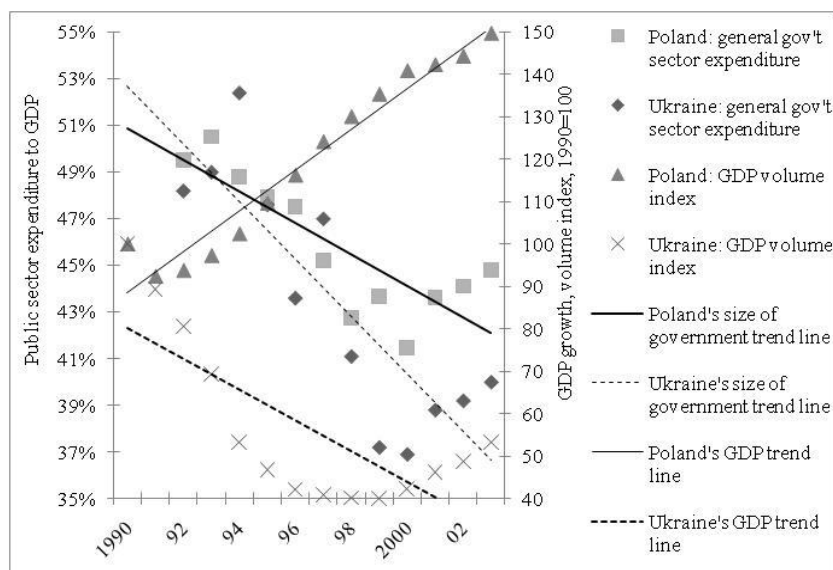


Figure 5.8. Economic growth and the general government sector expenditure as share of GDP, Ukraine and Poland, annual percentages and trends, 1992-2003

Source: Author’s calculations on the basis of EBRD (1995, 2004); USSC (2000, 2002, 2003, 2004a); NBU (2004); World Bank (1999); PSCO (1996, 2000, 2002, 2003, 2004a); Easterly and Sewadeh (2001); UN (2004); OECD (2004a).

Furthermore, the idea of limited government causing better economic performance and development is questionable, when applied to our comparative study. Figure 5.8 shows the comparative sizes of the Polish and Ukrainian states defined by the share of general government sector expenditures to GDP. It indicates that the Ukrainian state has been downsized at a much faster pace than its Polish counterpart. However, as Figure 5.8 indicates, in Ukraine, the process of ‘de-statisation’ has appeared to coincide with economic decline. By contrast, in Poland, the regression trend line of the general government sector’s expenditure moves almost diagonally downward to the right, whereas the economic growth trend moves diagonally upward to the right, thus, generally supporting the monetarist argument.

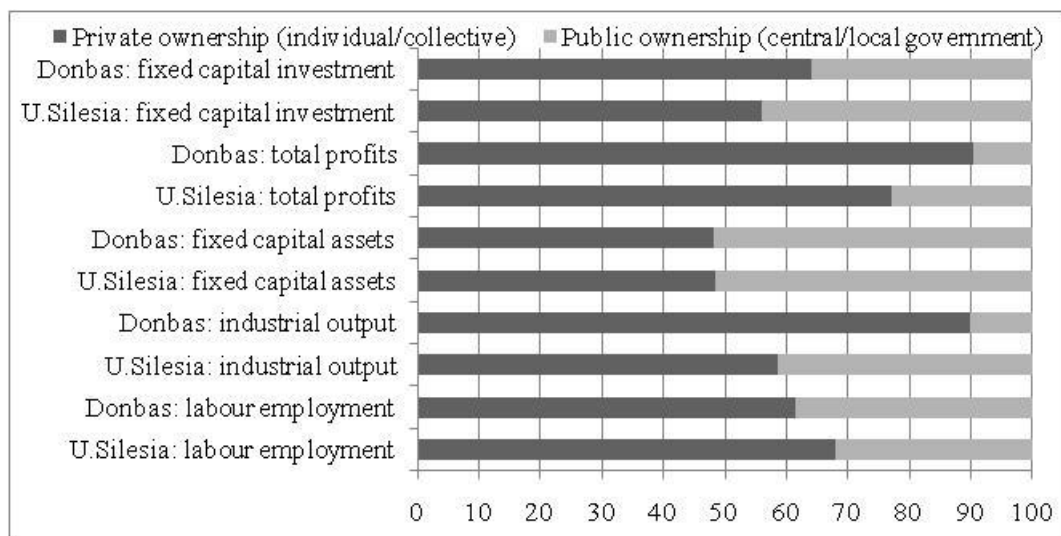


Figure 5.9. Ownership structure, Silesian voivodship and Donets oblast, 2002-2003

Source: Author’s calculations on the basis of DOSO (2002, 2003, 2004a); SOK (2001, 2003c, 2003d).

In another contrast to the liberal transition paradigm, the extent of state ownership and control over the economy and factors of production cannot account for economic and industrial performance alone. Figure 5.9 shows that across the entire regional economy, the Donbas has been characterised by a more extensive privatisation drive. Larger shares of investments, profits, and output have been owned and controlled by the private enterprise in the Donbas than in Upper

Silesia. Slightly more labour has been employed by the private sector in the Polish region, whilst the state owns or controls analogous shares of productive assets in both regions. On the other hand, neither of the two regions is one where private ownership and control of the means of production has totally prevailed.

In addition, it is hardly possible to find a definite correlation between state ownership and development and, conversely, between privatisation and growth. Figure 5.10 below shows that the Donbas industry returned to growth (in 1997) with over 66 per cent of output being produced by non-state-owned enterprises.

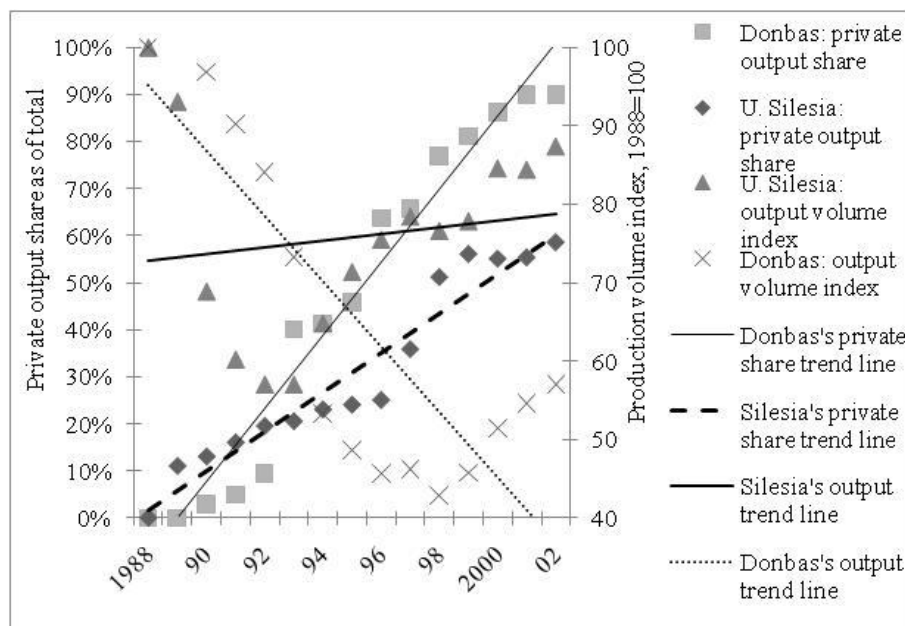


Figure 5.10. Privatisation of Upper Silesian and Donbas industries and industrial growth, 1989 - 2002

Source: Author's calculations on the basis of VSO (1989, 1991, 1992, 1994, 1996, 1997, 1998); SOK (1999, 2000, 2001, 2002a, 2003c, 2003d); DOSO (1991a, 1992, 1993, 1994, 1995, 2000, 2002, 2003); some Upper Silesia's data inputs for the early 1990s are estimates based on regression.

In Upper Silesia, industrial growth resumed (in 1994) with less than one-quarter of output in private hands. The contrasting regression trend lines presented in Figure 5.10 cast further doubts on the integrity of the free market hypothesis as applied to both Upper Silesia and the Donbas. Figure 5.10 indicates that there is an evident positive correlation between Upper Silesia's privatisation progress and the regional industrial output dynamics. Yet, by contrast, in the Donbas, the privatisation trend line's direction is in conflict with the region's industrial growth regression trend. Thus, following the orthodox transition paradigm and applying economic liberalisation as the major independent variable to the study of transformation in Upper Silesia and the Donbas does not lead



to an adequate explanation of the post-communist phenomena in the two regions. An alternative approach is needed.

## **CONCLUSION**

In this chapter I have examined the possibility of applying the orthodox transition model of post-communism to the comparative study of Upper Silesia and the Donbas. I have claimed that the transition paradigm cannot be applied to resolve the major research question of this book for it contains a number of fundamental problems. The concept of the virtuous circle of liberalisation, which explicitly provides for simultaneous and mutually beneficial political and economic liberalisation, cannot be applied to growing post-communist economies with partly liberalised polities or economies. On the other hand, I have argued that (economic) liberalisation in itself can hardly function as the major independent variable. The explanatory power of the transitology model, based on free-market oriented reforms (macroeconomic stabilisation, fiscal consolidation, privatisation and structural adjustment), has appeared to be of limited applicability to this study, since neither of the two post-communist regions appears to present a case sufficiently close to the neo-liberal ideal.

The importance of differences in the initial conditions between Upper Silesia and the Donbas has been emphasised. I share the opinion of a number of scholars that inflationary pressures, the phenomena of disorganisation and trade implosion had a much more detrimental effect upon the former Soviet territories and on the Donbas in particular, than on the post-communist countries of Central and Eastern Europe. Nevertheless, it has been contended that such a standpoint further weakens the explanatory power of the orthodox transition model, which stresses the importance of ‘right policies’ (i.e. full multiple liberalisation), as the primary independent variable. This chapter’s empirically-driven discussion has not been a test capable of falsifying the entire orthodox theory of transition. The major purpose of this discussion, however, has been to demonstrate the weak explanatory power of the transition-as-liberalisation hypothesis and the inappropriateness of the neo-liberal transition model as regards the post-communist transformation paradox found in the comparative case of Upper Silesia and the Donbas.

## **PART TWO SUMMARY: THE LIBERAL TRANSITION PARADIGM, ITS EXPLANATORY MODEL AND APPLICABILITY**

In Part Two, I have critically examined the transition paradigm of the post-communist transformation and evaluated the explanatory power of its theory. In Chapter 4, I have considered

the basic premises, assumptions, and deduced explanations for the divergent outcomes of post-communism provided by the system transfer approach. I have claimed that the orthodox transition paradigm has been based on the philosophical premises of liberalism and constructed within the methodological frameworks of neoclassical political economy and the economic approaches to politics. It has developed a paired liberalisation hypothesis. According to the liberal analytical model of transition, the liberalisation of the economy should be combined simultaneously with the liberalisation of the polity. Only the workings of mutual liberalisation and the construction of a social formation based upon the virtuous circle of economic and political freedoms guaranteeing unhindered economic and political competition are considered to be sufficient to ensure successful transformation. A partly-liberalised polity and partly-reformed economy can only generate a transition failure. The absence of any substantial liberalisation means a non-transition, that is, some form of continuity of the old regime.

The causal model derived from liberal theory puts its primary emphasis on the balance of power between communist hard-liners and liberal democratic opposition, and on the results of the 'founding' elections. The victory of the anti-communist opposition results in political liberalisation and the introduction of liberal democracy, which triggers market-oriented reforms aimed at establishing the free enterprise economy and, thus, leads towards the ultimate success of transformation. The victory of ex-communists and the old elite results in the rejection of liberalisation as such. The indecisive outcome of the initial elections stalls political liberalisation and leads towards authoritarianism, which, in turn, generates a deficient corrupt economic system, resulting in economic decline, social regress, and political instability. The three resultant outcome scenarios (successful, non-existent, and failed transitions) are said to be representative of the entire period of post-communism.

In Chapter 5, I have attempted to apply the orthodox model of post-communism to the comparative study of Upper Silesia and the Donbas in transition. My discussion has substantiated the necessity of having an alternative approach towards the post-communist phenomena. The conventional transition model has been incapable of interpreting the dynamic nature of the transition outcomes in the two regions concerned. I have argued that the concept of the virtuous circle of liberalisation cannot be effectively applied to growing economies with incompletely liberalised polities. Moreover, liberalisation in itself could hardly be useful as the major independent variable in the study of Upper Silesia and the Donbas under post-communism. I have argued that the negative legacies of state socialism, which were inherited by different post-communist countries to a different degree, could provide a much more suitable explanation for the economic depression of the first half of the 1990s, than the one developed by the orthodox transition model, which places responsibility on slow and incomplete liberalisation. The

explanatory power of the orthodox transitology model, based on the simultaneous radical liberalisation of the post-communist economy and polity, has appeared to be of limited applicability for this book's research problem. Essentially, the neo-liberal model cannot provide an adequate answer as to why Upper Silesia and the Donbas have been following a similar performance trajectory, despite possessing arguably different degrees of economic and political freedoms? A pressing need for an alternative conceptual approach has been identified.

## **Part Three**

### *The Political Economy of Capitalism in Transition*

## **Towards an Alternative Paradigm of the Post-Communist Transformation**

Part Three is aimed at resolving the research problem of this book (i.e. why have two structurally similar, old industrial regions of neighbouring East European countries generated varied transformation outcomes?) by providing a more adequate account for the internal dynamics, tensions, and forces of post-communism in Upper Silesia and the Donbas. In Chapter 6, I will outline an alternative approach towards post-communism which draws its assumptions and explanations from two pioneering works in comparative political economy by Peter A. Hall and David Soskice, and by Bruno Amable. The new theoretical framework of the post-communist transformation is based upon Amable's concept of hierarchical and complementary institutions, which are the result of the contentious path-dependent process of political economy. The core idea of this alternative approach is that particular socio-political dynamics, mediated through the national political system, lead towards the establishment of particular institutional arrangements. The ultimate outcome of such political-economic processes of institution-building in different environments is the variety or diversity of types of modern capitalism. Variant models of capitalism might not resemble each other in form. However, provided they have generated a natural complementary mix of major institutional arrangements, variant capitalisms might resemble each other in performance, that is, most of the ideal-types could be capable of delivering sustainable growth in output, productivity, employment, and income.

It is contended that by applying this comparative political economy framework to the study of post-communist transformation in Upper Silesia and the Donbas, I will be able to define generic features of post-communist capitalism and to conceptualise its future. I argue that the 'varieties of capitalism' theory can yield a much deeper insight into the post-communist phenomena than the liberal transition paradigm. Consequently, in Chapter 7, I will examine the contemporary institutional design of post-communist capitalism in Poland and Ukraine in general, and in Upper Silesia and the Donbas in particular. I will claim that similarly sound economic and industrial performance reported by both Upper Silesia and the Donbas since the mid-1990s is the primary outcome of newly-developed – though partial and incomplete – institutional complementarities

within the two capitalist formations. I will further argue that the significant difficulties experienced by Upper Silesia and the Donbas in resolving some urgent social welfare and human development problems are caused by a number of institutional inconsistencies which (still) characterise post-communist capitalism of the two regional versions. In Chapter 8, by applying the theory of institutional political economy, I will show how the two variant post-communist capitalisms have been constructed and why they have evolved into the present combined form.

## **THE PATH DEPENDENCE OF POST-COMMUNIST TRANSFORMATIONS**

The orthodox neo-liberal paradigm, especially its classical orthodoxy or ‘free market fundamentalism’, has been strongly rejected by a large number of scholars from the very start of the post-communist era. As early as 1990, John Kenneth Galbraith, a leading US political economist, attacked the mainstream transition strategy as being based on an ideological construct of the free enterprise economy that ‘bears no relation to reality and exists all but entirely in the minds and notably in the hopes of the donor’ (*Transition*, November 1990: 8). Thus, the fundamental flaw of the dominant transition policy direction has been attributed to a misunderstanding of the foundations of a market economy as well a misunderstanding of the basics of an institutional reform process by reform models based on conventional neoclassical economics (Stiglitz 1999, 2003; Kołodko 1999, 2000a; Marangos 2002). For the critics of Washington consensus reforms, the neo-liberal marketisation of the post-communist countries has become synonymous with a catastrophic loss of national wealth, economic mismanagement, wasted resources, and social misery (Kołodko 1998). They have maintained that whenever democratic governments followed neo-liberal tenets, the outcome has been stagnation, increased poverty, political discontent, and the debilitation of democracy (Bresser Pereira, Maravall, and Przeworski 1993).

Some critics of the orthodox transition paradigm – historical and sociological institutionalists, and new institutionalists of neoclassical political economy – have followed a modern theory of institutions, institutional change and their effect on economic performance developed by Douglass C. North (1978, 1984, 1990). Others have followed the French School of Economic Regulation, with its emphasis on the diversity of different ‘mixed’ capitalist economies. They both have emphasised the existence of historically dependent paths of development and cultural rules and norms that represent institutional constraints to or opportunities for change. Generally, the concept of path-dependency in social sciences refers to the non-uniqueness of the ultimate equilibrium. In other words, path-dependency means that a state of balance between the opposing forces (in which there is no tendency to change) is not independent of how the (economic

or political) system gets there; there exists a possibility that what happens in one period affects the following events for a long time subsequently. However, path-dependency should not be confused with hysteresis implied in the transition paradigm. Whilst hysteresis means a retardation, lagging of an effect behind its cause (as during the policy reform time lag), path-dependency stresses the duality of heritage and creation, i.e. ‘evolutionary features of system trajectories characterised by out-of-equilibrium self-organisation’ (Chavance and Magnin 1997: 197).

Applied to the problem of the post-communist transformation, the path-dependent approach focuses on three fundamental concepts – mixture, diversity, and complexity. The transition paradigm is rejected by path-dependence theorists for its study of the present as an approximation of a designated future that is flawed by teleology in which concepts are driven by hypostasised end-states (Stark 1997). They see the transformation processes as resembling not so much the legacies of the past or the architectural design of the ideal future as ‘bricolage – construction using whatever comes to hand’ (Stark 1992). Path-dependence is thus ‘a theory neither of determinacy nor indeterminacy but a method for grasping the recombinant character of social innovation’ (Stark and Bruszt 2001: 1132). In the words of David Stark, the major theorist of the path-dependency approach:

As the science of the not yet, transitology studies ... the transitional present [as] a period of dislocation [in which] society undergoes the passage through a liminal state suspended between one social order and another, each conceived as a stable equilibrium organized around a coherent and more or less unitary logic. But is ours still the century of transition? ... Change, even fundamental change, of the socialist world is not the passage from one order to another but rearrangements in the patterns of how multiple orders are interwoven. Organizational innovation in this view is not replacement but recombination. Thus, we examine how actors in the post-socialist context are rebuilding organizations and institutions not *on the ruins* but *with the ruins* of communism as they redeploy available resources in response to their immediate practical dilemmas. With such a concept of path dependence, we explain not the persistence of the past but how multiple futures are being contested in the present. Instead of paralysis and disorientation or of condemnation to repetition or retrogression, we see ongoing processes of organizational innovation – for it is through adjusting to new uncertainties by improvising on practised routines that new organizational forms emerge (1997: 35-36; italics in original).

For the scholars of path dependence, ‘designer capitalism’ cannot work in post-communist Europe, since it is based on a set of wrong assumptions. Firstly, the capitalist institutions that have performed so well in other economies cannot be replicated according to a set of instructions. Secondly, a new social order cannot be dictated and policymakers in newly emerged democracies are constrained by the citizenry, which may not be willing to bear the costs of transition. Thirdly, it is wrong to assume that the collapse of communism has left an institutional void. Therefore, the

‘hastily drawn-up marching orders to create capitalism in six steps or sixty’ would be inevitably constrained, if not blocked totally, by institutional resources that have survived the exit from state socialism (Stark 1992).<sup>32</sup>

Besides its closer attention to the socialist past and the explicit rejection of the ‘only liberalisation matters’ postulation of the orthodox system transfer theory, the path-dependent approach’s major contribution to the field of post-communist studies has been in its shift of the stress to institutions, organisational forms or ‘modes of governance’. Yet, in this respect, the position of the approach is contrary to the revived conservative concept of convergence, which is both the desirable and advisable ending point of the post-communist transformation according to the conventional transitology. The path-dependent approach emphasises that instead of examining political economies of post-communist Europe according to the degree to which they conform to, or depart from, the ideal types of Western-style capitalism, one should be concerned with variations and mutations evolving from the recombination of the inherited forms with emerging new ones. Therefore, in place of *transition* (driven by hypothesised end-state), the path-dependent approach analyses *real transformations*, in which the introduction of new elements occurs in combination with adaptations and reconfigurations of already existing institutional norms. The path dependence approach not only recognises the ‘mixed’ or ‘recombined’ forms of capitalism which have emerged in Central and Eastern Europe as being inevitable, but it also presumes that post-communist countries might eventually benefit from such a diversity and flexibility of organisational forms (Stark 1996; Grabher and Stark 1997; Stark and Bruszt 1998).<sup>33</sup> According to Bernard Chavance and Eric Magnin:

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<sup>32</sup> In another passage, David Stark and Laszlo Bruszt have forcefully argued against the core assumption of the orthodox transition paradigm: ‘Assuming that they were “starting from scratch”, Western advisors from the International Monetary Fund and university-based institutes issued instructions for new “rules of the game”. But the ruins of communism were not a tabula rasa; and so the new hybrid game was played with institutions cobbled together partly from remnants of the past that, by limiting some moves and facilitating other strategies, gave rise to a bricolage of multiple social logics. If from these coexisting and overlapping principles they are building a distinctively postsocialist capitalism, they share with all modern societies a common feature that the social fabric is woven with multiple, discrepant systems of value. Neoliberals, whose free market doctrines guide the IMF, would not be fond of this metaphor. For them, the fall of communism is nothing more or less than the triumph of the market. Capitalism has a single logic, pervasive now throughout the globe and increasingly throughout every sphere of society ... There is no viable Third Way, much less a fourth or fifth, but only a single path, a one best way (2001: 1129).

<sup>33</sup> One has to be mentioned here that a similar evolutionary perspective has also been adopted by several libertarian economists, most notably by Peter Murrell and Kazimierz Poznański (see Murrell 1992a, 1992b, 1995; Poznański 1995, 1996, 2001), and by some conservative sociologists (King 2002), who have long advocated a gradualist strategy of economic transition. However, in striking contrast to the critical path-dependent tradition, the liberal evolutionist scholars believe that the East European type of capitalism is defective. They claim that the most relevant meaning of the ‘path-dependent’ nature of transition is that capitalism has been built with the ‘communist tools’: ‘This form of capitalism is not recognisable, because a similar property structure does not exist in any well-developed capitalist countries. Rather than instantly fading away like a stain treated with a strong detergent, communism has retained a strong hold on the emerging capitalism’ (Poznański 2001: 320-21).



The notion of the 'mixed economy' has been the target of wide criticism ... Economic liberalism opposing or criticizing in principle the notion of the mixed economy has obscured both the real nature and variety of Western capitalism, and the specific problems of systemic change in the post-socialist world. The concept of a 'market economy' understood as a kind of pure or simple system reducible to a single universal coordination mode is misleading. Capitalist systems, in their historical and national diversity, have all been characterised by a high degree of institutional and organizational variety, and by a complex repertoire of coordination modes or governance forms ... In place of a monocausal pure system, we find in the family of capitalist systems combined or mixed economies in which various forms are present and different principles are at work ... Post-socialist transformation has produced complex developments in the economy which cannot be reduced either to marketization and privatization as general trends, or to simple obstacles and delays in this direction. Specific and evolving configurations of post-socialist economies are characterized by their composite, combined or mixed features. Such heterogeneity does not boil down to the simple 'transitory' nature of economies moving from one alleged pure system to another. It depends on the historical and path-dependent character of systemic change and on the complex nature of capitalism in general (1997: 196-97).

A significant consequence of the path-dependent approach lies in the sphere of methodology and new paradigm-seeking. As some authors have argued, what is currently lacking is a paradigm of post-communist capitalism developed around the concept of 'divergence', of different types of capitalism in the post-communist world (Lane 1999). The theorists of path-dependence have been the first to attempt to conceptualise this newly emerging 'composite, combined or mixed' capitalism in transition. As Stark and Bruszt (1998) have maintained, one cannot grasp the post-communist world through the old dualisms of private/public, market/hierarchy, capitalism/socialism, since after the demise of state socialism the 'method of mirrored opposition' – comparisons East-West – are no longer fruitful. They have proposed to engage in 'comparative capitalisms', i.e. into the comparative institutional analysis of 'really existing' capitalisms vis-à-vis each other to describe and account for the emergence of a distinctively East European capitalism. Hence the research question of the path dependent approach towards post-communism is whether recombinant processes – blurring of public and private, blurring of enterprise boundaries, and blurring the 'boundedness' of legitimising principles through which actors claim stewardship of economic resources – result in a new type of mixed economy as a distinctively East European capitalism (Stark 1997; Stark and Bruszt 1998). Yet, as these theorists of path-dependence admit, if a full appreciation of the distinctive character of an East European capitalism can only be achieved through comparison to other relevant cases, how are we to engage that comparison without already understanding the major contours of various post-communist cases themselves?

## INSTITUTIONAL COMPLEMENTARITY, HIERARCHY, AND POLITICAL-ECONOMY EQUILIBRIA

To respond to the research problem posed by the path-dependence approach, one has to address two fundamental issues: (a) the issue of ‘major contours’ of capitalism itself, and (b) the path-dependent (re-)drawing of these contours. The first problem refers to which institutional arenas of capitalism should indeed be considered central to the working of the whole system. The second problem is how these institutions are created or arrived at. We will start with the second question first, before returning to the definition of capitalism and its major contours.

The classical idea that the production, distribution and consumption of wealth in a human society is solely attributed to the action of ‘economic man’, who, in a consistent action and a rationally calculating manner, allocates inputs of land, labour, and capital, has long been questioned since the mid-18<sup>th</sup> century by the great works of the German Historical School, Karl Marx, Max Weber, economic sociology in France, and institutional economics in the USA. The common ground for these criticisms is that the classical political economy of Adam Smith and David Ricardo ignores the non-economic, ‘super-structural’ or institutional environment. The rise of neo-classical economics in the late 19<sup>th</sup> century and, especially, the revision of the market doctrine by monetarism and supply-side economics in the late 1960s and 1970s, have prompted a renewed attention to ‘the rules of the game’ (for a debate about modern institutional economics theories, see Hodgson (1994) and Williamson (1994)).

Orthodox economics has been criticised for relying on distorting and oversimplifying theoretical formalisations and mathematical models (Hodgson 1988), and for neglecting ‘the set of fundamental political, social and legal ground rules that establishes the basis for production, exchange and distribution’ (Davis and North 1971). Douglass North’s *Institutions, Institutional Change and Economic Performance* (1990) – with its statement of the institutional framework as a major determinant of the performance of an economy – has provided a new impetus for the study of institutions. Generally following the rational choice theory, North defines institutions as the humanly devised constraints that shape, structure, and motivate political, economic, and social interactions; or, in other words, as the rules of the game in a society that consist of both formal institutions (constitutions, law, property rights) and informal constraints (customs, sanctions, norms, codes of behaviour, traditions), which reduce uncertainty by establishing a stable (but not necessarily efficient) structure to human interaction (1990; 1991).

Whilst accepting North’s definition of institutions, a number of authors, however, have raised some further questions. The first question is whether different institutions are totally autonomous or whether they function in some interdependent fashion. Masahiko Aoki (1994) has been the first to

argue that, similar to the concept of ‘complementary goods’, there can exist complementarity between the institutions of political economy. In the basic case of complementary goods, pairs of goods for which consumption is interdependent, for example motor-cars and petrol or bacon and eggs are known as complements; and changes in the demand for one will have a complementary effect upon the demand for the other. In the case of *institutional complementarity*:

Two institutions can be said to be complementary if the presence (or efficiency) of one increases the returns from (or efficiency of) the other. Conversely, two institutions can be said to be ‘substitutable’ if the absence or inefficiency of one increases the returns to using the other. [...] This point about institutional complementarities has special relevance for the study of comparative capitalism. It suggests 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 ... If this is correct, institutional practices of various types should not be distributed randomly across nations. Instead, we should see some clustering along the dimensions that divide liberal from coordinated market economies (Hall and Soskice 2001b: 17-18).

In addition to complementarity, another essential question with regard to institutions in political economy is whether there are institutions that are more at the core of the system than others, i.e. the institutions which solve the problem of rule-enforcement mechanisms, since not all institutions are necessarily self-policing. Some have addressed the issue by considering institutions as problem-solving cognitive models of individual behaviour (Mantzavinos 2001). Others, however, have redefined the whole view of an institution as an endogenous-equilibrium strategy of human interaction: ‘a self-sustaining system of shared beliefs about a salient way in which the game is repeatedly played’ (Aoki 2002). In a critical review of new institutionalism, Caporaso and Levine have pointed out to the following problem with applying economic reasoning to political institutions:

With the extension of self-interest calculation to the design of institutions, we lose any sense of an enduring social world within which persons find themselves, discover their identity, their sense of self, and the wants appropriate to that sense of self. Institutions, in part, make up that enduring social world. Our institutions allow for a frame of reference that is not contingent on exogenous preferences. If institutions are to take on this role, self-interest cannot be exogenous to them, or at least not to all of them. At a minimum, this suggests a division between those institutions aimed at serving self-interest, and thus for which exogeneity might be a reasonable assumption, and those institutions that participate in the formation of interests, for which the exogeneity assumption is inappropriate. To the extent that political institutions fall into the second class, political economy might concern itself with clarifying the necessary distinction (1992: 156-57).

Bruno Amable has recently merged the two dominant views of institutions (i.e. as the rules of the game and as equilibrium strategies) by defining a two-tier game structure for the behaviour of agents. The lower tier defines agents' strategy in a given institutional framework; institutions in such a setting are taken as rules of the game. The lower tier corresponds to a situation of relative institutional stability, in so far as the rules of the game are not significantly altered by the individual strategies devised by agents. On the other hand, the upper tier, which is the level of the meta-game in the institutions-as-rules view, defines the framework of the lower-tier game. The upper tier, thus, corresponds to Aoki's game, where institutions emerge as self-sustaining equilibrium strategies (Amable 2003: 34-35). Amable's upper tier institutions also correspond to what Caporaso and Levine have implicitly described as the second, upper class institutions. Whilst this does not fully settle Caporaso's and Levine's problem,<sup>34</sup> Amable's two-tier institutional framework explicitly pushes for the existence of a hierarchy among institutions.

*Institutional hierarchy*, according to Amable, thus means that institutional design in one area depends on or takes into account the constraints and incentives associated with the institutions prevailing in other areas. While the notion of complementarity links different institutions between different elements, conditioning the coherence of the whole system, the notion of a hierarchy insists that one institution or a few institutions somehow impose the conditions as to which complementary institutions are going to supplement them and those few institutions dictate the dynamics of the whole architecture as such. Yet, according to Amable, the true source of hierarchy is not anteriority, since institutions can be changed. Following Ostrom's (2001) distinction between three types of rules, Amable maintains that institutional hierarchy is defined according to which set of rules dictate the design and possibilities of other rules. By focusing on the conflict of interest, his approach goes further by explicitly considering the political aspect in the emergence, stability, and dynamics of institutions affecting the economy and the polity.

Amable outlines a theory of institutions as a set of rules that structure social interactions in particular ways not only as endogenous (i.e. self-sustaining) equilibrium strategies, but more specifically as political-economy equilibria, i.e. as the outcome of strategic interactions among agents in a specific power structure. Hence a choice of institutions directly or indirectly becomes a political choice. It reflects the political equilibrium that prevails in the society. Institutions are a product of the compromise that has been reached over distributional conflicts. According to this theory of institutions as a socio-political compromise, the institutional configuration of an economy depends on the formation of a stable dominant social bloc coalescing different socio-political

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<sup>34</sup> Similar to North and his followers, Amable formalises his theory in rational choice terms using a game-theory bargaining methodology. However, in contrast to the new institutionalists of neoclassical political economy, Amable significantly relaxes the underlying thesis of exogenous technology, preferences, and interests (see Amable 2003: Chapter 2).

groups<sup>35</sup> inclined to support a coalition with a certain political strategy. The implementation of this strategy leads to institutional change in a direction that is beneficial to the dominant social bloc. However, the dominant social bloc itself is an alliance of different and, on occasion, diverging interests. Therefore, the institutional structure that will rise from the political strategy which it supports will be a re-negotiated compromise.

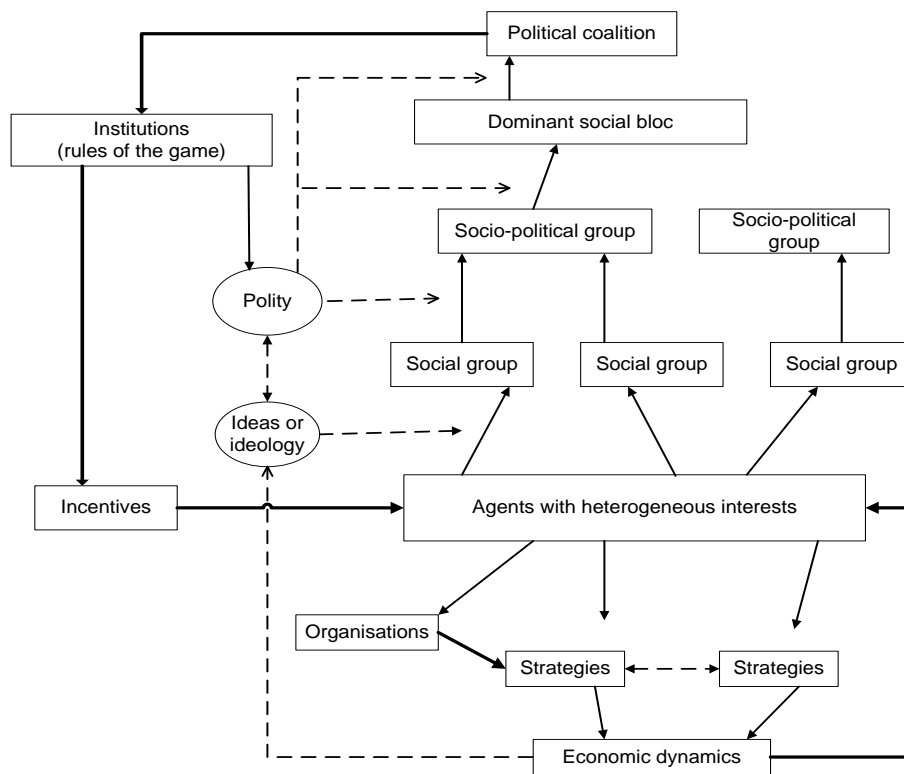


Figure 6.1. Institutions as a political-economy equilibrium: Bruno Amable's theory of political economy

Source: Amable 2003: 48.

Figure 6.1 provides a graphic presentation of Bruno Amable's theory of political economy. In striking contrast to the static theory of post-communist transformations, Amable's approach has an in-built output feedback loop. Economic performance has a direct and regular effect upon social agents. Furthermore, the aggregation of social preferences is conducted within the prevalent ideological setting, whereas the formulation of political demands and the formation of the winning political coalition are mediated through the political system:

Because social agents do not generally possess a perfect vision of all interdependencies and complementarities between institutions, the compromise does not apply to all the institutions of an economy, but has to be re-established as changes in the economic

<sup>35</sup> A socio-political group, accordingly, joins together several social groups (e.g. workers, managers, farmers, pensioners, etc.) that have a common political goal.

environment modify agents' options and strategies ... Complementarity between institutions makes the implementation of policy, as well as institutional design, more complex. Institutional design in one area depends on the institutions prevailing in other areas ... Whereas the notion of complementarity links different institutions and modes of organization in a specific architecture and focuses on interaction between the different elements conditioning the coherence of the whole system, the notion of a hierarchy insists on the relative importance of one or a few institutions for the structure of complementary and the dynamics of the institutional architecture as such ... Hierarchically superior institutions according to our definition are not necessarily those that change the least. A rational political strategy from the point of view of political agents may well be to favour change affecting the most crucial institutions for the dominant bloc as long these changes are profitable for the bloc and reinforce the political support of the coalition. Therefore, stability of institutions is also a function of the political-representation system, such as the number and weight of veto players. Institutions are less likely to change if they are hierarchically at the top and if changes affect in differentiated ways the different socio-political groups that have some veto power (Amable 2003: 66-67, 69).

Thus, taken as a whole, the outlined theory of institutions and politics portrays an economy as a system governed by a set of complementary institutional forms resting on specific political equilibria, which, in turn, define the hierarchy among institutions (see Amable 2003: Chapter 2). The question to be put further is focused on the sets of complementary institutional forms – institutional arenas – which are located at the top of the institutional hierarchy.

## **WHAT INSTITUTIONS MATTER UNDER CAPITALISM?**

Here we return back to the first question associated with the path-dependency approach's quest for a (potentially distinctive) East European capitalism, that is, to the 'major contours' of capitalism. In other words, what specific institutions are considered to be decisive in influencing the performance and productive specialisation of a capitalist economy through which one could potentially identify the main features of post-communist capitalism? Prior to discussing the major characteristics of the emerging capitalist political economies in Upper Silesia and the Donbas and the ways they are governed and stabilised, one should, firstly, define the notion of capitalism. According to Abercrombie, Hill and Turner, capitalism in its 'pure' form may be briefly defined by (a) private ownership and control of the economic instruments of production, i.e. capital; (b) the gearing of economic activity to making profits; (c) a market framework that regulates this activity; (d) the appropriation of profits by the owners of capital (subject to taxation by the state); and (e) the provision of labour by workers who are free agents (1994: 41).

Most dictionary definitions of capitalism (also called ‘free market economy’, or ‘free enterprise economy’) usually denote a distinct form of social organisation or economic system, dominant in the Western world since the break-up of feudalism, and based on generalised commodity production, in which most of the means of production are privately owned and/or controlled, individuals are free to maximise profits, the bulk of the wage-earning workforce is engaged in employment by private (non-governmental) employers, and production is guided and income distributed largely through the operation of markets, i.e. by the price system (see Bogdanor 1987: 74-75; cf. Bannock, Baxter, and Davis 1992: 61; Robertson 1993: 49-50; Britannica 1999-2000; McLean 1996: 54).

A number of authors, however, consider the application of minimalist definitions of capitalism, such as those that equate it with private ownership of the means production, wage labour, and economic co-ordination through free markets, or those that equate capitalism with profit maximisation under the price system, or with a combination of both, to be inadequate. Some argue that the inappropriateness of the above-mentioned definitions of capitalism lies in their disregard of capitalist money and banking as the autonomous and crucial structural specificity of capitalist development (for a critique of orthodox economic and classic Marxist theories of money, see Ingham 1999). Others emphasise that capitalism is both a multidimensional and contradictory form of social organisation and control (Dahms 2000a). Thus, they argue that analyses of capitalism on the basis of concepts such as ‘free and self-regulating market’ or ‘private enterprise’ tend to be increasingly problematic in the light of the transformations of advanced capitalism in the twentieth century (Dahms 2000b). Most authors agree that in practice there exist some limitations on market freedoms that have reshaped the inner logic of market mechanism in all countries. Furthermore, capitalism is analysed through conflicting meanings by different social scientists (see Giddens 1971).<sup>36</sup> Finally, it has been argued that minimalist notions of capitalism are particularly inadequate for the study of post-communist transformations aimed at exploring the divergence of models of post-communist capitalism in Eastern Europe, since they obscure various manifestations of capitalism in modern industrialised societies. Recognising these criticisms, rather than focusing on the definition of generic capitalism, in the following sections I will briefly explore various models of actually existing modern capitalism.

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<sup>36</sup> According to an alternative sociological definition: ‘capitalism, as a type of political economy, is a system of production taking place for market exchange utilising money as a medium which determines differentials of income, levels of investment and the distribution of goods and services; productive assets are privately (collectively or individually) owned, and profit leading to accumulation is a major motive of economic life. The state, which is embedded in a more or less pluralistic society, established an effective system of law which secures private property and rights of owners over the proceeds of production. A major legitimating theory is that of democracy, or polyarchy, which entails competition between parties and groups for influence over the legislature and executive arm of government’ (Lane 2000: 486).

### **The French *Régulation* School**

Since Andrew Shonfield's (1965) pioneering work on alternative structures of modern capitalism, there have been two major schools of thought aimed at developing a fully-fledged theory of comparative capitalist systems – the French *Régulation* school and the 'varieties of capitalism' approach. A group of scholars, known collectively as the School of economic regulation, has argued that there are no constant, ahistorical economic principles of capitalism.<sup>37</sup> Strongly influenced by Marxism, they have considered capitalist development to be shaped by institutional and social factors, particularly by social-class relations and political action. According to the *régulationniste* theoretical writings, capitalism develops through a series of distinct phases or modes of development. Each mode consists of the *regime of accumulation* and the *mode of regulation*. The accumulation regime comprises a particular pattern of economic activity, i.e. the productive system that has its own internal dynamics and follows a certain growth path linked to a given technological trajectory. The mode of regulation is an assembly of institutions or 'structural forms' which act to guide and stabilise the accumulation regime. Modes of regulation govern five relationships which are considered central to all capitalist economies: the form of the capital-labour relation (i.e. the wage-labour nexus); the nature and form of competition between firms; international relations (i.e. how the national economy is inserted into the international economy); monetary and credit arrangements; and public authorities (i.e. the form of state economic management). The wage-labour nexus is assigned the core precedence over the other four institutional domains (Jessop 1990; Brenner and Glick 1991; Grahl and Teague 2000).

During the 1990s, the Regulation school produced an intellectual off-spring – a 'social systems of innovation and production approach' (or SSIPs), which has been based on more robust and wider international comparisons, whilst the French school focused on the largest G-7 economies. The SSIPs approach has several types of capitalism clustered around different institutional characteristics (and different geographical regions), which are associated with different innovation capabilities and divergent patterns of industrial and economic specialisation (see Hollingsworth and Boyer 1997). The approach has concentrated on the interaction between six major contributing areas: the scientific sector, the technological sector, the industrial sector, the education and vocational training system, the system of labour relations, and the financial system (for a review of the SSIPS, see Amable 2003: 85-86). However, given the approach's emphasis on innovation, its empirical basis has been in sectoral and regional studies. Therefore, the typology of capitalism produced within the systems of innovation and production approach can significantly underplay or alter the differences between different countries, if assessed on a nation-wide basis

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<sup>37</sup> The *Régulation* school can be broadly associated with a group of French economists, sociologists, and political economists such as Aglietta (1979, 1998), Lipietz (1986, 1993, 1997), Boyer (1987, 1991, 2000), and Coriat (1993).



(for this critique of the SSIPs, see Hall and Soskice 2001b: 3-4). Moreover, as one of the critics has emphasised, the process of classifying countries in different groups within the SSIPs framework does not separate strictly institutional determinants (e.g. the financial system or labour relations) from economic characteristics such as industrial or technological specialisation (Amable 2003: 92)

### **The ‘Varieties of Capitalism’ Approach**

Peter A. Hall and David Soskice (2001a) have gone beyond the *régulationniste*-inspired SSIPs by postulating that many of the most important institutional structures depend on the presence of regulatory regimes that are the preserve of the nation-state. Therefore, one has to examine national-level differences between capitalist economies and use more parsimonious terms in which to characterise these differences. The two authors have developed a ‘varieties of capitalism’ approach based on the analysis of strategic interactions between five institutional spheres: industrial relations, vocational training and education, corporate governance, inter-firm competition, and intra-firm employee co-ordination arrangements. The major contribution of this perspective has been the concept that, due to the discovered existence of institutional complementarity, national political economies can and ought to be compared by reference to the way in which firms resolve the co-ordination problems they encounter in all these five spheres. Following Michel Albert’s delineation between the ‘neo-American’ and the ‘Rhine’ models of capitalism (1993), the ‘varieties of capitalism’ approach draws the core distinction between the two polar ideal types of capitalist political economies: *liberal market economies* and *co-ordinated market economies*, with the USA and Germany playing the symbolic poles of a spectrum along which capitalist nations can be displayed. In summary, the ‘varieties of capitalism’ theorists maintain that in liberal market economies, firms co-ordinate their activities primarily via hierarchies and competitive market arrangements by adopting general short-term strategies, whereas in co-ordinated market economies, firms rely more heavily on non-market horizontal co-operative relationships to harmonise their endeavours with other actors and to build their specific core competences in the long term (see Hall and Soskice 2001b: 21-33).

While the broader line of analysis of the ‘varieties of capitalism’ approach has gained a major acceptance amongst political economists, the central criticism has been focused on the approach’s binary classification of the capitalist economies (between liberal and co-ordinated). Vivien Schmidt (2002), for instance, has analysed business relations, labour relations, and government relations in several major political economies of the West. As a result, she has identified three ideal-typical models of capitalism: market capitalism (exemplified by Great Britain and the United States), managed capitalism (Germany, the Netherlands, Sweden), and state capitalism (France and Italy). While developing a framework of ‘discursive institutionalism’ and

focusing on policies, practices, and politics of the adjustment to the challenges of globalisation and Europeanisation pursued by the United Kingdom, France, and Germany since the late 1970s, Schmidt argued that even by 2000 the West European capitalism did not converge and remained distinguishable according to the three main varieties. Furthermore, as some critics of the ‘varieties of capitalism’ have argued, countries that neither belong to liberal market economies nor can be clearly identified with co-ordinated market economies – the ‘intermediate cases’ – are regarded as somewhat deficient. In the U-shaped relation between performance and institutional features all these transitional cases are thus expected to generate inferior results and are located at the bottom of the U-shape. However, not all the intermediate cases have actually been characterised by poorer performance or lower-value comparative institutional advantage (for this line of criticism, see Amable 2003: 79-85).

Amable (2003) has critically incorporated the ‘varieties of capitalism’ approach into his cross-national analysis of modern capitalist economies and developed a new typology of diverse modern capitalism. His ‘diversity of capitalism’ approach is based on the differences of major institutional forms and different institutional complementarities which are developed among them in five broad spheres: the character of competition in product markets, the wage-labour nexus and labour-market institutions, the sector of financial intermediation and corporate governance, the social protection system, and the education sector. The core finding of Amable’s research is that there are more than two or three types of capitalism and that each of these types is characterised by specific institutional complementarities. In other words, the mechanisms of institutional complementarity do not follow ‘more market versus more state intervention’ logic subsequently in each of the institutional spheres but the institutional complementarities evolve in a much more intricate way. As the result of an extensive large-scale comparative analysis of twenty one major capitalist economies (the core OECD member states), Amable has identified five different models of modern capitalism: the market-based Anglo-Saxon model, Asian capitalism, the Continental European model, the social-democratic Scandinavian model, and the South European (Mediterranean) model. Following the ‘varieties of capitalism’ approach, Amable has also maintained that there exists a strong link between countries’ institutional structure and the kind of economic activities they specialise in. An obvious example that one can find in both Hall and Soskice (2001) and Amable (2003) is that industries in which competitiveness is based on high-risk, short-term investment (e.g. biotechnology, information and communications technology) will thrive in countries where stock markets are well developed, whereas industries based on long-term, low-risk investment (e.g. heavy engineering, iron and steel, instruments) are more likely to be developed in countries where traditional bank-based finance is dominant.

The joint conclusion of the theorists working on the ‘varieties of capitalism’ theme is that the alleged all-out superiority of market-based economies needs to be qualified. Institutional variables have a significant effect when interacting with each other and should be analysed in this way. For instance, sound macroeconomic performance is possible either with uncoordinated industrial relations and deregulated product markets, or with coordinated industrial relations and regulated markets. As Amable has summarised: ‘there does not seem to be a clear growth advantage unconditionally attached to the specific features of the market-based model. Regulated markets and centralized financial systems can deliver good growth performance too’ (2003: 218).

Table 6.1. Key institutional variables in the comparative political economy of capitalism

<i>Conceptual frameworks</i>	<b>Major arenas for the comparative institutional analysis of political economies</b>					
The Régulation School (Aglietta, Boyer)	The wage-labour nexus	Competition between firms	International relations	Monetary arrangements	The state	–
Social Systems of Innovation and Production (Hollingsworth, Boyer, Amable)	Science	Technology	Industry	Education and training	Labour markets	Finance
‘Varieties of Capitalism’ (Hall and Soskice)	Industrial relations	Vocational training and education	Corporate governance	Inter-firm relations	Internal (employee) coordination	–
Discursive Institutionalism (Schmidt)	Inter-firm relations	Industry-finance	Investment	Government relations (state characteristics)	Wage bargaining	State role in labour relations
The Diversity of Capitalism (Amable)	Product-market competition	The wage-labour nexus and labour-market institutions	The financial-intermediation sector and corporate governance	Social protection and the welfare system	The education sector	–

The consideration of particular features of each of the five major types of modern capitalism identified by Amable and the comparison of the two post-communist capitalist systems with these ideal types will be conducted in Chapter 7. Here I conclude this theoretical review by summarising the perception of the key arenas for the comparative institutional analysis. Table 6.1 lists major institutional domains through which the two major schools of comparative political economy discussed above (the French Regulation School and the ‘varieties of capitalism’ approach) and their offshoots operationalise the research hypotheses. Table 6.1 indicates that there has been a growing consensus amongst the scholarly traditions on the top hierarchy of core institutional domains that shape both the macroeconomic performance and the comparative institutional advantage (i.e. national specialisations in scientific, technological and industrial activity) of capitalist economies. The majority of the approaches include into their analysis such spheres as:

inter-firm competition, wage and industrial relations, finance, education and training, the state and social protection.

For the comparative analysis of post-communist capitalism in the two regions of Poland and Ukraine, this book will adopt the ‘diversity of capitalism’ theoretical model, as developed by Amable (2003). It is believed that Amable’s theory incorporates in the most systematic way both the political economy of institution-making and the wider typology of modern capitalism available at the moment. Thus, to discover the contours of actually existing East European capitalisms and to identify determinants of the post-communist transformation in Upper Silesia and the Donbas, my investigation in the next chapter will be concentrated on the following elements of the two post-communist political economies: product-market competition, the labour market, the financial system, the social protection sector, and the education system.

The main reason for the adoption of Bruno Amable’s theory of diverse capitalism and of the overall varieties of capitalism approach is that such an analytical framework allows us to abandon the constraints imposed by the dominant paradigm’s fundamental assumption that in order to progress and succeed all of the twenty-seven post-communist countries must transit towards the singular destination of free market-based capitalism. The diversity of capitalism theory implies that – besides the Anglo-American model of competitive liberal capitalism – there are a number of other effective and efficient transformation ends which can be better suited to the inherited and newly-constructed institutional complementarities and comparative advantages of the emerging market economies of the post-communist world.

However, the application to post-communist studies of the reviewed Western political economy theories generally, and of the varieties of capitalism approach in particular, has at least two important limitations. Firstly, since its very beginning, the Régulation School and its intellectual off-springs have been focused on the inner working of relatively large and self-contained national economies. Some observers suggest that, subsequently, French regulationists and other scholars of modern capitalism have posed the question of whether national remains the primary scale of analysis or whether more attention should be devoted to the local, the regional and the global scale of regulation, government and governance (Jessop 2002: 468; see also Jessop 1997a, 1997b). Yet, the amount of interesting work that regulationists and their associates have devoted to either the international or the sub-national regimes have been one of the smallest (see Jessop 2002). My literature analysis appears to confirm such criticisms as well. Within the five major schools and approaches reviewed in this chapter (see Table 6.1.), only the original Régulation approach identifies the international regime as a distinctive and crucial factor that determines the functioning of modern political economies. Furthermore, none of the five approaches explicitly conceptualise the issues of local and regional governance and regulation; neither do they

differentiate between the national and sub-national patterns of capitalism. Finally, the focus on five major institutional variables which are said to matter the most in well-established and relatively stable types of capitalism may reduce the complexity of the post-communist transformation. In the following chapter, I will make an effort to minimise such potential shortcomings by adding evidence concerning regional regulatory regimes as well as the impact of global finance on the sector of financial intermediation and corporate governance in Upper Silesia and the Donbas.

## CONCLUSION

In this chapter, I have outlined an alternative theoretical framework which lays the basis for an alternative paradigm of the post-communist transformation. Firstly, we have examined the criticisms of the transition paradigm made by the theorists of path-dependence – an unorthodox approach to post-communist studies, which postulates the inevitability of some ‘bonding’ between the previous regime of state socialism and the newly-created post-communist socio-economic formation. The path-dependent approach sees the post-communist transformation as a complex and innovative recombination and mixture of old and new institutions, organisational forms, and modes of governance. The path-dependent theorists reject the orthodox transition paradigm for its treatment of post-communism as a transition from one pure and unitary ‘totalitarian’ or ‘collectivist’ archetype to another unitary whole of ‘the free market’. Instead, they emphasise the establishment of a new type of mixed economy (‘a distinctive East European capitalism’) and put forward an ambitious research agenda focused on the comparative analysis of real post-communist cases. It has been contended that following the research agenda of the path-dependent approach should lead towards a more adequate account of the divergent trajectories of post-communist transformation.

In the current research, I have had to resolve two further questions. The first one involved defining core institutional variables and identifying their complementary hierarchy. The second issue referred to the (political) process of institutional change. It has appeared that Bruno Amable’s theory of institutions as a political-economy compromise could provide the necessary explanatory model. Taken as a whole, his theory of institutions and politics presents the economy as a system governed by a set of complementary institutional forms resting on specific political equilibrium that defines the hierarchy among institutions and is mediated through the political system.

This chapter has identified specific institutions that are considered to be decisive in influencing the performance and productive specialisation of a capitalist economy and through which one can establish the main features of (potentially distinctive) post-communist capitalism. I

have reviewed five major conceptual frames of comparative capitalist systems: the French *Régulation* School, the social systems of innovation and production approach, the ‘varieties of capitalism’ approach, discursive institutionalism, and the ‘diversity of capitalism’ theory. Following the latter, in the next chapter, I will examine the major institutional arenas of post-communist capitalism in Upper Silesia and the Donbas. I will focus on product-market competition, the labour market, the financial system, the social protection sector, and the education system. It is contended that the examination of these five variables will allow us to discover the contours of actually existing capitalisms in Upper Silesia and the Donbas and, thus, to identify the determinants of the post-communist transformation in the two regions.

## **Post-Communist Capitalism in Upper Silesia and the Donbas**

The primary objective of this book is to account for the different patterns of the post-communist transformation established by two most similar East European regions. How can one explain or interpret the varied outcomes of post-communism in Upper Silesia and the Donbas? Why have the two regions followed similar trajectories in some spheres and not in others? As I have claimed in Part Two, the orthodox neo-liberal transition model is inapplicable and not appropriate as far as my research purpose is concerned. The orthodox paradigm accurately portrays the differences in political and economic starting positions of post-communist countries in 1989 or 1991. Yet, the legacies of the communist past are usually presented as a residual variable, as the most crucial pre-determinant of everything else to follow. By contrast, I will argue that the answer to this book's research question is to be found in the political economy of emerging post-communist capitalism, i.e. in the dynamic relationship between economic change and political change and in the economic and political causes and effects of the rise of a capitalist economic system in post-communist societies. In this chapter I will examine the institutional characteristics of the newly-established capitalism in Upper Silesia and the Donbas. Consequently, in Chapter 8, I will interpret the two types of this post-communist capitalism as an expression of distinct socio-political compromises that emerge out of the conflict of interests amongst agents. Although the outcomes of the post-communist political struggles are indeterminate, they are constrained, mediated, and enabled by the political system, i.e. by those social interactions and institutions through which a society or a dominant socio-political bloc makes and implements binding decisions.

In Chapter 6, I have discussed five major complementary institutional domains, product-market competition, the wage-labour nexus, the finance sector, social protection, and the education sector, which are identified in the literature on comparative political economy. For the overall analysis of the two post-communist capitalist systems, I have generally adopted the 'diversity of capitalism' methodology, which was developed by Amable (2003) based on the extensive data-base compiled by the OECD research staff in the late 1990s – early 2000s. As I deal with the public regulation and national legislative and institutional frameworks, the comparative discussion must be focused to a

great extent on the national rather than the sub-national level of governance. The missing institutional indicators for Poland and Ukraine presented in this chapter are my own calculations and scores, constructed from primary sources and national data using the respective OECD techniques. To illustrate the institutional differences on the regional level, I will provide the necessary data on Upper Silesia and the Donbas as well. The institutional features of the two post-communist capitalisms will be contrasted with the countries that are found to be the most representative of five different ideal types of modern capitalism, namely the market-based model, the social-democratic model, Asian capitalism, the Continental European model, and the Mediterranean model.<sup>38</sup>

## PRODUCT-MARKET COMPETITION

The nature, form, and intensity of competition between firms in the markets of goods and services are determined by public regulation, i.e. specific institutional settings defined by the state to govern product markets. This is the first fundamental institutional domain that is believed to differentiate existing models of capitalism. Nicoletti, Scarpetta and Boylaud (2000) of the OECD have collected and formatted a database of internationally comparable data on certain economy-wide and industry-specific regulations; and provided a multi-stage estimation of indicators of regulation that summarise (at different level of detail) the extensive information on the regulatory environments characterising OECD member-states. Overall, they have constructed seventeen detailed indicators of regulation to describe the regulatory environment in the product market. The detailed indicators were classified in the following three broad regulatory domains: (a) state control over business enterprises, (b) barriers to entrepreneurship, and (c) explicit barriers to international trade and investment.<sup>39</sup>

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<sup>38</sup> These five ideal-typical models of capitalism have been identified and examined by Amable and are said to be most associated with the following OECD countries correspondingly: (1) the UK, USA, Australia, and Canada; (2) Finland, Denmark, and Sweden; (3) South Korea and Japan; (4) Germany, Belgium, France, and Austria; (5) Greece, Italy, Portugal, and Spain. According to Amable's factor and cluster analyses, the United Kingdom is the closest existing example of the ideal market-based model of capitalism; Finland is the nearest country to the ideal social-democratic model; Korea is the country closest towards the 'Asian' ideal type of capitalism; whilst Greece approximates the Mediterranean model. With regard to the paragon of each cluster, i.e. the country that comes closest to the average position of the cluster as a whole, the USA is said to be most average for the market-based cluster. The paragon of the social-democratic cluster is Denmark, that of Continental European countries is Germany, and Spain is the paragon for the Mediterranean cluster. As there are only two countries within the Asian-capitalism cluster, each of them can play the role of the archetype (see 2003: Chapter 5).

<sup>39</sup> In particular, the domain of *state control over business enterprises* includes detailed indicators of public ownership and the state involvement in business operation such as: (a) the scope of the public enterprise sector (in 24 manufacturing and service industries); (b) the size of the public enterprise sector (in 24



Without entering into further details, one has to mention that according to the ideal type classification of modern capitalism, in the sphere of product-market competition, market-based economies are characterised by the high importance of price competition and the non-involvement of the state in product markets. Economic agents in the Anglo-Saxon model are co-ordinated through market (price) signals, whilst product-markets are open to foreign competition and investment. Social-democratic economies are characterised by the high importance of quality competition, the strong role of the state in product markets, and the high degree of co-ordination through channels other than market signals. Product markets in the social-democratic model are open to foreign competition and investment. Asian capitalism is characterised by the importance of both price and quality competition, the high involvement of the state, the great degree of non-price co-ordination, and the high level of protection against foreign firms and investment. The role of large corporations in Asian capitalism is particularly essential. Continental European capitalism is characterised by the moderate importance of price competition and relatively high importance of quality competition. Public authorities are involved in regulating product markets and the degree of non-price co-ordination of economic agents is relatively strong. Domestic product markets in Continental European economies are moderately protected against foreign firms and investment. In the Mediterranean model, product-market competition is characterised by price- rather than quality competition, the involvement of the state, little non-price co-ordination, and moderate protection against foreign trade or investment. Product markets in South European economies are dominated by small firms (Amable 2003: Chapter 3).

Table 7.1 presents the summary indicators of the product-market regulatory framework in the three main fields of state control, barriers to entrepreneurship, and barriers to trade and investment, for Ukraine and Poland, as well as for five countries that are believed to be representative of modern capitalism's models, in particular, the United Kingdom (market-based

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economic branches); (c) the existence and extent of special rights over business enterprises; (d) legislative control over public enterprises; (e) the existence of price controls in competitive industries; and (f) the use of command and control regulations, both economy-wide and at the industry level. *Barriers to entrepreneurship* cover detailed indicators with regard to regulatory and administrative opacity, administrative burdens on start-ups, and barriers to competition such as: (a) the features of the licensing and permit system; (b) the communication and simplification of rules and procedures; (c) economy-wide administrative burdens on start-ups of corporate firms; (d) economy-wide administrative burdens on the start-up of sole-proprietor firms; (e) industry-specific administrative burdens on start-ups in retail distribution and road freight companies; (f) the scope of legal barriers to entry (in 24 manufacturing and service industries); and (g) the existence of antitrust exemptions for public enterprises or government-mandated behaviour. Finally, *explicit barriers to international trade and investment* are focused on outward-oriented policies such as: (a) barriers to share-ownership for non-resident operators (economy-wide and in the telecommunications and air travel industries); (b) discriminatory procedures in international trade and competition policies; (c) regulatory barriers to trade; and (d) average (production-weighted) tariffs (for a full description of the product-markets regulation analytical methodology used in this thesis, see Nicoletti *et al.* 2000).

capitalism), Denmark (social-democratic capitalism), South Korea (Asian capitalism), Belgium (Continental European capitalism), and Italy (Mediterranean capitalism).

*Table 7.1.* A synopsis of summary indicators of product market regulation by domain, point estimates, late 1990s – early 2000s

Summary indicators				
	Overall indicator	Domains		
	Product market regulation	State control	Barriers to entrepreneurship	Barriers to trade and investment
UK	0.5	0.6	0.5	0.4
Denmark	1.4	2.5	1.3	0.5
Belgium	1.9	2.8	2.6	0.6
Italy	2.3	3.9	2.7	0.5
Korea	2.4	2.3	3.1	1.7
Poland	3.3	4.2	1.8	3.7
Ukraine	3.0	2.8	2.9	3.3

*Note:* The comparative scale range is 0 – 6 (from least to most restrictive product-market regulation).

*Source:* OECD (2007); Nicoletti, Scarpetta, and Boylaud (2000); VRU (1991a, 1991b, 1992, 1996, 2000a, 2000b, 2003b); USSC (2003); CMU (2004a, 2004b); World Bank (2004b, 2005), and author's own calculations and scores on the basis of the methodology of Nicoletti *et al.*

Table 7.1 shows that Polish capitalism is characterised by moderate- to heavily regulated product markets, extensive government involvement in the economy, the large scope of the public sector, the high level of co-ordination of economic agents through non-market signals, the moderate to low level of administrative burdens for entrepreneurship, and intense protectionism. Table 7.1 indicates that, on average, the very high degree of product-markets regulation in Poland appears to be rather unparalleled. It may approximate the most heavily regulated Mediterranean and Asian-capitalism clusters: Poland's product-markets regulatory framework is close to the former (see Italy) with regard to the level of state control and barriers to entrepreneurship, and to the latter (see Korea) in the field of outward-oriented protectionist policies. Yet, as Table 7.1 illustrates, the overall Polish product market regulation indicator clearly stands out against the background set by the representative countries of modern capitalism. In turn, Ukrainian capitalism is characterised by moderately regulated product markets; the involvement of the state is mild; the protection of the domestic product markets is relatively high; and the administrative burdens and barriers to entrepreneurship are moderate. On average, Ukraine's product-markets regulatory framework is even closer to that of Italy and South Korea than Poland's.

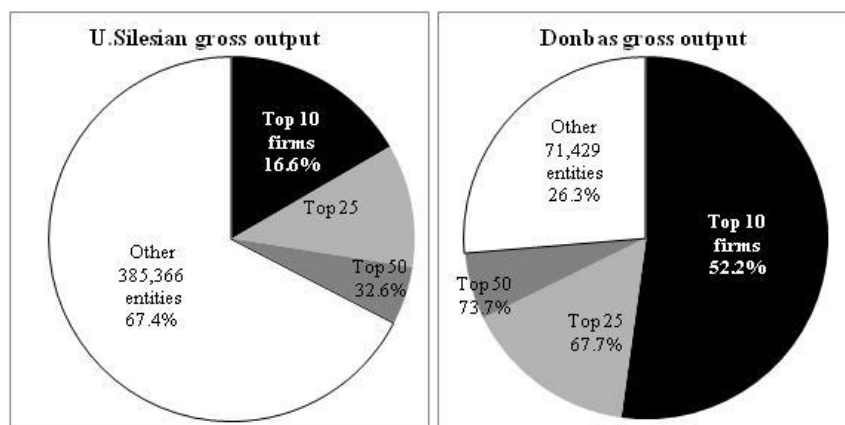


Figure 7.1. Gross regional output by firm size, Upper Silesia and the Donbas, 2001

Source: Author's calculations on the basis of DOSO (2003); SOK (2003b); *Rzeczpospolita* (2002); *Investgazeta* (2003b).

With regard to more specific features of the product-market structure of the Upper Silesian and Donbas economies, it appears that the Polish region shares one of the most distinctive characteristics of the Mediterranean model, as the Upper Silesian economy in transition has been dominated by small firms and single proprietorships. Figure 7.1 demonstrates that the Upper Silesian economic structure appears to be much more dispersed between small firms and sole traders, whilst the fifty largest companies have produced less than one-third of the regional gross output. By contrast, Figure 7.1 shows that big conglomerated business is the most powerful economic centre in the Donbas. In 2001, the Donbas's ten largest companies produced over half of the gross regional output (i.e. the sum of gross value added and intermediate consumption), whilst the top fifty firms covered almost three-quarters of the gross regional output. The difference in the level of economic significance between the Donbas and Upper Silesian business entities is even more visible in employment patterns. Overall, in 2001, an average registered industrial firm employed only 12 people in Upper Silesia, whilst the corresponding figure in the Donbas stood at 156 (author's calculations on the basis of DOSO 2003 and SOK 2003b).

Thus, if one applies the dichotomous 'varieties of capitalism' approach of Hall and Soskice (2001a) to our comparative case, the Donbas (or rather its formal product-market regulation) would fit generally into the co-ordinated market capitalism model. In turn, Upper Silesia would appear to be amongst the most extreme present cases of non-market relationships of co-ordination. Considering the structure of the product markets in Upper Silesia and the Donbas in Amable's 'five models of modern capitalism' terms, it appears that the Polish region shows one of Mediterranean capitalism's typical features, i.e. the importance of small firms and single proprietorships. Nonetheless, the degree of state control and the level of formal barriers to trade and investment in Upper Silesia have been at a much higher level than that of South European countries, leaving this

post-communist political economy distinct from the rest of actually existing types of modern capitalism. On the other hand, the Donbas economy is characterised by the moderate level of product-market regulation and the overwhelming importance of large corporations. These features of product-markets regulation in the Donbas as well as the extent of the region's industrial concentration indicate a close proximity to the corporate Asian model of modern capitalism.

## **THE WAGE-LABOUR NEXUS AND LABOUR MARKET INSTITUTIONS**

The second institutional arena that I examine is concerned with the industrial and employment relations, as well as with capital, labour, and state institutions, which govern these relations. We begin with listing the general characteristics of industrial and labour relations which are believed to characterise the ideal types of modern capitalism. According to the 'diversity of capitalism' theory, the market-based model is differentiated by weak employment protection and extensive labour flexibility: easy recourse to temporary work and easy hire and fire. In Anglo-Saxon economies there is no active employment policy, wage-bargaining is decentralised, whilst trade-unions pursue defensive strategies. The social-democratic model is characterised by moderate employment protection, co-ordinated or centralised wage bargaining, active employment policy, strong labour unions, and co-operative industrial relations. In the Asian capitalist economies employment protection is provided within the large corporation. This model's major features include limited external labour flexibility, labour-market dualism, seniority-based wage policy, accommodating industrial relations, and strong firms' unions. There is no active employment policy, and wage bargaining is decentralised. The Continental European model is characterised by high employment protection, limited external labour flexibility, conflicting industrial relation, active employment policy, moderately strong unions, and the co-ordination of wage bargaining. Industrial relations in South European economies are said to be characterised by high employment protection within large firms but also by labour-market dualism (i.e. a 'flexible' fringe of employment in temporary and part-time work). The industrial relations are potentially contentious. There is no active employment policy, but wage bargaining is centralised (Amable 2003: Chapter 3).

First, to assess and compare the differences in labour market institutions in the two post-communist regions with the advanced capitalist economies, I use an OECD-developed comprehensive technique to analyse the employment protection legislation – the first specific aspect of labour market regulations. Nicoletti *et al.* (2000) have compiled and reviewed fifteen detailed indicators of the strictness of employment protection legislation, which they have grouped into two

broad domains, one referring to provisions for workers with regular contracts and the other referring to provisions affecting workers with fixed-term or contracts with the temporary work agencies.<sup>40</sup>

Table 7.2. A synopsis of summary indicators of employment protection legislation by domain, point estimates, late 1990s – early 2000s

	Summary indicators		
	Overall indicator	Domains	
		Employment protection legislation	EPL Regular contracts
UK	0.5	0.7	0.3
Finland	2.1	2.3	1.9
Austria	2.4	2.8	2.0
Japan	2.6	3.0	2.3
Portugal	3.7	4.3	3.2
Poland	1.9	2.3	1.4
Ukraine	2.5	3.4	1.6

Note: The comparative scale range is 0 – 6 (from least to most restrictive labour market regulation).

Source: VRU (1971); *Halyts'ki Kontrakty* (1998); Nicoletti, Scarpetta, and Boylaud (2000); OECD (2004c); World Bank (2004b, 2005); and author's own calculations and scores on the basis of the methodology of Nicoletti *et al.*

Table 7.2 presents the results of the factor analysis for regulation effecting regular and temporary contracts in Poland, Ukraine, and five representative countries of major models of modern capitalism. It shows that, in general, Poland's political economy is characterised by a very moderate level of employment protection, firmly below the social-democratic model's average (cf. Finland). Ukraine, on the other hand, appears to have a much less flexible labour-market regulation, close to the level of employment protection attributed to the Continental European model (cf. Austria).

<sup>40</sup> The regulations examined on permanent employment cover: (a) *procedural requirements* that refer to the process that has to be followed from the decision to lay off a worker to the actual termination of the contract; (b) *notice and severance pay* that refers to three tenure periods (the tenure periods are nine months, four years, and twenty years) beyond any trial period, dismissed on grounds of poor performance or individual dismissal, without fault; and (c) *prevailing standards of and penalties for 'unfair' dismissals* that include the conditions that identify an unfair dismissal, when employers cannot demonstrate appropriate efforts to avoid the dismissal, or when social, age or job tenure have not been considered; it also includes the length of the trial period and account is taken of the fact that, in some cases, labour courts may require employers to reinstate a worker affected by an unfair dismissal, or award high compensation payments in excess of regular severance pay. Indicators on the stringency of employment protection legislation for temporary and part-time contracts focus on regulations for fixed-term contracts and for contracts under temporary work agencies, including the following elements: (a) 'objective' reasons under which a fixed-term or temporary contract could be offered; (b) the maximum number of successive renewals; and (c) the maximum cumulated duration of the contract (for a full description of the labour market regulation analysis technique used, see Nicoletti *et al.* 2000).

The second specific aspect of the wage-labour nexus is the nature of industrial relations. The major variables considered here concern (a) wage-bargaining co-ordination (e.g. inter-organisational co-ordination through national agreements; intra-organisational co-ordination by trade unions, by employers' federations; or through pattern bargaining); (b) centralisation and corporatism (national, industry, or company, weighted levels of wage-bargaining), (c) the role of governments in bargaining (direct intervention, statutory minimum wage), (d) trade union density, (e) industrial disputes, and (f) practices of national social dialogue and relations between managers and employees evaluated through the collective agreement coverage.

Table 7.3. Summary indicators of industrial relations, point estimates, late 1990s - early 2000s

		KOR	GBR	ITA	AUT	FIN	POL	UKR
Levels of bargaining	Inter-sectoral				X	XXX		X
	Sectoral	X	X	XXX	XXX	X	X	XX
	Company	XXXX	XXXX	XX	X	X	XXXX	XX
Coordination	National agreement			2	1	2		1
	Intra: unions				1	1		1
	Intra: employers				1	1		1
	Pattern bargaining				2	1		2
Government role	Pay indexation mechanism							
	Statutory minimum wage		1					
Capital-labour relations	Union density, %	11.4	31.2	34.9	36.5	76.2	14.7	73.0
	Industrial disputes,	97.4	22.4	76.4	1.2	54.8	4.7	28.4
	Direct collective bargaining coverage, %	12.5	32.5	82.5	97.5	92.5	42.5	80.0

Notes: Levels of bargaining: maximum score is 5 ('xxxxx') divided over three levels. Co-ordination mechanisms: '2' is major / strong; '1' is minor / weak. Else: absent.

Industrial disputes are evaluated as the average number of days lost to strikes per 1000 salaried employees in the last five years for which data are available (principally 1998-2002).

Source: Authors calculations and scores on the basis of VRU (1971); Elmeskov, Martin, and Scarpetta (1998); *Halyts'ki Kontrakty* (1998); Visser (2000); Carley (2002); OECD (2002a, 2004c); USSC (2003); ILO (2004); ITUFR (2004); MLSPU (2004a, 2004b, 2004c); Seniv (2004).

Table 7.3 presents a synopsis of major industrial relations indicators for Poland, Ukraine, and five advanced capitalist countries: the United Kingdom, Finland, South Korea, Austria, and Italy. It appears that the major features of the Polish industrial relations are decentralised wage-bargaining, the low level of co-ordination, extremely sparse labour unionisation, and narrow collective agreement coverage. Relations between managers and employers in Poland are non-confrontational, as the small number of strikes indicates. Generally, the limited co-ordination and centralisation of wage bargaining in Poland resemble very closely the decentralised flexible labour

markets of liberal market-based economies (cf. Great Britain). By contrast, Ukraine's industrial relations are characterised by the moderate degree of wage-bargaining centralisation, extensive co-ordination, the very high level of trade union density, and very broad collective agreement coverage. As regards the degree of wage-bargaining centralisation and co-ordination, Ukraine's industrial relations have clearly become neo-corporatist and the country's wage-labour nexus approximates the Continental European model (cf. Austria). On the other hand, Table 7.3 shows that the Ukrainian pattern of capital-labour relations may approximate the social-democratic model (cf. Finland), as indicated by moderately confrontational relations between managers and employers in the country as well as by Ukraine's much higher trade-union density in comparison with the Continental model exemplified by Austria.

The third aspect of the wage-labour nexus and labour-market regulation examined here is employment policy. By focusing on the scope of employment and wage policies, one can show to what extent national governments are committed to intervening in labour markets and to what extent the current type of industrial relations and wage-bargaining is working. Since the second half of the 1990s, the return of the Ukrainian state to the labour market has been one of the most important changes from the previously chaotic transition period. The transformation of labour-capital relations has been amongst several profound developments in employment policy in the Donbas in this regard. The first half of the 1990s was characterised by an increasingly high degree of wage inequality. The wage differential had then widened in both regions, although Upper Silesia witnessed a relatively smaller increase. Since the mid-1990s, however, the development of neo-corporatist arrangements in the Donbas has resulted in a spectacular reversal in the wage differentiation.

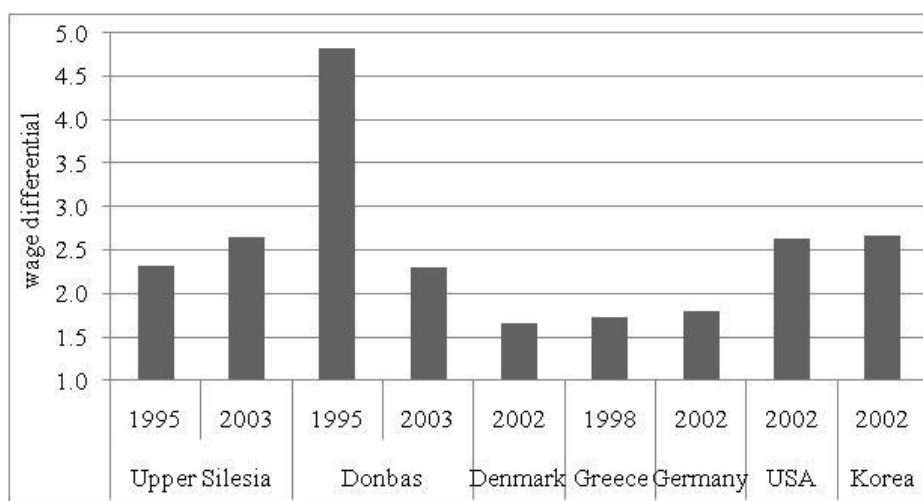


Figure 7.2. Wage differentiation developments within the manufacturing sector, Silesian voivodship and Donets oblast, international comparison, 1985-2003, wage level of the highest paid industry v. the lowest paid industry (= 1.00)

*Source:* Author's calculations on the basis of DOSO (1991a, 1991b, 1992, 1995, 2000, 2002, 2003); VSO (1989, 1992, 1997, 1998); SOK (2002, 2003a); ILO (2004).

Figure 7.2 demonstrates that, although being still rather high, the level of wage inequality in the Donbas has been levelled dramatically. When evaluated between different industries, it is currently lower than in Upper Silesia, the United States or Korea. By contrast, Upper Silesia has been experiencing a gradual rise in the overall wage differentiation since the very beginning of transformation. By 2004, the degree of wage inequality in Upper Silesia reached that of the market-based model. Whereas the wage differentiation trend in the Donbas has been further downwards, Upper Silesia appears to be approaching the level of wage inequality associated with market-based capitalism.

As regards state intervention in labour markets, I examine public expenditure on labour markets programmes which is usually analysed through active and passive measures. Active labour market measures involve spending on public employment services and administration, labour market training, youth measures, subsidised employment, and measures for the disabled. Passive labour market intervention activities cover unemployment compensation and support for early retirement for labour market reasons.

*Table 7.4.* Public expenditure on labour market programmes, as percentage of GDP, 1999-2001, period average

	<i>Korea</i>	<i>UK</i>	<i>Italy</i>	<i>Germany</i>	<i>Denmark</i>	<i>Poland</i>	<i>Ukraine</i>
Active measures	0.50	0.35	0.59	1.25	1.67	0.33	1.01
Passive measures	0.15	0.66	0.69	1.98	3.18	0.76	1.58
<b>Total</b>	<b>0.64</b>	<b>1.01</b>	<b>1.28</b>	<b>3.24</b>	<b>4.85</b>	<b>1.09</b>	<b>2.59</b>

*Source:* Author's calculations on the basis of OECD (2002a); VRU (2002, 2003a); CMU (2003); IMF (2003a).

Table 7.4 summarises the data concerning public expenditure on active and passive labour market programmes in five representative capitalist countries as well as in Poland and Ukraine. It shows that the extent of state intervention into Poland's labour markets in the late 1990s – early 2000s has been low and close to market-based model countries (cf. the UK). There are no direct comparative data available on the amount of public spending on labour market programmes in Ukraine. I have assessed the level of Ukraine's state intervention as the sum of direct state budgetary allocations for active labour market measures and the average annual expenditures by Ukraine's three public labour market-related financial institutions: the Temporary Employment Disability Social Insurance Fund, the State Obligatory Unemployment Social Insurance Fund, and



the Job Accident and Occupational Disease Social Insurance Fund. The figure obtained suggests a relatively high level of public intervention in Ukraine's labour markets. Table 7.4 shows that the Ukrainian indicator is somewhat atypical. It is relatively close to the Continental European model's level of public intervention in labour markets (cf. Germany) and evidently higher than in all other types of modern capitalism, except for the social-democratic model as exemplified by Denmark. Since 2001, the Ukrainian government has been gradually increasing the annual budgetary allocations envisaged for active labour market measures which have significantly boosted public spending on government employment policy measures from the level shown in Table 7.4 (see *Uriadovyi Kur'er*, 17 April 2002).

Thus, the wage-labour nexus and labour market institutions in Upper Silesia and Poland have been characterised by the moderate level of employment protection, decentralised and un-coordinated wage-bargaining, low trade union density, narrow collective agreement coverage, defensive union strategies, a low degree of state intervention in labour markets, and very high wage flexibility. The overwhelming majority of these features, except for employment protection, indicate a gradual shift of the Polish post-communist political economy towards the market-based model of the wage-labour nexus. By contrast, the Donbas and Ukraine have dramatically reversed the shift from labour-market flexibility towards neo-corporatism based on long-term conceptions of common interest between organised powerful agents (for an analysis of different types of industrial-relations system, see Crouch 1993). Since the late 1990s, the wage-labour nexus in Ukraine has been increasingly characterised by a large number of neo-corporatist features such as moderate employment protection, highly centralized and co-ordinated wage-bargaining, strong trade unions, more co-operative industrial relations, declining wage differentials, and the initiation of active employment policies. Most of these characteristics are usually associated with the social-democratic as well as Continental European models of capitalism

## **THE FINANCIAL-INTERMEDIATION AND CORPORATE GOVERNANCE SECTOR**

Capital and corporate governance markets represent the third distinctive institutional domain of modern capitalism. The financial system in market-based Anglo-Saxon type economies is characterised by the high degree of minority shareholders' protection, low ownership concentration, the importance of institutional investors, an active market for corporate control (i.e. take-overs, mergers and acquisitions), the high sophistication of financial markets, and the development of venture capital. The social-democratic Scandinavian model is usually characterised by the high

share of institutional investors, the great importance of stakeholders (suppliers, employees), high ownership concentration, the absence of the market for corporate control, no sophistication of financial markets, and the high degree of banking concentration. Major features of the financial-intermediation sector in the Asian model of capitalism include the low level of protection of external shareholders, high ownership concentration, the great involvement of banks in corporate governance, no active market for corporate control, no sophistication of financial markets, the limited development of venture capital, and the high degree of banking concentration. The Continental European model is typically characterised by the low degree of protection of external shareholders, high ownership concentration, no active market for corporate control, low sophistication of financial markets, the moderate development of venture capital, high banking concentration, and the importance of banks in firms' investment funding. In the Mediterranean model, the basic features of the sector include the low protection of external shareholders, high ownership concentration, bank-based corporate governance, no active market for corporate control, the low sophistication of financial markets, the limited development of venture capital, and high banking concentration (Amable 2003: Chapter 3).

### **Finance**

In Table 7.5 below I have summarised a number of fundamental indicators (for South Korea, the UK, Portugal, Germany, Denmark, Poland and Ukraine) that are typically used to evaluate the sector of financial intermediation. The level of development of the financial system is assessed through the overall size of the capital market as the sum of domestic assets of commercial banks and stock market capitalisation to GDP. The type of the financial system (i.e. bank-based v. stock-market-based) is evaluated as the ratio of the assets of deposit money banks to stock-market capitalisation. The overall level of development of commercial banks is analysed as the amount of private deposit money bank credit granted as a percentage of GDP. The importance of institutional investors (i.e. pension funds, insurance companies, investment funds, etc.) is assessed as the total amount of their financial assets to GDP. Correspondingly, the development of the stock-markets is evaluated as the overall capitalisation as a percentage of GDP. The sophistication of the financial system is analysed through the level of development of venture capital and insurance. The degree of banking concentration is evaluated as the share of the assets of the three largest deposit money banks in the total assets of the commercial banking sector. The degree of foreign bank penetration is analysed as the share of the assets of all foreign-owned banks in the total deposit money banks' assets. The importance of the state in the financial system and the degree of state intervention in the capital market are evaluated as the amount of central bank assets to GDP and degree of public bond market capitalisation.

Table 7.5. Major indicators of the financial-intermediation sector, 1999-2001

	<i>KOR</i>	<i>GBR</i>	<i>PTL</i>	<i>GER</i>	<i>DNK</i>	<i>POL</i>	<i>UKR</i>
Overall size (domestic assets of deposit money banks + market capitalisation), % GDP	136.3	277.4	92.9	130.8	204.3	49.0	37.0
Banks v. stock markets (deposit money bank assets/market capitalisation)	2.21	0.92	1.23	1.41	2.81	2.38	2.05
Private credit, % GDP	89.5	132.4	138.4	120.3	138.5	27.6	13.7
Financial assets of institutional investors, % GDP	77.2	190.9	51.9	81	103.2	9.6	1.7
Stock-market capitalisation, % GDP	42	144	41	54	53	14.5	12.1
Venture-capital investment, % GDP	0.164	0.851	0.117	0.159	0.071	0.121	...
Life insurance penetration, premium volume, % GDP	0.085	0.106	0.027	0.030	0.045	0.010	0.005
Banking concentration, three largest banks' assets to all commercial bank assets, %	31.2	26.9	52.5	48.1	69.6	36.9	54.1
Foreign bank ownership, % total bank assets	-	-	6.0	4.0	0.0	75.0	11.0
Central bank assets, % GDP	1.4	0.7	0.3	1.1	1.3	2.5	13.6
Public bond market capitalisation, % GDP	0.18	0.30	0.36	0.33	0.47	0.22	1.29

*Note:* Most indicators are for 2001. Foreign bank penetration in the advanced capitalist economies is as of 1995; Poland's and Ukraine's data on foreign banks are for 2003.

*Source:* Author's calculations on the basis of Beck, Demirgüç-Kunt and Levine (1999); Demirgüç-Kunt and Levine (1999); Baygan and Freudenberg (2000); Mazullo (2001); Baranovskyi (2003); Schröder (2003); Baranovskyi and Sidenko (2004); Investgazeta (2002, 2003b); Miles, Feulner and O'Grady (2004); NBU (2004); OECD(2004a); Tyhypko (2004); USSC (2004a), Zaderei (2004).

The data presented in Table 7.5 clearly indicate that the financial systems of both Poland and Ukraine are greatly underdeveloped and do not resemble any of the currently existing archetypes. Although the Polish capital market appears to be slightly bigger than the Ukrainian one, the overall size of the financial sector is very small in both countries. The financial systems in both countries are bank-based, which strongly differentiate them from the market-based model of capitalism. However, since both commercial banks as well as stock markets in the two countries are very weak, it is not possible at this stage to identify what strategic direction the systems of financial intermediation in Poland and Ukraine will follow. The capital markets are rudimentary and institutional investors are almost non-existent. Although venture-capital investment in Poland appears to be relatively developed, insurance penetration is lower than in Portugal, a country with the weakest financial system in Western Europe.

The major differences between the Polish and Ukrainian financial-intermediation sectors have been in the role of the state and in banking ownership and concentration. The role of the central bank in Ukraine is much more important than in any other country on the list: the size of Ukraine's central bank is half the size of all commercial banks. Correspondingly, the Ukrainian

government appears to be a much more active player on the financial markets. On the other hand, commercial banking is concentrated and domestically owned. By contrast, commercial banking in Poland is rather dispersed and almost totally controlled by large multinational banking corporations. In general, the financial system in both of the post-communist countries appears to be much more underdeveloped and weak than even that attributed to the Mediterranean model of capitalism. According to the majority of indicators presented in Table 7.5, the financial-intermediation sectors of Poland and Ukraine are analogous to the developing world's average (upper-middle and lower-middle income group averages respectively) (author's assessment on the basis of Beck, Demirgüç-Kunt and Levine 1999-2002).

### Corporate governance and business environment

The observed underdevelopment of the Polish and Ukrainian financial markets has been also accompanied by mediocre corporate governance standards and relatively poor business environment provision. In 1999 and in 2002, the World Bank and the EBRD conducted two large-scale qualitative surveys of business environment and enterprise performance (BEEPS 1999 and 2002 respectively) in 26 post-communist countries. The 2002 survey covered 6,100 firms, of which 500 in Poland and 463 in Ukraine (see World Bank 2004a).

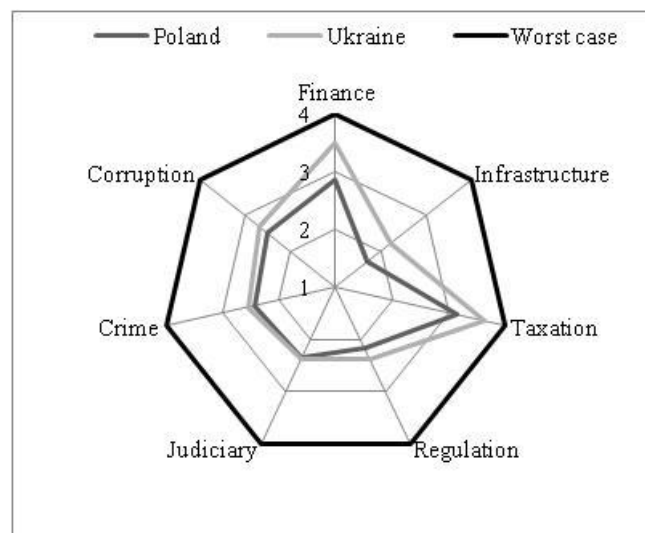


Figure 7.3. Business environment in Poland and Ukraine in 2002, average score by dimension and country on a scale of 1 (minor obstacle) to 4 (major obstacle)

Notes: (i) the responses to specific questions aiming to identify particular aspects of the business environment are aggregated into seven dimensions: finance, infrastructure, taxation, regulation, judiciary, crime and corruption. The finance measure combines two aspects with equal weights: the interest rate and ease of access to long-term financing in both 1999 and 2002; infrastructure combines a general question on infrastructure in 1999 and two questions with equal weights in

2002, one on electricity supply and the other on telecommunications services; taxation combines two aspects with equal weights: tax rates and tax administration both in 1999 and 2002; regulation combines three aspects with equal weights: customs and trade regulations, business licensing and labour regulations both in 1999 and 2002; judiciary and corruption are assessed in one question each in both the 1999 and 2002 survey; crime combines two aspects: street and organised crime in both 1999 and 2002; (ii) the calculation procedure: (a) calculation of grouped categories, e.g. finance, for each firm, (b) calculation of unweighted averages of seven dimensions for each country and (c) calculation of averages for each dimension across countries.

*Source:* Author's calculation on the basis of Fries, Lysenko, and Polanec (2003); World Bank (2004a).

Figure 7.3 summarises the qualitative assessment of the business environment by Polish and Ukrainian entrepreneurs, firm managers, and other representatives of business community. The BEEPS 2002 results generally correspond to my evaluation of the role of the state in both countries, the degree of state involvement in the economy, and the level of the financial sector's development, made in the previous sections. Figure 7.3 indicates that Ukraine has been characterised by a relatively better business environment than Poland. It shows that according to the opinion of the local business people, taxation, finance, and corruption were amongst the three most significant obstacles to doing business in Ukraine. On the scale from 1 (minor obstacle) to 4 (major obstacle), the average score of the Ukrainian business environment was 2.22. Poland's business environment was graded with the score of 2.45 points. Analogous to the business situation in Ukraine, taxation, finance, and corruption were reported as the greatest troubles for conducting economic activities in Poland. Comparing with other post-communist countries, Poland's business environment was ranked the second worst (25<sup>th</sup> position out of 26<sup>th</sup> countries), between Moldova (24<sup>th</sup>) and Albania (26<sup>th</sup>). Ukraine's position was seventh worst (20<sup>th</sup>), between Bulgaria (19<sup>th</sup>) and Bosnia and Herzegovina (21<sup>st</sup>) (author's calculation on the basis of Fries, Lysenko, and Polanec 2003).

*Table 7.6.* Cross-border mergers and acquisitions and foreign direct investment, 1988-1999

	<i>KOR</i>	<i>GBR</i>	<i>PRT</i>	<i>GER</i>	<i>DNK</i>	<i>POL</i>	<i>UKR</i>
	1988-1999						
M&A cross border sales, by economy of seller, total value per capita, US\$	346	7678	397	1496	2295	265	4
	1992-1999						
FDI inflows, as % of GDP, average	0.75	2.65	1.62	0.63	2.29	2.93	0.73

*Source:* Author's calculations on the basis of Easterly and Sewadeh (2001); UNCTAD (2000); USSC (2003).

Given similarly mediocre business environment situations in Poland and Ukraine, the most striking difference between the two financial systems and markets for corporate governance has been in the types of the most active business players. In the Donbas, it is private domestic capital that has been (a) providing most of the enterprise finance capital through firm's retained earnings and investment, and (b) taking over local enterprises via the privatisation process. By contrast, in Upper Silesia, it is foreign capital along with the Polish state that has become the most active player on the local market for corporate control. Table 7.6 shows major indicators of cross-border corporate sales, mergers and acquisitions for Korea, the UK, Portugal, Germany, Denmark, Poland and Ukraine. It indicates that as regards mergers and acquisitions, foreign companies have been as active in Poland as in several established capitalist economies. Furthermore, the importance of foreign direct investment in the country since the mid-1990s has become even higher than in the United Kingdom. The role of direct foreign investment in Ukraine appears to be moderate, on the level of continental Europe and East Asia (cf. Korea and Germany). Yet, notwithstanding Ukraine's much more open and formally liberal foreign trade and investment regulations, the size of FDI attracted to the country has been disproportionately low, compared with Poland. The regional data show a similar picture. By the end of 2003, the cumulative amount of FDI in-flows per capita amounted in Upper Silesia to US\$ 1893. The amount of foreign capital invested into the Donbas on a per capita basis has been twenty times smaller and amounted in 2003 to US\$ 96 only (author's calculations on the basis of DOSO 2000, 2003; SOK 1998, 2000, 2001, 2003a; and PI&FIA 2004a, 2004b).

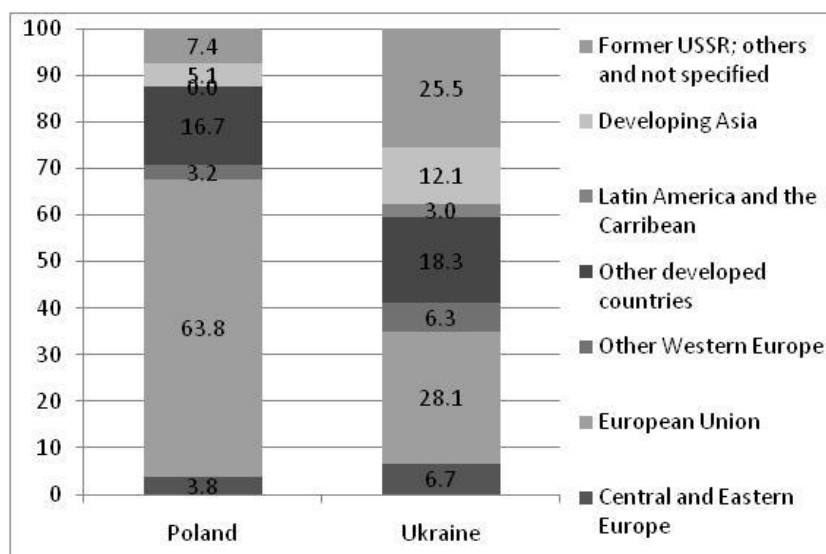


Figure 7.4. Foreign direct investment by geographical origin, Ukraine and Poland, 1999

Source: Author's calculations on the basis of UNCTAD (2000); USSC (2003).

The larger than expected share of foreign direct investment and cross-border corporate sales in the Polish economy is due, to a great extent, to the initial speculative wave of foreign capital markets' interest in a new member of the EU single market and to initial one-off privatisation deals associated with it. The geographical origin of FDI in-flows appears to confirm such suggestions. Figure 7.4 shows that the great bulk of direct foreign investment into Poland (almost 70 per cent) has come from the European Union member states, Switzerland and Norway. By contrast, the largest share of FDI (32 per cent) invested in Ukraine comes from firms from post-communist economies (Russia, the former Soviet Union, and Central and Eastern Europe). Generally, the share of advanced industrialised countries in total overseas investments into Ukraine has amounted to one half, compared with 84 per cent of Western FDI in Poland.

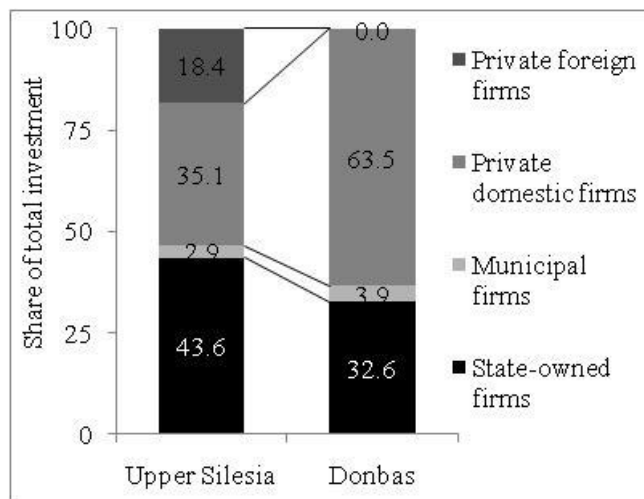


Figure 7.5. Major destinations of capital investment in-flows, Upper Silesia and the Donbas, average percentage share of total volume, 1998-2002

Source: Author's calculations on the basis of DOSO (2000, 2003); SOK (1998, 2000, 2001, 2002).

Together with foreign actors, the Polish state has been the most important source of finance capital funds. Figure 7.5 indicates that whilst in the Donbas it has been private domestic enterprises and their own sources of finance-generation that comprised two-thirds of capital investment in-flows in the region, the major concentration – almost one half – of all capital investment in Upper Silesia has been made by state-owned enterprises. Due to the official policy of consecutive Polish governments which have favoured the so-called strategic investors in the privatisation process, large multinational corporations have been the most active players on the domestic market for corporate control (i.e. mergers and acquisitions) in Upper Silesia. The state has also retained its ownership and control of the largest enterprises.

By 2002, five Upper Silesian industrial enterprises<sup>41</sup> had been acquired by several big Warsaw-based holding companies (*grupy kapitałowe*) such as: foreign-owned *Elektrim Capital Group* (annual sales of US\$ 1.2 billion) and *Żywiec Capital Group* (annual sales of US\$ 0.6 billion), and the state-owned *Impexmetal Capital Group* (annual sales of US\$ 0.8 billion). However, since over 40 per cent of all industrial assets in Upper Silesia had still been in state ownership by the beginning of 2004, corporate control in the region has remained relatively underdeveloped.

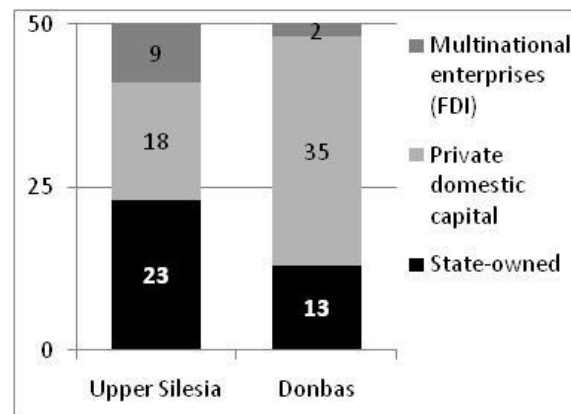


Figure 7.6. Fifty largest companies by ownership structure, Silesian voivodship and Donets oblast, 2001

Source: Author's calculations on the basis of *Rzeczpospolita* (2002); *Ukrainskaia Investitsionnaia Gazeta* (2003b).

The significant role played by the state in Upper Silesia is also evident from the property structure of the region's largest companies. According to Figure 7.6, in the early 2000s, almost half of the fifty largest companies in Upper Silesia were still state-owned, compared with only a quarter of the Donbas's top fifty companies controlled by the state. Figure 7.6 also indicates that, notwithstanding Poland's rather protectionist outward-oriented policies, the Upper Silesian market for corporate control has been characterised by a considerable presence of multinational corporations. By contrast, the degree of multinational presence in the Donbas has been disproportionately low; the regional economy appears to be dominated by private domestic capital.

Whilst the process of capital ownership concentration in Upper Silesia has been rather slow, given the policy of the Ukrainian government to favour national capital in the process of rapid large-scale privatisation, the concentration of capital and industrial assets in the Donbas has reached giant proportions. By 2004, about thirty of Ukraine's largest companies and over one hundred of other industrial, agricultural, and service sector firms, had been acquired by two extremely large

<sup>41</sup> Fabryka Kotłów Rafako SA; Huta Zawiercie SA, Zawiercie; Walcownia Metali Dziedzice SA, Czech.-Dziedzice; Huta Metali Nieżelaznych Szopienice SA, Katowice; and Grupa Handlowa Żywiec (*Rzeczpospolita* 2002).



Donetsk-based holding companies – *The Industrial Union of the Donbas* (ISD) and *System Capital Management* (SCM). The total consolidated revenues of the ISD in 2003 amounted to US\$ 5.1 billion, whilst the SCM's turnover has also been approaching that figure. Turning, by the late 1990s, into two of the three largest holding companies in the country, ISD and SCM have become the most specific characteristics of the Donbas variant of post-communist capitalism. The Donbas conglomerates operate a vast network of holdings and combine the vertical integration structure within and outside the Donbas with a flexible system of strategic alliances – special partnerships aimed at either guaranteeing a stable supply of resource inputs (e.g. with state-owned coal-mines) or providing a well-established international marketing network for output exports (e.g. with multinational steel traders).

To conclude, the financial system (including the finance sector and the market for corporate control and governance) has been the most peculiar institutional arena of post-communist capitalism. Upper Silesia's financial and corporate domain has been characterised by a moderate level of ownership concentration, and the limited development of institutional and venture-capital investment. The finance sector is bank-based and the state plays a very important role in the control and finance of industrial companies. Another distinctive characteristic of the Upper Silesian and, generally, Polish finance and corporate governance markets is that they have been dominated by many West European banks and Western Europe-based multinational corporations. In turn, the Donbas's financial-intermediation sector has been characterised by the extremely high degree of ownership concentration, active processes of the acquisition of local firms by large Donbas-based private holding companies, the low degree of sophistication of the financial system, and the absence of institutional investors and venture capital. The role of the state and commercial banks in the financial system is relatively important. Banking is concentrated in a few domestic deposit money banks. Nonetheless, on a more general level, all the three types of finance markets (banks, stock markets, and institutional investors) have been far too weak and underdeveloped in the two post-communist regions to allow us to associated them fully with a particular model of modern capitalism and identify their future directions. The two financial systems can only be definitely associated with those of the middle-income group of developing countries.

## **SOCIAL PROTECTION AND THE WELFARE SYSTEM**

Social protection does not always mean 'the state against the market'. On the contrary, the welfare system is believed to rescue the market from itself by preventing market failures. As argued by Estevez-Abe, Iversen and Soskice (2001), social protection complements and aids the market by

helping economic actors overcome market failures in skill formation. They have argued that the shape of social protection has bearings on national competitive advantage in international markets and the choice of product market strategies. Since the availability of specific skills requires appropriate forms and levels of social protection, institutional differences that safeguard returns on specific skills explain why workers and employers invest more in specific skills. On the other hand, the absence of such institutions in countries such as the USA, Canada or Australia, gives workers a strong incentive to invest in transferable, generally-applicable skills. In such an environment, it then also seems to be more productive for firms to pursue product market strategies that use these transferable skills intensely.

As to the individual features of social protection in different ideal types of advanced capitalist societies, weak social protection and a low involvement of the state are the major features of market-based economies. Although there exist important differences between the USA and Great Britain, the welfare system's emphasis in the Anglo-Saxon model is generally presumed to be on poverty relief ('social safety net'), means-tested benefits, and a private-funded pension system. The social-democratic economies are characterised by an extremely high degree of social protection, the prominent role of the state, the great importance of the welfare state in public policy and society. The Asian capitalism model is characterised by a very low level of social protection and a small share of public expenditures in general welfare. Social expenditures are directed towards poverty alleviation, whilst the overall share of welfare expenditures in GDP is minimal. The Continental European economies are characterised by a high degree of social protection, employment-based social benefits, government involvement, the important role of the welfare sector in society, contribution-financed social insurance, and pay-as-you-go pension systems. The Mediterranean model is characterised by a moderate level of social protection and the heavy involvement of the state; the expenditure structure is oriented towards poverty alleviation and pensions. Some South European countries have particularly generous family- and elderly-oriented welfare systems (Amable 2003: Chapter 3).

Different typologies of welfare systems have been developed. According to prevailing opinion, the USA, Australia, Ireland, Canada, Japan and Korea (i.e. most of the countries of the Anglo-Saxon and Asian capitalism models, except for the UK) belong to the liberal, 'residual-welfare' model (or the weak, non-welfare, 'zero-level' model of social protection). The United Kingdom, the Netherlands, Spain and Portugal are considered 'minimal-universalist' welfare systems. The welfare systems of the other two remaining Mediterranean European countries are regarded as much more generous 'subsidiarist' or 'Latin particularist-clientelist' models.<sup>42</sup> The

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<sup>42</sup> 'Subsidiarity' is a major concept of the Roman Catholic social theory that rests upon an understanding of society as an organism characterised by a hierarchy of mutually supportive organs. In this view, nothing

Nordic countries are said to belong to the ‘maximal-universalist’, social-democratic model of the integral welfare state. France, Germany, Austria, and Belgium are characterised as Continental conservative-corporatist welfare systems (for this comparison of major typologies of welfare systems found in the literature, see Amable 2003: 154-60). I analyse the welfare system of the two East European capitalisms by comparing the level and character of public social expenditure in Poland and Ukraine with the variety of advanced capitalist countries.

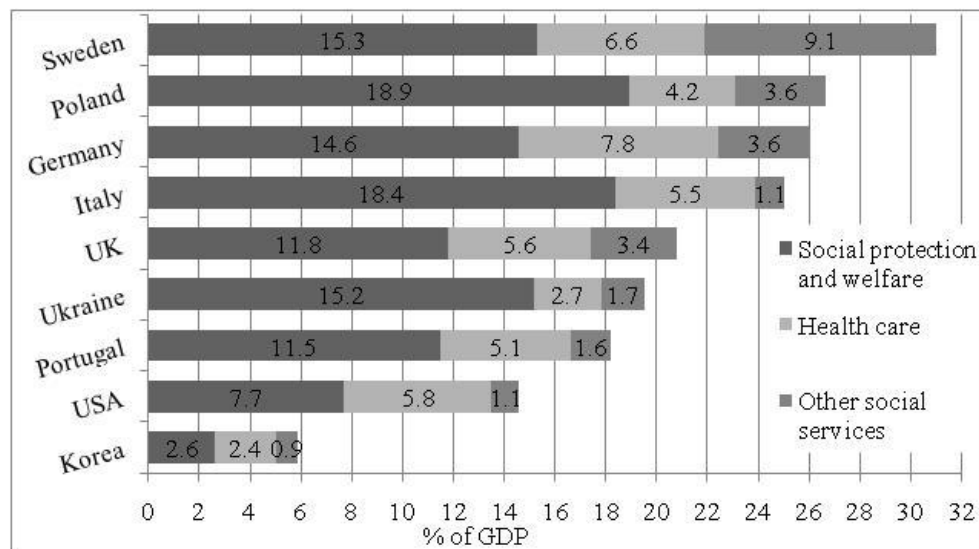


Figure 7.7. Public social spending by major allocations, as percentage of GDP, Poland and Ukraine, international comparison, average shares in 1998-2002

Source: Author’s calculations on the basis of USSC (2000, 2002, 2003); IMF (2003a); PCSO (2000, 2001, 2002, 2003); OECD (2004a, 2004c, 2004d).

Figure 7.7 presents the data broken up by three broad categories of public social expenditure such as: (a) social protection and welfare that covers public expenditure on pensions and old-age cash benefits, disability, occupational injury and unemployment benefits, active labour market programmes, and income support to the working age population; (b) health care; (c) housing benefits, culture, arts, sport and physical exercise activities, and other social services including religious programmes. Figure 7.7 indicates that with the average share of public social spending in Ukraine’s GDP of 19.5 per cent, putting in between the UK and Portugal, the country’s welfare system clearly belongs to the minimalist-universal system of social protection. The relative level of social protection and welfare support in Ukraine (15.2 per cent of GDP alone) is as high as in

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should be delegated to higher organs that can be accomplished by individuals or lesser or subordinate bodies. Thus, according to the European Roman Catholic welfare philosophy, informal care should, whenever possible, take precedence over state intervention in social welfare service (see Cross and Livingstone 1997). However, neither ‘Latin’ nor ‘subsidiarist’ adjectives can be used purely with regard to the Eastern Orthodox Greece and its social protection sector.

Scandinavian and Continental European economies (cf. Germany and Sweden), but public expenditure on health and other social services is much lower. By contrast, Poland's welfare system, with the level of public social expenditure amounting to 26.7 per cent of GDP, is amongst the most generous social protection systems in Europe. Moreover, the level of public spending in Poland on social protection and welfare support alone (18.9 per cent of GDP) is by far the highest among all the advanced capitalist economies. It is this feature that indicates a strong similarity of the Polish social protection system with Mediterranean 'Latin' paternalism, as exemplified by Italy. Yet, the level of social protection provided by the Polish welfare state outstrips even that of its particularist-clientilist counterparts.

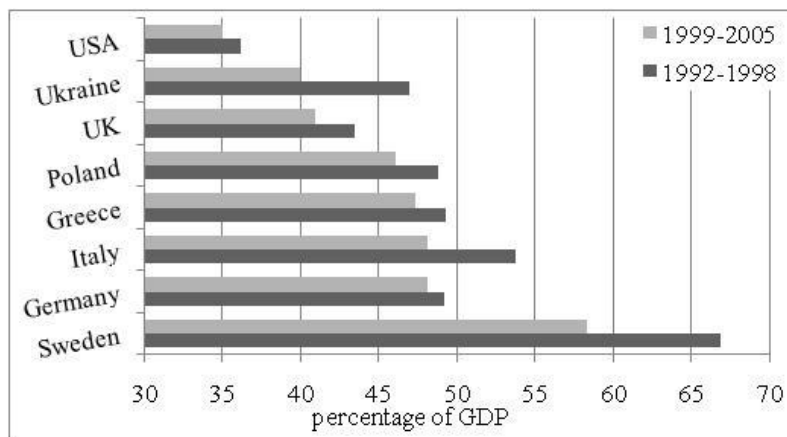


Figure 7.8. General government sector expenditure, as share of GDP, Poland and Ukraine, international comparison, average shares per period, 1992-1998 and 1999-2005

Source: Author's calculations on the basis of USSC (2000, 2002, 2003); IMF (2003a); PCSO (2000, 2001, 2002, 2003); OECD (2004a, 2004d).

My classification of the two post-communist welfare systems is also supported by the data on the changing role of the state in their economies. Figure 7.8 summarises the average shares of general government sector expenditures to GDP in Poland, Ukraine, and a number of representative capitalist economies. Advanced public budgeting procedures allow us to examine the planned level of overall public spending until the end of 2005. Figure 7.8 indicates the high degree of the Polish state's involvement in the economy throughout the entire period of the post-communist transformation. On average, the size of government in Poland has been large and comparable currently with the South European model of heavily regulated capitalism (cf. Greece and Italy). By contrast, under post-communism, Ukraine has been experiencing a dramatic change of the role of the state and the government withdrawal from the economy to the levels far below than those of the UK – one of the closest existing examples of the free market economy and the limited welfare state.

## THE EDUCATION SECTOR

The education sector is considered the fifth institutional foundation on which a nation's comparative advantage can be built. It has been emphasised elsewhere that in the sphere of education and vocational training, firms face the problem of securing a labour force with suitable abilities and competence, while employers face the problem of determining how much effort and resources to invest in which skills. As the theory of institutional complementarity implies, the outcomes of this coordination problem impact not only on the fortunes of individual companies and workers, but also on the skill levels and competitiveness of the entire economy (Hall and Soskice 2001b: 7). The educational system in the market-based model is usually characterised by low public expenditures, a highly competitive higher-education system, non-homogenised secondary education, weak vocational training, emphasis on general and easily-transferable skills, and life-long professional training. In social-democratic economies, the education sector is characterised by a high level of public expenditures, high enrolment rates, emphasis on the quality of primary and secondary education, importance of vocational training, emphasis on specific skills, and the prominent role of retraining and life-long learning. Asian capitalism is characterised by a low level of public expenditure, high enrolment rates, emphasis on the quality of secondary education, company-based training, importance of scientific and technical education, emphasis on specific skills, and weak life-long learning outside the corporation. The education sector in the Continental European model is characterised by a high level of public expenditure, high enrolment rates in secondary education, emphasis on secondary-education homogeneity, developed vocational training, and emphasis on specific skills. In the Mediterranean model, the education sector is characterised by low public expenditures, low enrolment rates in tertiary education, weak higher-education system, weak vocational training, no life-long learning, and the emphasis on general skills (Amable 2003: Chapter 3)

Historically, both the Polish and Ukrainian educational systems were formed under the heavy influence of the Continental European models of France and Germany respectively.<sup>43</sup> Therefore, amongst several common attributes of the two sectors are high levels of curricula standardisation and mainly school-based vocational training and professional education. The major difference between the Soviet Ukrainian educational system and its central European counterparts, however, was in the degree of differentiation between 'general' and 'vocational' programmes, which was low in the former and high in the latter. Under state socialism, the education sector in Ukraine was characterised by moderate individual initiative and average employer initiative in life-

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<sup>43</sup> The education sector in the Mediterranean Europe was historically formed under the French system's influence as well.

long learning, dominant institutionalised role of employers in vocational training, and average employer's role in continuing training. In turn, the education sector in People's Poland was characterised by limited individual initiative and minor employer initiative in life-long training, a slightly formalised role of employers in initial vocational training, and a weak employer's role in continuing training (for a review of different European education and training systems, see Aventura, Campo and Möbus 1999). Under post-communism, some of the inherited institutional features of the Polish and Ukrainian systems of training and education have been retained, whereas others have experienced major changes. To evaluate the extent of this transformation and to assess its systemic direction, Table 7.7 below provides a synopsis of several contemporary educational and science indicators for Poland and Ukraine, as well as for South Korea, the USA, Greece, Germany, and Sweden.

Table 7.7. Major indicators of the education sector, 1999-2002

	KOR	USA	GRE	GER	SWE	POL	UKR
Primary gross enrolment ratio, %	102*	98	97	100	110*	100	97
Secondary enrolment ratio, %	91	93	96	100	146*	103*	97
Tertiary enrolment ratio, %	82	81	61	48	76	58	58
Of which, percentage share:							
standard university degree	58	94	...	85	91	97	73
technical and professional degree	41	4	...	15	4	1	26
post-graduate degree / doctorate	1	2	...	>1	6	1	1
Training participation, as % of workforce	...	41.4	17.4	25.4	60.2	16.0	10.3
Total expenditure on education, as % of GDP, (private spending)	6.0 (2.5)	7.3 (2.2)	3.9 (0.2)	5.3 (1.0)	6.8(0.3)	5.6 (0.2)	6.0 (0.7)
Of which, total expenditure on tertiary education, (private)	2.1 (1.7)	2.7(1.8)	0.9 (-)	1.0 (0.2)	1.8 (0.2)	0.9 (0.1)	1.3 (0.4)
Gross domestic R&D expenditure, % of GDP	2.96	2.80	0.68	2.50	4.61	0.70	1.20
R&D expenditure by source of funds							
Industry	72.5	66.2	24.2	66.0	71.9	30.8	41.4
Government	25.0	28.7	48.7	31.5	21.0	64.8	28.1
Other national sources	2.1	5.1	2.5	0.4	3.8	2.0	4.4
Abroad	0.5	0.0	24.7	2.1	3.4	2.4	26.2
Researchers per million people	2880	4099	1400	3153	5186	1473	2118
Scientific publications per million inhabitants	141	594	212	453	939	117	367

Note: The net enrolment ratio is the ratio of enrolled children of the official age for the education level indicated to the total population of that age. Net enrolment ratios exceeding 100% reflect discrepancies between these two data sets. In addition, a further discrepancy may arise from the fact that school pupils repeating the same grade are included in the same data set with younger enrolled children of the official age for the same education level.

Source: Author's calculations on the basis of OECD (2002, 2004b); UNDP (2003, 2004); USSC (2003, 2004a, 2004b); UNAS (2004); UNESCO (2004, 2004).

Table 7.7 indicates that Poland's educational system has been characterised under post-communism by the emphasis on publicly-funded educational institutions and the very high importance of secondary education. In 2002, less than a third of all students in Poland studied at private universities and other non-state institutions of tertiary education (see PCSO 2003: 256). Yet, generally, tertiary education appears to be of moderately low importance in the country as the low level of expenditure on tertiary education shows. Poland's education sector has been further characterised by the low importance of research and development, relatively weak scientific achievements, and by the high importance of the state in funding R&D activities. Life-long learning and continuing professional training play no major role within the education system of the country. Generally, the majority of indicators compiled in Table 7.7 indicate a closer relation of Poland's education sector towards the Mediterranean model, as exemplified by Greece. This resemblance has been recently identified by other researchers as well (see Schoen 2003).

In turn, the Ukrainian educational system has been characterised by relatively higher expenditure on education, the great importance of vocational training, the emphasis on tertiary education, a potentially significant role of R&D activities, considerable scientific achievements, the limited importance of the state as a source of research and development funds, the essential role of industry-financed R&D, and the high importance of foreign R&D investment. The amount of private spending on education in Ukraine has been relatively small, whilst the role of the state and of public spending remains to be vital. There appears to exist some general resemblance of the Ukrainian education sector to the Continental European model of public education, as indicated, among other similarities, by the great role of technical and professional (polytechnic) tertiary-level education in Ukraine. The very high share of Ukrainians studying for a technical or professional tertiary degree might explain the country's apparently low continuing training participation rate.

*Table 7.8. Major indicators of the education sector in Upper Silesia and the Donbas, 2000-2002*

		<i>U. Silesia</i>	<i>Donbas</i>
Educational attainment of the population, over 15 years old, as % total	Below upper secondary	57.9	25.1
	Upper secondary and post-secondary technical	32.9	61.7
	University tertiary	9.2	13.2
Continuing professional training, as % of workforce		16.0	14.2
Researchers per million of inhabitants		1254	2039
Average regional R&D expenditure, % of GDP		0.43	0.55

*Source:* Author's calculations on the basis of DOSO (2000, 2003); USSC (2004b); SOK (2002, 2003a).

The education sectors of Upper Silesia and the Donbas appear to show a similarly divergent picture. They present a better contrast, however. As Table 7.8 indicates, the Upper Silesian system of vocational training and education has been characterised by very weak higher-education institutions, the extremely high importance of primary and basic secondary education, marginalised life-long learning and continuing training, and undersized R&D personnel. Some of the features of Upper Silesian education sector appear to be close to the Mediterranean-type model (cf. Greece in Table 7.7). The R&D section of the education sector in the Donbas has also been close to the weak South European level. However, the major characteristic of the Donbas educational system is a very high importance of the tertiary education, both at the university- and technical college levels. Furthermore, in addition to 62 per cent of the Donbas workforce possessing some vocational skill or technical professional degree, over 14 per cent of the regional workforce have been engaged in various retraining and skill-upgrading programmes.

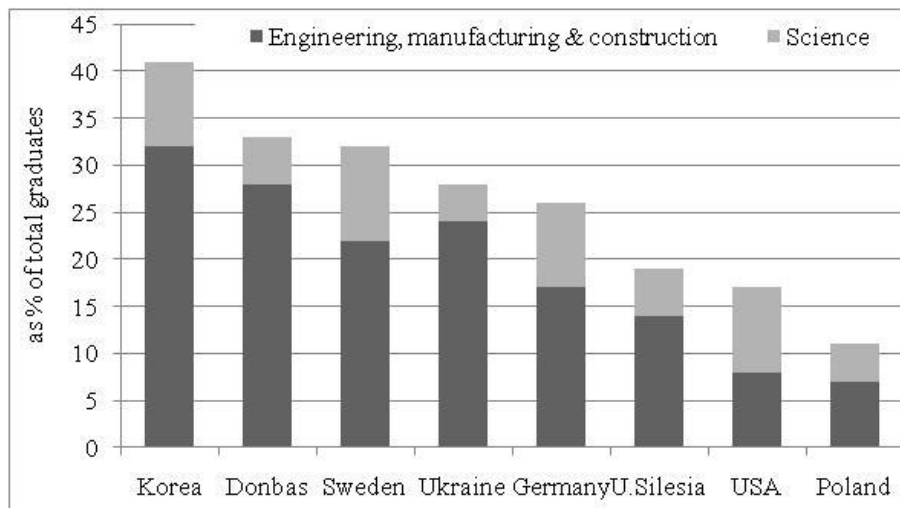


Figure 7.9. Science, technology and engineering graduates, Upper Silesia and the Donbas, international comparison, as percentage of all tertiary education graduates and doctorates, 2001-2002

Source: Author's calculations on the basis of SOK (2003a); DOSO (2003); UNESCO (2004).

Thus, under post-communism, both Upper Silesia and the Donbas, and Poland and Ukraine in general, have retained some of the inherited institutional features and maintained primarily public-funded education sectors. Similar to the other institutional domains, there have been a number of changes within the two educational systems as well. Figure 7.9 indicates a very high proportion of science and technology graduates and doctorates produced by the Donbas education sector in contrast to a low proportion of industry-related graduates produced by the Upper Silesian education sector. Generally, the education sector in the Polish region has been undeveloped and



oriented towards elementary education and basic general skills. The large bulk of the Upper Silesian labour force possesses a primary school degree as the highest educational achievement, whereas a relatively low proportion of the workforce has experienced post-secondary education. On the other hand, in the Donbas, the education sector has been characterised by a relatively stronger higher-education system, great importance of professional, technical and vocational education and training – all part of the Soviet educational heritage. Certain features of the Upper Silesian education sector appear to be close to the Mediterranean model of basic public education; whereas some of the Donbas's educational characteristics approximate the Continental European public education sector. Nevertheless, a large number of the educational characteristics discussed above remain to be specific to each of the two old industrial regions of Eastern Europe and their historical legacies.

## **ALTERNATIVE CAPITALISMS IN TRANSITION**

Having examined in detail the five major institutional domains in Poland's and Ukraine's industrial heartlands, we may now turn to identifying the core attributes of post-communist capitalism. What kind of capitalism is emerging in post-communist Europe? How close is it to the well-established models of modern capitalism? The available literature on post-communist capitalism contains a number of weaknesses and ambiguities, some of which have been discussed previously (see Chapters 4 and 6). The authors working within the orthodox neo-liberal transition paradigm stress that a large number of the transition economies have approached the free-market standard. By contrast, the overwhelming majority of scholars working within alternative conceptual frameworks maintain that the social formation which emerges in the post-communist world can hardly be described as 'capitalism' under any circumstances (mostly) because of the absence of a hegemonic capitalist class (i.e. a propertied grand bourgeoisie) and the resultant lack of social cohesion and institutional coherence (on the 'chaotic' nature of the post-communist social transformation, see Lane 2000; on the perverse character of post-communist capitalism, see Eyal, Széleányi and Townsley 1997; Burawoy 2001; King 2001, 2002; Poznański 2001).<sup>44</sup>

### **Two types of post-communist capitalism**

This book takes a different line of argument, however. It is contended that a general picture can be developed with regard to the kind of capitalism which has been emerging in Eastern Europe. I argue that a specific 'post-communist' type of capitalism has arisen. This capitalism in transition

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<sup>44</sup> See also summary proceedings of 'What type of capitalism in the post-communist economies?', 13<sup>th</sup> Research Seminar on Managing the Economic Transition, University of Cambridge, 12<sup>th</sup> March 2004. Available at: [http://www.business.mmu.ac.uk/research/met/programmes\\_13.htm](http://www.business.mmu.ac.uk/research/met/programmes_13.htm)

appears in several parallel non-converging forms. As a generic term, post-communist capitalism is characterised by the possession of a prevailing – yet incomplete – set of complementary institutions that provide a broadly coherent and cohesive arrangement of information and co-ordination mechanisms for post-communist economic agents. Although there have been a number of observed approximations to some of the well-established ideal-types of modern capitalism, the East European socio-economic formation on the whole is still an unfinished enterprise, which moves into uncharted waters of systemic transformation.

Table 7.9. Major features of capitalism in the two post-communist regions

<i>Institutional arena</i>	<i>Upper Silesia</i>	<i>Donbas</i>
Product-market competition	<b>Heavily regulated product markets; administrative burdens for corporations; high role of direct state involvement; importance of small firms</b>	<b>Moderately to heavily regulated product markets; administrative burdens for entrepreneurship; moderate state involvement; importance of large corporations</b>
Wage-labour nexus	Mild employment protection; decentralised labour markets; uncoordinated wage-bargaining; weak trade-unions	<b>Moderate employment protection; co-ordinated labour markets; centralised wage-bargaining; relatively strong trade-unions</b>
Financial sector	<b>Underdeveloped; currently bank-based; active role of foreign multinationals and the state in finance market and corporate governance</b>	Underdeveloped; <b>currently bank-based; active domestic private involvement in finance market and corporate governance structures</b>
Social protection	<b>'Latin' welfare state (particularist-clientilist subsidiarism); high level of social protection and public spending</b>	Limited (minimal-universalist) welfare system, <b>moderate degree of social protection</b> , low level of public spending on health care and additional social services
Education	<b>Weak public education system; importance of primary and basic vocational education</b>	<b>Public education system; importance of professional and special technical education and training</b>

Note: Boldfaced typing indicates institutional complementarity.

On the basis of our discussion in this chapter, Table 7.9 summarises the core features of the two regional forms of post-communist capitalism. Post-communist capitalism in Upper Silesia is characterised by the great importance of the state and high direct government involvement in the economy, heavy regulation and moderately high protection of product markets, numerous administrative burdens for large corporations, the prominence of small firms and sole traders, and by the large public sector. In the sphere of labour markets and industrial relations, Upper Silesia's capitalism is characterised by a mild degree of employment protection, little co-ordination and high decentralisation for wage bargaining, increasing wage flexibility, and weak trade-unions. The financial sector in Upper Silesia is bank-based. However, banks, financial intermediaries, and capital markets in the region are underdeveloped and weak. The finance sector's sophistication is very low, whereas banking concentration is very limited and most of Upper Silesia's banks are

owned and controlled by large multinational banking corporations from the advanced European Union member-states. Private domestic capital is underdeveloped, whilst the regional market for corporate governance and control is almost entirely dominated by foreign multinational corporations and government-controlled actors. The welfare system in Upper Silesia is characterised by a high level of social protection; generous public social expenditures are oriented towards poverty alleviation, pensions, and family-oriented benefits, whereas health care and additional social services are of less importance. Upper Silesia's education sector is weak, with the emphasis on basic general skills and primary education.

The Donbas variant of post-communist capitalism is characterised by a moderate level of the public authorities' involvement in the economy, relatively moderate level of non-price 'co-ordination', and relatively high protection against foreign firms and investment in product markets.<sup>45</sup> As regards the wage-labour nexus, the core features of post-communist capitalism in this region include moderate employment protection, highly centralised and co-ordinated wage bargaining, moderately strong unions, declining wage flexibility and increasingly active labour market policies. The sector of financial intermediation in the Donbas is underdeveloped and weak. Both the finance and corporate governance control markets in the Ukrainian region are characterised by a very high level of ownership concentration, limited development of institutional and venture capital investment, and the great role of domestic private capital in firms' finance and management. The welfare system exists in the Donbas in a universal but extremely limited form. Amongst its main features are a moderate level of social protection, very low public spending on health, and a low level of government involvement in providing additional social services. The Donbas education sector is characterised by a relatively high level of public expenditure, high enrolment rates in post-secondary and tertiary education, developed vocational, professional, and technical education and training, the high importance of retraining and lifelong learning, and an overall emphasis on industry-specific skills and knowledge.

Table 7.9 demonstrates that three to four out of five major institutional domains in each of the two forms of post-communist capitalism are distinguished by intra-systemic congruousness and coherence. In Upper Silesia, (i) heavily regulated product markets dominated by small firms, (ii) the basic public education sector, (iii) the paternalist social protection system, and (iv) the importance of banks, foreign multinationals and the state in the financial system can be described – according to the theory of institutional complementarity – as compatible institutional domains. I examine the complementary institutional dynamics correspondingly. First, heavily regulated product markets and a large public sector entail low competitive pressure that allows employment stability. Under

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<sup>45</sup> On the informal level, there have been a number of allegations about high protectionism against foreign companies. See, for example, Valentin and Couronne (2004) and *The Economist* (2004e).

low competitive market pressure, stable finance-industry relations can be established. The structure of product-markets dominated by small firms and the region's industrial specialisation do not require a highly skilled workforce.<sup>46</sup> Second, the skill level of the workforce prevents the need to engage in risky high-tech activities. The weak education system does not allow a large, highly skilled workforce. In turn, low personal investments in specific skills lower the demand for social protection. Third, high welfare expenditures imply high tax distortions on the domestic market. On the other hand, high levels of social protection decrease the demand for individual risk diversification. Fourth, underdeveloped financial markets and stable bank-industry relations slow down structural change and enable employment stability. Weak individual risk-diversification possibility implies a higher level of social protection. The deep involvement of the state in the financial-intermediation sector and corporate governance allows strong protection of stakeholders and enables long-term business strategies. Foreign multinationals bring (potentially massive) external capital reserves into the domestic financial-intermediation sector (for a comprehensive discussion on institutional complementarities, see Amable 2003).

In the Donbas, (i) moderately regulated product markets dominated by large corporations, (ii) highly co-ordinated and centralised industrial relations, (iii) a 'polytechnic' public education system, (iv) a low to moderate degree of social protection; and (v) the prominence of domestic private capital in the markets for finance and corporate governance and control are institutionally complementary domains. First, mild internal competitive pressure allows relatively slow structural change and enables a relatively high degree of employment protection. Yet, external market pressure demands substantial productivity gains. Moderate competitive pressure allows the development of a stable finance-industry relationship. The pursuit of productivity gains results in the adoption of labour-shedding strategies which are politically sustainable only with social protection. Moderate degrees of both price- and quality-based competition demand a workforce with a high level of secondary and post-secondary education, whereas slow structural change favours the acquisition of specialised skills. Second, regulated labour markets and employment protection prevent fast structural change. Employment protection limits the need for a strict short-term-profit constraint. Employment protection, both legal and institutional, lowers the demand for a high degree of social protection. Employment protection is an incentive to invest in specific skills, whilst high levels of labour market centralisation and co-ordination favour the designation of useful industry-specific skills. Third, labour force with specialised skills enables stable industrial strategies to be followed. A strong polytechnic public education system allows for (offensive) flexibility. It also demands the protection of individual investments in industry-specific skills, i.e. employment protection and a moderate degree of social protection. Fourth, a moderate degree of social

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<sup>46</sup> We shall return to the question of industrial specialisation in greater detail in Chapter 8.

protection implies mild tax levels and distortions on the domestic market. Social protection enables specialised-skills acquisition. Fifth, a domestic industry-controlled sector of financial intermediation and corporate governance prevents short-term constraints and enables long-term business strategies to be followed. The absence of short-term-profit constraints allows employment stability (within large firms). Underdeveloped financial markets and stable bank-industry relations slow down structural change. Yet, weak individual risk-diversification implies a higher level of social protection. In the next chapter, I will test the applicability of the hypothesis deduced from the theory of institutional complementarity – postulating that different models of capitalism generate different comparative institutional advantages – to the comparative study of Upper Silesia and the Donbas in transition.

This chapter's detailed examination of post-communist capitalism in Upper Silesia and the Donbas also shows that each of the two types is still in its formative stage, characterised (on a theoretical level) by a number of systemic incompatibilities. Although both of the two regional finance sectors are currently bank-based, which is fairly complementary with other institutional features of the two capitalisms in transition, the financial systems in Upper Silesia and the Donbas have remained greatly immature and weak in comparison with any of the existing models of modern capitalism. Furthermore, in the case of Upper Silesia, the wage-labour nexus that is based on labour market flexibility has not been complementary with the overall logic of the regional type of post-communist capitalism. Decentralised labour markets are usually those that are characterised by the absence of employment protection. Moreover, they operate in the market-based version of capitalism. Labour market flexibility favours firms' adjustment to strong competitive pressure and makes fast structural change less costly. Decentralised *and* deregulated labour markets allow quick adjustment of the labour force and maintenance of short-term profits. Weak employment protection and important structural change are incentives to invest in general skills. Fluid labour markets diminish risks and lower the demand for social protection (see Amable 2003: Chapter 3). By contrast, our discussion in the previous section has shown that, besides decentralisation, Upper Silesia's labour market institutions are also characterised by moderate employment protection, thus, potentially signalling a major in-built systemic incompatibility as regards the wage-labour nexus.

In turn, the Donbas's limited welfare system is (at least theoretically) incompatible with the overall institutional logic of the regulated capitalism model that the Ukrainian region appears to be evolving into. A minimal public-funded social protection system does not protect against unemployment and, thus, fluid labour markets are necessary (see Amable 2003: Chapter 3). The existence of a liberal minimalist welfare state calls for market-based means of risk diversification through private insurance; private pension funds should provide an institutionalised voice for shareholders in a system of corporate governance. Low protection for specific-skills investment

provides incentives for individuals to acquire general skills in order to move from job to job and make retraining easier. All these institutional effects that typically emanate from a minimal social protection system can contravene the inner workings of a regulated market economy. In Part Four, I will examine whether the apparent systemic incompatibilities identified here on a theoretical level have had any far-reaching repercussions on the real transformation of the two regions under post-communism.

### A uniform direction of the systemic change?

If there exists post-communism capitalism, what systemic direction has it taken and can it approximate any established type of modern capitalism? On the basis of our discussion of the inherited institutional characteristics of state socialism in Upper Silesia and the Donbas in Part One, and taking into account the comprehensive analysis of different models of capitalism undertaken in the present Part Three, I have put the institutional systemic changes of the two regions on a wider comparative scale. Figure 7.10 below presents the outcome of my speculation. It describes the movement from state socialism to capitalism accomplished so far by Upper Silesia and the Donbas across the five major institutional domains including product-market competition, the wage-labour nexus and labour-market institutions, the financial-intermediation sector and corporate governance, social protection, and the education sector.

<i>Previous model</i>	Post-communist alternatives by institutional domain
S T A T E → S O C I A L I S M	<i>Product markets: regulated v. deregulated</i>
	<u>Asian</u> → <u>Mediterranean</u> → Soc-dem→ContinentEurope→Market-based
	<i>Labour markets: protected / coordinated v. flexible</i>
	Mediterranean→ <b>ContinentEurope</b> → Asian→ <u>Soc-dem</u> → <u>Market-based</u>
	<i>Finance: bank-based v. stock market-based</i>
	<b>Backward</b> →Mediterranean→ ContinentEurope→ Asian→ Soc-dem→Market-based
	<i>Welfare: universal v. restricted / none</i>
	Integral welfare state→Continental corporatism→ <u>Latin subsidiarism</u> → <b>Minimal universalism</b> →Zero-level of social protection
	<i>Education: public with specific skills v. private with general skills</i>
	<b>ContinentEurope</b> → Soc-dem→Mediterranean→Asian→Market-based
	<u>Mediterranean</u> →Asian→Market-based →ContinentEurope→Soc-dem

Figure 7.10. The intra-systemic spectrum of the post-communist transformation changes in Upper Silesia and the Donbas

*Note:* Donbas capitalism's attributes are highlighted in **bold**; Upper Silesian capitalism's attributes are underlined.

The positioning of inherent institutional features of different models of modern capitalism (the Mediterranean, Asian, social-democratic, Continental European, and market-based) across this spectrum of institutional change depends only on the ideal-types' apparent proximity to state socialism in the spheres of product markets, labour markets, finance markets, and social protection, as analysed and described in Amable (2003: Chapter 5). Thus, Figure 7.10 does not imply that various types of capitalism were all preceded by state socialism. The positioning of the capitalist ideal-types in the education sector depends upon their proximity to the Soviet and Polish education systems inherited by the Donbas and Upper Silesia respectively. I have added an additional 'undeveloped' category to describe the two post-communist financial systems.

Figure 7.10 confirms the overall dissimilarity between the institutional designs of the two post-communist capitalisms. It indicates that according to several institutional characteristics, the post-communist transformation of the Donbas may be seen as a gradual movement from the Soviet system of state socialism towards what can be cautiously and roughly described as the co-ordinated (Asian/Continental European) model of capitalism, whereas the systemic change in Upper Silesia may be considered a movement towards the Mediterranean model of capitalism. Nevertheless, given the uncompleted nature of the regional transformations, any such categorisation can be only tentative. Figure 7.10 shows also that the degree of transformation experienced by the two regions has been profound in some institutional arenas, but moderate in others. The most definitive conclusion one can draw on the basis of this discussion is that, even after a decade of transformation, post-communist capitalism – in each of its two regional versions – does not bear a strong resemblance to any of the existing ideal-types of modern capitalism.

### **A DISTINCTIVELY EAST EUROPEAN MODEL?**

In the path-dependent tradition, this chapter has viewed 'post-communist' or 'transition' capitalism as a generic term, that is, not as one socio-economic formation in transit towards one pure competitive market-based capitalism, but as capitalism in the making after the collapse of state socialism. Broadly following the theory of institutional complementarity and hierarchy, I have argued that each of the two post-communist capitalisms has generated a prevailing set of partially complementary and mutually supportive institutions. In the next chapter, I will consider whether the present degree of partial institutional complementarity within the two forms of post-communist

capitalism has boosted the regional macroeconomic performance and provided a considerable impetus to the socio-economic regeneration of Upper Silesia and the Donbas.

I have also established that none of the two East European capitalisms under close scrutiny resembles any of the five major models of capitalism, which are said to exist in the 'First World' of industrially advanced countries, or in what currently has been more technically described as 'high-income OECD'.<sup>47</sup> It has been contended that the two forms of post-communist capitalism do not closely resemble each other either. Both of the two still incomplete variants of post-communist capitalism possess several institutional characteristics that appear to be incongruous with their overall institutional designs. However, the newly emerged forms of social and economic organisation in Upper Silesia and the Donbas are dissimilar and cannot constitute one uniquely 'East European' or 'post-communist' version of capitalism. The existence of institutional non-complementarities and underdeveloped finance and capital markets can hardly qualify for a distinctively East European or post-communist status. Those are the inherent problems of any 'emerging' capitalism in the world. It is contended that the two styles of post-communist capitalism are parallel (non-converging) and indeterminate outcomes of the political-economic struggle between various socio-political groups over the course of transformation and the institutional design of their respective societies. In this, they come close not only to the 'emerging markets' of the Third World, but to the developed world of modern capitalism as well. Yet, why have such different forms of post-communist capitalism emerged? In the next chapter I will examine how the described fundamental institutional changes were achieved and what have constituted the basis for socio-political compromises involved.

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<sup>47</sup> Almost all members of the Organisation for Economic Co-operation and Development, an international body established in Paris in 1961, are rich, industrialised, capitalist countries of North America, Western Europe and Japan. Except for Turkey, Mexico, Poland, and some other poorer new member states, over 20 other OECD countries have become to be statistically classified as 'high-income OECD'. See, for example, UNDP (2004). For a detailed discussion on the use of euphemisms in the international publications and developmental debate, see Hadjor (1993: Introduction).



## **Two Types of Post-Communist Capitalism in the Making**

In this chapter I will consider the socio-political conflict of interests among agents out of which the two types of post-communist capitalism have emerged. In addition, I will evaluate the effect of newly-emerged institutional structures on the efficiency of the Upper Silesian and Donbas economies. First, I will examine how indeterminate political choices structured, mediated, and enabled by different political systems in Upper Silesia and the Donbas (and in Poland and Ukraine respectively) have resulted in alternative designs of the institutions of post-communist capitalism in the two regions. In the second section of this chapter, I will question whether post-communist capitalism has produced adequate comparative institutional advantages, and what effect the new institutional framework has recently had on the productivity and macroeconomic performance of the two regions. By applying the theory of institutions as a political economy equilibrium, described in detail in Chapter 6, I will claim that the post-communism transformation has created different economic and, thus, electoral dynamics in the two regions. The overall push for rapid implementation of radical Washington-consensus reforms has been significantly undermined in both regions as the result of socio-political compromises. As a consensus-based type of polyarchy, Upper Silesia (and Poland in general) has attained its political-economy equilibrium around a more regulated, protected type of capitalism with an extensive and generous welfare system. By contrast, being a majority-based political system, the Donbas (and Ukraine in general) has settled for a relatively more liberal form of market co-ordination. However, contrary to the portrayal of the Ukrainian political system as an unconsolidated autocracy by the orthodox transition paradigm, I will argue that the country's polity is characterised by a large number of veto players which have managed to limit any further liberalisation drive and to block effectively the total dismantlement of the national social protection sector. Thus, similar to the process of institutional change in the industrially advanced, rich countries of the West, institutional change in both Upper Silesia and the Donbas has also been the expression of a political-economy equilibrium. To date the outcome of such socio-political compromises has been generating positive macroeconomic performance in both regions.

## POLITICAL EQUILIBRIA OF INSTITUTIONAL CHANGE

### Party politics in Poland

The politics of the post-communist transformation in Upper Silesia and Poland has been characterised by regular shifts from the conservative and libertarian Right to the social-democratic and statist Left. In the early 1990s, following the semi-free parliamentary elections of June 1989, and after the early elections of October 1991, the Polish parliament had been fragmented and produced a series of short-lived minority coalition governments dominated either by the libertarian Democratic Union (UD, later Freedom Union – UW) under Tadeusz Mazowiecki (1989 – 1990) and Hanna Suchocka (1992-1993), or by the conservative Roman Catholic nationalist coalitions under Jan Krzysztof Bielecki (1991) and Jan Olszewski (1991-1992).<sup>48</sup> Although the early post-communist governments, implementing the ‘shock therapy’ transition strategy designed by Leszek Balcerowicz (UD-UW), had greatly liberalised Poland’s markets and decentralised wage-bargaining, they could not proceed with the rapid large-scale privatisation of state-owned assets. Due to apparent political controversies involved in the privatisation of state enterprises by the government installed via a broad movement based upon the nation’s biggest trade union, the first Solidarity government of Tadeusz Mazowiecki had to adopt a very gradual approach. By the end of 1990, as the result of the ongoing economic crisis and output collapse, the government of Mazowiecki resigned, while the bulk of Solidarity split into several rival trade unions and a host of populist anti-communist and religious nationalist groupings, most of which remained deeply suspicious of the free market economics advocated by Solidarity’s liberal intelligentsia wing. Notwithstanding numerous ‘privatisation offensives’ that were to turn Poland into ‘a society of capitalists’, Poland’s right-wing coalition governments of the early 1990s were unable to proceed with privatisation without provoking public outcry (see Slay 1994: 102-32). Janusz Lewandowski, head of the Polish privatisation ministry in the Bielecki and Suchocka governments, was quoted as saying that ‘our privatisation programme was immediately confronted with all sorts of strikes, protests, and resistance. I don’t recall a single transaction that went unopposed’ (Slay 1994: 127).

Massive public resentment with the neo-liberal reforms resulted in September 1993 in the second early elections which brought back to power the Polish Left in the form of a coalition of ex-communists of the Democratic Left Alliance (SdRP, later SLD) and protectionists of the Polish Peasant Party (PSL). The mass privatisation programme was initiated only in the second half of 1995, some two years after the Polish political system was stabilised. Yet the privatisation efforts of the SLD-PSL coalition under Prime Ministers Waldemar Pawlak (1993-1995), Józef Oleksy (1995-

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<sup>48</sup> After the fall of Jan Olszewski’s coalition government, Waldemar Pawlak of the Polish Peasant Party headed the caretaker government for a month in June-July 1992.

1996), and Włodzimierz Cimoszewicz (1996-1997) faced numerous obstacles. Although the socialist governments proceeded with the general market-oriented course of Poland's economic transformation, they firmly abandoned the *laissez-faire* notions of the previous governments and resorted to more active state involvement and institution-building (Kołodko 1996, 1998, 2000a; see also Kołodko and Nuti 1997).

After the September 1997 Parliamentary victory of the right-wing coalition of the conservative Solidarity Electoral Action (AWS) and the neo-liberal Freedom Union, then led by Leszek Balcerowicz, architect of the Polish Washington-consensus transition strategy, the government of Jerzy Buzek (1997-2001) accelerated the process of liberalisation and privatisation. However, an attempt by the UW to initiate the so-called second Balcerowicz's reform aimed at dismantling Poland's welfare state and closing down Upper Silesia's loss-making coal mines, steel works, and other state-owned enterprises, ran up against fierce opposition both outside and within the governing coalition, leading to the collapse of the two-party parliamentary majority. As a result, Upper Silesia entered the 21<sup>st</sup> century with 353 state-owned enterprises controlling well over half of the regional fixed capital assets, particularly in the heavy industries (i.e. coal mining, iron and steel, chemicals and petrochemicals, gas, electricity, and water supply) and services (railways, public transport, public utilities). Between 1<sup>st</sup> August 1990 (the beginning of the privatisation programme) and by 2001, out of 705 Upper Silesia's state-owned enterprises included in the privatisation process, only 265 (or 38 per cent) had been privatised or liquidated via sales of asset components (author's calculations on the basis of SOK 2000b, 2001).

In 2001, when the Upper Silesian industrial output registered a decline and unemployment reached 20 per cent, the centre-left SLD in the coalition with the Labour Union (UP) entered the government (2001-2004). As one of the observers of Polish politics has pointed out, while generally supporting the major elements of the 1999 Party of European Socialist Manifesto and the 'Third Way' Blair-Schröder Declaration, the SLD and its then leader, Leszek Miller, tried to be cautious about endangering the party's traditional electorate:

To date Miller has made use of the Jospinian slogan *yes to a market economy, no to a market society*. He has also gone on record as stating: 'The founding fathers of the new political left must be aware that they face a difficult task ... The majority of Polish society yearns for social justice. The SLD can count on wider social support if it is to respond to this sentiment with a concrete programme that is free from the spirit of neo-liberalism' (Day 2000: 104).

However, Poland's left of centre parties have not been the exclusive critics of the free market doctrine or the only supporters of the welfare state. As most authors agree, the majority of the Polish centre-right and right-wing parties have opposed the Polish Left as regards the role of the

Roman Catholic Church and fundamental religious values in the society, as well as on issues concerning the consequences of and responsibilities for the nation's communist past. Nevertheless, across other major dimensions of the social-economic cleavage, on the issues of income inequality, state interventionism, the protection of domestic industries, agriculture and the Polish country-side, the two largest political formations – post-communist socialists and post-Solidarity conservative, nationalist parties – have usually composed a common ‘centre’ of the Polish ideological continuum (Kubiak and Wiatr 2000; cf. Herbut 1999).

Amable has suggested that in the relationship between partisan politics and the diversity of capitalism, a stronger weight of left and left-libertarian parties would be expected to support the emergence of institutions closer to the social-democratic model and the extensive welfare state, whilst market-based capitalism should be associated with the dominance of centre and right-wing parties (2003: 183-88). The political stance of the two Polish left-libertarian parties, the Civic Platform and Freedom Union, with regard to the welfare state has traditionally been hostile (Kopczyński 2000).<sup>49</sup> By contrast, the trade-union based Solidarity Electoral Action and its off-springs, as well as the country-side Polish Peasant Party, along with the populist protest *Samoobrona* [Self-Defence] movement and the Christian fundamentalist and nationalist League of Polish Families have long been advocating support for the losers of transition and opposing what they regard as liberalism and monetarism (Antoszewski and Herbut 1999).

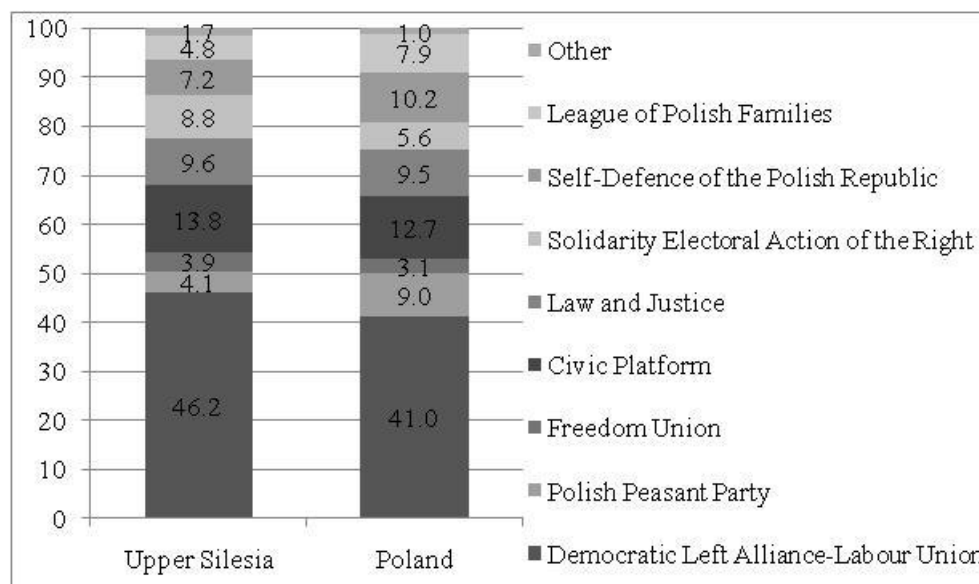


Figure 8.1. Electoral results of the September 2001 parliamentary elections, Silesian voivodship and Poland, percentage in total

Source: Author's calculations on the basis of PSEC (2001).

<sup>49</sup> The Civic Platform (*Platforma Obywatelska* – PO) has been recently experiencing a gradual transformation from a libertarian party towards classical Thatcherism, combining economic liberalism and social conservatism.

Figure 8.1 shows the political preferences of the Upper Silesian and Polish voters during last Parliamentary elections in September 2001. It demonstrates that, generally, the voters in Silesian voivodship have been more left-leaning than generally across the country, whilst the parties which support a strong state and social protection, both of the Left and Right, have attracted the bulk of the overall votes.<sup>50</sup> Thus, partisan politics dominated by the traditional Left and the religious Right in Upper Silesia strongly correlate with what one can tentatively describe as the ‘Mediterranean’ features of post-communist capitalism in the region, in particular, with the great importance of the state in the Upper Silesian economy, heavy government regulation, and the ‘Latin’ residual-welfare state that provides the full level of traditional social protection for the old, the poor, and the unemployed, but does not extend towards additional public social services.

### **Party politics in Ukraine**

Whilst in the early 1990s, the traditional Left organised around Ukraine’s Communist party was the dominant political force in the country, the emergence and development of capitalism has been characterised both in Ukraine and in the Donbas by the dominance of the centre and centre-right political forces. On the advent of the Soviet Union’s collapse, the March 1990 elections in Ukraine produced a 280-member strong majority of the Communist party in the Ukrainian legislature (*Verkhovna Rada*, 450 members in total), which elected Vitold Fokin, former chairman of the State Central Planning Commission, to head the Ukrainian Council of Ministers in October 1990 - October 1992. With the establishment of a directly-elected presidential office in 1991 and the election of Leonid Kravchuk to this chief executive position (1991-1994), the power balance somewhat shifted towards the presidency. However, until the March 1994 extraordinary elections, the Communist majority in the Ukrainian Parliament, though reduced to 239 members, had been effective in postponing on occasions the most radical of the market-oriented attempts of Ukraine’s successive governments.

Although the large-scale liberalisation of markets in Ukraine began only very late in 1994, the privatisation process was started – in its ‘spontaneous’ form – at the end of 1980s by the Soviet government of Nikolai Ryzhkov through the law on employee-leasehold enterprises with management-employee buy-out rights. The decisions of the Soviet Ukrainian government were echoing those of Moscow at that time. After Ukraine’s successful independence referendum and the presidential victory of Leonid Kravchuk (both in December 1991), the official programme of privatisation was drafted and initiated as the core reform by the government of Prime Minister

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<sup>50</sup> Those parties and coalitions include the Democratic Left Alliance – Labour Union and the Polish Peasant Party on the left side, and the Solidarity Electoral Action, the Self-Defence, and the League of Polish Families on the right side of the country’s political spectrum respectively.

Leonid Kuchma (October 1992-September 1993). However, in the circumstances of economic collapse and hyper-inflation, privatisation along with other cautious market-oriented reform measures of Kuchma's government were derailed by the left-wing majority in the mid-1993.

The painful collapse of the USSR in 1991 resulted in the disastrous phenomena of disorganisation and trade implosion (see Chapter 5) and provoked in the Donbas the feeling of an approaching 'civil war', 'revolution' or 'social explosion' (see interviews with Donbas inhabitants in Siegelbaum and Walkowitz 1995: 186; 209). In 1993, when the retail price inflation in the country reached its record level of 10,156 per cent a year, a massive wave of protest began in the Donbas, with nearly 80 coal mines going on strike in one day. The industrial action was coordinated by the Donbas strike committee which put forth radical political demands: (1) regional independence for the Donbas, and (2) a country-wide referendum on confidence in Ukraine's president and the parliament. Up to 400 mining and major industrial enterprises in the Donbas took part in the strike. According to most commentators, the scale of popular discontent turned the coal-miners' strike into not so much an economic struggle 'as a struggle between the Donbas region and the rest of the country' (Siegelbaum 1997: 18). Though the June 1993 strike was initiated by the miners, it had been eventually subsumed within a larger regionalist framework. The political demands of the miners for the 'socialisation' of state property enjoyed full support from coal mining trade-unions, mine managers and other industrialists, all the Donbas-based political parties and movements (from the Liberals to the Communists), local government officials, mass media and the majority of the region's population (see Mykhnenko 2003a, 2004c). As Crowley and Siegelbaum argued in the aftermath of the event:

It was therefore not simply a strike of miners and other workers, nor a "directors' strike" with workers performing the role of foot soldiers, but a regional protest against the government in Kiev, its president, and policies that had brought the Donbass to its knees. After ten days of protest, the Donbass returned to a state of precarious normalcy, but not before Prime Minister Leonid Kuchma had agreed to the strikers: basic demands for the release of additional funds for wage increases, the granting of 'economic independence' to the region, and a republic-wide referendum on Kravchuk's presidency and the parliament. The government soon backed away from its promise to hold the referendum but, under pressure from a volatile electorate, organized parliamentary elections in March-April and an early presidential election in June-July 1994. Repeating a pattern set in Lithuania and Poland, Ukrainian voters delivered a stunning defeat to nationalists in the parliamentary elections. Three months later, Kravchuk, who had ridden the earlier wave of nationalism, was ignominiously defeated by Kuchma, the former prime minister, who received overwhelming support from the Donbass (Crowley and Siegelbaum 1995: 72).

Banking on the resentment of people with the early reforms, Leonid Kuchma defeated the incumbent president on a mixed platform which combined both the calls for a wider protection and support of the domestic industries and closer economic and political ties with Russia and that

country's markets. However, in October 1994, the administration of newly-elected President Kuchma launched a programme of radical neo-liberal reforms of macroeconomic stabilisation, liberalisation, and marketisation, developed by a team of monetarist economists headed by Viktor Pynzenyk, with the participation of a number Western advisors, including Bohdan Havrylyshyn and Anders Åslund (UP 1994a).<sup>51</sup> Fully resembling the orthodox IMF policy reform model discussed in Chapter 4, the transition manifesto of Kuchma was implemented by non-party technocrat governments under the following Prime Ministers: Vitalii Masol (June 1994 - March 1995), Yevhen Marchuk (March 1995 - May 1996), Pavlo Lazarenko (June 1996 - June 1997), Vasyl Durdynets (July 1997), and Valerii Pustovoitenko (July 1997 - December 1999). As in the case of Poland, under the pressure of domestic industrial lobbies, the Ukrainian legislature was later forced to implement a number of industrial policy and protectionist measures (for special tax treatment of Ukraine's steel industry, see Mykhnenko 2004a). However, the stabilisation-liberalisation-privatisation basis of the 1994 reform strategy remained almost unaltered. After the March 1998 parliamentary elections, and, especially, as the result of Kuchma's presidential re-election in November 1999, the political discourse in the country and in the Donbas has shifted further to the right. By the end of 1999, the centre and centre-right members of the Ukrainian parliament gathered a majority coalition, which endorsed a monetarist chief of the central bank, Viktor Yushchenko, to form a new government (December 1999-May 2001). Under Yushchenko as well as under his successor, Anatolii Kinakh (May 2001-November 2001), public welfare provisions have been scaled down further.

Nonetheless, due to the political opposition, the limited welfare state has been left intact. This is especially evident in the Donbas, a region long famous for its working class militancy and the traditional left of centre political affiliation. During the 1999 presidential run-off, Petro Symonenko, hard-line leader of Ukraine's Communist party, won 41.2 per cent of the votes in the Donbas, whilst his standing nationwide was 37.8 per cent. Leonid Kuchma's share in the Donbas was 52.9 per cent, whilst in the country generally he received over 56 per cent (UCEC 1999). During the most recent parliamentary elections in March 2002, the share of the traditional left-wing parties in the Donbas was higher than nation-wide. According to Figure 8.2 below, contrary to the overall picture in Ukraine, the clear winner of the 2002 elections in the Donbas was the centrist political bloc 'For a United Ukraine', whilst none of the left-libertarian (the Greens, Winter Crops Generation, *Yabluko*), conservative (Yushchenko's 'Our Ukraine'), or right-wing populist movements (e.g. Yulia Tymoshenko's Bloc) managed to pass over the 4 per cent electoral threshold in the region.

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<sup>51</sup> Formally, the system of central planning in Ukraine was abolished on 22nd December 1994, by a special Presidential Decree No. 799/94 'On the state Planning of Economic and Social Development of Ukraine for 1995' (UP 1994b).

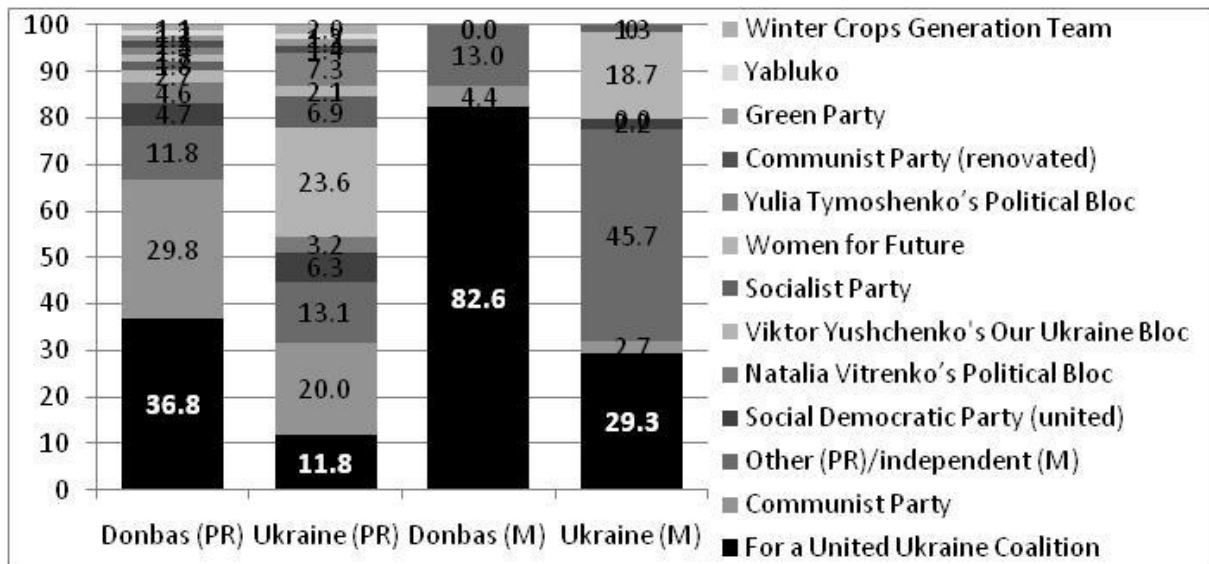


Figure 8.2. Electoral results of the March 2002 parliamentary elections, Donets oblast and Ukraine, percentage in total

Note: PR – nationwide party list proportional representation (50 per cent of parliamentary seats); M – majority vote in single-member districts (another half of all parliamentary seats).

Source: Author's calculations on the basis of UCEC (2002).

Figure 8.2 shows that the winning coalition in the Donbas, *For a United Ukraine*, gained 37 per cent of votes on the nationwide proportional representation list (see Donbas PR) and won almost all majoritarian single-member constituencies in the region (see Donbas M). This political coalition was formed for the 2002 parliamentary elections by the centre-right Donetsk-based Regions Party, headed by the then Donbas governor Viktor Yanukovich, and the Ukrainian League of Industrialists and Entrepreneurs (USPP), led by Anatolii Kinakh. 'For a United Ukraine' was later joined by three centrist parties such as the neo-corporatist Labour Ukraine (which represents the interests of big business), the Popular Democratic Party (associated with the civil service bureaucracy and political establishment) and the rural Agrarian Party.

The core of the political coalition's ideology represented by the Regions Party, Labour Ukraine, and Ukraine's two major special interest groups of industrialists and commercial farmers has been a 'new centre' formed around neo-corporatism, state encouragement and support for big domestic capital and 'national champions', protection of local industries and farming, import-substitution, decentralisation of powers, and 'poly-culturalism', i.e. the development of the Ukrainian culture along with the protection of Ukraine's large Russian-speaking community and ethnic minorities (URP 2004; LUPP 2004). Thus, the corporatist features of the regulated post-communist capitalism in the Donbas as well as the preservation of the social protection system can be attributed fully to the partisan politics of the region's institutional transformation.



## Political system

As I have established in Chapter 7, the dominant set of the institutional arenas of post-communist capitalism in the Donbas has been relatively more competitive and less regulated than the very rigid characteristics of the tightly co-ordinated capitalism in Upper Silesia. It is contended that the institutional characteristics of the two post-communist political systems have made a long-lasting impact on the construction of variant capitalisms in transition.

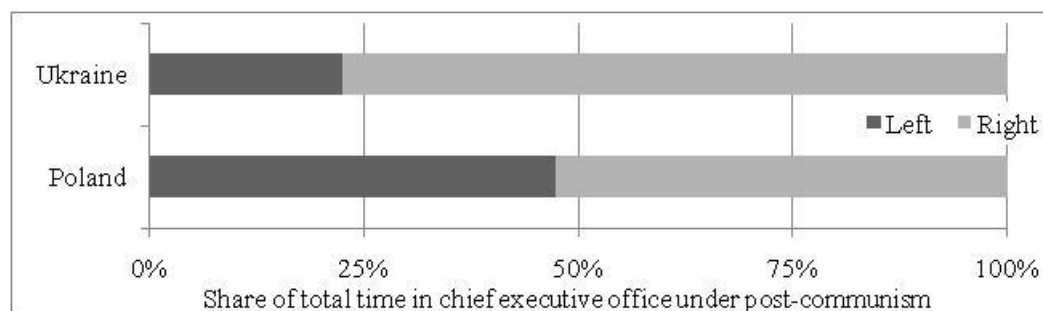


Figure 8.3. Partisan control of chief executive office, Poland and Ukraine, share of total time under post-communism (August 1989/1991 – December 2004)

Figure 8.3 roughly compares the total time during which the political power in the two countries was in the hands of the left-wing or right-wing governments.<sup>52</sup> Following Frye's and Hellman's (2001) methodology, Figure 8.3 allocates the chief executive power's weight to the council of ministers in the case of Poland, and to the presidential office in the case of Ukraine.<sup>53</sup> The historical time-line starts for Poland in August 1989, with the endorsement by the Polish Sejm of the first

<sup>52</sup> The political leaning of the government is identified by the party ideology and political affiliation of the Prime-Minister. The Democratic Left Alliance (SLD) and Labour Union (UP) are regarded as the major left-leaning parties. Although the Polish Peasant Party (PSL) is considered by most authors as a centrist force, the party's determined opposition to economic liberalism, monetarism, and the free market ideology, and its long affiliation with the socialist SLD allow us to put the PSL government into the left-dominated timeline. The Democratic, later Freedom, Union (UD-UW), and the Solidarity Electoral Action (AWS) are regarded as the major parties of the Right. Thus, Poland's governments of the Left have been as follows: Waldemar Pawlak (PSL), June – July 1992; Waldemar Pawlak (SLD/PSL), October 1993 – March 1995; Józef Oleksy (SLD), March 1995 – February 1996; Włodzimierz Cimoszewisz (SLD), February 1996 – October 1997; Leszek Miller (SLD/UP), October 2001 – May 2004; Marek Belka (SLD/UP), May 2004 - presently. Poland's governments of the Right have been as follows: Tadeusz Mazowiecki (UD), August 1989 – December 1990; Jan K. Bielecki (independent), January 1991 – December 1991; Jan Olszewski (presidential), December 1991 – June 1992; Hanna Suchocka (UD), July 1992 – October 1993; Jerzy Buzek (AWS/UW), October 1997 – October 2001.

Ukraine's governments (chief executive offices) of the Left have been as follows: Leonid Kravchuk (independent), December 1991 – June 1994; Ukraine's governments (chief executive offices) of the Right have been as follows: Leonid Kuchma (USPP), July 1994 – October 1999; Leonid Kuchma (independent), November 1999 – December 2004).

<sup>53</sup> From March 1990 until the establishment of the presidential office in December 1991, the chief executive functions in Ukraine were divided between the chairman of the Parliament and the chairman of the Council of Ministers.

Solidarity government, and for Ukraine in August 1991, when the country declared its independence. Figure 8.3 shows that, whilst Poland's political transformation under post-communism has been characterised by a balance between the Left and the Right, throughout the entire period of Ukraine's political transformation, the Right has dominated the power position. This finding confirms the hypothesis of Amable's political economy theory which postulates that partisan politics is strongly associated with major dimensions of the diversity of capitalism: 'the left-right axis seems to follow the social-democratic to market-based line; a higher proportion of left and left-libertarian votes would express a preference for fewer market-based mechanisms and a more universal Welfare State' (2003: 188). The observed difference between political struggles in Poland and Ukraine, thus, correlates with the fundamental differences between the two forms of post-communist capitalism.

In Part Two, I have discussed the conventional neo-liberal approach towards the political economy of transformation. It has been established that the dominant perception among various authors, political commentators and the international financial organisations is that the Polish political system was transformed under post-communist into a free and competitive (parliamentary) democracy, whilst the evolution of the Ukrainian political system was towards a partly free 'concentrated' super-presidential regime, or even towards an 'unconsolidated authoritarianism'. It has often been alleged that the concentration of political power within the executive branch of government has limited political competition and contestability in Ukraine and across the former USSR, and that this form of 'partly free' political system provides the so-called business oligarchs and nomenklatura insiders with ample opportunities to 'capture the state' and turn it into a private favour-generating machine (for this position on corruption and government, see Frye and Shleifer 1997; Sachs and Pistor 1997; Shleifer and Vishny 1998; Hellman 1998; Hellman, Jones, and Kaufmann 2000, Hellman and Kaufmann 2001). Hence the question one ought to ask then is why the Ukrainian variant of capitalism has not evolved into an outright liberal, market-based form?

Before we turn towards comparing the political systems in Poland and Ukraine, it is necessary to look at how the literature on comparative political economy interprets the differences between political systems underlying the different models of capitalism. According to Bruno Amable's factor-analysis, the diversity of modern capitalism is strongly correlated with differences in political equilibria; and, in addition to partisan politics (expressed through a basic left-right differentiation), institutional features of particular political systems also contribute to differentiating the major types of capitalism:

Some of our findings confirm expectations. Market-based economies are characterized by a high degree of concentration of political parties; however, the relation between the distance from the market-based model and the measure of political concentration is not

monotonic, but rather U-shaped. [Mediterranean] economies very distant from the market-based model exhibit a high degree of political concentration too. On the other hand, economies with intermediate position on the first factorial axis [representing the distance from market-based capitalism], i.e. Continental Europe, social-democratic economies, and the Asian model, all exhibit a low degree of political concentration (2003: 190-91).

At first, it could appear that Ukraine's electoral system, which was based on the single-member-district majority vote for the parliamentary elections (between 1990 and 1998) and on direct presidential elections should indeed generate a largely disproportional, 'winner-takes-all' situation, leading to the high concentration of power both in the executive and legislative branches of the government. By contrast, Poland's consensual democracy, which uses proportional representation, should result in a much more fractionalised legislature and multi-party governing coalitions. Given that Ukraine's chief executive office, in contrast to Poland's, has been controlled almost throughout the entire transformation period by a right-leaning politician heavily influenced by the vested interests of big business, the question why the Ukrainian post-communist capitalism has not shifted under President Kuchma more towards the liberal market-based form seems to be paradoxical. A more detailed analysis of the two political systems, however, can provide an explanation for this phenomenon.

Table 8.1 summarises major indicators of the Polish and Ukrainian post-communist political regimes. First, it indicates the relative political power weight of the chief executive office in the two countries on the basis of the political data-base of post-communist countries compiled by Frye and Hellman (2001). Table 8.1 shows that the executive power index of Ukraine's president (8 points) is only marginally higher than that of Poland's head of state (7 points). Since Frye and Hellman have argued that most of the CIS countries are presidential systems, their data-base does not provide a comparative power index of the prime-ministerial offices in the presidential regimes. However, in comparison with the amount of chief executive power enjoyed by other post-communist presidents on the scale from 1 to 20 (e.g. Croatia – 9, Russia – 15, Belarus, Uzbekistan, and Turkmenistan – 18), the formal powers of the Ukrainian president do not seem to be overly concentrated.

*Table 8.1.* A synopsis of indicators of the political system, Poland and Ukraine, 1990-2000

		<i>Poland</i>	<i>Ukraine</i>
Executive branch	Executive power of president / prime-minister, 1-20	7/11	8
Legislature	Electoral rules, proportional -1, plurality - 0	1	0.5
	What is the vote threshold for representation?	5 %	4 %
	Herfindahl Index Government, 0-1	0.50	0.48
	Herfindahl Index Opposition, 0-1	0.42	0.29
	Herfindahl Index Total, 0-1	0.28	0.20
Stability and Checks &	Average parliamentary majority, %	63	36

Balances	Average veto players	4.11	4.78
	Longest tenure of a veto player	3.50	3.33
	Shortest tenure of a veto player	1.45	3.00
	Maximum difference of orientation among Government parties, average, 0-1	0.33	0.66

*Note:* proportional - nationwide party list proportional representation (1, if total; 0.5, if 50 per cent of parliamentary seats); plurality – majority vote in single-member districts representation (0, if total; 0.5, if 50 per cent of parliamentary seats).

*Source:* Author's calculations on the basis of Beck *et al.* (2001b); Frye and Hellman (2001).

Second, it appears that the majoritarian (mixed after 1998) electoral system in Ukraine does not lead towards more concentration of government's power in the Ukrainian Parliament. Three Herfindahl indices, compiled in Table 8.1 on the basis of a new extensive cross-national data-base of political institutions developed by Beck, Clarke, Groff, Keefer, and Walsh (2001), show the average degree of fractionalisation of Ukraine's and Poland's legislatures under post-communism. The indices focus first on the governing side, then on the opposition, and, consequently, on the entire legislature. These data indicate that both parliaments have been extremely fragmented under post-communism and that, on average, Ukraine's legislature has been much more fractionalised. Moreover, Table 8.1 shows that whilst the Polish governments typically have had to rely on an almost two-third (coalitionist) majority in the Sejm, the Ukrainian governments usually have depended on a small majority of votes inside the Verkhovna Rada, amounting on average to 36 per cent only.

The third important variable of a political system concerns the so-called veto players. As Beck *et al.* (2001) have contended, whilst all existing analyses of the impact of decision-making time horizons rely on chief executive turn-over measurements, in systems in which the prime minister or president is not the only veto player, these political elite turnover measures present a biased picture of the horizons of all veto players.<sup>54</sup> In most countries, however, there are multiple veto gates (legislature, president, prime-minister, constitutional court, etc). Accordingly, the number of checks and balances in the political system should allow one to measure whether the government is more or less consensual. A considerable number of empirical findings in the literature on comparative political economy suggest that the presence of few veto players favours the emergence of market-based capitalism, whereas highly regulated product markets typically require a large number of veto players (e.g. see Amable 2003: Chapter 5).

As Table 8.1 shows, both the Polish and Ukrainian political systems have been characterised under post-communism by a larger number of key veto players (4.11 and 4.87 respectively). Yet, as

<sup>54</sup> Post-communist studies also fall into this methodological in-built selection bias trap. See, for example, Frye and Hellman 2001; World Bank 2002; Dąbrowski and Gortat 2002.

George Tsebelis (2002) has argued, what matters most is not simply the number of veto gates but the ideological distance between extremes, i.e. the range of orientation. A wider range produces more stability as different veto players would be more inclined to block a change they do not favour, whilst a small range would create a more spacious room for political manoeuvring. In our comparative case, as Table 8.1 shows, the Ukrainian political system has been characterised by a much larger ideological differentiation between the key veto players (0.66 to 0.33 in Poland), whilst, on average, they have stayed in power for much longer periods than in Poland (3 years in Ukraine to 1.5 years in Poland respectively).

Thus, Poland's consensual political regime has structured the particular political choices generated in the partisan struggles of post-communism to produce its specific – heavily regulated – variant of post-communist capitalism. In turn, although Ukraine's chief executive office has been occupied by a centre-right figure for a much longer period than in Poland, a large number of built-in veto gates combined with the overall ideological fragmentation in the country have pushed the post-communist political struggles towards more consensual decision-making. As a result, post-communist capitalism in the Donbas has not acquired almost any of the attributes of the Anglo-Saxon competitive model and institutional change in the region has been directed towards a social compromise formed around the construction of the 'social-market' neo-corporatist model of regulated capitalism. A question remains, however, as to whether the two variants of post-communist capitalism are capable of functioning effectively. In the next performance-related section of the chapter, I will examine whether and how the post-communist institutional changes have had an impact on the production systems of Upper Silesia and the Donbas.

## **TRANSFORMING COMPARATIVE ADVANTAGES**

In the previous section I have established a close link between the institutional forms of the two post-communist capitalisms and the character of political institutions through which those social transformations have been moulded. Now we can examine the regional evidence of newly-gained comparative institutional advantages. Does post-communist capitalism work? Has one institutional combination produced comparative advantage over the other? It is contended that the cumulative development of partially complementary links between the major institutional domains of each of the two different styles of post-communist capitalism has been the key factor behind the similarly robust economic recovery and growth, which Upper Silesia and the Donbas have been experiencing since 1994 and 1997 respectively. The strengthening of complementary institutions has brought coherence and cohesiveness to the system's overall functioning, allowed for the

development of comparative institutional advantages, and ultimately has led to enhanced macroeconomic performance.

### Industrial specialisation

One of the strongest predictions of the ‘varieties of capitalism’ literature is that there ought to be a definite connection between a country’s systemic institutional composition and the type of economic activities it specialises in. For example, countries of the Mediterranean model of capitalism tend to specialise in traditional, non-innovative, low-technology industries and activities (Amable 2003: 200-210). On the other hand, countries of the Continental European model, especially as exemplified by its two core countries – France and Germany – have long specialised in mechanical engineering, electric machinery, tools and instruments, transport equipment, and basic chemicals (Hall and Soskice 2001b: 36-44). Following Amable’s formula (2003: 201), I have examined the industrial specialisation of Upper Silesia and the Donbas through trade data, using the specialisation index to reveal relative contribution of different industries to the foreign trade balance.

Table 8.2. Comparative institutional advantages of the two types of post-communist capitalism, late 1990 – early 2000s

	–	+
<i>Upper Silesia</i>	Agriculture (-0.82) Plastics and rubber (-0.69) Chemical products (-0.67) Paper and printing (-0.66) <u>Optical, medical, precision, other instruments</u> (-0.50) <u>Machinery and equipment</u> (-0.38)	<b>Mining and quarrying</b> (0.53) Basic metals and metal products (0.48)
<i>Donbas</i>	Agriculture (-0.95) Paper and printing (-0.85) Wood and furniture (-0.82) Plastics and rubber (-0.60) <b>Non-metallic minerals</b> (-0.44) Other manufacturing, n.e.c (-0.39)	Basic metals and metal products (0.61) <u>Optical, medical, precision, other instruments</u> (0.59) <u>Transport equipment</u> (0.57) <u>Chemical products</u> (0.38)

Note: ‘-’ means a negative contribution to the foreign trade balance; ‘+’ means a positive contribution to the foreign trade balance on the scale from -1 to +1. The index increases with the relative trade surplus of respective industry.

Source: Author’s calculation on the basis of trade data from VSO (1998); DOSO (2003). The specialisation index is calculated according to the methodology defined by Amable (2003: 201).

As the index is based on both export and import data, it allows to avoid the usual drawbacks associated with export-specialisation indices, which may seriously distort the picture due to the

neglect of re-exporting activities. Table 8.2 describes the industrial specialisation of Upper Silesia and the Donbas identified on the basis of the latest available regional foreign trade data. The results summarised in Table 8.2 appear to confirm fully the development of different comparative institutional advantages in the two regions along the general lines of the institutional characteristics of their economies. The economic branches are ranked in accordance with their relative contribution to the trade balance of the respective region. The added emphasis is only to contrast visually the differences between the economic specialisation of the two regions. Table 8.2 shows that at the end of the twentieth century, Upper Silesia's economy specialised in the production of coal, and iron and steel products, whilst the major specialisations of the Donbas economy, besides metallurgy, were optical and precision instruments, transport equipment, and basic chemicals. Conversely, chemical products, machinery and equipment, optical and precision instruments were amongst the most heavily imported items on Upper Silesia's foreign trade balance list. In turn, the Donbas economy was increasingly reliant on imported coal (see 'non-metallic minerals'). Thus, the industrial specialisation patterns of Upper Silesia fall into the low-technology and traditional industrial activities that typically characterise the most heavily regulated capitalist economies, whilst the Donbas industrial specialisation broadly follows the moderately regulated – intermediate – model of capitalism.

### **Productivity and efficiency**

One of the major findings of Part One has been that since the mid- and late 1990s, the macroeconomic performance of both Upper Silesian and Donbas economies has improved significantly. In this sub-section I analyse efficiency and productivity patterns of the two economies in order to assess their progress in converting the inherited production systems and shifting from the extensive towards the intensive regime of capital accumulation. The regional statistical offices do not provide full time-series data on labour, capital, or output productivity. Therefore, one cannot evaluate comprehensively the trajectory of productivity generated by the Upper Silesian and Donbas economies under post-communism. My analysis is limited to labour productivity patterns.

We begin by comparing the available GDP per worker data for Poland and Ukraine, which should show whether the two economies have been enjoying any improvements in labour productivity. Figure 8.4 indicates that labour productivity has been rising in Poland since 1992. In Ukraine, labour productivity had been falling along with the country's GDP until the mid-1990s. However, since 1996, labour productivity has rapidly recovered in Ukraine and almost caught up, in volume index terms, with Poland's indicator.

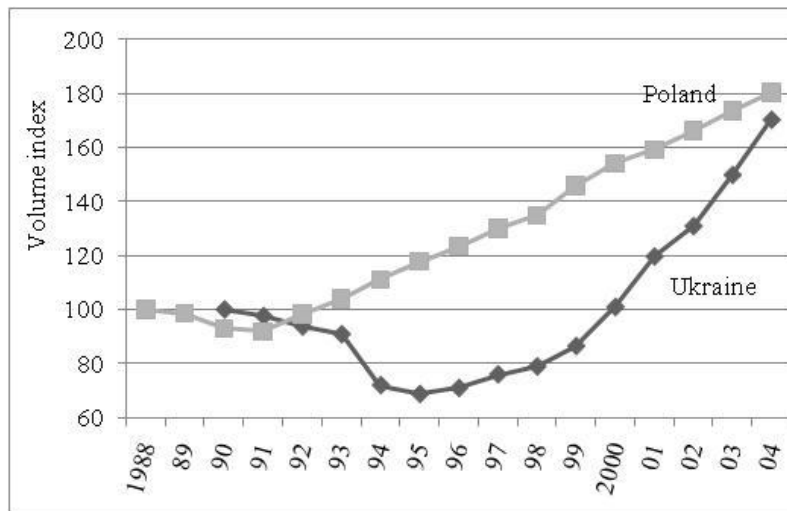


Figure 8.4. Labour productivity under post-communism, Poland and Ukraine, GDP per worker in US\$ at PPP, volume index, 1988 -2004, 1988 = 100 for Poland, 1990 = 100 for Ukraine

Note: 2004 – estimate.

Source: Author’s calculations on the basis of UPA (2002); USSC (2003); NBP (2004b); NBU (2004); USSC (2004a); Groningen (2004); OECD (2004a).

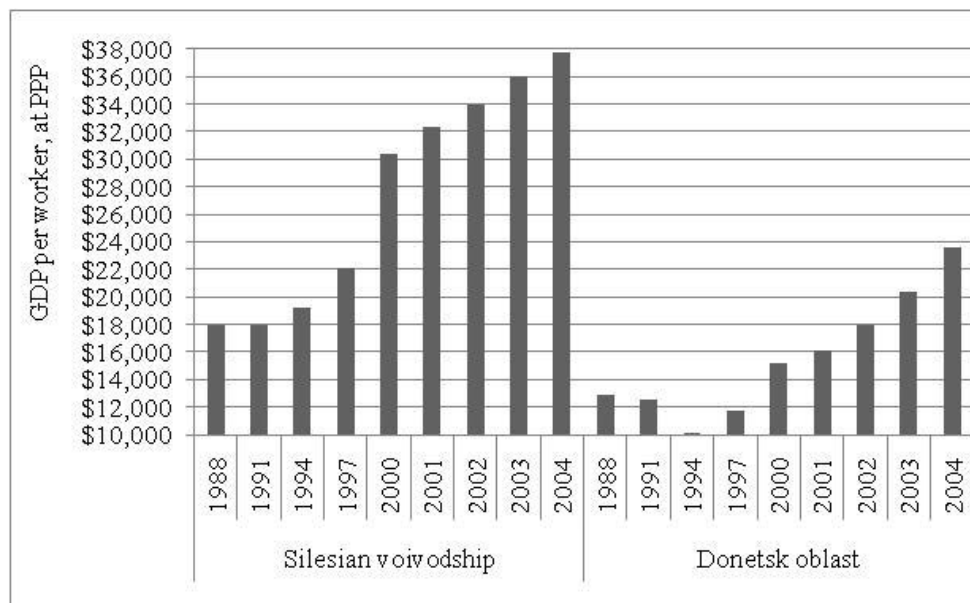


Figure 8.5. Labour productivity in Upper Silesia and the Donbas, 1988-2004, GDP per worker in US\$ at PPP

Note: 2003 – estimate; 2004 – forecast. GDP data include estimated shares of informal economy.

Source: Author’s calculations on the basis of VSO (1989, 1992, 1996, 1998); SOK (1999, 2000, 2002, 2003, 2004a, 2004d); DOSO (1991a, 2002, 2003, 2004a, DOCSO 2004a, 2004b); USSC (2003, 2004a). The respective currency exchange rates are taken or calculated on the basis of Easterly and Sewadeh (2001); UN (2004); NBP (2004b); NBU (2004). Some early data inputs are estimates based on regression.



The shift towards intensive growth is also evident in Upper Silesia and the Donbas. Figure 8.5 contrasts the gross regional product per worker indicators at purchasing power parity prices in the two regions. It demonstrates that, in real terms, labour productivity doubled in both Upper Silesia and the Donbas between 1988 and 2004. Thus, the productivity of the two regional economies has been growing even faster than the overall labour productivity nationwide. Figure 8.5 also indicates that the increase in labour productivity has become more pronounced since the late 1990s. This generally supports the ‘varieties of capitalism’ hypothesis of the increasing returns on complementarity of institutions: increased efficiency and effectiveness might be achieved through a greater complementarity of capitalist institutions.

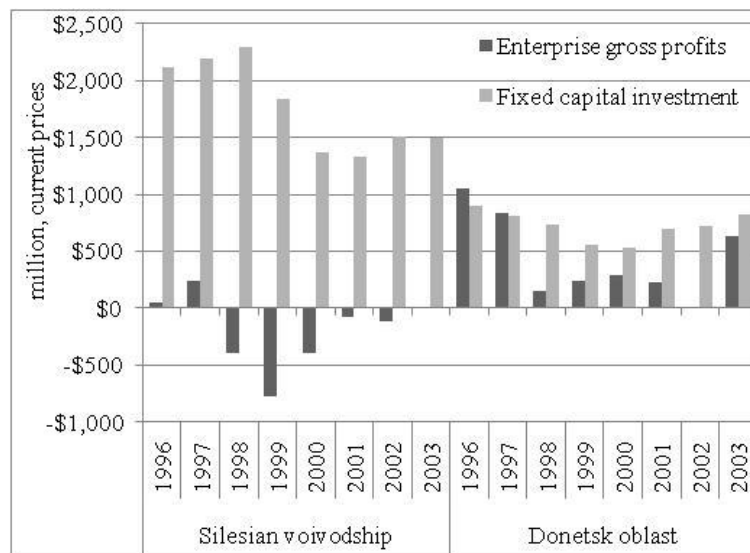


Figure 8.6. Investment outlays on fixed assets and gross profits, Silesian voivodship and Donetsk oblast, absolute volume in US\$ at current prices, 1996-2003

Source: Author’s calculations on the basis of VSO (1997, 1998); SOK (1999, 2000a, 2001, 2002a, 2003c, 2003d, 2003e, 2004a); DOSO (2000, 2002, 2003, 2004a). The respective currency exchange rates are taken or calculated on the basis of NBP (2004b); NBU (2004).

Yet, notwithstanding the evident achievements of the two regional economies as regards macroeconomic performance, a number of major problems have remained as well. First of all, as Figure 8.5 indicates, even after a twofold increase, the productivity of the Donbas economy has still been lagging far behind the Upper Silesian level. To catch up with more advanced economies, the Donbas industrial structure has to be modernised to produce more value-added products. Given the region’s specialisation in iron and steel, mechanical engineering, instruments, transport machinery, and chemical products, a potential up-grade of the regional capital stock would require massive

financial in-flows (for a discussion on the challenge of Ukraine’s industrial modernisation, see Mykhnenko 2004a, 2004b; cf. Valentin and Couronne 2004).

Figure 8.6 shows, however, that the amount of finance capital that has been invested in the Donbas economy since the mid-1990s, about \$719 million per year on average, does not meet its needs and is two and a half times smaller than \$1769 million per year which has been invested on average in the Upper Silesian economy during the same period. On the other hand, Upper Silesia’s current specialisation patterns have appeared to be largely unprofitable. Notwithstanding the region’s rapid economic recovery and expansion (see Chapter 2), Figure 8.6 shows that between 1996 and 2003 Upper Silesian enterprises incurred losses of almost \$1.5 billion of losses. As ‘ploughing-back’ has not been really an option for the Upper Silesian economy, the region has become increasingly dependent on external sources of capital, chiefly of foreign origin.

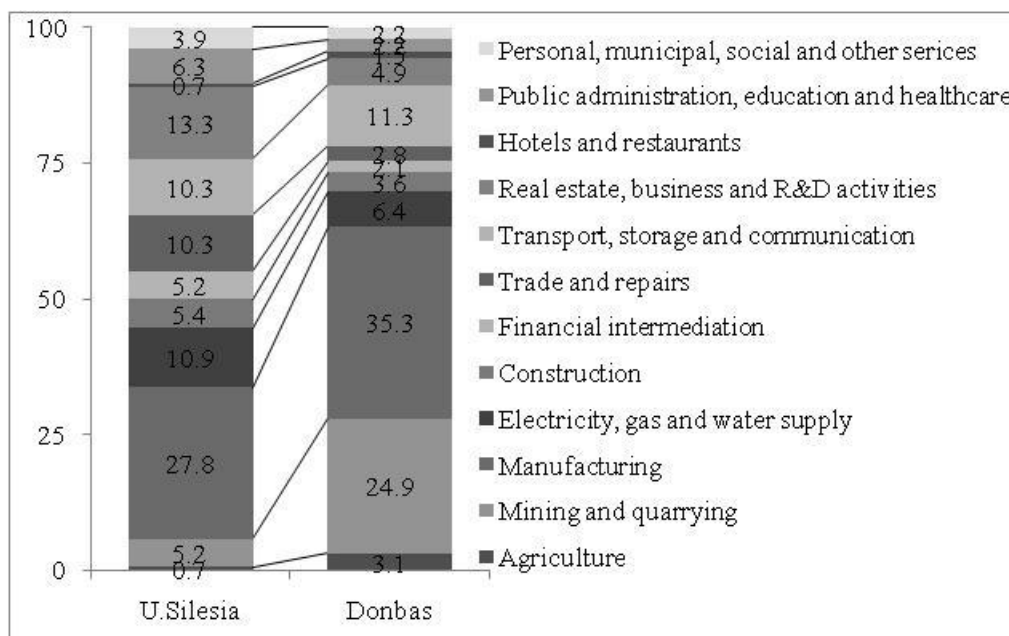


Figure 8.7. Investment outlays on fixed capital assets by destination, Silesian voivodship and Donets oblast, 1998-2002, period combined average

Source: Author’s calculations on the basis of SOK (1998, 2000, 2001, 2002a, 2002b, 2003c); DOSO (2000; 2002; 2003).

Yet, as the most recent investment trends indicate, the major destinations of capital investment in Upper Silesia are not mining and manufacturing industries, the region’s key specialisation activities, but various services such as real estate, retail trade, financial intermediation, products storage and handling. By contrast, as 8.7 shows, almost two-thirds of capital investment in the Donbas was attracted to the various industrial branches. The Donbas’s private domestic capital has been supporting the comparative institutional advantages of the regional economy, whereas in Upper

Silesia this role has had to be played only by the state, since the foreign investors have been largely ignoring the region's coal and steel industrial specialisations.

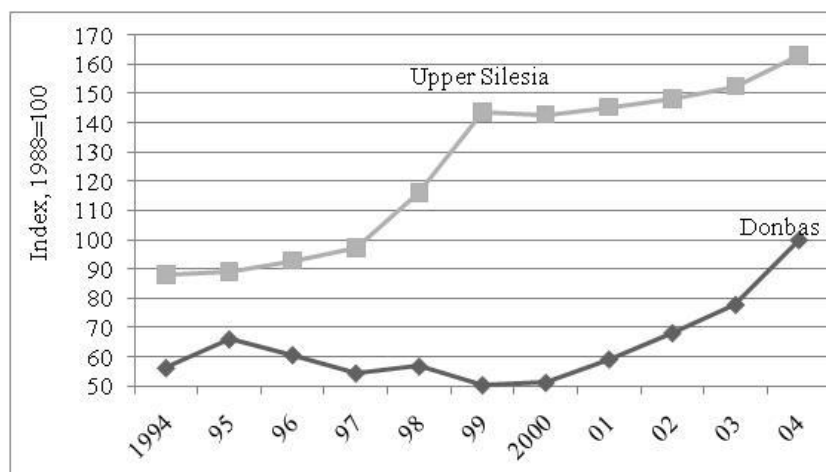


Figure 8.8. Real wage growth trajectories, Silesian voivodship and Donets oblast, volume index, 1988-2004

Note: 2004 data are for January – September.

Source: Author's calculations on the basis of DOSO (1991a, 1992, 1993, 1994, 1995, 2000, 2002, 2003, 2004a); DOSCO (2004a, 2004b); USSC (2003, 2004a, 2004c); NBU (2004); VSO (1989, 1992, 1995, 1997, 1998); SOK (1998, 2000, 2001, 2002a, 2002b, 2003c, 2003e, 2004a, 2004d). The additional RPI figures are taken from PSCO (2004a), USSC (2004a).

The underdevelopment of the financial sector in Upper Silesia has been replaced by the regional economy's reliance on external and foreign financial capital and investment. As the result of the weakness and underdevelopment of Ukraine's financial system, and due to the lack of external finance, capital investment in the Donbas has had to be financed almost exclusively via enterprises' retained earnings. Re-investment of profits by the Donbas enterprises, however, has been carried out at the expense of wage labour. Figure 8.8 indicates that whilst the growth in labour productivity has led in Upper Silesia to the general increase in real wages, the situation in the Donbas has been almost the opposite: when real labour productivity doubled in the region during the transformation, the average real wage only recovered to its pre-transformation level in 2004. If one takes into account the undeclared part of wages and salaries paid in the shadow economy according to its most excessive estimates provided by the World Bank, i.e. 27.6 per cent of gross national income in Poland and 52.2 per cent of GNI in Ukraine (see World Bank 2004: 165, 174), the estimated full real wage and salary indices would stand in 2004 at around 191 and 149 of their 1988 percentage levels in Upper Silesia and the Donbas respectively. These estimated figures indicate that whereas the productivity gains in Upper Silesia have been largely compensated in

terms of rising labour wages and salaries, the difference between the two indicators in the Donbas amounts to over 50 per cent in business's favour.

## **CONCLUSION**

This chapter has argued that the most distinctive features of Upper Silesia's post-communist capitalism, with its heavy regulation of product markets and 'Latin' welfare state subsidiarism are the product of the political predominance of the Christian-Democratic and Catholic nationalist parties on the Right together with the social-democratic and state interventionist parties on the Left of the political spectrum in both the region and the country as a whole. The less-regulated, moderately competitive, neo-corporatist character of post-communist capitalism in the Donbas combined with a minimal, yet universal, welfare state is the result of the political predominance of the centre-right governments, heavily influenced by industrial and other special interests. However, in a sharp contrast to the postulation of the neo-liberal transition theory, the attempts of the centre-right politicians to move towards full-scale liberalisation of the Ukrainian post-communist capitalism have been seriously constrained by the country's increasingly consociational polyarchy.

We have also discovered that both Upper Silesia and the Donbas have been developing their new and re-gained old comparative institutional advantages largely in correspondence with the theory of institutional complementarity. The continued industrial and trade specialisation of the Upper Silesian economy in mining and quarrying, and metallurgy has maintained traditional low-technology activities and gives rise to similarities with other rigidly regulated economies. On the other hand, the Donbas's economic specialisation in heavy engineering, instruments, and basic chemicals largely correspond to the specialisation patterns that are typically attributed to moderately regulated capitalist economies. I have established that both post-communist capitalisms have begun to generate positive performance results which are evidently demonstrated by the growing productivity of the two economies. Yet, although both types of post-communist capitalism appear to work, generating substantial performance gains, a number of unresolved deficiencies remain. In the next chapter, I will consider whether the lack of comprehensive institutional complementarity might become the major problem of post-communist capitalism as far as the system's economic and social performance in the long run is concerned.

## **PART THREE SUMMARY: THE POLITICAL ECONOMY OF POST-COMMUNISM**

In Part Three, I have aimed at finding an adequate interpretation for the divergent patterns of post-communism generated by two structurally similar old industrial regions. In Chapter 6, I have laid the foundations for an alternative paradigm of the post-communist transformation. This alternative paradigm, first, draws its assumptions from the path-dependent approach within post-communists studies that views transformation as a complex and innovative recombination and mixture of old and new institutions, organisational forms, and modes of governance. The theory of path-dependence emphasises the establishment of a new type of mixed economy and puts forward an ambitious research agenda focused on the comparative analysis of real post-communist cases. Second, the alternative paradigm borrows its basic concepts and categories from the ‘varieties of capitalism’ school of comparative political economy, in particular, from Bruno Amable’s theory of institutions as a political-economy compromise. As a whole, Amable’s theory of institutions and politics presents the economy as a system governed by a set of complementary institutional forms resting on a specific political equilibrium that defines the hierarchy among institutions and is mediated through the political system. Product-market competition, the labour market, the financial system, the social protection sector, and the education system have been identified as the major institutional domains that shape macroeconomic performance of a capitalist political economy. It has been contended that the examination of these five variables should allow us to discover the contours of actually existing capitalisms in Upper Silesia and the Donbas and, thus, to identify determinants of the post-communist transformation in the two regions.

Chapter 7 has applied the new conceptual model to interpret the research problem of this book. As a result, I have established that the observed differences between the outcomes of the post-communist transformation in Upper Silesia and the Donbas (see Chapter 3) have been rooted in the divergent styles of the regional economic systems. I have also identified the differences between the two post-communist capitalisms as emerged in Upper Silesia and the Donbas. Post-communist capitalism in the Polish region has been characterised by a generally large role for the state and direct government involvement in the economy, heavy regulation and moderately high protection of product markets, administrative burdens for large corporations, the prominence of small firms, and the existence of a large public sector. In the sphere of labour markets and industrial relations, the major features of Upper Silesia’s capitalism have been mild employment protection, little co-ordination and high decentralisation for wage bargaining, an increasingly high level of wage flexibility, and weak trade-unions. The financial sector in Upper Silesia has been bank-based, weak and underdeveloped. The finance sector’s sophistication is very low, whereas the banking concentration is limited and most of Upper Silesian banks are owned and controlled by large multinational banking corporations. Private domestic capital is underdeveloped, whilst the regional

market for corporate governance and control is dominated by foreign multinational corporations and government-controlled actors. The welfare system in Upper Silesia is characterised by a high level of social protection and generous public expenditures. Upper Silesia's public education sector is weak, with the emphasis on basic vocational skills and primary education.

Post-communist capitalism in the Ukrainian region is characterised by a moderate level of public involvement in the economy, relatively moderate non-price 'co-ordination', and a high degree of administrative barriers to entrepreneurship and foreign investment. The core features of the Donbas labour market have been moderate employment protection, highly centralised and co-ordinated wage bargaining, massive trade unions, declining wage flexibility, and increasingly active labour market policies. The financial system in the Donbas has been underdeveloped and weak. The sector of financial-intermediation and corporate control in the Donbas has been characterised by a very high level of ownership concentration, a limited development of institutional and venture capital investment, and by a great role of domestic private capital in the finance and management of local firms. The Donbas welfare system exists in a universal but limited form, with moderate levels of social protection, low public spending on health, and limited involvement of the state in providing additional social services. The Donbas education sector has been characterised by a relatively high level of public expenditure, high enrolment rates in post-secondary and tertiary education, developed vocational, professional, and technical education and training, and the overall emphasis on industry-specific skills and knowledge.

Chapter 7 has also established that each of the two forms of post-communist capitalism possesses a set of partially complementary institutions. In Upper Silesia, institutional complementarity has been developed through the mutually enhancing operation of heavily regulated product markets with many small firms, paternalist social protection system, basic public education sector, and the underdeveloped financial system dominated by foreign multinationals and the state. In turn, in the Donbas, moderate- to heavily regulated product markets with few large corporations, highly co-ordinated and centralised industrial relations, 'polytechnic' public education system, and the prominence of domestic private capital in the markets for finance and corporate control have been characterised by institutional complementarity. It is contended that the present degree of partial intra-systemic institutional complementarity within the two post-communist capitalisms has been sufficient to enhance the regions' macroeconomic performance in the medium run.

Nevertheless, having examined the five institutional domains of post-communist capitalism in Upper Silesia and the Donbas, I have concluded that each of them also possesses a number of systemic incompatibilities. Firstly, the financial systems in Upper Silesia and the Donbas have remained very immature and underdeveloped in comparison with any of the existing models of modern capitalism. Secondly, in the case of Upper Silesia, labour market flexibility has not been

complementary with the overall logic of a heavily regulated rigid capitalism. In turn, the very limited welfare system in the Donbas has been incompatible with its variant of capitalism in transition. In the following Part Four, I will examine how the interplay of the initial conditions and the institutional dynamics has determined the varied performance trajectories of the two regions and how the partially complementary and partially substitutable institutional factors account for the divergent social and developmental outcomes of post-communism.

Chapter 8 has examined how the two different types of post-communist capitalism were constructed. I have established that the ‘Mediterranean type’ features of Upper Silesia’s post-communist capitalism are the product of a social compromise reached in the process of transformation between the Christian-democratic and Catholic nationalist political forces on the Right, and the social-democratic and interventionist parties on the Left. On the other hand, the relatively more liberal character of the Donbas capitalism combined with a minimal-universal welfare state is claimed to be the result of the political predominance of the centre-right governments which represent industrial and other special interests of the private domestic capital.

We have also discovered that both Upper Silesia and the Donbas have developed their new and re-gained comparative institutional advantages largely in correspondence with the theory of institutional complementarity. Furthermore, both post-communist regions have begun to generate positive performance results which are evidently demonstrated by the growing productivity of their economies. Yet, I have claimed that to improve the developmental prospects of the two social and economic formations, the institutional complementarity within the two capitalist systems has to be strengthened. In Part Four, I will discuss the ways by which this could be achieved.

## **Part Four**

*The Determinants of the Transformation in Upper Silesia and the Donbas*



## **Institutional Dynamics of Post-Communism**

In this concluding chapter of the book, I will ascertain the determinants of the post-communist transformation in Upper Silesia and the Donbas and will provide the answer as to why two structurally similar old industrial regions of Eastern Europe have generated divergent post-communist outcomes. Five particular questions identified in Part One of this study will be examined in this regard. First, I will consider why the initial (most negative) transformation phase lasted a short period of time in Upper Silesia, whereas it has been much more protracted in the Donbas. Second, I will discuss the reasons behind the similarly robust economic recovery and growth that Upper Silesia and the Donbas have been experiencing in the third current phase of the post-communist transformation. Third, I will examine what factors can account for the divergent outcomes of post-communism in the two regions in the related spheres of inequality, extreme poverty, unemployment, and crime. Fourth, I will analyse why the improvements registered in Upper Silesia and the Donbas as regards the quality of life and natural environment standards have been dissimilar. Fifth, I will consider the reasons behind the divergent health, human survival and development outcomes of the post-communist transformation in the two regions. Consequently, the chapter will discuss the practical and theoretical implications of the major findings of this study. It will identify the ways by which the defining structural interrelationships can be fostered and enhanced. It will also consider broader research directions that the political economy of post-communism has to address in order to progress. Finally, this chapter will conclude with a discussion of the futures of post-communist capitalism.

### **INHERITED LIABILITIES AND TEMPORAL REFORM TRAJECTORIES**

Amongst the first major differences in the post-communist transformation pathways of Upper Silesia and the Donbas, which I have identified in Part One, was the magnitude of the initial industrial and economic decline suffered by the two regions in the early 1990s. As I have

established in Part Two, the explanation favoured by the neo-liberal transition theory has been that ‘policy matters’, i.e. the post-communist countries which followed the rapid and radical market-oriented reform were to suffer less output losses, whereas the countries which opted for the gradual ‘muddling through’ transition strategy were inevitably punished by a greater extent of economic collapse. However, this conventional neo-liberal explanation has been considered inadequate. By dividing the entire period of the transformation into specific distinct phases in Part One, I have recognised that there have been several causes behind the ‘Great Post-Communist Depression’ of the early 1990s, as the output growth dynamics within each period in the two regions were dissimilar. For instance, in the mid-1990s, the Donbas industrial production was contracting almost twice as fast as in the earlier transformation period of the late 1980s and early 1990s. By contrast, industrial production in Upper Silesia registered its biggest fall within the first period of transformation in the late 1980s – early 1990s (see Chapter 2). Yet, it was in the second transformation period (in the mid-1990s), when the Donbas experienced the introduction of the radical Washington consensus market-oriented reforms and consequently suffered the largest degree of output collapse. The earlier period of ‘muddling-through’ reforms in the Donbas and Ukraine coincided with a milder output contraction. Correspondingly, Upper Silesia’s biggest output contraction occurred in the early 1990s, during the implementation of ‘shock therapy’. Thus, it has appeared that liberalisation, privatisation, and marketisation have been in themselves amongst the major initial growth-reducing factors.

On the other hand, it has been argued in Chapter 5 that on the balance sheet of the starting conditions that are positively or negatively related with a successful post-communist transformation, Upper Silesia’s initial conditions in the late 1980s included the overwhelming majority of assets, whereas the Donbas inherited a very large number of liabilities. Upper Silesia was significantly less dependent on foreign markets and distant suppliers than the Donbas, and, thus, the Polish industrial stronghold was much less prone to be effected by highly damaging exogenous shocks of the late 1980s – early 1990s, caused by the collapse of the USSR and the communist trading bloc. Secondly, although both regional economies were macro-economically distorted at the end of the communist era, the situation in the Donbas appeared to be much worse: the Ukrainian region inherited a much higher level of repressed inflation. Hence when I have taken into account the starting conditions of transformation in Upper Silesia and the Donbas, it has appeared that the difference in the scale of the post-communist economic depression suffered by Upper Silesia and the Donbas can be attributed, to a very large extent, to the region’s inherited macroeconomic distortions.

On the basis of our discussion and the data examined in the previous chapters, it is thus contended that the ultimate force which has caused the initial economic depression, endured by Upper Silesia and the Donbas to a different degree, lies in the interaction between the inherited structural liabilities and temporal reform trajectories. The initial exogenous shock arising from the collapse of state socialism, Comecon, and the disintegration of the USSR, was much more pronounced in the Donbas, causing the detrimental effects of disorganisation and trade implosion (see Chapter 5). In turn, after the initial output contraction caused in the Donbas mainly by the exogenous shocks, the regional economy experienced yet another phase of disorganisation associated with the implementation of the Washington consensus reforms in the mid-1990s (see Chapter 2). By contrast, the Upper Silesian economy has not experienced any substantial degree of trade implosion. In addition, the damaging effects of disorganisation, caused by Poland's radical dismantlement of the institutions and co-ordinating mechanisms of the centrally planned economy in the early 1990s, were also less extensive in Upper Silesia.

As discussed in Chapter 7, the newly-emerged variant of post-communist capitalism in the Donbas is as distant from the previous socio-economic system of state socialism as Upper Silesia's post-communist capitalism, suggesting at least a similar degree of radicalness which has characterised the post-communist transformation strategies. However, two historical facts warrant reiterating in this regard. There was an almost five year long time lag between the beginning of radical market-oriented reforms in the Polish region and in its Ukrainian counterpart. The radical Washington-consensus policy reform (the 'Balcerowicz plan') was introduced in Upper Silesia and in Poland on 1<sup>st</sup> January 1990. The similarly radical market-oriented reforms were only introduced in the Donbas and Ukraine in late December 1994. Given the considerable time lag between the two events, the comparative similarity in the magnitude of the systemic change experienced by Upper Silesia and the Donbas appears to suggest that institutional change in the Ukrainian region has been accomplished within a much shorter time period. Hence a temporarily more radical reform trajectory in the Donbas did not allow enough space for making necessary adjustments in the spheres of production and exchange, resulting in intense disorganisation and, thus, causing a lengthier period of economic decline and stagnation. In contrast to the Donbas, in addition to the milder effects of disorganisation and trade implosion, Upper Silesia's post-communist transformation has been characterised by an earlier start, thus, providing economic agents with more time to accommodate the ongoing institutional change.

## **INSTITUTIONAL COMPLEMENTARITY TAKING ROOT**

It has been argued in Part One of this book that, according to a large number of time-lagged performance indicators, both Upper Silesia and the Donbas follow almost parallel macroeconomic trajectories from the initial decline towards consequent fast recovery and growth. By 2004, the Upper Silesian economy expanded by about 50 per cent from its pre-transformational gross domestic product per capita level, whereas the Donbas economy grew by one-third respectively. Furthermore, since the late 1990s, the Donbas economy and society have been catching up with Upper Silesia and steadily lessening the income and human development disparity, which had earlier widened between the two regions. I have also established that in a great number of economic, social, and human development spheres both Upper Silesia and the Donbas have progressed beyond previous levels of development (see Chapters 3). Moreover, I have discovered in Chapter 7 that since the mid-1990s both Upper Silesia and the Donbas have been developing their new or re-established comparative advantages – a process accompanied with massive labour productivity gains. Why then have *both* Upper Silesia and the Donbas been broadly following an upward trajectory in the fields of economic and industrial growth, human development, and labour productivity?

This second major finding of the study is explained by the gradual and cumulative establishment in the two regions of specific dominant sets of complementary political-economic institutions (see Part Three). It is contended that the reversal of the initially negative performance trends and the following positive macroeconomic performance and developmental progress achieved by Upper Silesia and the Donbas since the second half of the 1990s have been principally due to a more consistent process of institution-building based upon negotiated socio-economic compromises as the result of which, a consolidated form of post-communist capitalism has emerged in both regions.

This book has shown that the newly emerged types of capitalism in transition have been characterised by a variety of institutional forms and modes of governance. Post-communist capitalism is still an unfinished enterprise that does not resemble any of the actually existing well-established models of modern capitalism in every respect. Nonetheless, three to four out of five major institutional domains in each of the two cases of post-communist capitalism are complementary. In Upper Silesia, heavily regulated product markets, the paternalist social protection system, the financial-intermediation sector governed by the state and dominated by foreign multinational enterprises, and the basic public education sector are interdependent and mutually re-enforcing institutional arenas. In the case of the Donbas, institutional complementarity has been taking root in the interaction between moderately regulated product markets, highly coordinated industrial relations, the financial sector dominated by private domestic capital, and the Continental public education system. The rise of (partially) complementary post-communist

capitalism has greatly boosted the productivity of the two economies and increased the level of capital investment. The newly-emerged political-economic systems of post-communist capitalism have delivered – for the most part – coherent and cohesive mechanisms of market co-ordination and state regulation in both Upper Silesia and the Donbas. The new post-communist economic formation has enabled the successful transformation of the inherited production systems of the two old industrial regions and, thus, facilitated the fundamental structural shift of Upper Silesia and the Donbas towards an intensive regime of accumulation.

## **PERSISTING INTRA-SYSTEMIC INCONGRUITIES**

I have argued in Part One that despite fundamental similarities in macroeconomic performance of Upper Silesia and the Donbas, both within the specific transitional stages and throughout the entire period under examination, there have been a considerable number of differences in the post-communist outcomes of the two regions. Besides various contingent quantitative differences, three systemic continuous discrepancies in the regional results of transformation have been identified. Therefore, I now turn to consider how the varied outcomes of post-communism in Upper Silesia and the Donbas have been caused by the persistence of non-complementary relationships between some of the major institutional arenas of post-communist capitalism in the two regions.

### **Inequality, unemployment, poverty and crime**

According to the third major empirical finding of this book, in sharp contrast to the Donbas, Upper Silesia's transformation has been characterised by a dramatic increase in inequality and relative extreme poverty, extremely high levels of chronic unemployment, and an ever-raising intensity of criminal behaviour (see Chapters 2 and 3). I argue that the non-complementary nature of Upper Silesia's labour market institutions with the four other major institutional domains of the regional political economy accounts for such a divergence of socio-economic outcomes, when compared to the Donbas. As I have established in Part Three, contrary to the overall institutional arrangements of heavily regulated rigid capitalism, the wage-labour nexus and labour market institutions of Upper Silesia's capitalism have been characterised by mild to low levels of employment protection, little co-ordination and high decentralisation of wage bargaining, very high wage flexibility, and weak and defensive trade-unions.

According to the theory of institutional complementarity, decentralised labour markets facilitate firms' adjustment to market pressure and make structural change less costly by easy hire and fire; a flexible labour market allows the quick adaptation of the workforce and the maintenance of short-term profits; liquid labour markets lower the demand for social protection (see Amable 2003: Chapter 3). In the case of Upper Silesia's post-communist transformation, labour-market flexibility has generated a constant outflow of the labour force from active employment and a continuous increase in wage differentiation. However, the absence of active employment policy in Upper Silesia, the region's heavily regulated product markets, underdeveloped financial system, weak education sector, and economic specialisation in heavy industries do not allow for a quick reaction to opening market opportunities, hinder job creation via business start-ups, and make labour retraining and, thus, moves from job to job, very difficult. The lack of institutional complementarity between the functioning of Upper Silesia's labour market and the remaining core institutional arenas of the regional political economy results in extremely high levels of chronic unemployment. In turn, Upper Silesia's welfare system has to substitute for employment stability, which is typically provided by the rigidity of labour markets in the heavily regulated model of modern capitalism, by an increased degree of social protection and poverty alleviation. However, as my analysis indicates, as the direct result of excess demand, the social protection system in Upper Silesia and Poland has been over-extended and increasingly financed through budget deficit spending (see Figures 5.7, 7.7 and 7.8). Upper Silesia's social protection system, based upon the principles of Latin particularist-clientelist subsidiarity, has been unable to cope with rapid change in labour markets and to decrease substantially or stabilise the rising levels of income inequality and extreme relative poverty. The mounting problems of unemployment, inequality, and extreme poverty in Upper Silesia have evidently resulted in escalating criminality.

The institutional dynamics in the Donbas have been very different: the region's moderate to low internal competitive pressure enables a relatively high degree of employment protection, which, in turn, prevents fast structural change and labour releases, easing the demand for social protection. The Donbas's highly co-ordinated labour markets and centralised wage-bargaining procedures protect regular employment and lessen wage differentiation, thus, preventing a rapid rise in income inequality. Given the relatively low demand, the region's minimal-universalist welfare system has been able to provide effectively a social safety net, which is demonstrated by the low level of relative extreme poverty and by the decline in criminal activity in the later stages of post-communism in the Donbas (see Chapters 2 and 3).

### **Quality of life and natural environment**

Another persistent difference between the social and developmental outcomes of post-communism in Upper Silesia and the Donbas that has been identified in Part One is the increased gap between the environmental and living standards in the two regions. Whereas the quality of life and environmental indicators have registered great improvements under post-communism in Upper Silesia, the situation in the Donbas has been rather uneven. Notwithstanding a considerable increase in the saturation of Donbas households with various durable consumer goods, motor-cars, and house installations, the average household cash expenditure patterns have indicated a downward movement towards a lower income consumption level, whilst the degree of water pollution in the region has tripled. It is contended that this fourth major empirical finding of the book is explained by the underdevelopment of the financial intermediation sector and corporate governance under post-communist capitalism as well as by the relative role of large corporations in the regional political economies.

As has been argued in Chapter 8, the transformation of the inherited production systems in Upper Silesia and the Donbas require extensive inputs of capital resources. Yet, the overall weakness of the two regional financial systems has considerably limited endogenous investment opportunities. The underdevelopment of the domestic financial sector in Upper Silesia has been substituted by the availability to local economic agents of external financial resources, chiefly in the form of foreign direct investment and public investment made by the central government through state-owned industrial enterprises. In contrast, Donbas industries have been almost fully privatised with little overseas involvement.<sup>55</sup> Given the underdevelopment of the regional financial system, and due to the lack of externally-generated finance, capital investment in the Donbas has had to be financed primarily by firms' retained earnings. The re-investment of profits by Donbas enterprises, however, has also been funded through cost-cutting methods, including a squeeze of real wages and salaries of the employed personnel as well as the evident neglect of environmental-protection measures. Therefore, in contrast to the Upper Silesian experience, the apparent upward trend in Donbas economic development identified previously did not result in an analogous improvement of the average quality of life in the region. Due to the political significance of large industrial corporations owned or controlled in the Donbas by domestic private capital and given the emerging neo-corporatist features of the Donbas polity, the trade-off between immediate endogenous saving and investment and future consumption has been made generally acceptable. In turn, given the availability of exogenous finance capital in Upper Silesia, immediate private consumption has been set as a definite priority.

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<sup>55</sup> It is arguably easier to re-allocate funds for environmental protection activities at state-owned industrial enterprises that are facing a softer budget constraint than at private firms operating under higher profit-oriented pressures.

## **Health, human survival and development**

The final major difference between the outcomes of the post-communist transformation in the two regions that has been identified in Part One lies in the sphere of human health, survival and development. Despite its constantly rising criminality and the steadily deteriorating mental health of the inhabitants, the Polish region has managed to recuperate fully and progressed substantially under post-communism in almost every health and human development sphere. In contrast, the social and human developmental outcomes of post-communism in the Donbas have been very mixed. Some crucial developmental achievements of state socialism in the Donbas, such as the containment of poverty-related infectious diseases or relatively high life expectancy, have been lost. In the process of the post-communist transformation, life expectancy at birth has declined in the Donbas by 3.1 years. By contrast, it has grown in Upper Silesia by 3.8 years. Between 1985 and 2003, the rate of active tuberculosis was halved in Upper Silesia, whereas it rose five times in the Donbas (see Chapter 3).

It is contended that Upper Silesia's generous social protection sector and high levels of public spending on health care and other social services have resulted in the region's steadily improving human development indicators. In turn, the dramatic decline in a number of crucial human survival and development indicators, which has been experienced by the post-communist Donbas, was caused by ever decreasing public expenditure on health and additional social services, and, generally, by the relatively low role of the state in the welfare system (see Chapter 7). Whereas the minimalist-universal model of the social protection and welfare sector that has emerged in the Donbas appears to be rather effective in the fields of poverty alleviation and income support, it has been unable to provide a necessary level of public health care services. Given the overall economic decline in the early phases of post-communism in the region, there has not been enough private funding in the Donbas to prevent hospital closures and the gradual deterioration of health care facilities.

## **IMPLICATIONS OF THE STUDY**

### **Redirect structural reforms**

By the early 2000s, considerable obstacles to the economic growth of the post-communist economies that had been initially posed by disorganisation, trade implosion, and inherited structural liabilities were fully surmounted. Moreover, as one of the major findings of this study has shown, in the long process of transformation each of the two regional political economies has been able to construct, re-work, and stabilise a distinct variant of post-communist capitalism – a post-communist



socio-economic formation of generally consolidated and mostly complementary institutional forms, norms, and structures. Nevertheless, the problem of the sustainability of the emerged types of capitalism in transition remains. As I have argued, each of the two post-communist capitalisms is characterised by at least one major intra-systemic incongruity which imbalances the complementary interrelationships amongst other institutional arenas and produces grave social consequences. The unresolved crisis of chronic unemployment, extreme relative poverty, rising inequality and crime suffered by Upper Silesia under post-communism has been directly related to the institutional non-complementarity of the region's wage-labour nexus and labour-market characteristics with the overall set of institutional mechanisms and arrangements. In the case of the Donbas, the region's persistent health and human development problems are considered an inevitable by-product of the very limited public health care provision. In addition, the financial-intermediation sectors in the two regions are very immature and too weak to sustain fully the on-going process of economic restructuring.

The first main implication of this study is the recognition that the currently dominant policy reform orientation towards further liberalisation, privatisation, marketisation, and 'de-statisation' has to be fundamentally revised to take into account particular patterns of interaction between complementary institutions of post-communist capitalism. In practice this means a redirection or – in our comparative case of Upper Silesia and the Donbas – a reversal of structural reforms towards non-market co-ordination, state regulation and public provision. In order to uncover fully the institutional dynamics of the heavily regulated model of capitalism that has been taking root in Upper Silesia as well as to prevent a full-blown social crisis in the Polish region, Upper Silesia's labour-market institutions and the regional wage-labour nexus ought to be transformed. Further structural reforms concerning the Upper Silesian labour-market institutions have to be aimed at (a) high formal employment protection at large firms with the preservation of the present 'flexible' fringe of employment at small firms and in temporary and part-time work, and (b) the centralisation of wage bargaining.

In turn, any further public welfare reforms in the Donbas have to lead to a higher degree of social protection, greater involvement of the state in the form of increased public spending on health care and additional social services. Only by redirecting the region's system of social protection closer to the Continental European standard, will one be able to strengthen the overall institutional complementarity of the Donbas type of capitalism and to resolve the pressing physical health and human development problems. Finally, if the two regions are to catch up with the industrially advanced economies, they have to develop the financial capacity to muster more savings for investment in overall economic modernisation. To provide a further boost to the developmental

prospects of Upper Silesia and the Donbas, the institutional complementarity within the two capitalist systems has to be advanced and reinforced.

Following the concept of institutional substitutability, an alternative set of structural reforms can be proposed as well. As discussed in Chapter 6, two institutions can be said to be substitutable if the absence or inefficiency of one increases the returns to using the other. At present, the lack in Upper Silesia of strong employment protection and labour market regulation mechanisms (aimed at preventing unemployment) is substituted for by the region's large welfare state provisions (aimed at protecting the unemployed). On the other hand, in the Donbas, the increased centralisation and co-ordination of labour markets (aimed at equalising wages and salaries) is used to substitute for the lack of a large welfare state (aimed at equalising general income and consumption patterns). To strengthen the apparent institutional substitutability between labour markets and social protection in Upper Silesia, the regional political economy has to move closer to the Danish 'flexicurity' model that combines a considerable degree of labour market flexibility with an integral welfare state provision (see Amable 2003: Chapter 6). Thus, while preserving the current level of employment protection, Upper Silesia's structural reforms should include the development of formal mechanisms of collective wage bargaining and, simultaneously, the expansion of the regional social protection system and the initiation of active labour market policies. In turn, the proposed structural reforms in the Donbas should be aimed at substituting for an arguably unaffordable generous social protection system the further strengthening of the regional labour market's neo-corporatist features.

### **Refocus academic analysis**

The second implication of this book is theoretical. It concerns a necessary revision of our discipline's theoretical and conceptual baggage, which, as some critics have recently suggested, remains some twenty years behind the tide (see Kubicek 2000). Four suggestions are tentatively proposed here in this regard. First, it is contended that the conventional approach to the post-communist transformation as a process of continuous multiple liberalisation has been totally exhausted and can hardly yield additional academic benefits. This book has illustrated the importance of theorising in the political economy of post-communism. It has shown that incorporating the perspective of comparative political economy into the study of post-communism does indeed provide a better handle on this complex phenomenon. This can not only improve our understanding of how markets can be built and how political development proceeds, but it can evidently uncover what *kind* of markets can be built through *which* political mediatory structures. Second, one has to recognise fully the dynamic and multi-stage nature of post-communism and investigate the most recent transformation trends and data without the intrinsic predisposition of the transition triad model through which the orthodox liberal paradigm conventionally pre-determines

which research questions are considered legitimate within the field of comparative post-communist studies. Third, it is believed that the political economy of post-communism as a sub-discipline has to change its major focus from the presently prevailing crude assessments of the two sets of economic and political freedom ratings towards more vigorous qualitative comparative research. The application of the theory of institutional complementarity and the ‘varieties of capitalism’ approach to the study of post-communist political economies can provide, arguably, a more adequate and value-neutral insight into the multiple processes involved in the transformations of post-communist states and societies. Fourth, it is necessary to develop a classification of different types of post-communist capitalism as well as of their comparative institutional advantages in order to discover which directions of structural reforms might be better suited for individual post-communist countries. To accomplish such an ambitious endeavour, one would have, first, to design and develop a comprehensive cross-national data-set of major indicators in the five institutional arenas of post-communist capitalism.

### **Limitations of the study**

There are two major contentious theoretical and methodological issues that this study has not been able to address fully. The first problem concerns our understanding and categorisation of the national and sub-national (i.e. regional and local) scales of analysis. At present, most of the theorising and research in political economy involves the national level. To a certain degree, the academic preoccupation with the national scale of analysis is simply due to an immeasurably larger amount and better quality of the data available on a country level, if compared with sub-national or local data sets. However, spatial aspects of public policies and economic change have long been a neglected theoretical issue as the result of the neoclassical tradition’s concept of (eventual) macroeconomic and developmental convergence. In order to proceed any further in the understanding and explaining of local and regional political-economic dynamics, both the conceptual and evidential deficiencies have to be addressed.

Another significant limitation of this study involves the relationship between the social categories of the formal and the informal. The view taken in this book has been analogous to the new institutional theory (see Chapter 6). In particular, although some formal institutions (e.g. laws and regulations) may contradict certain informal institutions (e.g. conventions and practices), the superior degree of legitimacy and legality of formal institutions means that they ought to be considered first and foremost (Amable: 2003: Chapter 2). However, in the post-communist context of intertwined old and new rules, laws, and conventions, the analysis of informal institutions has to be conducted as vigorously as that of the formal ones. The research agenda concerning the category of the informal ought to proceed along the basic lines of qualitative research, involving in-depth

interviewing and, if possible, other techniques of participant observation. Yet, such an enterprise would be possible in comparative studies under conditions of very significant fieldwork funding, unconstrained time resources, unhindered access to the subject of examination, and advanced multilingual proficiency. The implication of the book in this regard is that *comparative* research into the informal side of the post-communist transformation has to be carried out by teams of researchers.

## **THE FUTURES OF POST-COMMUNIST CAPITALISM**

Is it feasible that the proposed reversal of the post-communist structural reforms will take place in the regions concerned? Can the revised policy reforms achieve support from a leading socio-political bloc in Upper Silesia and the Donbas, and, generally, in Poland and Ukraine respectively? On the other hand, will the distinctive forms of post-communist capitalism continue to exist in the following decade for the scholars of political economy to scrutinise and ponder over? The last question appears to be the easiest to answer. Although the globalisation of the Washington consensus and its implementation in the formerly communist societies has promoted the overall tendency in the post-communist world towards greater liberalisation, privatisation, and marketisation, great divergence remains. Starting from a fairly similar point, the two regional political economies that have been examined in this book have proceeded along distinct pathways of post-communist transformation and have developed different forms of systemic institutional arrangements. Moreover, neither of the two regional post-communist political economies examined show resemblances to the market-based model of capitalism, which the post-communist countries have been advised to emulate. These differential strategic responses to the external pressures of neo-liberal globalisation and to the internal pressures of structural adjustment adopted by Upper Silesia and the Donbas, and by Poland and Ukraine generally, suggest that post-communist countries will continue to follow their different ways to transformation long into the future. The political economy of post-communism will not be void of its subject matter as a result.

It is much more difficult to foresee a broadly supported reversal of structural reforms taking place in one or in both post-communist regions under consideration. As the direction of proposed structural reforms has to be contrary to the currently dominant line of thinking, that is, not towards further deregulation and liberalisation, but towards increased co-ordination of labour markets and more extensive public welfare system with higher levels of social spending, an alternative reform strategy would have, first, to enter regional and national politics through more ‘social’ or ‘regulated’ market ideas and discourse. As the latest presidential campaign in Ukraine has shown,

the issues of ‘shared growth’, social protection and public welfare, and the recognition of the significance of the state’s role in the provision of public services, including health care, are fully back on the political agenda in the country. During the televised presidential debate between the two run-off candidates – monetarist banker Viktor Yushchenko and Ukraine’s prime minister and conservative industrialist Viktor Yanukovych – on 15 November 2004 both candidates prioritised wages, pensions, income benefits, and other public social spending programmes (BBC Monitoring 2004). Besides the electoral rhetoric, the government of Viktor Yanukovych, who served as the Donbas governor in 1997-2002 and contributed personally to the creation of the region’s institutions of post-communist capitalism, has also been substantially increasing pensions and other social benefits in the course of 2003 and 2004 (CMU 2004c; cf. *The Economist* 2004h). Current political trends in the Donbas and Ukraine indicate a strong potential for the emergence of a winning socio-political bloc that could support the promotion of a more comprehensive welfare state and regulated labour markets. Therefore, the proposed reversal in the direction of structural reforms in the Ukrainian region and in the country in general appears to be potentially feasible.

Prospects for the proposed change in the nature and functioning of Upper Silesia’s industrial relations and labour-market institutions are rather gloomy, however. The currently ruling socialist coalition of the Democratic Left Alliance (SLD) and the Labour Union (UP) is in full disarray. Although the SLD, successor to Poland’s communist party, still possesses strong institutional and political links with Poland’s largest trade-union organisations, the party has been too gravely damaged by internal dissent and various corruption scandals to remain a considerable political force after the up-coming parliamentary elections in 2005. The other two left-wing parliamentary parties – the Labour Union and the newly-formed Polish Social Democracy remain very small to channel independently an alternative reform agenda. Given the overall political trends in the country, it seems highly unlikely that besides the weakened Polish Left, other political forces could entertain the ideas of regulated labour markets and integral welfare state provisions. Despite vocally opposing the excesses of neo-liberalism and liberalism as a whole, neither the populist small-farmers’ movement *Samoobrona* (Self-Defence) nor a conservative Catholic nationalist party, the League of Polish Families, has shown any serious attempts to move beyond their usual anti-German and Euro-sceptic agenda. The two main representatives of the political Right in Poland – Civic Platform (*PO*) and Law and Justice (*PiS*) – profess liberalism on economic issues and conservatism on social ones (on current Polish political affairs, see *The Economist* 2003a, 2003b, 2004a, 2004b, 2004c, 2004f, 2004g, 2004i).<sup>56</sup> Since the coalition of the PO and PiS is widely predicted to become Poland’s next government, it is highly unlikely that the reversal of structural reforms in Upper

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<sup>56</sup> The PiS leaders advocate tougher responses to crime and the re-introduction of the death penalty. In turn, the PO ideology has been described by the British weekly *The Economist* as ‘Thatcherite conservatism jealous of national sovereignty’ (2004d, 2004e).

Silesia's industrial relations or social protection system that has been proposed here could occur in the first decade of the 21<sup>st</sup> century.

If the essential systemic alterations are made and the institutional complementarities (or substitutabilities) of the two regional economies are amplified and re-enforced, both variants of post-communist capitalism would achieve optimum effect and become capable of bringing the post-communist societies around to their self-proclaimed destination point of catching-up with the West. Upon the condition that these viable and complementary institutional structures of control and regulation are in place to guide the performance of the emerging intensive regimes of production, capitalism in transition would cease to exist as a distinctive socio-economic formation, and then one would be able to claim that the post-communist transformation was fully complete.

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