5. Economy
5.1. Guide to the Chapter

This chapter deals with **comparative conceptualization of economic phenomena**. It will unfold along the lines of Table 5.1, which contains many of the concepts that are introduced, sorted according to the three polar types from the six ideal type regimes of the triangular conceptual space.

The chapter begins by introducing relational economics, which provide a general viewpoint for the analysis of the economies of the six ideal type regimes. The main point of relational economics is that state decisions follow from public and private actors’ relations, which can take legal forms—like formal lobbying—as well as illegal forms—like bribery and other kinds of corruption. Part 5.3 features a typology and analysis of different forms of collusion, including a corruption typology and a typology of corruption brokers. Also in the same part, we provide (1) a case study of Hungary with big data analysis for the transformation of corruption schemes (after a regime change from patronal democracy to patronal autocracy), (2) a critique of global corruption indicators, (3) description of the criminal ecosystem, that is, how (illegal as well as legal) public actors coexist with (authorized or unauthorized) illegal private actors, (4) an analysis of relation in communist dictatorships, including *blat* or the “economy of favors,” and (5) a culture-based explanation of lower-level corruption and relations (such as *guanxi* in China) in the post-communist region.

In Part 5.4, we deal with the question of state intervention. We provide a general framework for analyzing state intervention in regimes with private markets, from liberal democracy to patronal autocracy, and explain how regulatory and budgetary intervention differs in patronal and non-patronal systems. Discussing regulatory intervention, we elaborate on the methods of rent creation and rent-seeking in different regimes, whereas the discussion of budgetary intervention explains the normative and discretional functions of taxation and spending.

Part 5.5 is devoted to the question of ownership. We start with a necessary digression about the history of political reorganization of ownership structure in the post-communist region, after which we describe the various methods and motives of (regime-changing) privatization. This is followed by an explanation of predation, or taking of non-monetary private property for private gain, in the post-communist region in a property-rights framework, distinguishing exogenous and endogenous rights as well as the methods by which these rights are violated and/or distributed. Here, we also build on the existing literature on predation, especially Vahabi’s analysis of the “booty value” of targets that we expand in our analysis by introducing two new terms: ‘stalking value’ and ‘hunting value’ (referring to the respective phase of predation).

Finally, Part 5.6 provides a contribution to the literature on comparative economic systems. We identify the dominant economic mechanism of competitive markets, namely regulated market coordination (after Kornai), and we also distinguish two types of redis-
Table 5.1. Economic phenomena in the three polar type regimes (with the topics of the chapters’ parts).

<table>
<thead>
<tr>
<th>Liberal democracy</th>
<th>Patronal autocracy</th>
<th>Communist dictatorship</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RELATION</strong></td>
<td></td>
<td></td>
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<tr>
<td>relation between economic and political elites is voluntary (lobbying)</td>
<td>relation between economic and political elites is coercive (patronalism)</td>
<td>n.a.</td>
</tr>
<tr>
<td>interest representation</td>
<td>interest collusion</td>
<td>interest repression</td>
</tr>
<tr>
<td>voluntary corruption</td>
<td>coercive corruption</td>
<td>voluntary corruption</td>
</tr>
<tr>
<td>free-market corruption</td>
<td>criminal state</td>
<td>blat (with nomenklaturists)</td>
</tr>
<tr>
<td>system-destroying corruption</td>
<td>system-constituting corruption</td>
<td>system-lubricating corruption</td>
</tr>
<tr>
<td>no authorized illegality (only unauthorized) in the criminal ecosystem</td>
<td>authorized + unauthorized illegality in the criminal ecosystem</td>
<td>no authorized illegality (only unauthorized) in the criminal ecosystem</td>
</tr>
<tr>
<td><strong>STATE INTERVENTION</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>normative state intervention (minimum amplitude of arbitrariness)</td>
<td>discretionary state intervention (maximum amplitude of arbitrariness)</td>
<td>n.a. (central planning)</td>
</tr>
<tr>
<td>normatively closed markets</td>
<td>discretationally closed markets</td>
<td>n.a. (no private markets)</td>
</tr>
<tr>
<td>rent-seekers are interest groups</td>
<td>rent-seekers are patronal networks</td>
<td>n.a. (no private enterprises)</td>
</tr>
<tr>
<td>general + sectoral taxes</td>
<td>general + sectoral + discrentional taxes</td>
<td>n.a. (no tax revenue from the private to the public sphere)</td>
</tr>
<tr>
<td>active control mechanisms (neutral supervisory intervention)</td>
<td>disabled control mechanisms (weaponized supervisory intervention)</td>
<td>n.a. (bureaucratic coordination of the economy)</td>
</tr>
<tr>
<td><strong>OWNERSHIP</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>founded via regime-changing privatization</td>
<td>founded via post-communist ownership redistribution</td>
<td>founded via communist nationalization</td>
</tr>
<tr>
<td>hostile takeover</td>
<td>centrally-led corporate raiding (reiderstvo)</td>
<td>expropriation</td>
</tr>
<tr>
<td>de jure and de facto property rights coincide</td>
<td>de jure and de facto property rights do not coincide</td>
<td>de jure and de facto property rights coincide</td>
</tr>
<tr>
<td>normative intervention in exogenous property rights</td>
<td>discretionary intervention in exogenous property rights</td>
<td>no exogenous property rights (monopoly of state ownership)</td>
</tr>
<tr>
<td>buyers and sellers exchange at market value</td>
<td>predators and prey takeover at stalking, hunting and booty value</td>
<td>n.a. (normative expropriation)</td>
</tr>
<tr>
<td>private property</td>
<td>power &amp; ownership (vlast &amp; sobstvennost)</td>
<td>state property</td>
</tr>
<tr>
<td><strong>COMPARATIVE ECONOMIC SYSTEMS</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>market economy</td>
<td>relational economy</td>
<td>command economy</td>
</tr>
<tr>
<td>competitive market</td>
<td>relational market</td>
<td>administrative market</td>
</tr>
<tr>
<td>regulated market coordination</td>
<td>relational market-redistribution</td>
<td>bureaucratic resource-redistribution</td>
</tr>
<tr>
<td>capitalism</td>
<td>political capitalism (mafia capitalism)</td>
<td>socialism</td>
</tr>
</tbody>
</table>
5.2. Relational Economics as a Challenger of the Neoclassical Synthesis

Conceptualization of economic phenomena may be best done within the interpretative framework of an economic theory. Indeed, economic theories already describe such phenomena: economic models developed for certain predefined situations give a precise description of the processes and behavior of the actors involved. Even if their assumptions are not perfectly met in reality, models can still be illuminating in the sense that they can be used as approximations, or points of reference, to understand the general logic of economic phenomena. As statistician George Box put it, “all models are wrong, but some are useful.”¹ In this sense, models are basically like ideal types—from which it follows that, just as we have argued that ideal types nearer to the reality of post-communism should be used for it, we need to find the economic theory that is the closest in its assumptions to the region.²

Debating basic assumptions has been central to economic thinking since the second half of the 20th century. The starting point of economists was the “orthodox” neoclassical synthesis, which combined microeconomics (the analysis of individual economic actors and their market interactions) and macroeconomics (the analysis of nation-level economic phenomena and international trade) into a unified body of economic theory.³ Maintaining the micro-macro framework, a number of new, so-called heterodox schools of economic thought have appeared in economic literature in the last decades, questioning the axiomatic assumptions of the models of the neoclassical synthesis.⁴

¹ Box and Draper, Empirical Model-Building and Response Surfaces, 424.
² Finding an appropriate theory is also essential to economists who want to make economic analyses of the region. However, we want to make it clear that this chapter’s primary aim is not to be an economic analysis but creating unambiguous means of expression to perform such analyses [→ Introduction].
³ For a seminal work, see Samuelson, Economics.
The economic theory we are going to use is also heterodox. We call it “relational economics,” although we are, to the best of our knowledge, the first to use this term for a distinct school of economic thought. Moreover, the theories we include in it are usually not bundled together, in spite of that they indeed constitute a coherent challenger of the neoclassical synthesis. We may show this by situating relational economics, putting it alongside other heterodox schools of economic thought. For the purposes of our framework, it is not necessary to give a full list of schools but only of the ones in the same “league” as relational economics—ones that question one of the basic axioms of neoclassical synthesis. We may identify three such axioms, regarding (1) economic actors, (2) the market, comprised of the actors’ exchanges, and (3) the state (Figure 5.1).\(^5\)

Figure 5.1. Three challengers of the neoclassical synthesis questioning some of its basic axioms.

- **Behavioral economics** questions the neoclassical axiom about economic actors—rational choice. Simply put, rationality in economics means making the decision that yields maximum profit (involves minimum cost). The models of neoclassical microeconomics assume that people are rational because (1) behavioral deviations from rational decision options are random and, in the long run, they statistically equal each other out and (2) those who behave irrationally face losses

\(^5\) For a more detailed account on the subject, see Mearman, Berger, and Guizzo, *What Is Heterodox Economics?*
5.2. Relational Economics as a Challenger of the Neoclassical Synthesis

and are eventually driven out of the market, meaning irrational actors cease to be market participants and it is the rational actors who populate the market. Behavioral economics refers to psychology and argues that irrationality is not random but predictable, and the workings of the markets are generally defined by phenomena such as heuristics and cognitive biases (loss aversion, framing, anchoring etc.). Therefore, behavioral economics holds that the neoclassical axiom of rationality should be augmented with a view of so-called “bounded rationality” in economic models.

◆ Institutional economics questions the neoclassical axiom about the market—that exchanges happen on the basis of supply and demand. The neoclassical synthesis holds that whenever (1) a market participant has A and values it less than B and (2) another market participant has B and values it less than A, a voluntary exchange of A for B will happen between them. For the first participant will find transferring his lower-valued A for the higher-valued B beneficial, and vice versa, the other will prefer making the exchange of his lower-valued B for the higher-valued A to not making the exchange. Institutional economics argues this is not necessarily true, because of (1) the presence or lack of institutions (such as property rights, contracts, and social norms) and also (2) transaction costs, meaning anything that stands in the way of people making voluntary exchanges. Therefore, institutional economics holds that the neoclassical axiom that only personal preferences, or supply and demand, guide the allocation of resources should be augmented with a focus on existing and changing constraints that structure political, economic, and social interaction.

◆ Relational economics questions the neoclassical axiom about the state—that its role is to correct market failures. Following the principle of rationality, neoclassical microeconomics concludes that the state should intervene in free market exchanges only in cases of market failure, that is, when individual rationality does not lead to group rationality (if each individual makes the right decision, the group make the wrong decision). Common examples include pollution and the underproduction of public goods, such as streetlights and dams. Expanding the definition of market failure, macroeconomics adds that the state should intervene to correct nation-level failures such as economic recessions, inflation, and unemployment.

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6 Friedman, “The Methodology of Positive Economics.”
7 For popular accounts on behavioral economics, see Ariely, Predictably Irrational; Kahneman, Thinking, Fast and Slow; Thaler, Misbehaving.
8 We are indebted to Balázs Krémer for his help in summarizing behavioral economics.
9 Varian, Intermediate Microeconomics, 15–17, 582–90.
12 Friedman, “Market Failure.”
Relational economics holds that the prescription of where the state should step in disregards the actual workings of politics and falsely takes it for granted that the state, when it steps in, will implement the theoretically optimal policies economists have derived. Instead of assuming an “omniscient benevolent dictator,” relational economics argues that (1) politicians behave like anybody else and they are just as self-interested or not as economic actors, (2) their incentives are set according to the relations that public and private actors are in, and (3) policy decisions are made accordingly. Therefore, relational economics holds that the neoclassical axiom of analyzing the state as an institution of correcting market failures should be augmented with an analysis of the real processes and phenomena (relations) from which state decisions follow, as well as an examination of the effects of these decisions from the viewpoint of relations.

Besides the fact that they all challenge a basic axiom of neoclassical orthodoxy, these three heterodox schools share two further similarities. First, they all argue that neoclassical thought, committed to methodological individualism, has neglected the possibility that individual preferences and action may be influenced by groups, which should thus be subject to economic analysis, too. Second, and more importantly for our book, all three challengers call the attention to reality: the reality about market participants, the reality about social institutions structuring the market, and the reality about governmental actors. They call for incorporating these insights into economic theory to make it more relevant to empirical reality.

For the purposes of our framework, it is relational economics we find the most applicable to the post-communist region. This is not to say the other schools (or other heterodox schools we have not mentioned) cannot be used meaningfully in these countries. Rather, we claim that relational economics can provide most insights about the functioning of post-communist regimes. For the other above described branches of economics cannot deal with states subordinated to elite interest. Indeed, until we do not break away with the axiom of treating the state as a benevolent actor who corrects market failures and serves the public good, the very possibility of a state not running on the principle of societal interest is eliminated. And, as we explained in Chapter 2, states in the post-communist region (and the mafia state in particular) are often subordinated to the principle of elite interest, and ignoring that would make faithful definition of post-communist regimes impossible.

It may be objected that “relational economics” is an unnecessary neologism. After all, public choice theory already rejects the neoclassical assumption about the state when it argues that, for any product or service, the alternative of the free market is a “political

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14 Holcombe, “Make Economics Policy Relevant.”
17 No wonder these heterodox schools learn from each other: institutional economics incorporates the idea of bounded rationality, whereas relational economics relies heavily on the theory of transaction costs.
market” and it is a question of analysis whether the political mechanism will or will not produce the desired outcome that the private market did not produce. We will also use many existing theories about rent-seeking, regulatory capture, predation, and corruption. Why a new term, then? First, unlike public choice, relational economics is not concerned with the economic analysis of political processes—it is concerned with political analysis of economic processes. More precisely, what we are interested in is how an economy that is heavily influenced by the regulations and other interventions of the state works, and how this working differs in regimes with different degrees of separation of the spheres of social action. In a way, relational economics is a branch of political economy that marries comparative regime theory and economic analysis: the former describes the formal and informal relations of public and private actors in the six ideal-type regimes, while the latter is guided by this description in analyzing economic functioning.

Second, and more importantly, that relational economics identifies the common starting point of existing theories about rent-seeking, corruption and so on means that it puts them on a “common track,” situating them as starting points of a larger theory that can be developed further. In other words, “relational economics” is the overarching framework where theories developed for Western economies can be expanded for post-communist regimes, or for polities where the spheres of social action are not separated and the actors organize themselves in informal patronal networks. To be more precise, the theories of public choice have been developed in the U.S. and mainly analyzed Western governments, the political influence of big business, and the economic and social consequences of governmental favoritism. Conceptualizing the economic phenomena of the three polar type regimes, we can start from this literature on formal and voluntary relations and develop a corresponding analysis of informal and coercive relations in patronal regimes. Thus, vertical patron-client relations can be analyzed vis-à-vis horizontal non-patronal relations, allowing us to delineate the latter from the former and getting important insights about post-communist economies.

On the other hand, what we also include under the umbrella of relational economics is the rich literature on corruption. For the most important types of corruption result from illegal and informal relations, prevailing between formally political and economic actors. In the next part, we will explain the general forms of relation and provide a typology of corruption, starting from how it differs from non-corrupt relation-forming acts like lobbying.

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18 For a seminal work on the field, see Buchanan and Tollison, The Theory of Public Choice–II.
19 Indeed, public choice theory is closely related to the rational choice school in political science. See Dunleavy, Democracy, Bureaucracy and Public Choice.
20 For two works analyzing the same phenomena from different ideological standpoints, see Stiglitz, The Price of Inequality; Stockman, The Great Deformation.
5.3. Relation

5.3.1. General Definitions: Relation, Cooperation, Collusion

In colloquial language, “relation” is basically synonymous to connection. For the purposes of our framework, we introduce a narrower definition, excluding the phenomena that are outside the realm of relational economics:

- **Relation** is a kind of connection between people which is informal/illegal and/or involves people who are formally situated in different spheres of social action.

Although existing literature on relation is largely dispersive, not treating the fields we have bundled together as a distinct school of economic thought, Randall G. Holcombe’s *Political Capitalism* stands out as an important exception. Holcombe does not use the term “relational economics” but, constructing a theory of “political capitalism,” he lays its foundations. For his main contribution lies precisely in synthesizing such widely recognized fields as public choice and elite theory into a coherent economic theory, describing economic decision-making in general and why the state prefers certain groups over others in particular (see Box 5.1). Analyzing the United States and its developed system of lobbying, Holcombe points out that, in a liberal democracy of separated spheres of social action, there are good economic reasons why the economic elite cooperates with the political elite when it comes to policy-making. According to him, democratic societies are divided into two classes: “the masses” and “the elite,” the main difference being the transaction costs of participating in political decision-making. In a liberal democracy, the masses can have their interests represented by (a) electing dedicated politicians, (b) forming interest group organizations with lobbyists or (c) getting elected themselves. One can easily argue that, in such a regime, the people have the means and the incentive to participate if they feel their interests are not served, and eventually—in the vein of neoclassical market theory—an equilibrium set of politically active groups develops with non-represented interests constantly entering the political mainstream. But, as Holcombe points out, participation, that is, (a), (b) or (c) requires a large number of people to be mobilized and organized, each having little incentive to participate because (1) they have little to gain individually and/or (2) they have little impact on the outcome and, in case of interest group organi-

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**Box 5.1. The theoretical bases of relational economics.**

“The elite theory developed by sociologists and political scientists describes how elites are able to network to control political and economic institutions for their benefit, but elite theory does little to explain the mechanisms by which the elite are able to exercise this control. Public choice theory fills that gap through its theories of interest group politics, rent-seeking, and regulatory capture that describe the mechanisms the elite use. But public choice theory, which takes an individualistic approach to the analysis of political decision-making, does not identify the elite as those who are able to receive the rents and capture the regulatory agencies. Elite theory fills this gap, so taken together, elite theory and the public choice analysis of political processes explain both who benefits from the political process and the mechanisms they use to get those benefits. The building blocks for a theory of political capitalism are well-established in the social sciences.”


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organizations, get the benefits of successful lobbying regardless of their participation (free riding). Hence the masses are, according to Holcombe, a high-transaction cost group. In contrast, the elite is a low-transaction cost group because they are either politicians or members of the economic elite, a relatively small group of people, each of whom has much to gain from favorable regulations and whose individual participation carries greater weight in the lobbying process than that of a single citizen out of millions. The result is a system where whenever it is the question who to prefer and at whose expense, the elites make the decision and they benefit themselves, spreading the costs over the masses. “The economic elite,” Holcombe writes, “influence the government’s economic policies to use regulation, government spending, and the design of the tax system to maintain their elite status in the economy,” whereas “[the] political elite who implement those policies are […] supported by the economic elite, which helps the political elite maintain their status […] The elite cooperate to use their political and economic power to retain their positions at the top of the political and economic hierarchies.”

From the viewpoint of relations, there are three important aspects of this theory we need to observe. First, it is not a coincidence that we (as well as Holcombe) used the word “class” above, for in the market economy of liberal democracies the formation of the group of beneficiaries and the group of cost-bearers is a market phenomenon. Even if we reject Holcombe’s overreliance on transaction-cost economics and add that collective action and voting behavior are not a pure function of individual cost-benefit analysis, it remains clear that (1) the outcome, or which interest groups are formed and which ones are not, is the result of the voluntary decisions of the parties involved, (2) while “the masses” or unorganized groups have a chance to vote at the end of every term and elect who they want, organized interest groups can influence decision-making on a daily basis and spend more resources to do so than ordinary people, and (3) business groups have particularly great influence over democratic decision-making. Therefore, it follows the logic of the market, or an “invisible hand” process which groups of private actors will form stronger relations with the public sphere, or which ones can bend political decision-making more to their own benefit.

Second and closely related to the first observation, the relation of political and economic elites is voluntary, to the mutual benefit of the parties. Moreover, lobbying in liberal democracies is ideal typically legal and regulated, so the relation is made transparent to the public. Finally, the third observation we need to make on the basis of Holcombe is that the rewards of both elite groups serve the reinforcement of their formal positions in their separated sphere of social action. Simply put, although they cooperate, the actors do not enter each other’s spheres: entrepreneurs do not also become politicians and politicians do not also become entrepreneurs. The members of the economic elite, getting favorable regulations, do not become part of the political elite. True,

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24 Holcombe, Political Capitalism, 2018, 1.
25 For a seminal critique, see Green and Shapiro, Pathologies of Rational Choice Theory.
the economic elite has vast influence over policy-making, but even in an ideal type liberal democracy there can be institutions like the American Legislative Exchange Council (ALEC), where state legislators and private sector members collaborate on model bills that may be introduced for debate in state legislatures. For even in that case, governmental decisions are made not by major entrepreneurs but the politicians, who are free to reject the lobbyists’ and the interest-reconciliation forums’ offers, just as they (can) freely reject the influence of the non-elites. If they do accept the offers, that is a voluntary exchange of legislation for campaign contributions or (relatively minor) personal benefits, which are used in the political machinery and/or are not turned into productive capital or private economic units (companies etc.). Thus, the members of the political elite do not become part of the economic elite: there is connection between the spheres of social action, but they are separated.

This kind of voluntary relation that serves the reinforcement of the participants’ formal position in their separated spheres may be conceptualized as “cooperation.”

- **Cooperation** is a type of relation when an actor or group of actors de facto and de jure situated in the economic sphere and an actor de facto and de jure situated in the political sphere connect voluntarily and formally/legally.

Holcombe uses the term “collusion” for the cooperation of economic and political elites for mutual benefit. However, the voluntary relations he analyzes happen through lobbying, that is, a formal and legalized process. “Collusion,” in our understanding, implies relations that are more informal:

- **Collusion** is a type of relation when an actor or group of actors de jure situated in the economic sphere and an actor or group of actors de jure situated in the political sphere connect informally/illegally.

There are three principally important features distinguishing collusion from cooperation. First, the parties involved are situated in formally separated spheres that can be informally connected. Second, the relation between the two elites can be voluntary as well as coercive. In the case of voluntary transactions, the economics of the relationship is not unlike the situation described by Holcombe: both parties need to offer something of value to the other to make him voluntarily relate. In this case, the relation can be described as horizontal and non-patronal, where no party can force the other one into the exchange (free entry) or force him to continue to make the exchange (free exit). In the case of coercive transactions, however, the economics of the relationship is considerably different. For

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28 Greeley and Fitzgerald, “Pssst ... Wanna Buy a Law?” Also, see Pogátsa, “A neoliberalizmus politikai gazdaságtana” [The political economy of neoliberalism].

29 Holcombe, *Political Capitalism*, 2018, 78; Pogátsa, “A neoliberalizmus politikai gazdaságtana” [The political economy of neoliberalism]. 58–59. As for “relatively minor” benefits, Holcombe’s example is arranging a job offer for a family member in the lobbyist’s industry. This is obviously not comparable to the wealth poligarchs and their adopted political families amass (see Box 3.1 [⇒ 3.3.3]).

then it is solely the cost-benefit calculation of the aggressor that decides whether the relation comes into being. In this case, the relation can be described as *vertical* and *patronal*, where one party can force the other one into the exchange (*unfree entry*) and force him to continue to make the exchange (*unfree exit*). Indeed, in the case of coercive transactions, the relation of political and economic elites is an **extra-market phenomenon**, meaning it does not follow the logic of the free market. The formation of the group of those inside the network of beneficiaries is **not the result of an invisible hand process but of the visible hand of the patron**. If participants are related informally as well as coercively, the members of the economic elite become part of the political elite (see oligarchs [3.4.1]) and the members of the political elite become part of the economic elite (see poligarchs [3.3.3]).

### 5.3.2. Collusion and Corruption: A Typology

#### 5.3.2.1. Developing an analytical framework

As we already mentioned, relation and corruption are closely related. We use the definition of corruption provided in Part 2.4.4, that is, “the abuse of entrusted power for private gain.” Here, “entrusted power” means the powers formally vested in a state position, and they are “abused” if they are used for private gain (typically illegally). This may happen involving, or upon the request of, private actors, which means the collusion of public and private actors. Indeed, the result of collusion is, by definition, corruption. But corruption might happen without collusion, too, such as in case of embezzlement. However, while such cases of intra-sphere corruption can appear in the post-communist region, they are not ideal typically different from similar cases in Western regimes. It is precisely collusive corruption where ideal typical differences can be observed, because of the ideal typical difference in the level of separation of spheres of social action.

To model corruption, we need to perform on its definition a “sociological disaggregation,” that is, to identify its key elements and dimensions by which different types of corruption can vary. One such disaggregation is offered by Diego Gambetta, who understands corruption as a principal-agent problem. According to him, there are **three major actors** of corruption: the **truster** (T), who is the principal entrusting someone with power; the **fiduciary** (F), who is the agent entrusted with the power; and the **corrupter** (C), who initiates the corrupt transaction because he wants his private gain to be served by “certain resources that F is not supposed to deliver to him, given the conditions of his relation to T” (emphasis in original). In this framework, it is F who abuses his position for private gain, contrary to the wishes of his principal, T, who entrusted him with power.

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31 The analytical framework is used to establish a typology on the basis of the structure of corruption. For a functionalist typology (of part of the same phenomena we analyze), see Jávor and Jancsics, “Corrupt Governmental Networks.”


33 Gambetta, “Corruption: An Analytical Map.” For the seminal paper on the neo-institutionalist model of corruption, see Groenendijk, “A Principal-Agent Model of Corruption.”

(hence corruption is a principal-agent problem). The corrupter, as Gambetta explains, can be a different person from the fiduciary, such as in case of bribery when C bribes F to get his private gain served, or he can be the same person as the fiduciary (F=C), such as in case of the above-mentioned embezzlement when the entrusted actor abuses his position for his own private gain.35

While insightful, Gambetta’s framework does not deal with cases when a public actor is both a principal and an agent. Yet among the hierarchical ranks of state bureaucracy, only those on the very bottom are purely agents and only those on the very top can be purely principals.36 Everyone in between is the (direct or indirect) principal of those under him and the (direct or indirect) agent of those above him.

This leads to two problems because of which the variety of collusive corruption that is characteristic of the post-communist region cannot be described in a simple principal-agent framework. First, if we identify the corrupt actor as purely an agent and his direct superior as his principal, we take the case out of the context of the state within which the corrupt act happens. A contextual analysis should take into account that the actor is a principal as well as an agent, and place him on a level of state hierarchy accordingly. Without this, corruption is analyzed in an isolated manner and a comparative typology of corruption appearing on different levels of the state hierarchy becomes unattainable. Second and closely related, Gambetta’s framework rules out the possibility of network corruption as it narrows the focus to only three actors. Indeed, because of the hierarchical nature of the state, if F is not someone on the very bottom—a pure agent—but he is also a T, he can use his subordinates (his Fs) as servers to facilitate the corrupt transaction.37 In other words, we can say that this second weakness is none other but excluding the possibility that a truster can be a corrupter, too, such as in case of top-down types of corruption which are especially prominent in the post-communist region.

In theory, a more complex principal-agent model could encompass cases of state-level network corruption. In practice, we believe it would lead to a most transparent typology of post-communist corruption if we constructed a genuine analytical framework. Starting with the actors who take part in a corrupt transaction, we must take into account (1) private as well as public actors, given that we are interested in collusive corruption, and (2) the hierarchy between public actors. Thus, we may differentiate three general levels by the actors’ formal position: private actors, public administrators, and governmental actors. The two latter levels are both part of the sphere of political action, yet their differentiation is crucial. For public administration (bureaucracy) only implements the law, enforces it and takes part in the regular operation of state institutions, whereas governmental actors make the law and regulate the public administration.38 All the three general levels can be further divided into sublevels, but here the only distinction we shall make is between elite and non-elite actors. In general, we define elite and non-elite as we did at the beginning

36 But in case of democratic regimes, they indeed are agents as well—agents of the people who elect them as representatives. See Katz, “No Man Can Serve Two Masters.”
37 Cf. Jávor and Jancsics, “Corrupt Governmental Networks.”
38 Hence the differentiation of “administrative corruption” and “state capture” in the literature of corruption. See Knack, “Measuring Corruption,” 256.
of Chapter 2 [→ 2.2.2]. In particular, elite and non-elite in the certain levels should be understood as follows:

- **among private actors**, non-elite means the ordinary citizen or small and medium sized enterprises, whereas elite means major entrepreneurs or oligarchs;

- **among public administrators**, non-elite means the administrators whose task is to be in direct, day-to-day contact with private citizens, whereas elite administrators are the bosses of the non-elite administrators (i.e., the heads of governmental departments or leaders of state organizations who regularly remain in the background from the citizens’ point of view);

- **among governmental actors**, non-elite means regular members of the legislation or the regulatory body of a local government who are not part of the executive branch, whereas elite means the executives of national or local government, like a mayor, the prime minister or the president.  

In terms of Gambetta, private actors can only be corrupters (C), non-elite public administrators can be corrupters and fiduciaries (C and/or F), and all the other actors can be corrupters, fiduciaries and trusters (C, F and/or T). In terms of the spheres of social action, “the elite of private actors” is largely synonymous to “economic elite,” although it may include elite actors from the sphere of communal action as well. Also, the private non-elite includes the market as well as the communal non-elite (such as citizens). As for the public sector, governmental actors comprise the political elite and public administrators, the non-elite.

From our definition of collusion, it follows that the second aspect a framework for collusive corruption must assess is the **types of informal/illegal connections** between the actors. Here, we have **three dimensions** by which we can classify. First, by **the actor’s role** in corruption: he can be either (a) the **demander**, who initiates the corrupt transaction; (b) the **supplier**, who abuses his public position; or (c) the **server**, who works for either party with the task to carry out and/or facilitate the corrupt transaction (often as an agent of the supplier). Again, in Gambetta’s terms, the demander is C, whereas the supplier and the server are indeed two types of F: the supplier is the F who enters into the corrupt relation voluntarily, whereas the server is the one who is instructed by his T.  

Also, incorporating Gambetta’s point that F can be the same as C, we need to acknowledge that one actor is not necessarily confined to a single role but can be both the demander and the supplier. This is the case when someone uses his public position to develop a corrupt network, whereby corruption is monopolized on the given level (those under the corrupt public actor are instructed to act in corrupt ways but are not allowed to satisfy any corrupt demand for their own private gain).

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39 In a liberal democracy, elite governmental actors also include the non-MP leaders of the governing party.

40 We do not include trusters *qua* trusters in our model explicitly because if corruption is a principal-agent problem and the fiduciary corrupts his position against the will of the truster, then that means that the truster is not part of the corrupt network in question. (And if a truster is part of it, then he is either a demander, supplier, or a—higher level—server.)
What suppliers “supply” (and demanders demand) is discretional treatment from state institutions, which should legally be normative and treat every person the same. Discretional treatment may result in (a) direct benefits, such as getting a license or winning an overpriced public procurement tender, in which cases the supplier gives the benefit in a single step by disregarding the legal requirements of such benefits, or (b) indirect benefits, when an influential (e.g., elite governmental) actor makes someone else to provide the benefit to the demander. Crucially, among indirect benefits one service that suppliers offer is krysha [→ 3.6.3.1], which in this context refers to disabling control mechanisms on a discretional basis. In other words, the supplier—especially in higher forms of collusive corruption—offers cover for the corrupt acts, whereby he ensures that control actors, like local inspectors or the police, disregard their legal duties and turn a blind eye to illegality. (Indeed, krysha can also be a direct benefit if it is the control actor who is bribed.)⁴¹

Going back to developing our framework, its second dimension is the regularity of connection. From this respect, corrupt transactions between certain actors can be made occasionally, negotiated case-by-case, or permanently, meaning a longer-term relationship involving a number of consecutive transactions. Finally, we must differentiate, as we have explained above, voluntary and coercive relations. Coercive relations in the analytical framework can also be dubbed as subordination or patronal relation (or patronal subordination), whereby (1) the will of one party (the patron) trumps that of the other (the client) in the transaction and (2) there is no free exit from the relationship, in the sense defined above.

5.3.2.2. Voluntary corruption: free-market corruption, cronyism, and state organization collusion

Having defined both the actors and the types of connections between them, we can draw up the analytical framework. In the following six figures (Figure 5.2–7), the set of circles represent the actors of an ideal type regime and, with fillings and arrows, we attempt to capture ideal typical corruption patterns, that is, actors of which level are in what connection with each other. These schematic depictions should not be understood in an exclusive manner: saying, for instance, that in free-market corruption must be an elite private actor who is connected to two non-elite public administrators (because that case is being depicted). Rather, these are to be seen as examples of the given corruption pattern, demonstrating the typical structure and forms of transactions belonging to it. Another crucial point is that we do not define the scope of corruption patterns in advance. That is, each corruption pattern may be typical to different parts of a country with different intensity. For the purposes of our description, we will explain how these patterns may appear (1) locally, in one institution of the regime, and (2) countrywide, meaning the pattern dominantly characterizes all exchanges among the given types of actors in the regime. (A more detailed description should deal with the aspect of scope of corruption as a variable, whereas (1) and (2) are two endpoints of a scale.)

Using the analytical framework, we define six types of collusive corruption. This part is devoted to the three voluntary types, the first of which is free-market corruption (Figure 5.2):

⁴¹ Ledeneva, How Russia Really Works, 86.
- **Free-market corruption** is a type of corruption where private actors collude with non-elite public administrators, and they carry out corrupt transactions voluntarily and occasionally. While the collusion may be initiated by either party, the corrupt transaction is initiated (demanded) by the private actor, and it is supplied by the public administrator.

In the case of free-market corruption, private interests hold an illegitimate sway in state and local government decisions concerning the allocation of resources, procurements, concessions, and entitlements. As a result, illegal barter deals are concluded between discrete private actors and non-elite, everyday administrators of state bureaucracy (office clerks, policemen etc.). Free-market corruption consists of a **series of individual phenomena**: an official responsible for a decision accepts or requests financial or other benefits for handling a case in a manner advantageous to the private actor. A state may be considered “corrupt” if there is a high occurrence of such incidents [→ 2.4.4], or if civil administrative or business matters can only be managed through bribes. It is this case when free-market corruption is countrywide, instead of remaining only local. However, it must be noted that, even if the pattern appears countrywide, these actions of free-market corruption are **occasional**, that is, happen case-by-case when one decides to take part in a corrupt transaction and are not organized as a group function on either side. Instances of free-market corruption are also **voluntary** on both sides of the deal. From this respect, it is immaterial whether the bribes are requested by members of the public administration or they are simply willing to accept them. As the definition states, the corrupt service is being supplied by members of the public administration, abusing their position, whereas the private actors accepting it are in demand of such transactions. Both parties are free to reject the offer for corrupt service, although an honest private actor may find himself in a disadvantaged position vis-à-vis corrupt private actors if he does so (especially if the pattern is countrywide).

*Figure 5.2. Schematic depiction of free-market corruption.*
The term “free market” in the name of this pattern partly refers to the voluntary transactions between the people involved \[\rightarrow 2.6\] and also to the fact that corrupt opportunities are not restricted to a specific group of people. Indeed, free-market corruption can be characterized as “open access,” meaning that anyone with the right amount of (monetary) resources can enter such corrupt relationships. Furthermore, open access results in competition with free entry. Where both corrupt supply and demand are numerous, private actors can compete in the amount of bribe they offer; and the public actors, in the amount they ask.\[42\] In more monopolistic examples, like that of a public procurement tender, only private actors can compete and the public actor can reap higher rents. Naturally, the illegal nature of such transactions constitutes a structural hole between corrupt supply and demand which often necessitates a corruption broker, who makes a functioning corruption market possible \[\rightarrow 5.3.3.2\].\[43\]

**The second pattern of voluntary corruption** is cronyism (Figure 5.3):

- **Cronyism** is a type of corruption where elite private actors collude with elite public administrators or governmental actors, and they carry out corrupt transactions voluntarily and occasionally or permanently (sometimes involving public administrators and non-elite private actors as servers). While the collusion may be initiated by either party, the corrupt transaction is initiated (demanded) by the private actor, and it is supplied by the governmental actor.

![Figure 5.3. Schematic depiction of cronyism.](image)

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\[42\] Diaby and Sylwester, “Corruption and Market Competition.”

\[43\] Jancsics, “A Friend Gave Me a Phone Number.”
In our understanding, “crony” is a specific person who is in informal voluntary relation with an elite public administrator or a governmental actor, who decides to give his crony preferential treatment in the competition for state positions or favors. Indeed, the meaning of the word “crony” in English is close to that of “friend” or “pal,” which implies no subordinating or patron-client relation whatsoever. The informal voluntary relation may have been formed before the concrete corrupt transaction, such as in case of longstanding friends, family members or corrupt business partners. In such cases, we can use the term “nepotism” as a specific subtype of cronyism. However, there are non-nepotistic cases of cronyism as well, when the relation is formed for one occasion between the private actor and the governmental actor. In either case, the definitive feature of cronyism—which will distinguish it from state capture—is the relation’s voluntary nature. In a sense, cronyism is an alliance of equals, a “client-client relation” where, even if the given people do collude for private gain numerous times, no party can force the other to continue to make such deals in the future. If we talk about cronies, that means no chains of dependency from either side (that is, no patronal relation) is formed between the parties. Both parties enter the relation voluntarily, for their own benefit, and they may exit from it freely if they find that option more beneficial.

When cronyism is local, happening with one governmental actor or institution, it also tends to be occasional. Even when the relations between participants have a history, they use this accumulated social capital to carry out corrupt transactions case-by-case, without beginning to show the signs of a more regular nature. However, as cronyism starts spreading and becoming more and more dominant countrywide, corrupt relations can also become permanent as they are systematized by a network of cronies. In his book Informal Politics in Post-Communist Europe, Michal Klíma analyzes such situation in the Czech Republic in depth. According to him, Czech political life is characterized by mutually beneficial alliances between major entrepreneurs and party members (though not complete parties), who both act by the principle of power centralization and personal-wealth accumulation. Creating informal networks that enmesh the political sphere in a bottom-up fashion, such crony networks realize a collusion of spheres as political actors become definitive in market action and economic actors become definitive in political action—although not as thoroughly as in case of a mafia state (see Box 5.2).

In essence, cronyism is similar to free-market corruption, the main difference being that cronyism reaches higher levels of the sphere of political action, including elite public administrators and governmental actors. In the case of free-market corruption, it is the direct decision-maker who is approached: for example, the one who decides to whom to sell a property or to whom to give a public tender. In the case of cronyism, the one who decides which property is for sale or in what project should public tenders be published is approached. The crony and his political associate are in different segments but at the same level of social hierarchy: they are both influential in their walks of life, and they decide to use their positions to collude with each other for mutual benefit.

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44 Cf. Khatri, Tsang, and Begley, “Cronyism.”
45 “Crony.”
The further difference between free-market corruption and cronyism is the occasional systematization, as well as the appearance of servers in the corrupt transaction. Governmental actors can use the public administration that belongs to them in carrying out cronyism, ordering them to treat certain people preferentially. It is typically elite public administrators who are in direct connection with the governmental actors and they may use their subordinates, that is, non-elite actors of the state apparatus, to facilitate the corrupt transaction. Such misuse of formal and legal vertical connections turns them into illegal subordination, where the elite public administrator carries out the will of the governmental actor and non-elite public administrators, the will of their elite bosses.

In scholarly as well as colloquial speech, “cronyism” is sometimes used to point out that the state uses its powers to serve special interests, as a consequence of lobbying. On the one hand, the comparison is understandable, because both cronyism and lobbying involve elite private actors who form voluntary relations with actors of the sphere of political action. On the other hand, cronyism is dissimilar to lobbying because cronyism is based on informal/illegal relations and transactions, and it involves preferential treatment of certain people, not certain industries or interest groups.

The final pattern of voluntary corruption is state organization collusion (Figure 5.4):

- **State organization collusion** is a type of corruption where elite administrative actors (leaders of state organizations) collude with private actors, and they carry out corrupt transactions voluntarily and regularly (using non-elite public administrators as servers). Both the collusion and the corrupt transaction are initiated (demanded) by the administrative actor, and he is also the supplier.

As opposed to free-market corruption, where the demander and the supplier of corrupt service are in different spheres of social action, in the top-down case the roles of supplier and demander are merged. For it is the elite administrator who abuses his office, and he does it for his own gain. More specifically, such cases usually involve most or all members of the board of a state owned enterprise, deciding to “illegally ‘sell’ the resources of their own organization. In order to manage this process smoothly, they need to develop internal informal networks. Organizations captured by these local elites ‘eat up’ their own resources,

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which significantly reduces their effectiveness and efficiency. [...] **Elite members** of such corrupt arrangements have strong decisional power to **choose suppliers and other business partners** of the organization. The most typical way to siphon resources off the system is by **receiving kickbacks** from these partners in return for approving overpriced orders” (emphasis added). Such arrangements cannot constitute countrywide networks— unlike cronyism—but always contain local networks, although the arrangement itself can be widespread if it characterizes most organizations of the (corrupt) state.

The **private actors** who are involved in the corrupt transactions **collude voluntarily with state organization actors** who give them the overpriced orders, whereas their relation is **regular**. For the heads of state organizations create a **scheme** by which they can systemically funnel the budgetary resources of their organization to private hands. Typically, such schemes can work for a longer period than similar schemes could in private enterprises, as a result of the so-called soft budget constraint of state organizations, whereas it is constantly threatened by internal and external control agents of the state. **Deactivation of control mechanisms** for as long as possible is one of the key components of sustaining corrupt networks and that is achieved by the perpetrators of state organization collusion in a number of ways, including bribery and “technicization.” As Jancsics explains, with the help of experts like “the organization’s middle-level professionals, lawyers, accountants, engineers, and economists” organizers of the corrupt network can custom-tailor tenders, so that only the targeted private actor will be suitable to win [→ 4.3.4.2]. Jancsics offers an example from Hungary, a 2009 call for tender of the tax authority that intended to buy cars for the organization. As he writes, the tender documentation “included a complicated

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49 Kornai, “The Soft Budget Constraint.”
description of the cars’ required parameters […]. The conditions were perfectly tailored to a specific model of one particular carmaker.\footnote{Jancsics, “From Local Cliques to Mafia State,” 134.}

5.3.2.3. Coercive corruption: bottom-up state capture, top-down state capture, criminal state

While voluntary corruption is an important phenomenon in the post-communist region, informal ties of relation there tend to be organized into 	extit{patron-client patterns of subservience}. Dominant actors subordinate other actors on the levels below them, creating informal networks which take over formal institutions and use them as façades. It is such cases of coercive corruption, involving patronal subordination that we classify below.

In line with existing literature, we use the general term “capture” in the context of coercive corruption as follows:

- **Capture** is a form of corruption, involving collusion of a coercive nature with only a part of the capturer’s sphere of social action. In other words, capture refers to partial cases of coercive corruption only.

In corruption literature, “capture” refers to the illicit and illegitimate subordination of state functioning to special interests of economic elites.\footnote{“Anticorruption in Transition,” 3.} Putting it in context, we redefine capture in three ways. First, as the etymology of “capture” suggests, there must be someone in the process who is captured, that is, whose will is being coercively dominated by the capturer. Hence, we narrow the definition to coercive corruption. Second, we differentiate three types of capture, including ones that are not initiated or demanded by the economic elite, being usually presumed by those using the term “state capture.”\footnote{TI, “Corruption Perceptions Index 2017—Full Source Description.”} Finally, we add to the definition of capture that it is always partial. For, on the one hand, the lack of this limit would result in a confusing situation where almost any autocracy or dictatorship that replaces a democratic establishment could be described as state capture.\footnote{True, capture must also be informal/illegal by definition because it involves collusion, but even this criterion is met by several autocratic turnovers that break legal continuity or override much of the existing legal corpus.} On the other hand, we also want to avoid the conflation of the case when oligarchs capture certain parts of the state with the case when the single-pyramid patronal network of an adopted political family turns the entire state into a criminal organization.\footnote{For an example of such conflation of terms, see Innes, “The Political Economy of State Capture in Central Europe.”} Theoretically, the latter case might be labelled as a “full capture” and former case, as “partial capture,” but practically it should result in a clearer and firmer distinction between the two situations if the definition of capture is narrowed down to partial cases beforehand.

The main dimension by which captures can be differentiated is the **direction of the capture**. By this aspect, we can distinguish (a) bottom-up capture, where the demander
of corrupt transaction is in the private sector, and (b) top-down state capture, where the
demander of corrupt transaction is in the public sector.

We are going to describe three types of coercive corruption, the first of which is
bottom-up state capture (Figure 5.5) which is simply referred to as "state capture" in the
literature:

- **Bottom-up state capture** is a form of corruption where elite private actors collude
  with elite public administrators or governmental actors, and they carry out cor-
rupt transactions coercively and occasionally or permanently (sometimes involving
public administrators and non-elite private actors as servers). The collusion and
the corrupt transaction are both initiated (demanded) by the private actor, and
supplied by the governmental actor.

In the case of bottom-up state capture, the actors’ cooperation becomes more complex not
only on the side of corruption supply but also on the side of corruption demand, given
that the corruption partners from the private sector are **oligarchs or crime bosses** of the
organized underworld. Although both of these types are included in the economic elite as
well as the private sphere, a distinction must be made between them. A crime boss of the
organized underworld mainly operates illegal economic activities (drug trade, prostitution,
oil bleaching, extortion, protection racket etc.) under illegal conditions. He stands in con-
fusion with representatives of public authority and seeks to draw them under his influence
by illegitimate means (bribery, threats, blackmail and occasionally physical violence). The
oligarch of post-communist systems seeks to secure illegal support for otherwise legal eco-

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55 For a seminal article, see Hellman, Jones, and Kaufmann, "Seize the State, Seize the Day."
nomic activity by means of corruption. Indeed, on the basis of this distinction, we may distinguish criminal state capture—the type of bottom-up state capture that is carried out by a crime boss—and oligarchic state capture—the type of bottom-up state capture that is carried out by an oligarch.

Bottom-up state capture is the coercive counterpart of cronyism, where corruption vertically reaches the higher levels of the public sphere and permanently subordinates political actors to the economic elite. Subordination may happen as a result of blackmail or extortion; or the political actor can also sell himself (or the powers vested in his formal positions) to subordinate service for a lump sum. It may be objected that in the latter case, the entry into collusion is voluntary. But as a result of it, the public administrator (such as a police chief or a state enterprise leader) or the governmental actor (such as a politician) cuts off his option to free exit because the private actor can coerce him into the exchange via blackmail, threatening the public actor to publicize his corrupt behavior. Therefore, from that point onwards he must use his formal powers according to the wishes of his “owner” regardless of whether he agrees with him or not. And as we understand free exit as a key component of voluntary relations, we regard the corrupt transactions resulting from such informal contracts coercive.

The situation described in the previous paragraph highlights also that bottom-up state capture can be permanent (as well as occasional). This leads us to another differentiation between bottom-up state capture and the influence of large state firms, often inherited from communist times and also having a permanent and sometimes exploitative relationship with governmental actors. The main difference is precisely the momentum of collusion: we can speak precisely about relation between different spheres of social action because there is no formal tie of ownership between the state and the captor oligarch. In the case of large state firms, there are formal ties: the firms themselves are operated by public administrators and therefore their activity might be a special case of intra-state lobbying or non-collusive corruption.

The servers of bottom-up state capture enter on both the private and the public administration level. As for the former, servers are subcontractors or suppliers of the oligarch who are in occasional and voluntary business relations with him (and, accordingly, they are also beneficiaries of the oligarch’s illegitimate market position). Public administrators are in a subordinate position to governmental actors because they are state employees and can be removed if they fail to comply with the formal rules (laws) or the informal commands of the captured politicians. Yet it is important to underline that even if there are permanent chains of patronal vassalage and not only locally but countrywide, state capture will remain partial: it will be composed of a high number of separate captures, not

57 Klíma argues that what we call cronyism is “an instrument for pursuing the seizure of the entire state in terms of incremental control of the main pillars of the political system. Only then can the ultimate goal be accomplished, i.e. to exploit state resources at all levels and cement the holding of political power. In other words, party capture is a fundamental element and a precondition for the development of full-scale state capture.” Yet Klíma distinguishes state capture by scope rather than the feature of coerciveness: cronyism may become countrywide, but it will not become state capture in our terms until it also becomes coercive (which it may). Klíma, Informal Politics in Post-Communist Europe, 26.
a full appropriation of the state by an informal network [→ 2.4.4]. Under such circumstances, pluralism prevails and political competition may still continue. The transfer of political power is still possible under constitutional circumstances, and the economic elite also maintains its relative autonomy as none of its members are indefinitely tied to certain political actors [→ 3.4.1.3].

The second type of coercive corruption is top-down state capture (Figure 5.6):

- **Top-down state capture** is a form of corruption where governmental actors collude with economic actors via the public administration, and they carry out corrupt transactions coercively and occasionally or permanently. Both the collusion and the corrupt transaction are initiated (demanded) by the administrative actor, and he is also the supplier.

Top-down state capture can be initiated by a single actor—such as a mayor of a municipal government—or by a group of actors—such as a party. In either case, patronal subordination extends primarily to people in the public administration and secondarily to economic actors. This implies a sequence of events: firstly, a person or a group enters the sphere of governmental actors; secondly, they patronalize that institution to be able to dispose over its public (coercive) instruments in a discretional manner; and thirdly, this power is used to patronalize certain economic actors. Naturally, there are economic actors who enter such relationships voluntarily, and those with activities not specific to the captured part of the public administration (a local government, certain ministries etc.) can decide not to enter into voluntary relations. As for those whose activity is specific, however, they need to accept the conditions set by the local patrons.

As a part of public administration is turned into a racket by its leaders (top-down), the hierarchy of their domain is filled up with their clients, resulting in patronalization.

Figure 5.6. Schematic depiction of top-down state capture.
The captured part of the state apparatus begins to be operated by the informal patronal network, systemically working by informal rules over formal ones.

Still, top-down state capture faces several limitations due to the fact that no patron possesses unconstrained political power in the entire polity. This limits every patron's ability to use the instruments of public authority: they can rule over only a certain part of the state, limited to its formal competences, and cannot patronalize other parts.\(^59\) First, this makes linked actions of corruption, where the cooperation of several state institutions would be necessary, less attainable. Second, the patron's position is dependent on political turns. An opposition victory can easily remove him, making it practically impossible to sustain his patronal network any further. This is particularly true in post-communist countries where the competition of political parties is often the facade for the competition of patronal networks [\(\rightarrow\) 3.3.7]. Finally, the lack of a power monopoly means the patron can hardly disable institutional checks. Constitutional limits on power concentration as well as effective law enforcement have the ability to contain informal networks and prevent the patron from wielding exclusive political power and making the entire state his private domain.\(^60\)

For the last type of coercive corruption, we borrow concepts from a phenomenon we have already defined—the criminal state. The difference is that the criminal state means the given pattern characterizes the entire country, while the criminal state pattern (Figure 5.7) may appear only locally as well:

- **Criminal state pattern** is a form of corruption where elite governmental actors collude with elite economic actors by using the entire public administration under them, and they carry out corrupt transactions coercively and permanently. Both the collusion and the corrupt transaction are initiated (demanded) by the administrative actor, and he is also the supplier.

The main difference between top-down state capture and a criminal state is the possession of unconstrained political power in a given territory. For with this power, a top patron can disable checks and balances and turn the (central or local) government into the business venture of his adopted political family. In Gambetta's terms, this is the only system where the roles of the truster, fiduciary and corrupter are merged in the person of the chief patron and there is no “innocent” ultimate truster or central authority above him. This sharply contrasts with state capture, which—following its partial nature—always implies the presence of an uninvolved ultimate truster on the top (who is betrayed by his fiduciaries).

Unlike the previous cases, where we distinguished local and countrywide scope of each pattern, we can distinguish three forms of the criminal state pattern by their scope. First, there is the local case, when the elite governmental actor is a mayor and he patronalizes a whole local government, turning it into a racket which is practically a “state in the

\(^{59}\) Illustrative is the case of Zhou Yongkang, who built a racket within the Chinese state step-by-step as he gained higher and higher formal positions and could patronalize more and more parts of the state administration accordingly. See Zhu, “Corruption Networks in China: An Institutional Analysis,” 36–39.

\(^{60}\) Hale, “Formal Constitutions in Informal Politics.”
state.” The famous—though not post-communist—example of a **geographically limited patronal racket** is the case of Kevin White, the mayor of Boston for sixteen years (1968–84) who established a criminal state pattern in his municipality by patronalizing virtually all levels of Boston's local government. Second, the criminal state pattern can be **countrywide when many local governments are turned into such patronal rackets**, becoming the dominant form of sub-sovereign governments in the given polity. Arguably, present day China features numerous sub-sovereign kleptocratic and mafia states, representing the criminal state pattern of corruption and eventually posing the risk of “mafiafication” of the party state [→ 5.6.2.3]. Finally, the criminal state pattern can **characterize the central government**, when it is the chief patron of the country who achieved a power monopoly and carries out a full appropriation of the state. This is what we originally called a criminal state, which is also one facet of the mafia state in patronal autocracy [→ 2.4.5].

**Figure 5.7. Schematic depiction of the criminal state pattern.**

<table>
<thead>
<tr>
<th>Governmental actors</th>
<th>Elite</th>
<th>Non-elite</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public administrators</td>
<td>Elite</td>
<td>Non-elite</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private actors</td>
<td>Elite</td>
<td>Non-elite</td>
</tr>
<tr>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

- Demander of corruption
- Server of corruption
- No role

- Regular transaction
- Occasional transaction
- Voluntary transaction
- Subordination

**Note:** All governmental actors are subordinated to the chief patron, that is, the head of executive. We decided not to represent every governmental actor with circles for the sake of clarity.

The criminal state is built by the development of a single-pyramid patronal network. First, **actors of the public administration are deprived of their autonomy to make corrupt offers** to private actors or to accept bribes in exchange for favorable treatment. Instead, they are subordinated to the chief patron's will and treat favorably those who are designated from above, that is, the clients of the chief patron. Second, a single-pyramid means that the multi-pyramid scheme, which characterizes the politically competitive landscape of top-down state capture, comes to an end. When a regime is characterized by the criminal state pattern of corruption, that implies that political opposition, including formal parties

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61 Schabert, *Boston Politics.*
and NGOs, have been neutralized and essentially turned into what all formal institutions are for the informal network: façades.

Third, the building of the single-pyramid network extends to the private sector as well, subjugated by the legislative and regulatory means the chief patron now disposes over. Drawing upon his monopoly of power, the chief patron breaks the autonomy of major entrepreneurs and oligarchs aiming to discipline, domesticate and settle them into his own chain of command [⇒ 3.4.1.4]. A network of subcontractors and suppliers extends this patron-client relationship to the lower reaches of the private sector as well, which also means protection monies are collected from both elite and non-elite private actors [⇒ 6.2.2.2].

5.3.3. Corruption Types in Comparison: General Dimensions and a Case Study for the Transformation of Corruption

5.3.3.1. Separation of the spheres of social action and other dimensions
A summary of the main characteristics of the six types of corruption can be seen in Table 5.2. We added the dimension on the nature of corruption to the table which, based on existing corruption literature, extends a continuum from the small-scale, low-value transactions of private actors and non-elite members of the public administration in free-market corruption—that is, petty corruption—to the large-scale, high-value transactions of governmental actors in a criminal state pattern—that is, grand corruption.62

It may be objected that cronyism can also be “grand corruption,” just as bottom-up state capture, whereas state organization collusion does not necessarily involve a higher amount of corrupt monies than cronyism. Our first answer to this objection is that our description is ideal typical, which means it does not aim at giving precise description for every case but points of reference for the analysis of those cases [⇒ Introduction]. The reason we believe state organization collusion ideal typically entails grander corruption than cronyism—our second answer—is that state organization collusion is systemic, whereby stable channels to funnel budgetary resources to private hands are built over an entire organization.

This leads to an important distinction. In corruption literature, “systemic” is used synonymously with “endemic” and refers to “corruption integrated as an essential aspect of the political, social and economic system.”63 This understanding, however, obscures the difference between cases when corruption is widespread and cases when corruption is made a system by an organizer from the top. For example, the former case can be socially accepted forms of free-market corruption, such as “gratitude money” in most of post-communist countries in Eastern Europe (doctors and nurses in state healthcare are regularly

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62 We are indebted to József Péter Martin for calling our attention to this aspect. Also, see Transparency International’s definition of grand corruption in TI, “What Is Grand Corruption and How Can We Stop It?” Cf. Moody-Stuart, Grand Corruption.

63 Beke, Cardona, and Blomeyer, “Political and Other Forms of Corruption in the Attribution of Public Procurement Contracts and Allocation of EU Funds,” 27.
given extra money, without which one can barely get decent service). These transactions are scattered, made occasionally and they are face-to-face, with each pair of actors making corrupt transactions without being part of a corruption network. It is crucial to distinguish such cases from state enterprise collusion, bottom-up and top-down state capture, and the criminal state pattern. For in those types, corruption is systematized by someone, that is, organized as a group function or network with permanent relations and a complex corruption scheme. Hence, it is worth making the following differentiation:

- **corruption is endemic** if it becomes a social norm—that is, an informal understanding that governs the behavior of social actors—without the organizing action of a central will and resulting in a large number of occasional transactions between various people;

- **corruption is systemic** if it is developed into a scheme—that is, a corrupt machinery of permanent relations—due to the organizing action of a central will and resulting in regular transactions between certain people.

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64 Kornai, "Hidden in an Envelope: Gratitude Payments to Medical Doctors in Hungary"; “Patients Bearing Gifts.”
If we want to define opposites for endemic and systemic, we may use the terms “sporadic” and “non-systemic,” respectively. As Jean Cartier-Bresson explains, in cases of non-systemic corruption “there are no rules of the game and the exchange is unstable by nature and leads to bargaining directed by impersonal agents who do not know each other. In such conditions, there is strong uncertainty about the price of the corrupt transaction and uncertainty about the result.”

In contrast, in systemic cases corruption is elevated into “a political, economic and social exchange. The organization of corruption by social networks then prevails and enables a real institutionalization of procedures.”

Another feature that appears in Table 5.2 is the medium of corrupt exchange. Here, we need to differentiate two dominant types of payments: bribe money and protection money.

- **Bribe money** is the payment, monetary or otherwise, that is given informally and voluntarily in exchange for the supply of a corrupt service.

- **Protection money** is the payment, monetary or otherwise, that is given informally and non-voluntarily upon the extortion of a patron.

Bribe money may include any kind of bribes or kickbacks, paid regularly in free-market corruption and cronyism. Protection money is extorted from the subordinated servers in the private sector and the public administration, who may not receive any extra payment for facilitating corruption but are not fired from their job or are not prosecuted in politically selective law enforcement. While bribe money involves primarily monetary transactions, protection money in top-down state capture or a criminal state pattern involves primarily favors, fulfillment of specific duties, by the subordinated actors.

This leads to the time dimension of corrupt exchanges. In free-market corruption, collusion ends with the corrupt act, whereby both participants are paid off. In a successful case, the private actor has been given the corrupt service and the public administrator, the bribe. In cases of cronyism, payment for the parties does not need to happen at the same time. Indeed, the literature notes that the relation between cronies can usually be described by reciprocity, involving “an act by party A to give something of value to party B without knowing when or if B will reciprocate, or to reciprocate an earlier favor given by B.”

Thus, cronyism can be understood as mutual investment in favors, given and accepted voluntarily by both parties. In a criminal state pattern, the situation is different because it is characterized by patron-client relations, where clients are coercively subordinated to patrons. In a developed single-pyramid patronal network, the “payment” of a front man, in form of companies which are de jure given to him, is not reciprocated immediately to the chief patron. But as the chief patron has de facto power over the front man’s property, he can dispose over them at a later date.

Closely related to this are the dimensions of autonomy—which refers to the free entry of the participants into corruption—and dependency—which refers to the exit options
of corrupt participants. When corrupt transactions are occasional, as they are in voluntary forms of corruption, autonomy of actors is fully retained and no chains of dependency are formed. In cases of regular transactions, there is a higher chance of dependency, especially because the more illegal acts are committed, the more the parties can blackmail each other, forcing them to continue to make corrupt exchanges. Also, coercive collusion immediately implies dependency, for there even the entry of one of the participants was involuntary. As for autonomy, the partial nature of captures allows some participants to retain a relative autonomy, a bargaining position and a competitive edge. But in a criminal state, the chief patron is the monopolist of autonomy. This means that, first, he is the only one who de facto answers to nobody in the polity and, second, who can delegate partial autonomy, with limited authorization, to sub-patrons in the patron-client network. Thus, the sub-patrons are both patrons and clients: clients to the chief patron but patrons to the lower-level clients in the adopted political family. Crucially, when talking about comparison of corruption types, such cases are not characterized by the bottom-up fashion of private actors approaching the political sphere with their claims, but rather the political regime that extorts the private actors as well as the taxpayers by way of contracts and, in case of a criminal state, privileges ensured to its subjugated oligarchs.

Finally, in cases of free-market corruption and cronyism, the collusion of spheres of social action is only occasional and partial. This is why we can, in spite of (sporadic) cases of voluntary corruption, treat regimes with corrupt states as ones with dominantly separated spheres of social action. This is the case because, just as in case of lobbying, the rewards of political actors ideal typically remain within their sphere of social action, meaning political actors do not become also market actors. As long as corruption does not involve permanent relations, no permanent collusion of the spheres of social action takes place.

As soon as permanent corruption relations are formed, whereby the patron, who is in one sphere of social action, gains power in another sphere of social action as well through his client's formal position (→ 3.2), the collusion of the spheres of social action becomes a permanent, potentially system-constituting feature. This is the case in state organization collusion and the three types of coercive corruption. Members of the economic elite, formally separated from the sphere of political action, get informal political power and become oligarchs. Members of the political elite, formally separated from the sphere of market action, get informal economic power and become poligarchs. True, the strength of collusion is not the same in every case; in cases of capture, which are partial, only some of the actors in the economic sphere (or the political sphere) become oligarchs (or poligarchs), meaning that there remain parts of each sphere that are not colluded. It is only in the case of a criminal state pattern when there is a complete collusion of the spheres of economic and political action, where the chief patron becomes the main poligarch of the country and gains control over the entire economy through his single-pyramid patronal network.

5.3.3.2. A typology of corruption brokers

Talking about ideal typical corruption schemes, we have indeed simplified the picture by depicting relations as direct contact between the actors. The abstraction was necessary for the sake of clarity, so that the description of the main characteristics of the corruption types is not obscured by the overabundance of details. But at this point we may elaborate and say
that, while direct contact between actors might exist, related parties often communicate,
and more generally manage the corruption network, indirectly, with the help of mediating
actors. Indeed, we have already introduced this type of actor in Chapter 3—the corruption
broker. Recall that a corruption broker connects participants of a corrupt transaction as
a mediator or “legalizes” the illegitimate business deal as a legal expert [3.4.2].

Corruption brokers—and brokers in general—are necessitated by so-called structural holes,
that is, a distance stemming from the formal/legal position of the actors who
wish to be involved in corrupt transactions. As Jancsics explains, corrupt deals “have
significantly higher transaction costs than legal economic transactions, since the actors
have to secretly find their corrupt partners. Participants of corruption cannot get help
from legal institutions such as the police or the judiciary, to enforce the corrupt deal if the
partner breaches the agreement. These factors make corruption exchanges especially risky.
Corruption brokers have important roles to reduce the risk and uncertainty and, thus, the
transaction cost of corruption. They help introduce corruption partners to each other and
act as a guarantor in the case of low-level trust between the partners. In some cases, they
provide full protection for their principals by hiding their identity of the other party.”

While structural holes can be found in any type of corruption, different forms
involve different structural holes and, thus, different types of brokers are employed. Table
5.3 outlines a typology of corruption brokers, specifying (1) the corruption type they are
specific to; (2) their principals, that is, the ideal type of the person who employs them;
(3) the structural holes which necessitate brokerage; (4) their basic functions; and (5) the
actors the brokers integrate into the network to bridge the structural hole and make the
corrupt transaction, as well as the extraction of corrupt profits, possible.

The first type to be defined is the freelance broker:

- Freelance broker is a corruption broker who does not belong to any specific power
network (political, economic, or patronal). In other words, he can be employed by
any kind of person regardless of power affiliations. His main function is linking
corrupt supply and demand in lower levels of state administration.

In the case of free-market corruption, the illegal nature of corrupt transactions constitutes
a structural hole between corrupt supply and demand. The private actor does not know
which public administrator should be corrupted (that is, who can be corrupted and who
is trustworthy enough), whereas public administrators cannot advertise their corrupt ser-
vices to the costumers. This is where freelance brokers enter and link corrupt supply and
demand, making a functioning corruption market possible. Freelance brokers might be
employed in non-nepotistic cases of cronyism, too, when an elite private actor wants to
approach the political elite to make a one-time, occasional deal, but does not know who
to approach or needs guarantees that the transaction will be made as arranged and that he
will remain anonymous.

68 Burt, Structural Holes.
69 Jancsics, “From Local Cliques to Mafia State,” 131–32.
70 Jancsics, “A Friend Gave Me a Phone Number.”
The opposite of a freelance broker is a representative broker, of which four subtypes are mentioned in the table.\textsuperscript{72}

\textsuperscript{71} We are indebted to Dávid Jancsics for checking an earlier version of this table and giving suggestions about it.

\textsuperscript{72} Jancsics, “From Local Cliques to Mafia State,” 131–36.
• **Representative broker** is a corruption broker who belongs to a specific power network (political, economic, or patronal). In other words, he is employed by people of a specific power affiliation or sometimes one certain person, oligarch or poligarch.

  ○ **Crony’s representative broker** is a representative broker who is employed in cronyism by either side, the private or the public actor. His main function is linking corrupt supply and demand in higher levels of state administration.

  ○ **State organization’s representative broker** is a representative broker who is employed in state organization collusion by the elite public administrator who initiates the corrupt scheme. His main function is disabling control mechanisms, while he is also used to involve money-launderers and private entrepreneurs who become the regular subcontractors of the corrupted state organization.

  ○ **Oligarch’s representative broker** is a representative broker who is employed in bottom-up state capture by an elite private actor (oligarch). His main function is disabling control mechanisms, while he is also used to connect money launderers and politicians, who receive the corrupt offers of the oligarch through the broker who also supervises the corrupt transactions.

  ○ **Poligarch’s representative broker** is a representative broker who is employed in top-down state capture by a governmental actor (poligarch). His main function is disabling control mechanisms, while he is also used to involve money-launderers and private entrepreneurs, who receive the corrupt offers of the poligarch through the broker, who also supervises the corrupt transactions.

Basically, we defined representative brokers for the four consecutive corruption types. **Crony’s representative broker** is the most similar to freelance broker as he also arranges occasional transactions between strangers. The two differences are that (1) a crony’s representative broker is not freelance, as he is employed for regular service by a concrete actor, and (2) he links corrupt supply and demand in higher levels of the social hierarchy.

The three other types of representative brokers cover forms of systemic corruption, namely state enterprise collusion, bottom-up state capture, and top-down state capture. In each of these cases, the actors know who to corrupt and, during captures, they might even employ coercion to develop their corrupt scheme. **The structural hole which necessitates the broker is between the existence of the scheme and the effective legal code**, which means that the brokers are needed to disable control mechanisms. “As corrupt networks grow,” Jancsics writes, “they face increasing external risks from different institutions, such as the judiciary, the tax authority, different audit organizations, and the media. One of the main tasks of representative brokers is to connect to these external organizations and turn off their control mechanisms. It means that the most powerful actors […] have ‘insider men’ in many places. These brokers are able to protect the corrupt network from the authorities or block ongoing investigations.”

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73 Jancsics, “From Local Cliques to Mafia State,” 135.
Another function of brokers in systemic patterns of corruption can be **hiding corrupt monies by involving (international) money-launderers**.\(^{74}\) As opposed to cronyism, where there is no systemic siphoning of public monies that would necessitate a built-out laundromat scheme,\(^{75}\) in systemic cases such schemes also need to be part of the corruption network. Indeed, this function of corruption brokers can be seen as a specific case of disabling controls, however, here they involve new actors in the network, namely those who offer the service of money laundering.

The representative brokers of oligarchs and poligarchs, employed in bottom-up and top-down state capture respectively, represent the interests of their principals in their sphere of informal influence. They help integrate actors, politicians or entrepreneurs, into the corrupt network, and they also fulfill the role of supervisors of the fulfillment of corrupt informal “contracts” and the smooth flow of favors in default of formal checks. Basically, as such representative brokers have influence over control mechanisms, they can initiate, to a limited degree, selective law enforcement: **they disable controls against trustworthy corrupt participants and activate them when someone breaks his word.** “If the [corrupt] payment is delayed, the corrupt organizers can impose different types of sanctions against the [private actor]: authorities may reject the firm’s invoice, they may freeze its bank accounts, or audit organizations may start an unexpected investigation.”\(^{76}\)

Brokerage in coercive corruption is also different from **non-coercive corruption** because, in the latter case, both parties may have their own brokers who represent them. In cases of coercion, however, or when voluntary ties of mutually beneficial trade are replaced by coercive patron-client chains, it is only the **dominant actor who has a broker** while subordinates (ideal typically) lose their bargaining power and must obey the patron’s orders, enforced by coercion.

When we reach a stable system of top-down state capture—such as in a local government—or a criminal state, three other types of brokers appear. Two of them have already been discussed in the previous chapter, right after we defined corruption broker in general:

- **Gatekeeper** is a corruption broker inside the public administration who is employed by a patron (in an informal patronal network). His main function is to hinder legal accountability, that is, to guarantee the bureaucratic background and protection of illegitimate deals.

- **Corruption designer** is a corruption broker outside the public administration who is employed by a patron (in an informal patronal network). Corruption designers can be individuals, like in cases of corruption brokers managing (international) laundromat schemes, or firms, the main function of which is to facilitate the process of transferring governmental monies to private hands.

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\(^{74}\) Cooley, Heathershaw, and Sharman, “Laundering Cash, Whitewashing Reputations.”

\(^{75}\) It is certainly possible that a crony also employs a broker to launder money from a single transaction, but we opine that is not ideal typical.

\(^{76}\) Jancsics, “From Local Cliques to Mafia State,” 136.
The third (and final) corruption broker has not been considered a broker before: the economic front man. Indeed, economic front man can be interpreted as a special type of representative broker, who bridges the structural hole between the de jure position and the de facto wealth of the oligarch/poligarch. Furthermore, as Jancsics observes, an economic front man also has the function of hindering economic accountability, meaning that he “may fulfill the ‘fall guy’ function that buffers risks between him and the oligarch. When things go wrong, the [front man] will be responsible for the tax, salary, or mortgage debts of the shell company, while the real owner is protected. There are many examples of the scheme when the [front man’s] company […] goes bankrupt and cannot compensate other entrepreneurs and suppliers. The affected firms will never get their money, since the shell company does not have any assets, being emptied before the filing of bankruptcy.”

5.3.3.3. From corruption risk to corruption certainty in public procurements: the case of Hungary

While a discussion about the ideal types of corruption in more abstract terms—as we have done up to this point—should lay a solid foundation for the analysis of corruption, it is worth to take a closer look at examples where the differences of corruption types can be illustrated. First, we give a more general illustration, describing public procurement procedures and explaining how a certain variable—the level of overpricing—is indicative of different types of corruption. Second, we follow up with the case of Hungary between 2009 and 2015, where data on public procurements show the signs of the operation of a criminal state.

The reasons we choose Hungary as a case study are three. First, Hungary is a post-communist country that saw in the above-mentioned period a shift from patronal democracy to patronal autocracy, one of the most important signs of which is systemic corruption in the form of a criminal state. Second, while post-Soviet patronal autocracies often rely on natural resources as a source of distributable rent, Hungary is a resource-poor country. Thus, patronal actors must rely on resources such as EU-funds and state investments, both of which are extracted through the system of public procurements. Third, and perhaps most importantly, Hungary has a feature that other patronal autocracies lack: availability of big data on public procurements. Usually, as there is no direct data on the occurrence of corruption, researchers attempt to show it either by discussing institutional mechanisms, through case studies, or through the perception of corruption as measured in public opinion polling of businesses and the general public. Yet, despite the utility of a model composed of a mosaic of case studies and legal analyses, there is still a need for a method that could verify the existence of a criminal state type of corruption through a large sample of individual corrupt transactions. Such ambition, however, faces several limitations, the most important of which is that broader procurement activities that are subordinate to these decisions are not normally available in databases that can be examined for research purposes. Yet the big data research done by István János Tóth of the Corruption Research Center Budapest (CRCB) offers a unique opportunity within

77 Jancsics, “From Local Cliques to Mafia State,” 140–42.
78 Jancsics, “From Local Cliques to Mafia State,” 141–42.
the post-communist region to detect signs of a top-down corruption pattern through a database of over 120,000 public procurements in 2009–2015.79 Below we rely on the calculations of Tóth and his colleagues.

Describing first public procurements in more general terms, the process of carrying out various public policy objectives through public tenders can be divided into the following three stages:80

1. **pre-bidding phase**, which includes needs assessment (public policy design and project design), and public procurement design;

2. **bidding phase**, which includes invitation to tender, the application phase, and contract awarding;

3. **post-bidding phase**, which includes appeals (lodged at the public procurement commission or at court) and occasional investigations by government control institutions, which can impose legal consequences (Government Control Office, State Audit Office, Public Prosecutor).

In a liberal democracy, these stages are separated from each other not only in terms of their content but also in regards to the persons representing and executing them. Although the stages concern the different layers and areas of the government, in a democratic setting the separation provides transparency as well as enforcing normative procedures and fair competition within the government and from the review bodies that are independent from it.

Under such conditions, the dominant terrain for corrupt transactions is the bidding phase. This is where the demander of a corrupt transaction—the applicant—and the supplier of a corrupt transaction—the assessor—meet each other. The offer is voluntary, and the value of the service is paid through a bribe. In such a case, it is closer to free-market corruption, as the expected tender winner is not a person or company that has been pre-selected from above, and there is some competition regarding the amount of the bribe as well. The bribe or extra income paid by the client is sometimes included in the overpriced bid. Yet the other applicants competing for the tender can underbid the price that has been agreed-upon by the actors in the corrupt transaction, which sets a scale for it. The assessor, however, cannot accept a sky-high bid during the corrupt transaction—to each side’s mutual benefit—since the losers, or those disqualified from bidding for any variety of reasons, can appeal the decision and win a ruling from the public procurement commission or in court (post-bidding phase). Thus the scale of overpricing is regulated and kept in check in a market-based way by limits that are created as a result of such appeals against arbitrary deals.

Overpricing can increase if the collusion is not only between, for example, the applicant and the assessor but also with the tender writer, or by manipulating the deadline

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79 CRCB, “Competitive Intensity and Corruption Risks.” For an analysis different from ours, see Fierăscu, *Redefining State Capture*.

80 Beke, Cardona, and Blomeyer, "Political and Other Forms of Corruption in the Attribution of Public Procurement Contracts and Allocation of EU Funds," 29.
and technicalities (pre-bidding phase). This is a case of **cronyism** or **bottom-up state capture** that can hinder the operation of the independent review bodies, since the very way the tenders are written can “legally” eliminate a significant portion of the competitors. Also, in cases of **state organization collusion** or **top-down state capture**, the initiator of corruption has access to the phases of public procurements on that limited territory which he administers, including bidding and perhaps the pre-bidding phase as well. But these forms of corruption, although they may facilitate tenders in which a desired bidder will win, **cannot result in a significant increase in overpricing as the review bodies may still reinstate applicants** who have been illegitimately excluded from the competition.

**Out-of-control overpricing**, on the other hand, can only occur under the conditions of a **criminal state**, where the initiator of systemic corruption, the chief patron, disposes over all three phases of public procurements. In a mafia state, a centralized guiding hand monitors and coordinates the stages of tailoring the project planning, invitation to tender, and assessment to a specific person/company. It also ensures that those eliminated from the tender are unable to win an appeal, while also **guaranteeing that the inspection and law enforcement agencies are unable to levy sanctions** on the writers and assessors of the tender because of their biased decisions. They simultaneously also eliminate free-market corruption; after all, it is not the assessor, but the review and managing agencies in their totality that award the winner of the tender. The **assessor is no longer bought off, but rewarded by being able to retain his status.**

What facilitates out-of-control overpricing is either that the activity itself is difficult to standardize (e.g., for IT procurement), or, in case the commission is more prone to standardization (e.g., the construction industry), through the post-bidding increase of funds, due to “unforeseen problems” or “additional tasks.” (Naturally, in this system of centrally-directed collusion, selected winners are not disqualified from later tenders when they are unable, even by chance, to estimate correctly in advance the extent of work to be done.)

Indeed, **the term “corruption risk,”** widely used in corruption literature and by watchdogs, **loses its meaning in such an environment.** For the word “risk” assumes the state, subordinated to the principle of societal interest, attempts to serve the public good via public tenders, and there is a risk that corrupt private actors and deviant public administrators will prevent this goal. Instead, in a criminal state we can speak about **“corruption certainty,”** where corruption is the norm and the public goal is the deviance. Indeed, in a criminal state it is more meaningful to talk about the risk that a deviant public administrator might serve the public good instead of smoothly carrying out the corrupt transaction.81

To sum up, **out-of-control overpricing is only possible with a centrally-controlled, state-run criminal organization—the criminal state.** Thus, the scale of overpricing can serve as an indicator of the functioning of this top-down pattern, one that helps through quantitative methods to distinguish this regime, patronal autocracy, from other, more “or-

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81 Naturally, in a criminal state there still exists corruption risk in the sense that deviant public administrators might serve their own private gain instead of that of the adopted political family [⇒ 5.3.4.2]. But the term “corruption risk” still needs to be used very carefully, because the case is not that a public-good serving public office may be abused for private gain—as it is assumed by corruption-risk researchers—but a corrupt public office may be corrupted in another direction.
ordinary” corrupt regimes. For the former, it is a constituting element that defines the system, while for the latter it is only an unpleasant side effect.

Having described how different corruption patterns can infect different phases of the public procurement procedure, we may turn to the case of Hungary. However, we should first mention that a limitation of verifying the existence of a criminal state type of corruption comes from the changes and manipulation of Hungarian public procurement law after 2010, which has also narrowed the scope of public spending not affected by politically motivated, discretionary decisions. This indeed is a logical corollary of the established criminal state for public procurements: the limit of public funds that can be spent without requiring a tender has been raised; the bidding period has been reduced; and cost makes up only 50% of the award criteria, while the rest is awarded by the politically-instructed assessment committee based on so-called qualitative (i.e., subjective) criteria. All of this has increased the opportunity for manually-controlled government orders and clientele building in public administration and large state distribution systems.

Another dimension of this phenomenon is that after 2010 low- and mid-level officials are no longer freely authorized to engage in corruption. Municipal institutions and authorizations have undergone state centralization and become subject to political monitoring from higher-ups to such an extent that the freedom of such low-level corruption has been appropriated from them, and the right to exercise it granted instead to the central authority. For major investments, however, the government has nearly unlimited power to officially designate an investment of economically-strategic importance, or prioritize it for national security reasons. These priority projects are exempted from regular public procurement procedures.

First, without presupposing we actually deal with a criminal state and corruption certainty, let us take a look at the change of corruption risk, measured traditionally by the presence of competition and public notice. Here, we can see a drastic increase after 2010. As Figure 5.8 shows, the risk indicator for public procurements related to EU funds was 0.21 in 2009, grew to 0.4 by 2011 and reached its peak at 0.54 in 2014. However, though this fact in itself provides the possibility to assume a systemic, qualitative change in public procurements, in theory it could also be explained simply by the extent of the occurrence of common corruption or state capture, both centrally directed and non-organized.

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83 TI, 18–29.
84 Hegedüs and Péteri, “Közszolgáltatási reformok és a helyi önkormányzat” [Public service reforms and the status of local governments]; Magyar, Post-Communist Mafia State, 131–32.
85 TI, "Black Book,” 28. Also, the situation has further moved in the criminal state direction since the end of our research period. In 2016, the government has given itself the direct authority to approve tenders exceeding 300 million forints, and in late 2018 several centrally controlled agencies were set up to manage every municipal as well as governmental tender above 700 million forints in construction, sport, and IT sectors. Szabó, “Purgatorbánium.”
Second, we may take a look at the change in the proportion of non-advertised invitations to tender. CRCB data shows that while less than one-fifth of all invitations to tender were unadvertised in 2009, this had become more than four-fifths by 2015 (Figure 5.9). Such a dramatic increase in the rate of unadvertised tenders would necessitate decisions from the mid-level of the public administration apparatus at a minimum. At the very least, this can be understood as an evolutionary phase of bottom-up state capture, since the bulk of non-advertised public procurements presume the existence of smoothly-operating channels of corruption.

From the economic side, an examination of overpriced public tender bids suggests a difference between the bottom-up state capture and the criminal state with respect to advertised and non-advertised public procurements. Indeed, the decision as to whether it should be advertised or non-advertised, or whether open, negotiated, or restricted tenders should be specified for EU or state funds, are decisions made at the government level. If the government finds that certain types of public procurements result in a large number of overpricing and partial deals, then it theoretically possesses all the necessary means to be able to steer tenders towards the direction of an open and advertised application process. Considering that the submission deadlines can be unrealistically short even for advertised tenders, it can be concluded that some mechanism allows the eventual winners to receive regular information required for the tender submission before its notice is posted. This could even be called “tender shorting.” And this is before a discussion of invitations to
tender and technicalities that are custom-tailored to an individual or company [\(\rightarrow 4.3.4.2\)]. Thus, the technical requirements of the tender outline the specifics of a bid that has already been selected to win. This is not a series of isolated incidents, but a wide-scale practice approved from the top.

However, this phenomenon might still fit into the bottom-up or top-down state capture pattern, as the collusion of the tender writer and assessor on the one side and the applicant on the other are sufficient. But the **out-of-control overpricing**, as demonstrated in Figure 5.10, has raised the rate of overpriced bids by several orders of magnitude for the bulk of these cases, cannot be explained through the concept of partial capture.

The prices for public procurement contracts show a much stronger level of distortion in 2015 than at any time prior. This process distorts the bids so far from normal market prices that it cannot be explained simply by a qualitative improvement or just the extent of corruption. Its scale likewise cannot be explained by an increase in the role of inherently more corrupt product markets within all public tenders. **The increase in corruption can be much better explained, not as the result of a spontaneous, free market process, but as the result of the organizing action of a central will.** Thus, these indicators speak to how free-market corruption risk is replaced by the certainty of a state-run criminal organization organized from above.86

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86 According to Tóth and Hajdu, the introduction of a new procurement type with low transparency but relatively simple administration is another important factor underlying this tendency. The Hungarian Public Procurement Law was changed in 2011 to allow such procedures below the value threshold of 25 million forints, resulting in increasing price distortion and increasing risks of (unauthorized as well as authorized) corruption. See Tóth and Hajdu, “Versenyerősség, társadalmi veszteségek és a 25 millió forintos értékhatár rejtélye” [Intensity of competition, social loss and the enigma of 25 million HUF threshold].”
We may finish this case study by an actual metric of corruption certainty: the odds of companies of the adopted political family winning. As Tóth explains, if we know how many times a company wins and loses when it comes to public procurement, we can determine its winning chance by a simple formula (odds = number of tenders won / number of tenders lost).\(^87\) According to this metric, the companies of Lőrinc Mészáros, Orbán’s main economic front man \([\to 5.5.4.3]\) are the best in the construction industry: when they enter competition, they have the highest chance of winning (odds: 9.9). This number is much higher than that of well-renowned foreign-owned firms, such as Colas (1.78), Strabag (2.57) or Swietelsky (1.61). If we look only at projects funded by EU funds, Mészáros performs even better, with a 28-fold chance of winning these tenders between 2011 and 2018 (there are two lost tenders against 56 wins).\(^88\) Also, if we look at how odds have changed over time, we find that while the odds of winning for major players in the field of construction procurements have hardly changed, Mészáros’ companies skyrocketed in 2017–2018 and have a 46-fold chance (only one lost tender against 46 wins).\(^88\) These data do not reflect the “risk” but the certainty of corruption—the only risk that can be reasonably raised is the risk that Mészáros would lose. When the state is a mafia state, it means that it is based on the twin motives of power concentration and personal-wealth accumulation: this is the benchmark for analyzing action in such an environment, not the

\(^{87}\) We are indebted to István János Tóth for making the exact numbers of won and lost tenders available to us.

\(^{88}\) Tóth, “Nyolc ábra egy magyar csodáról” [Eight figures on a Hungarian miracle].
ideal of neutral political actors dominantly serving the common good and deviant public administrators occasionally abusing their power for private gain [→ 7.4.7].

5.3.4. Corruption Measurement, Criminal Ecosystem, and the Role of Corrupt Monies in Regime Survival

5.3.4.1. A critique of global corruption indicators

Similarly to hybridology, which either disregards patronal networks or understands them as deviance from the democratic ideal, corruption research also usually presumes that **corruption is deviance** which governments and formal institutions attempt to eliminate in pursuit of effective and more rational governmentality.89 On the one hand, this implicitly assumes the supremacy of the formal over the informal, that is, that public officials act and think primarily in accordance with their legal position and illegal abuses of power may happen only secondarily. On the other hand, this approach is similar to that of neoclassical macroeconomics, which assumes that the state necessarily runs on the principle of societal interest and wants to reduce the misuse of public funds accordingly. Such presumptions makes many traditional accounts of corruption research, including the ones which **global corruption indicators** are based on, unable to assess most of the previously described corruption types beyond free-market corruption. Indeed, these indexes are inadequate to measure the specificities of corruption in the post-communist region.

To substantiate our point, it is worth taking a closer look at one of the most popular indicators, Transparency International’s **Corruption Perceptions Index (CPI)**.90 CPI is a composite index published annually for most of the world’s countries. As we already mentioned, TI’s general definition of corruption is “the abuse of entrusted power for private gain” involving “public officials, civil servants or politicians.”91 However, in spite of the broad definition, TI is indeed concerned with a more narrow range of corruption types. More specifically, the phenomena CPI attempts to capture may be divided into three groups. First, there are general instances of corruption where it is not specified who initiates the abuse or whose private gain is served. These include “diversion of public funds,” or “prevalence of officials using public office for private gain.” Second, there are specific instances like “bribery,” “meritocratic versus nepotistic appointments in the civil service” and “state capture by narrow vested interests.” Finally, the largest group of aspects CPI focuses on is institutional guarantees: “ability of governments to contain corruption,” “adequate laws on financial disclosure,” “legal protection for whistleblowers [and] journalists,” or “access of civil society to information on public affairs.”92

89 Baumann, “A Failure of Governmentality”; Fougner, “Neoliberal Governance of States.”
90 For our more detailed analysis of CPI, see Magyar and Madlovics, “From Petty Corruption to Criminal State.”
91 TI, “Corruption Perceptions Index 2011 - FAQ.”
92 TI, “Corruption Perceptions Index 2017 - Full Source Description.”
What these three categories have in common is the above-mentioned presumption of corruption being a deviance. They understand the state by its formal identity: as dominantly an institution of the public good, with some subordinates who deviate from that purpose and abuse their position by requesting or accepting bribes and appointing cronies without a legitimate basis. Accordingly, private influence over the content of laws and rules—in our terms, bottom-up state capture—and the influence over their implementation—in our terms, free-market corruption—are the two regarded forms of abuse.93 Also, the questions in the third category imply the state does want to persecute corruption, just that it may not have the “ability” to do so or it lacks the formal rules which otherwise would overrule informal impacts in general.

The fact that TI views corruption as a deviance limits the CPI’s ability to offer a reliable picture regarding the prevalence of the various types of corruption, particularly top-down forms. These datasets still offer partial insight into the extent of corrupt transactions that are initiated by private actors, possibly under coercion, and whether these grow into the bottom-up state capture stage on a systemic basis. But they do not provide a picture of the situation when the initiator of a corrupt transaction is neither the company nor public administrators with the potential to extort, but the criminal state itself. To put it in terms of an example: global corruption indicators survey private actors about whether they have to bribe officials to “get things done,” for example to win a public procurement tender. But this way the survey disregards the situation when the entrepreneur does not even have the chance to bribe anyone, for public procurements are already distributed from the top and public officials must simply ratify the chief patron’s chosen client as winner. This pattern of criminal state may persist for countries such as Hungary, which are placed in the mid-range in terms of TI’s country rankings, as well as for countries such as Russia or the post-communist nations of Central Asia, who are placed at the bottom of the rankings.94

5.3.4.2. The attitude of the criminal state toward unauthorized illegality

Global corruption indicators are mainly tuned to lower-level types of corruption. From this, it follows that criminal states get rankings not according to their actual level of corruption—which would include higher-level, top-down forms as well—but according to how successful they are in eliminating lower-level corruption. If a criminal state takes on an aggressive attitude toward free-market corruption, it may get a better ranking than a criminal state which leaves free-market corruption alone or perhaps even nourishes it—whereas both states are indeed corrupt at their core.

This leads us to the broader question of the attitude of criminal states toward unauthorized illegality. As we explained above, a criminal state means that the chief patron as the head of executive power runs the state as a criminal organization, and accordingly the members of the informal patronal network engage in illegal acts as part of the proper functioning of the state. But they may do so only if their illegality is authorized, that is, permitted by the chief patron (krysha [→ 3.6.3.1]). Indeed, actors who engage in illegal

93 For free market corruption, TI uses the term “administrative corruption.”
94 TI, “Corruption Perceptions Index 2017.”
acts outside the single-pyramid patronal network and without the chief patron’s permission commit unauthorized illegality.

The chief patron must have some kind of attitude or strategy toward unauthorized illegality, the cases of which range from occasional unauthorized corruption cases to competing criminal groups and clans (which may even evolve from each other). 95 Describing the possible attitudes, we can turn to Charles Tilly and his seminal work *Trust and Rule*, in which he analyzes the coexistence of formal governmental structures and informal “trust networks” (criminal gangs, secret societies, religious sects etc.). 96 Tilly understands this coexistence as a function of the bottom-up attitude of informal actors toward the state and the top-down attitude of the state toward the informal actors. Lower-level types of corruption, while not necessarily “networks” but certainly informal and requiring the trust of the parties, would be described by Tilly as engaging either (a) in “concealment,” meaning the actors try to avoid “detection and manipulation by the authorities;” or (b) in “clientage,” meaning the actors acquire “protection by intermediate authorities […] at a price.” 97 On the other hand, the state—in Tilly’s terms—is able to choose from three “modes of control:” repression, toleration, and facilitation, marking a range from negative through neutral to a positive attitude by the state. 98

We may add a fourth mode as well: takeover of the preexisting illegal groups or networks and integrating them into the criminal state by replacing and subjugating the actors currently involved in them. This mode is qualitatively different from the other modes that do not break the autonomy of trust networks: rather, they treat them as closed, autonomous entities that the state attacks, leaves alone, or helps, but does not try to reorganize their internal workings and force their members to serve a new master. In contrast, takeover means the breaking of autonomy, whereby the chief patron gains control over the trust network, its management and incomes. When its autonomy is broken, the network undertakes no more independent job, only commissions from the chief patron. This way, the trust network is integrated into the single-pyramid patronal network of obedience.

Ideal typically, the criminal state takes the attitude of toleration and leaves the corrupt networks alone if the cost of repression/takeover would surpass its benefits, such as the income that could be collected if the networks were taken over. In turn, it becomes repressive and tries to eliminate lower-level corruption if it recognizes it as an unnecessary disturbance and challenging competitor. This is more typical of post-communist regimes that are in the sphere of influence of the European Union, but repression is the traditional attitude toward unauthorized illegality in the classical mafia as well. Indeed, the expression “protection” money comes from the incident that people living under the authority of the mafia are compelled to pay money in exchange for the elimination of private banditry, that is, that the mafia does not allow anyone else to rob them. 99 In the mafia state, the bulk

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95 Illustrative is the case of Aslan Gagiyev and his criminality-based clan called “Family,” which extended from the criminal underworld to the political sphere through ministers and high-ranking law enforcement officials. Anin, “The Brotherhood of Killers and Cops.” On clans, see Chapter 3 [3.6.2.1].

96 Tilly, *Trust and Rule*.

97 Tilly, *Trust and Rule*, 34.


99 Gambetta, *The Sicilian Mafia*. 
of “anarchic” free-market corruption is similarly **eliminated** by either breaking existing networks (repression), settling over them and taxing them in a negotiated connection (facilitation), or subjugating them to the single criminal organization of the state (takeover).

**In case of facilitation,** what happens is that the criminal state “settles over” an existing network and starts taxing it without breaking its autonomy. In other words, the leaders of the members (or rather its more important members or “kingpins”) are not replaced and they can continue to function, whereas the criminal state’s authorities will no longer pursue them if the network pays his taxes and remains within the agreed boundaries of operation. Using Tilly’s term, we can identify this kind of coexistence as a case of **brokered autonomy** [→ 2.2.2.2].

Facing the overwhelming capacity of the chief patron to crack down on its enemies, it is rational from existing criminal networks to enter into a brokered autonomy instead of fighting the domination attempt. However, if (a) they do fight the domination attempt or (b) they break their informal contract by expanding beyond the agreed boundaries or (c) they become an unbearable risk to the power monopoly of the adopted political family, the network is either repressed or taken over. **In case of takeover,** the previously decentralized corruption business is put under his supervision. The case is similar to nationalization of a legal activity by a constitutional state, after which the political elite can centralize or decentralize the monopolized function. In a mafia state, where corruption is one of the state’s primary functions, this monopolized function can be **centralized or decentralized.** If it is centralized, that means that the chief patron himself manages and taxes these networks; if it is decentralized, then the corruption opportunities are handed out to loyal sub-patrons in the form of “concessions” or a “franchise system.” Such a system means none other than authorization to illegality, typically up to a certain magnitude of corrupt money that can be appropriated.100 (Those receiving the opportunities can then, in turn, gather and monopolize the various channels of corruption on a local level under themselves.) Corruption concessions are limited, not only geographically but also to the given economic activity. Ideal typically, the chief patron centralizes corrupt businesses which are linked to already centralized industries with high profits, such as natural resource extraction, whereas he decentralizes corruption businesses linked to industries with low centralization and lower profits, such as certain retail activities.101 (Also, when the criminal state decides to take over, the chief patron and sub-patrons may also establish new, alternative corruption networks that operate along the lines of preexisting patterns.)

Up to this point, we discussed the criminal state’s relation to corrupt networks. However, among unauthorized illegal actors, we also find **criminals** who engage in acts which are illegal **per se,** not because they involve the abuse of entrusted power (robbery, smuggling, human trafficking, drugs and weapons trade etc.). **Toward them,** the **chief patron can have exactly the same kinds of attitudes.** Throughout history, according to Tilly, “[authorities] faced with predatory trust networks such as pirates and bandits generally chose within a range running from repression by coercive means (attacking them directly) to facilitation

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100 As Ledeneva and Baez-Camargo write, “[regional] ‘feeds’ are informally, yet zealously, monitored. As a Russian anecdote has it, ‘state officials are caught not for stealing but for stealing too much for their rank.’” Baez-Camargo and Ledeneva, “Where Does Informality Stop and Corruption Begin?,” 57.

by means of capital (enrolling them as privateers or mercenaries). A chief patron might engage in repression if he is not interested in criminal activities or finds it too risky to run them (like in Hungary). But the means of repression was applied in Russia as well, where criminal groups prominent in the period of oligarchic anarchy were systematically attacked during the establishment of the single-pyramid patronal network. In Nothing is True and Everything in Possible, Pomerantsev documents the case of Vitaly Djomochka, a former gangster turned movie director, offering a vivid illustration of how Putin’s mafia state set out to end anarchic unauthorized criminality and replace it with the centralized control of the patriarchal head of the adopted family—similarly to the above-mentioned classical mafia (see Box 5.3).

On the other hand, in today’s Russia, under Putin’s more consolidated regime it is more common that criminal groups are hired for specific goals. In essence, these criminals become violent entrepreneurs who enter in an enforcement partnership with the chief patron, not posing a threat to his monopoly of violence. The commissions of such groups may involve a variety of services from maintaining order through intimidation to the liquidation of rivals. In cases like the Russian one, the relationship of state and organized crime is mutually beneficial and leads to mutual reinforcement.

While in case of non-criminal states, organized crime can engage in criminal state capture and take over parts of the public administration (like in China), in a criminal state the chief patron may settle over activities of organized crime or take it over, granting it a permanent and substantial role in the regime. For an example of the latter, we can mention Montenegrin poligarch Milo Đukanović, who was linked by the prosecutor’s office in Naples to an organized racket of cigarette smuggling in 2003. For an example of settling over a criminal network, according to the information gathered by one of this volume’s authors in Uzbekistan in 2016, the Uzbek criminal state settled over illegal currency exchange of criminal organizations (who had developed the system in the country earlier). We can say that illegal currency changers

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102 Tilly, Trust and Rule, 105.
104 Stephenson, “It Takes Two to Tango.”
106 Griffiths, “Smoking Guns.”

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in Uzbekistan reached a brokered autonomy, so the criminal state’s attitude toward it was facilitation. The Uzbek police allowed criminals to operate but at the same time the same policemen tapped into the illegal currency exchange network, collected “taxes” from those who pursue this activity, and the monies were delivered through the police chief, a local sub-patron, to the chief patron. The gained profit was distributed among the participants of the network.\textsuperscript{107}

To sum up, we can use Tilly’s terminology to describe the coexistence of a criminal state and unauthorized illegality (Table 5.4). According to him, the situation can be understood in the conceptual space spanned by three broad ideal types of relation: (1) segregation of the illegal elements from the public sphere (such as when the state takes on an inimical attitude); (2) negotiated connection between the illegal elements and the public sphere (such as in case of brokered autonomy); and (3) integration of illegal elements and the public sphere.\textsuperscript{108} In case of non-criminal states, integration would mean that actors of unauthorized illegality—that is, all illegality in a non-criminal state—become legally accepted. In a criminal state, integration means takeover, or when the illegal network remains illegal but run by the adopted political family hereafter.

Table 5.4. Modes of control of unauthorized illegality and the result in a criminal state.

<table>
<thead>
<tr>
<th>Action of the criminal state toward unauthorized illegality</th>
<th>The form of coexistence (the result of state action)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Repression (attack/restraint)</td>
<td>segregation (eliminated unauthorized illegality or “private banditry”)</td>
</tr>
<tr>
<td>Toleration (leave alone)</td>
<td>segregation (no more molestation of the illegal actors)</td>
</tr>
<tr>
<td>Facilitation (settling over it)</td>
<td>negotiated connection (brokered autonomy of the illegal network / hiring criminals as violent entrepreneurs)</td>
</tr>
<tr>
<td>Takeover (breaking its autonomy)</td>
<td>integration (illegal network managed by the adopted political family)</td>
</tr>
</tbody>
</table>

5.3.4.3. The criminal ecosystem: national and global

In the previous part, what we described was the coexistence of illegal elements, including authorized and unauthorized illegality. For this community of actors, we can introduce the term “criminal ecosystem.”\textsuperscript{109}

- **Criminal ecosystem** is the community of illegal public and private actors in a defined geographical area, interacting as a system.

\textsuperscript{107} On the Uzbek organized upperworld and its relations to the organized underworld, see Chayes, *Thieves of State*, 101–17. The situation might have changed since 2016, as Uzbekistan lifted remaining currency controls in late 2019 (i.e., the Uzbek som is now freely exchangeable).


\textsuperscript{109} We take the term “criminal ecosystem” from Moisés Naim, who uses it in an article as a figure of speech but does not define it. Naim, “Mafia States.” Without any relation to our topic, the term has too been used in the scholarly literature on cybercrime. See, e.g., Yang et al., “Analyzing Spammers’ Social Networks for Fun and Profit.”
Segregation, negotiated connection and integration describe the basic patterns of the criminal ecosystem in a given polity. In a criminal state, in a case of segregation, we can see an ecosystem of a strong criminal state and low or moderate unauthorized illegality, either because the state does everything it can to eliminate it (repression) or because it was so insignificant in the first place that the criminal state left it alone (toleration). In a case of negotiated connection, the criminal ecosystem can be described by—pushing the biological metaphor further—the pattern of parasitic symbiosis: the adopted political family settles on preexisting illegal networks and forces them to comply and pay a tax, but in exchange they can keep their autonomy and their illegal businesses are no longer molested by law enforcement and other legal agencies. Finally, in a case of integration, the appearance of the criminal state transforms the criminal ecosystem in a way that formerly unauthorized illegality becomes authorized and blossoms under the management of the adopted political family.

There are two ways we can elaborate our understanding of the criminal ecosystem. The first one comes by recognizing that, up to this point, we described unauthorized illegal actors as groups or collectives and the relation of these groups to another group, the adopted political family. However, the dynamics of the criminal ecosystem can also be analyzed on the individual level, focusing on individual paths from the illegal private sphere to the public sphere. Sociologist Svetlana Stephenson cites Jean-François Bayart with respect to such phenomena and explains that the Gramscian notions of “molecular process” of fusion and “reciprocal assimilation” can be used when people from the private sphere (1) enter the public sphere “via personal networks, exchanging favours and economic opportunities, and membership in charities and political parties” and (2) they get “integrated into the highest levels of the state bureaucracy.” Indeed, post-communist regimes have seen, as a mirror image of the criminalization of the state, the decriminalization of former members of the criminal underworld who entered the public sphere and began a political career. An example for this can be former Moldovan chief patron Vladimir Plahotniuc, who has been accused by Interpol as well as investigative journalists to have ties to the Russian mafia and cases of money laundering, human trafficking for prostitution, and “death squads” that are responsible for the assassination of several illegal elements. Upon entering the sphere of political action, such actors typically end being crime bosses—actors pursuing illegal economic activities with illegal access to it—and become oligarchs or poligarchs—actors pursuing legal economic activities with illegal access to it. Such individual transformations from the criminal underworld to the upperworld are typical of systems that have gone through the period of oligarchic anarchy after the regime change.

The second way to further analyze criminal ecosystems is by recognizing that, up to this point, we have defined the “geographical area” in the term’s definition as a polity—in other words, we have spoken about national criminal ecosystems. In contrast, we can speak about the global criminal ecosystem as well, which involves illegal elements all over the world, interacting as a system. On the one hand, this means that poligarchs and oligarchs from different countries are connected to each other, either in voluntary connections for mutual benefit or as a result of coercive subordination to a larger chief

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111 Miller, Moldova under Vladimir Plahotniuc.
Box 5.4. The global criminal ecosystem.

“This volume of money [cannot] be hidden under a mattress or passed from palm to palm during a handshake. Processing such large sums [requires] banks willing to accept the money without asking questions […] and a way for politicians to draw on their illicit funds to purchase luxuries. […] Offshore finance is what [makes this] possible. […] An individual with dirty cash to spare can buy a yacht using a bank account in Switzerland, which is controlled by a foundation in Liechtenstein, which is overseen by a limited partnership in Britain, which is owned by a company in Belize, which is owned by a trust in the Marshall Islands. The number of jurisdictions that can be used is practically limitless, and each one further obscures the connection between theft and expenditure. […] It is pointless to ask whether Russia is a kleptocracy. It is more appropriate to examine how Russia’s elites are part of a kleptocratic system by which their thefts from the national budget are connected, via Scottish limited partnerships and Moldovan or Latvian banks, to the London property market.”


the global real-estate sinkhole, which is particularly needed in the stage of spending. As the authors explain, “once money is ‘cleaned’ through networks of companies, its controllers may use it to advance both [their] social or political goals and […] business interests.” Thus they turn the global luxury real estate market, which the authors call a “sinkhole” because there “foreign nationals invest billions of dollars every year, mixing illicit and legal funds into assets protected by Western property laws.”

The last sentence is especially important, as it notes the ironic situation that the proper functioning of criminal states requires non-criminal states. For the latter are limited in their access to private economic businesses, either because (a) state institutions are not in patron. On the other hand, oligarchs and poligarchs can also be connected to international criminal organizations or networks. As Oliver Bullough points out, these are needed because, while stealing can be done domestically, the members of adopted political families also need to obscure these monies—either in the eye of their authorities or in that of the public—and they also want to spend them. Thus, oligarchs and poligarchs, with the help of corruption brokers, use money-laundering schemes, involving financial institutions all over the world which offer the service of keeping money without asking questions from the depositors or answering them to authorities (see Box 5.4). According to Alexander Cooley, John Heathershaw and J. C. Sharman, the services offered for these purposes—presumably to both the criminal underworld and the criminal upperworld—can be put in two groups:

- offshore finance, which is particularly needed in the stage of obscuring. Offshore finance is the keeping of illegal monies in banks as well as the “systematic use of shell companies” by wealthy individuals, oligarchs and poligarchs, “who wish to operate in secrecy.” About post-Soviet countries, the authors write that “offshoring and state-building have been intertwined, with regimes and ruling families amassing personal fortunes by channeling to foreign accounts rents from state assets such as commodities, foreign aid, and the sale of or profits from Soviet-era enterprises;”

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114 For a description of the famous Russian laundromat scheme, see Miller, Moldova under Vladimir Plahotniuc, 125–52.
the hand of a single chief patron who could use them in predatory ways or (b) because the country is a liberal democracy, where the owners of shell companies are protected by all the institutions and laws that have been developed to separate the market and the political spheres of social action. This situation has been exploited extensively by adopted political families and private criminals alike, from Hungary through Russia to Central Asia. Understanding the global criminal ecosystem as the illegal counterpart of the global economy, we may even say that—in a world-systems approach—Russia acts like a core that uses liberal democracies as periphery, whereas countries like Hungary are integrated as semi-peripheral actors in Russia’s global criminal ecosystem [➔ 7.4.5].

5.3.4.4. The use of corrupt monies: consumption, hoarding, and reinvestment in capital and politics

Although we have described various forms of collusion and corrupt mechanisms in detail, we have spent little time on the direct result of corruption: corrupt monies. We did speak about public procurement projects as a source of rent, and other techniques of personal-wealth accumulation (rent-seeking, kleptocratic, and predatory ones [➔ 2.4.3]) are going to be discussed in detail. But we did not speak about the use of corrupt monies. Whereas, as we mentioned above, the reason the members of adopted political families need to engage in launderat schemes through the global criminal ecosystem is because they want to spend, that is, use their money for various purposes after it has been diverted from the state budget. Among these purposes, we may distinguish four typical uses of corrupt monies for adopted political families:

- **consumption**, which means the direct spending of monies on goods and services for the private pleasure of oligarchs and poligarchs (buying luxuries like cars, yachts, houses, wristwatches etc.);\(^{117}\)

- **hoarding**, which means the reserving of monies in offshore accounts and the de jure private hands of economic front men [➔ 3.4.3] for (1) future consumption and (2) the case of various potential negative shocks (including removal from power);\(^{118}\)

- **reinvestment in economy**, which means the use of monies in building the adopted political family’s economic machinery, consisting of economic front men, shell companies, and various newly founded and predated, booty companies [➔ 5.5.4];\(^{119}\)

- **reinvestment in politics**, which means the use of monies in building the adopted political family’s political machinery, consisting of media, the transmission-belt party, (fake) “opposition” parties and politicians, bureaucrats, GONGOs, think tanks etc.

\(^{116}\) Cooley and Heathershaw, *Dictators Without Borders.*


\(^{118}\) Yuichi Kono and Montinola, “Does Foreign Aid Support Autocrats, Democrats, or Both?”

\(^{119}\) Brückner, “Mibe fektetnek a NER-lovagok? [What do the NER’s champions invest in?]”
Through these modes of patronal spending, corrupt monies play an essential role in the survival of adopted political families in both patronal democracies and autocracies. Indeed, with the sole exception of consumption, which (especially if it is widely perceived) may rather cause a loss of popularity and reduced survival chances, all the three other modes contribute to the informal patronal networks’ longevity. First, the most obviously helpful way of spending is reinvestment in politics, by which top patrons can expand their political empire, especially on the media front. In a patronal democracy, a competing patronal network can ensure through its own media outlets—in de jure private hands—that its messages will be spread on a nationwide scale, both when it is in and out of power. The media is helpful for the same reason in a patronal autocracy, however, there the single-pyramid patronal network dominates the (private) media market, sets the political agenda and spreads positive as well as negative propaganda messages (including the criminalization of opposition, disloyal or targeted actors) both when it is in and out of power. This means that, if the chief patron is removed from power peacefully and he is not forced to leave the country and surrender his network’s tangible assets, he can still spread favorable narratives through his media empire that may even pave the way for his return.

This leads us to the second way that ensures longevity: hoarding. In a patronal democracy, when an informal patronal network is removed from power by a competitor, its survival is essential to the system’s self-reproduction. Cyclical changes, and the constant possibility thereof, are needed to produce patronal democracies’ dynamic equilibrium, and that is ensured by preventing any one patronal network becoming dominant and by guaranteeing that no newly instituted leading patronal network can fully deprive its competitors of their (economic and political) assets. When a patronal network is dominant, that is, in a patronal autocracy, the same situation prevails, especially because the hoarded wealth and companies are not in the hands of the leading elite’s party but in the hands of de jure private actors. This not only means that the party and its formal leadership have no de facto influence over how these monies are spent (hence, a transmission-belt party). From the perspective of longevity, de jure private hoarding provides security of property for the case of a regime change. The situation is the same as with the above-mentioned non-criminal states, which respect Western property rights and do not confiscate or freeze the foreign bank accounts of the criminal state’s leaders. The same goes for a new, democratic leading elite (in the unlikely case it gets to power), for it is then committed to legal-rational legitimacy and Western-type property rights, and cannot simply expropriate the adopted political family’s assets. Indeed, the adopted political family has the necessary resources either to escape—if oligarchs/poligarchs must leave the country—or to rebuild and maintain their informal power structure—if the adopted political family is just pushed into opposition. Oligarchs of the adopted political family can still finance the informal patronal network and operate its media, exerting influence over the country. Hoarding can also be helpful in times of economic crises, when members of the adopted political family can still be fed from the “family treasury” and thus the chances of defection can be reduced. As Pomerantsev and Weiss note, that offshore financial institutions aid and abet autocrat’s money laundering “keeps elites happy while simultaneously

120 Cf. Lyebyedyev and Makhortykh, “#Euromaidan.”
giving [the chief patron] a lever with which to come down on them at any time, ensuring loyalty and just the right amount of paranoia.”\textsuperscript{121}

While moving the corrupt monies abroad brings the advantage of legalizing the loot under the protection of Western legal systems, it also moves it from under the jurisdiction of the adopted political family. This is a major disadvantage when it comes to reinvestment in the economy, where discrentional state intervention is an essential component of the profitable functioning of the adopted political family’s companies [\(\rightarrow\) 5.5.4.3]. Therefore, reinvestment is done in the domestic as well as the foreign economy, whereas domestic companies contribute to both the generation of corrupt monies and to regime survival of a patronal autocracy. As members of the adopted political family lay their hands on strategic industries and infrastructure, they gain leverage toward economic actors home and abroad. As for the former, as the economic empire expands, more and more people get to work for the adopted political family’s companies, either as employees or as subcontractors. Thus, large numbers of voters and their families get an incentive to support the leading political elite, for they can (rightfully) see it as the primary reason why their employer companies thrive, whereas a possible regime change can easily risk their jobs [\(\rightarrow\) 6.2.2.2]. As for foreign actors, the most important source of leverage, helping regime survival as a means of creating more favorable geopolitical environment, is asymmetric interdependence via global markets. This advantage may exist if there are certain, important goods that are supplied to the country only by the respective patronal autocracy, whereas vice versa there is no such relationship that would create dependence. Such countries become de facto clients to the chief patron, at least to the degree they cannot afford (politically) too high prices on the products the adopted political family supplies. Such relationships have been exploited by Russia, for instance, exercising “Gazprom diplomacy” through discrentional control over its natural gas and oil supplies [\(\rightarrow\) 7.4.3.2].\textsuperscript{122}

5.3.5. Relation in Communist Dictatorships

5.3.5.1. Total subordination and the three economies

Up to this point, we have dealt with relation in capitalist environments, that is, in polities with private markets, and compared cases of collusion of private actors with public actors. We have shown that how corruption can be conceptualized when the spheres of social action are separated, and how that can evolve into a situation when the spheres of social action collude. To make the picture complete, we now turn to communist dictatorships, where the spheres of social action are merged. In this case, there is total subordination of societal actors by the party state but in a formal form, meaning one-party system and the monopoly of state ownership. From this, it follows that, unlike the situations discussed above, in a communist dictatorship there are no private economic actors, whereas the rights of private communal actors are also restricted.


\textsuperscript{122} Lough, “Russia’s Energy Diplomacy.”
To understand the form and role of corruption in a communist dictatorship, we need to understand the layers of the communist economy. Indeed, in such regimes, three economic modes coexist. State ownership is the basis of the “first economy,” which is a determining force of the economy following the wave of nationalizations (collectivizations). In case there are moderately tolerated private businesses linked to the state sector, they make up the “second economy,” which filled in the market gaps of the general shortage stemming from the centrally planned economy in a rather surprising bounty of forms: in retail, retail services and the so-called backyard farmsteads, tied to agricultural cooperatives.

The category of the “third economy” can be used to designate the myriad market maneuvers oiled by informal transactions, also in the context of the consumer bottle-necks of the shortage economy. The great variety of forms of informality, both solicited and expected, permeate the gamut of socialist society—from the reception desk to the party chairs—rather evenly. At virtually all points of economic contact across the shortage economy that accompanied state monopoly, individuals would find themselves equipped with some stock, service, or competency in a discretionary decision to sell, for which they could pocket a tip, gratuity or corrupt allowance. For this system worked in a quasi-egalitarian manner, after all the opportunities for illegitimate ways of accumulating wealth were greatly limited even for leaders in the economy built on state monopoly, while by means of their “mini-monopolies” the hundreds of thousands people in the lower strata of the system could also impose their “allowances.”

In scholarly literature on Soviet Russia, the term “blat” is used to designate such transactions and relations of the third economy. As Alena Ledeneva explains in her renowned volume Russia’s Economy of Favors, blat was indispensable in the rigid environment of a planned economy. For without the barter of non-monetary goods and services on the basis of informal personal relationships, it was practically impossible to get anything in the Soviet Union, from the white porcelain toilet bowl to paying jobs (see Box 5.5). However, it is important to see that, while blat is a historical term, referring to a phenomenon which was observed in the Soviet Union, it is also ideal typical to communist dictatorship, characterized by the repression of private markets in favor of central planning.

While blat makes the lives of the people in a communist regime easier, the function of corruption in communism is not simply to “get things done” more conveniently.

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123 Juhász, “Társadalmi együttműködés az első, a második és a harmadik ökonómiában” [Social cooperation in the first, second, and third economy].
Indeed, corruption in a planned economy can be conceptualized, by its general function, as **system-lubricating corruption**, which makes it possible for the consumers to have their demands served, under a system that was not designed to adjust to consumer wishes (central planning). In a planned economy, the colloquial expression “grease money” gets its literal meaning: **without lubricating the machinery, the planned economic system itself would in fact be paralyzed**. The unavoidable, system-preserving character of these mutual reciprocities that could be placed anywhere on the scale of legitimacy and illegitimacy make this web of corrupt transactions a morally accepted convention \[ \rightarrow 5.6.1.5 \].

5.3.5.2. Comparing *blat* to other forms of corruption

Having defined corruption as the abuse of public office for private gain, we need to realize that **not every transaction resulting from *blat* relations in the third economy is also corruption**. Indeed, when the action does not involve a public office, we cannot speak about corruption. However, when *blat* is carried out either (a) between public actors, such as between state enterprise leaders and higher-level nomenklatura members via tolkachi, or (b) between a public actor and an actor from a different sphere of social action, we can speak about non-collusive and collusive corruption respectively.

Furthermore, *blat* is to be distinguished from so-called economic crimes, which basically were the communist equivalent of embezzlement of post-communist regimes. For in case of economic crimes (as well as embezzlement) corruption supply and demand, or the provider and the beneficiary of the corrupt service, are not separated but are fulfilled by the same person, who abuses his public office for his own private gain. *Blat*, in contrast, is always an interpersonal relation (exchange), and the one who occasionally abuses his position to give a favor is different from the one who demands it.

Using the dimensions of collusion and separation of corruption supply and demand, we can contrast *blat* with other forms of corruption (Table 5.5). In our conceptual toolkit, there is no other form of separated non-collusive corruption than *blat* between public actors. On the other hand, collusive *blat* shares the characteristics of other forms of collusive corruption where supply and demand are separated, namely free-market corruption, cronyism, and bottom-up state capture. As for the table’s right column, containing forms of corruption where supply and demand are united, we can find economic crimes and embezzlement as non-collusive forms and state organization collusion, top-down state capture and criminal state as collusive forms.126

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124 Ledeneva presents a comparative analysis of *blat* to bribery and corruption in Ledeneva, *Russia’s Economy of Favours*, 39–47.

125 Łoś, “Economic Crimes in Communist Countries.”

126 In Table 5.5, we did not distinguish by the dimension of systemicness, and we spoke about *blat* only in its form of individual transactions. Yet in Chapter 1, we hinted that such relations can be systematized \[ \rightarrow 1.4.1 \], and indeed *blat* networks can feature “kingpins” who control the flow of products and services. Extreme cases when access to resources is possible only through the network are colloquially referred to as “blatnoi mir” (*blat* world), where the kingpins essentially decide life or death.
Table 5.5. Comparing types of corruption by the dimensions of collusion and the separation of supply and demand.

<table>
<thead>
<tr>
<th>Corruption supply and demand are...</th>
<th>separated</th>
<th>united</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>non-collusive corruption</strong></td>
<td>• blat between public actors (via tolkachi)</td>
<td>• economic crimes (in communist dictatorship)</td>
</tr>
<tr>
<td>(carried out by people from the same sphere of social action)</td>
<td></td>
<td>• embezzlement</td>
</tr>
<tr>
<td><strong>collusive corruption</strong></td>
<td>• blat between public actors (nomenklatura) and non-public subjects</td>
<td>• state organization collusion</td>
</tr>
<tr>
<td>(carried out by people from different spheres of social action)</td>
<td>• free-market corruption</td>
<td>• top-down state capture</td>
</tr>
<tr>
<td></td>
<td>• cronyism</td>
<td>• criminal state</td>
</tr>
<tr>
<td></td>
<td>• bottom-up state capture</td>
<td></td>
</tr>
</tbody>
</table>

For an economic analysis of corruption in communist and capitalist economies, we can turn to Kornai’s distinction between **buyers’ corruption** and **sellers’ corruption** (which is illuminating even though Kornai apparently defines corruption more broadly than we do). According to Kornai, the market economy can be described as a “buyers’ market,” for there it is the buyers’ wishes which are definitive. Sellers compete, innovate and make various other efforts to attract more buyers. In contrast, the command economy of communist dictatorships is a form of “sellers’ market,” where it is the sellers’ wishes which are definitive. Buyers have to make efforts to win over the sellers, who are monopolists of certain goods in redistributive positions of the nomenklatura.\(^{127}\) It follows from this distinction the difference in the nature of corruption. In the buyers’ market of a liberal democracy, there is sellers’ corruption, for it is among the sellers’ efforts for winning over buyers to initiate corrupt acts (such as not giving receipts to reduce price by the tax) and sell some products—which, in normal and non-corrupt competition in the market economy, would remain unsold surplus. In the sellers’ market of a communist dictatorship, there is buyers’ corruption, for it is the buyers’ effort needed for winning over sellers to initiate corrupt acts (such as giving an extra, under-the-table payment) and get some products—which, in normal and non-corrupt monopoly situations in the socialist economy, would be in shortage.\(^ {128}\)

5.3.5.3. The effect of the regime change on corruption patterns

When the buyers’ market is abruptly turned into a sellers’ market—that is, during the regime change—the structure of informal relations also goes through a transformation. In the post-communist region, regime change resulted in unprecedented inequalities not only in wealth, but in terms of corruption prone positions as well. Since the shortage economy dissolved in the interactions of the participants of the private sector, the arena of corruption was driven back into the channels of business established between the private and public sectors. Yet in this new situation the client was no longer the small customer of


the old communist regime but increasingly the ever-wealthier circle of businessmen, from the small lessees of local government commercial premises to the oligarchs commissioning legislative regulations. In short, the more democratic and “egalitarian” nature of corruption in blat was replaced by elite-level corruption.

Changes in blat following the regime change included:

◆ a narrowing of the circle of those to be corrupted and an end to its mass aspect, as well as its basically becoming linked to the participants of the public administration and the political elite;

◆ a transformation of the structure of decision-making in areas affected by informal relations: displacing advantages tied to everyday consumption, state assistance that offered advantages in the competition for accumulation of wealth came into the foreground (privatization, state and local government procurement, tenders, real-estate reclassifications, permits issued by the authorities etc.);

◆ a significant growth of the profit margin to be achieved through individual corrupt decisions: it was no longer a consumer good one could acquire under the counter of the state owned shop by greasing palms but the entire factory that made it, along with the retail chain that distributed it, purchasing it on a loan from the state;

◆ a permanent divergence of the roles in informal transactions: no longer was “everyone” simultaneously “corruptor” and “corrupt” as they participated in the widely strewn social fabric of scarcity, but the initiators of the corrupt transactions, who approached actors in the public sector, now came from the private sphere.

To sum up, the formal separation of the spheres of social action created Western-like situations in the sense that now there were formally private actors who could collude with the formally public actors. However, because the separation was only formal, the informal networks that were formed enmeshed the newly established capitalist environment and resulted in more complex forms of collusion than Western corruption, including top-down state capture and the criminal state.

5.3.6. The Culture of Relation in the Post-Communist Region: From Family Obligations to Blat and Guanxi

In the post-communist region, relation can be modelled in abstract terms but it can hardly be understood as a social phenomenon without taking social culture into account. We have underlined this already in Chapter 1, outlining a path dependence argument which pointed out the cultural determinants of centralized and monopolized forms of corruption, the origins of single-pyramid patronal networks and the reasons why corruption surpasses bottom-up forms and shows the signs of a top-down nature. Focusing on lower levels of corruption and informality, we can also reveal cultural elements already in pre-communist times which persisted through the communist and post-communist periods with different intensity in the Western and Eastern parts of the region.
We can find the cultural determinants of corruption by focusing on those social institutions where giving discretionary favors enjoyed social legitimacy as a norm. In pre-communist times in general and before the separation of the spheres of social action in particular, there were two such institutions: family and friendship. On the one hand, they are similar in three respects:

- they both involve the giving of discretionary favors, meaning that family members and friends are preferred over other members of the society on the basis of their identity;
- they both are reciprocal relationships, meaning that every favor from member A to B involves an implicit, unspecified agreement about compensation, which is nevertheless expected to take place at some future point [→ 3.2];
- they both feature strong ties, meaning that the members’ relationship is longstanding, emotionally intense and/or intimate (mutual confiding) [→ 6.2.1.1].129

On the other hand, they are different in three other respects:

- family is based on kinship ties, whereas friends are not blood related;
- friendship ties are chosen, whereas family ties are given (as far as one is born into them);
- supporting family members is obligatory, whereas supporting a friend is optional.130

The culture of family obligations131 is related to the fact that, before the welfare state, families were the primary providers of welfare as well as a “social safety net.” Family members helped each other to make ends meet, and in effect the family’s wealth was treated as common property that had to be shared among the members in a (more or less) equal and equitable manner.132 Friendship could fulfill a similar function, especially when there was great disparity in wealth between friends and one helped the other. Following the classic study of Jeremy Boissevain, we refer to such forms of friendship as patronage, which is to be distinguished from patronalism and the patron-client relations we have talked about in the previous parts of this book. For patronage, while an asymmetrical relationship where “the nature of the services exchanged may differ considerably,”133 it is also (1) a relationship where both parties are friends and chose to form strong ties with each other voluntarily, therefore not only (2) the so-called “patron” is free to decide whether he helps

129 Granovetter, “The Strength of Weak Ties,” 1361.
130 Huntington, Political Order in Changing Societies; Boissevain, “ Patronage in Sicily.”
131 Naturally, a family member was not obliged to help everyone who had a kinship relation to him but rather his closer family circle. In 19th century Europe, for example, family obligations were “extended to blood relatives as far as second cousins, the limit of range within which the Church prohibits marriage.” Boissevain, “Patronage in Sicily,” 19.
132 Gladstone, Before Beveridge.
133 Boissevain, “Patronage in Sicily,” 18.
his so-called “client,” who is the main beneficiary of the relationship, but (3) the “client” is free to reject the “patron’s” offer. In contrast, the patron-client relations in patronal networks constitute (1) coercive relations, where (2) the patron is the main beneficiary of the relationship and (3) the client is not free to reject the patron’s “offers” (orders). In short, patronage and patronalism differ in terms of power: the richer friend in patronage helps but does not rule, whereas the patron in a patronal network rules and might or might not help.

As societies modernize and more and more impersonal and professional institutions of state bureaucracy are established, there appears a mismatch between the culture of discretionality—as manifested in the traditional social institutions of family, friendship, patronage and patronalism—and the newly introduced culture of normativity. As Huntington points out, corruption “in a modernizing society is […] in part not so much the result of the deviance of behavior from accepted norms as it is the deviance of norms from the established patterns of behavior[:] according to the traditional codes in many societies, an official had the responsibility and obligation to provide rewards and employment to members of his family. No distinction existed between obligation to the state and obligation to the family.”

In the West, where modernization as well as the separation of the spheres of social action took place in a centuries-long process, institutional changes were slow enough that cultural changes could follow them. Simply put, morality could develop hand in hand with legality. Discretionality following traditional norms has gradually lost its social legitimacy and more and more of the reciprocity system of family favors in the public sphere have been requalified as some form of immoral as well as illegal abuse. However, in countries where social changes happened more rapidly, the gap that appeared between morality and legality was larger than in slow and gradual changes, and morality did not have the time or the intent to embrace the alien ways imposed upon its existing structures.

In the countries we deal with, the first abrupt change of social institutions happened after 1917 with the establishment of communist systems. In such an environment, pre-existing strong-ties networks of family, friendship, patronage and patronalism were partially eliminated (where they were based on the nobiliary or “capitalist bourgeois” class status of some members) and partially extended with a myriad of weak ties under blat. Morality of subjects and legality of the system did not and could not match, given that the rigidity of the command economy made it nearly impossible to make ends meet without informal—and sometimes corrupt—blat relations. In countries where the culture of family obligations had been particularly strong, blat partially retained its familiar structure and continued to blossom even after the end of the command economy. This has been
5.4. State Intervention

5.4.1. The General Framework

5.4.1.1. The character of state intervention: normativity and discretionality

Since the distinctive feature of the state is the monopoly of the legitimate use of violence, it follows that the distinctive form of state action is using this power. When this power is used on economic actors or in the sphere of market action, we can speak about state intervention:

137 Kornai, “Hidden in an Envelope: Gratitude Payments to Medical Doctors in Hungary.”
• **State intervention** is an action by the state in the private market which employs state coercion to (a) make involuntary deals happen or (b) prevent voluntary deals from happening.

The first point to be noticed here is that state intervention means the **use of coercive, extra-market means by the state in the economy** [→ 2.6]. By definition, the state is the only actor who can do this legitimately in a stable polity [→ 2.2.1] and this is precisely what differentiates political actors from economic and communal actors, that they can use political power of the state in social interactions. A second and closely related point is that, a state, like private people, might engage in voluntary transactions, like when it trades or privatizes [→ 5.5.2], these do not qualify as state intervention according to our terms. In these cases, the interference of the state in the market is no different from the interference of any actor, for it uses market (not extra-market) means.

Third, state intervention is conceptually possible only in capitalist economies, for it necessitates—by definition—a private market where the state can intervene. Therefore, in this part we are not going to discuss communist dictatorships and planned economies, where—while the party state uses coercion in the economy constantly—the private market is abolished altogether in favor of central planning [→ 5.6]. Finally, following the basic premises of relational economics, we can say that the **character of state intervention is defined by relations between private and public actors**. In the following, we explain this in more detail, using the typology of relations provided in the previous part.

Let us start from **liberal democracy** and the constitutional state. In such a polity, the **main form of relation** is cooperation. Interest groups lobby for certain policies and politicians decide which one should be taken into account. Indeed, this is what the **principle of societal interest** means: in Chapter 2, we defined the constitutional state as being subordinated to that principle; we stated that the societal interest consists of the particular interests of certain groups of the society; and the principle of societal interest means that these groups with particular interests are involved in the transparent and formalized process of interest representation and decision-making.

These groups, which may become the **target groups** of state intervention, are defined by their position in the social structure, that is, by a **normative criterion**, which any member of the society can theoretically meet. In other words, such groups may be an industry, a class, a minority, and so on, all being defined by an abstract criterion irrespective of their specific membership. Everyone is treated the same: anyone who meets the criterion automatically enters the group.₁³⁸ From that the target groups can be defined by a normative criterion, it follows that the constitutional state views them as such and intervenes normatively. These can be defined as follows:

• **Normative intervention** is a form of state intervention which targets social groups that meet certain criteria irrespective of who the exact persons belonging to the

₁³⁸ True, it is the state which needs to recognize people as being members of certain groups. The state has to register someone as unemployed, entrepreneur (of a certain industry), or whatever, to know who to apply the respective laws to. But ideal typically in a constitutional state this is an irrelevant technicality, and the state apparatus does include everyone in the group who indeed meets the given criterion.
In other words, normativity means that the state has a public policy goal that targets a social phenomenon, not limited to concrete people but anyone who happens to be in the respective social group. Simply put, normative interventions are impersonal, whereby constitutional states “systematically provide services and benefits to citizens and organizations [...] without a reference to [...] the identity and political connections of an organization’s principals.”

Benefits or losses stemming from normative interventions are born by everyone who happens to be in the respective social group.

On the other hand, corruption is none other than discretional treatment. More specifically, in cases of collusive corruption, people with public office are involved in collusion precisely to do what could not be done by the law, that is, to receive preferential treatment vis-à-vis other people. Even if the laws that embody state intervention are formally normative, corruption makes the effect of state intervention discretional.

The effect of corruption on state intervention depends on how corrupt the state is. The more the state becomes corrupt, the more discretional the effects of state intervention become, and the less corruption becomes a deviance of state functioning. To put this in more specific terms, it is worth revisiting our terminology for states of different legal status in Chapter 2. In Table 5.6, it is shown which forms of collusive corruption from our typology are dominant according to the definitions of corrupt state, captured state, and criminal state. (“Dominance” means that other forms of corruption might appear in the given state besides the one we list, but only lower types. That is, in a captured state, there can be free-market corruption, but in a corrupt state there cannot be state capture, for if there was state capture, the state would requalify as a captured state by definition.)

The conceptual starting point of state fits the definition of the constitutional state of liberal democracies. There, both the intention of the regulator—the one who creates the law or manages a subdivision of the state—is the same as the intention of the dominant institution—in this case, the formal laws which provide the actual framework for political action—is normative intervention. The one this intention is opposed by is the corrupt state administrator, who, in sporadic cases of free-market corruption, wants to give discretional treatment to certain people. This may be called a non-structural deviation, for both state intentions (of the regulator and of the dominant institution) are against such actions.

The status of corruption is the same in a corrupt state, although there free-market corruption is already endemic. In a captured state, however, the instances of (a) state organization collusion, (b) cronyism, (c) bottom-up state capture or (d) top-down state capture mean that the regulator’s intention changes as he becomes the one who wants to carry out discretional treatment. In this case, when the regulator’s intention—discretinality—does not meet the intention of the dominant institution—normativity—corruption can be regarded a structural deviation.

The final option is when both the regulator’s and the dominant institution’s intention is discretionality. That is the case when the role of dominant institution is taken over by an

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Table 5.6. The status of corruption in states of different legal status.

<table>
<thead>
<tr>
<th>Political regime (state type)</th>
<th>Dominant forms of collusive corruption</th>
<th>Regulator’s intention</th>
<th>Intention of the dominant institution (form)</th>
<th>Discretional treatment resulting from corruption meets the intention of…</th>
</tr>
</thead>
<tbody>
<tr>
<td>State</td>
<td>• free-market corruption (sporadic)</td>
<td>normative</td>
<td>normative (formal state laws)</td>
<td>neither the regulator, nor the dominant institution (non-structural deviation)</td>
</tr>
<tr>
<td>Corrupt state</td>
<td>• free-market corruption (endemic)</td>
<td>normative</td>
<td>normative (formal state laws)</td>
<td>neither the regulator, nor the dominant institution (non-structural deviation)</td>
</tr>
<tr>
<td>Captured state</td>
<td>• state organization collusion</td>
<td>discretionary</td>
<td>normative (formal state laws)</td>
<td>the regulator, but not the dominant institution (structural deviation)</td>
</tr>
<tr>
<td>Criminal state</td>
<td>• criminal state</td>
<td>discretionary</td>
<td>discreitional (informal patronal decisions)</td>
<td>both the regulator and the dominant institution (norm / constitutive element)</td>
</tr>
</tbody>
</table>

informal network, whereby **corruption turns from a deviance to a norm**, or even more so, a **constitutive element** of the regime. This is the case in a **criminal state**, which, as we explained in Chapter 2, is a central element of the mafia state of patronal autocracies [→ 2.4.5]. Indeed, as opposed to the principle of societal interest, the **impetus of a mafia state is elite interest**, which means the twin motives of power concentration and wealth accumulation for the adopted political family. As opposed to normative target groups of state intervention of constitutional states, the **targets** are defined by allegiance to the informal patronal network, that is, by a **discretional criterion** that only certain members of the society can meet, namely those who have been let in by the chief patron. In other words, it is the particular interest of the adopted political family which the state aims at serving, and this group is defined by a specific criterion of personal acceptance and individual belonging. There is no automatic entrance to the adopted political family, meaning everyone is individually assessed and adopted (or not) accordingly.

As the intervention’s target group can be defined by a discretional criterion, it follows that the mafia state views it as such and intervenes discretionally:

- **Discretional intervention** is a form of state intervention which targets certain people (e.g., the adopted political family or its enemies) as a result of the decision of its head (e.g., the chief patron). In other words, the effects of a discretional regulation depend on subjective and informal criteria, allowing for different treatment of people on the basis of their identity (personal with double standard).
In other words, discretionality means that the state has a patronal policy goal that targets certain individuals. Such intervention, as opposed to normative intervention, is not impersonal but personal. **Benefits or losses** stemming from discretional interventions are **born by the specific individuals who are targeted**; and one—in a patronal autocracy—becomes a target when the chief patron (discretionally) decides so.

State intervention can be formally as well as informally discretionally. **Formally discretionally intervention means a violation of equality before the law**, when the written laws themselves name the given person or company, such as in case of exemptions from normative interventions (regulations, taxes etc.). **Informally discretionally intervention means a violation of equality after the law**, when the written laws are normative *per se* but informal relations are used for discretional implementation or changing the legal framework whenever it would also affect someone who the chief patron does not want to be affected.

**The systemic character of discretionality in state intervention is directly proportional to the level of collusive corruption**, and therefore it positively correlates with the lack of separation of the spheres of social action. This follows the definitions of the concepts involved, for as we move from the state to the criminal state, the higher forms of collusive corruption appear, and the higher the forms are, the stronger the collusion of the public and private spheres is. In the ideal typical “state,” there is normative intervention with no discretionality in either a positive or a negative direction. But the more the nature and extent of state intervention becomes discretionally, or the higher forms of collusive corruption we reach, the more opportunity for preferential treatment opens. When we reach the criminal state level, we can see the maximum **amplitude of arbitrariness** [2.4.6]. However, we do not say that a criminal state treats everyone arbitrarily and uses no normative intervention at all. On the contrary, normative intervention is supplemented, and not replaced, by discretional intervention in the state’s arsenal when corruption appears. What “amplitude” expresses is **the range of choices among different ways of intervention**, or in other words the state’s ability to intervene negatively and positively at the leading political elite’s (or its head’s) whim. The **wider the amplitude of arbitrariness is, the more discretionally decision options are available to the leaders**, and actual instances of state intervention will be scattered between the two endpoints of the amplitude.

We do not feature the figure depicting the amplitude of arbitrariness again, but we refer the reader back to Figure 2.2 in Chapter 2. There, on the horizontal axis, there are emphasized points (D1, D2 etc.) showing the change in the character and extent of the arbitrariness. One might object that these indeed are qualitative changes, which means these forms can only be put on a discrete (ordinal) scale but not a continuous one. However, our use of the terms “higher” and “lower” levels of corruption has been more than mere playing with words: **the higher type of corruption we examine, the more decisions are affected, and the wider the amplitude of arbitrariness is**. In a corrupt state, discretional intervention can only reach the implementation of the laws and there are no servers of corruption who would be involved and coerced to act discretionally. Indeed, there are no corrupt networks in a corrupt state as every corrupt public administrator acts in free-market corruption (petty corruption). In a captured or a criminal state, discretional intervention reaches a higher level: it becomes a structural or constitutive element and there are
numerous servers involved in large corrupt networks, connecting formerly independent actors and institutions of the state machinery (grand corruption).°\textsuperscript{140}

To sum up, the way from the ideal typical “state” to the criminal state can be interpreted as a way from the impetus of creating the rules of the game to the impetus of building a patron-client network. In a criminal state, patronal relations define state intervention, resulting in great rewards and wealth for some, and bitter punishments and impoverishment for others. In place of a market economy of competing autonomous actors, a relational economy of dependent actors is established \(\rightarrow 5.6\).

5.4.1.2. The means of state intervention

Having described the character of state intervention, we now may turn to its means. In other words, the question is the following: What do political actors actually do when they intervene normatively or discretionally in the private economy? The answer varies in states of different legal status which, allows us to make a diagram similar to Figure 2.2 (Figure 5.11). A crucial difference, however, is that in Chapter 2’s diagram, as we moved toward the criminal state, the nature of state action (intervention) changed, meaning it was qualitatively as well as quantitatively different in the distinct state types. But as we already indicated, the means of state intervention do not change but build on each other. In other words, the higher forms of corruption appear, the more types of means become available for political actors, while the ones which were already there are still being used—in line with the general character of state intervention shown above. To be specific: in a corrupt state, governmental actors use normative means and corrupt administrative actors affect those means’ implementation, but the former still remain definitive as the latter do not pass new laws but simply exercise illegal veto power over the implementation of existing rules and regulations. In a captured state, corrupt elite actors of the sphere of political action intervene discretionally and non-corrupt ones, normatively, while some of the discrentional implementation which was carried out by independent public administrators in a corrupt state will now be the duty of the servers in corrupt governmental networks. Finally, in a criminal state, public administrators are all integrated in the single-pyramid patronal network and they affect implementation discretional at the orders of the chief patron, while central acts of discrentional intervention coexists with normative interventions, instrumentalized to the needs of the adopted political family.

As for the content of laws, although several typologies of state activism have been suggested by scholars for different capitalist economies,\textsuperscript{141} we offer the one below for the purposes of our framework. We divide the types of state intervention into four general groups:

- regulatory intervention, which includes state regulations such as price control, prohibition, or limiting entry to a market by monopolistic grants;
- budgetary intervention, involving every intervention that is part of the redistribution process, such as taxation and the resultant government spending;

\textsuperscript{140} In the figure, every leap between emphasized points (state types) is shown as equal. However, this is not part of the definition, which includes only that the function is strictly monotonically increasing. How big the leaps are is a question of empirical analysis in every case (polity).

\textsuperscript{141} For an example in the “varieties of capitalism” paradigm, see Levy, “The State after Statism.”
• **property-taking intervention**, referring to the public takeover (nationalization) of non-monetary property, such as the land or company of private actors;

• **supervisory intervention**, which involves the workings of the various control agencies of the state, such as the police and the tax office.

Figure 5.11. The correlation between the means of state intervention, the level of collusive corruption, and the inactivity of controls.

Supervision is usually not regarded as a form of state intervention. For in neoclassical macroeconomics, the state intervenes to promote the public good and the existence of supervisory agencies is no more than a mere technicality, providing the vehicle or the control mechanisms that make the (normative) interventions of the three other types possible. However, these agencies do use state coercion during compulsory supervision that makes them agents of state intervention even in a liberal democracy.¹⁴² As we move from the constitutional state to the criminal state, the less these agencies work as controls and the more they become instruments of selective law enforcement \(\rightarrow 4.3.5\). In the economy, this means that supervisory agencies can be used to discretionally determine how stifling the environment of an

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economic actor is—whether he is constantly subject to (tax or other) inspections or never, whether fines are imposed on him or not etc. In short, supervisory intervention becomes, rather than a guarantee of normativity, an instrument of discretionality \[\rightarrow 4.3.5, 5.5.4]\.

From this, it follows that supervisory intervention gets more and more corrupted as we move from lower to higher forms of corruption. Indeed, while inactivity of control mechanisms is one of the key prerequisites of successful corrupt transactions, corruption more generally implies that control agencies are made to take sides with corrupt actors by turning a blind eye to the corruption of their side (krysha) and engaging excessively with targets on other sides.

From the starting point of the “state,” controls are fully active and the state engages in all four types of intervention on normative bases. In the corrupt state, free-market corruption can become endemic only if control mechanisms are locally disabled, that is, the actors responsible to prevent corruption in the infected area of public administration are persuaded to disregard the prevailing corrupt relations. Thus, it becomes possible to discretionally veto the implementation of normative state intervention, typically in exchange for bribery (kickbacks).

On the level of the corrupt state, it is less likely that corrupted control agents are used to attack targets, for the public administrators engage in corrupt transactions only occasionally and such activities are limited to those private-sector initiated occasions. True, certain actors could try to use control agents to reduce competition from other corrupt participants, but as every such actor is connected to only a few control agents and none of them controls the entire local agency personally, such hostility would risk the elimination of the corrupt business of both parts. The situation is different in a captured state, where discretionary decisions of state intervention are made on the subregime-level, that is, in the area under the authority of a single subdivision of the state machinery (a state organization, a ministry, a municipality etc.) which they can locally monopolize in respect to corrupt transactions. As more permanent schemes are developed, corrupt actors might face entry to their locally monopolized corrupt market or simply make deals which cannot be enforced without threats imposed by selective law enforcement, which is usually made possible with the help of corruption brokers within the state hierarchy. Finally, in a criminal state, all types of intervention can be discretionational with regime-level control mechanisms disabled. The formally controlling institutions become informal weapons in the hands of the chief patron, who can initiate both supervisory intervention and centrally-led predation using the bloodless means of state coercion.

Parallel to the amplitude of arbitrariness that widens as state intervention becomes more and more discretionational, we can find the continuous increase of the amplitude of vulnerability as well. In terms of negative state intervention—that is, one that aims at disadvantaging or attacking certain economic actors—vulnerability refers to the corruption of control mechanisms and the attacked actors’ ability to defend themselves via formal institutions. The closer the state is to the criminal state, the more ability the corrupt actors have to use supervisory intervention to their own benefit, and consequently the fewer autonomous institutions of the law the attacked actors can turn to in the hope that they will have the ability and willingness to defend them (by exercising effective control).\[143\] In terms

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of positive intervention—that is, one that aims at advantaging certain economic actors—vulnerability refers to the preferred actors’ dependence on the state as a single source of wealth. In a market economy free of discretionary intervention, it is the consumers who buy or refrain from buying, and therefore they decide who will survive and grow and who will have to look for another occupation or business. The point of discretionary intervention is precisely to remove this decision-making power from the hands of the consumers and give it to a political actor, who can thereby reward economic actors. But the more an economic actor’s success is a result of the discretionary intervention rather than competitiveness and market performance, the less the actor is able to keep and build a fortune autonomously, and the more he becomes dependent on the leading political elite and its discretionary favors. Possibly, some clients have entrepreneurial skills they could profit from under free-market conditions, especially if they are coerced into the corrupt relationship rather than voluntarily choosing it instead of the otherwise existing market [→ 5.3.2.3]. Yet in such cases, that is, being a client in a patronal network typically means higher profits and requires less (innovative market) efforts than being an entrepreneur in competition [→ 5.5.4.3], which means the same actors could not reach the same wealth without discretionary support. In addition, Tamás Gallai is right to point out that competitive businessmen typically have a headstrong, autonomous character, which also entails a poor tolerance for dependency—and this is not true of the clients in a patronal network.144 The general point is that, the greater the weight of discretionary intervention is, the wider the amplitude of vulnerability is; the path from the corrupt state to the criminal state means the path from single, individual corrupt transactions to vassalage and patronal dependence.

In the following parts, we elaborate on two of the four types of state intervention: regulatory and budgetary intervention. As for supervisory intervention, first, we already analyzed politically selective law enforcement in the previous chapter [→ 4.3.5] and, second, the previous few paragraphs were devoted to the forms and effects of supervisory intervention. The reason we did this and did not give supervisory intervention a separate part is because it is more general than, and indeed encompasses, the three other intervention types. As far as property-taking intervention is concerned, we decided to explain it in the context of ownership in the next part, where we offer a broader analytical framework for nationalization and property rights [→ 5.5].

5.4.2. Regulatory Intervention: The Forms of Rent Creation

5.4.2.1. General definitions

The broadest definition of regulatory intervention is using state coercion to prohibit people from making an exchange. More specifically, the state, relying on its monopoly of the legitimate use of violence, can prohibit the sale of a certain product or can prohibit a sale above or below a certain price.145 A common example for the latter—price control—is the

144 Gallai, “Mennyire veszélyes Oroszország a Nyugat szabadságára?” [How dangerous is Russia to the liberty of the West?].
145 Rothbard, Man, Economy, and State, 1075.
minimum wage law, which defines a so-called price floor below which employment is not allowed. Types for the former—product control—include (a) total ban, when a product cannot be sold or bought by anyone, and (b) partial ban, when a product can be sold or bought only by people with authorization. The forms of such authorization range from occupational licenses through compliance with labor and consumer protection rules to outright monopoly grants to certain producers, who are selected to fulfill a monopolized state activity. Indeed, both partial ban and price control entail prohibition, for certain types of economic activities are outlawed—namely, the activity of those without the state’s seal of approval. In a regulated market, only those can pursue a business who meet the state’s requirements; everybody else is forcibly prevented from selling and/or buying (making offers). Unauthorized exchanges in a regulated market are subject to criminal persecution by the state.

The result of partial ban is creating barriers to entry to a certain market, whereby those already in the market enjoy more or less protection from potential competitors, who need to pay a fixed cost before they could start competing. From the point of view of those who wish to enter, regulatory intervention counts as a specific instance of closing an open market. Weber distinguishes open and closed social relationships, writing that a relationship “will be spoken as ‘open’ to outsiders if and insofar as its system of order does not deny participation to anyone who wishes to join and is actually in a position to do so. A relationship will […] be called ‘closed’ against outsiders so far as […] participation of certain persons is excluded, limited or subjected to conditions.” Inspired by this distinction, we offer the following operational definitions for open and closed markets:

- **Open market** is a type of market where the entry of new competitors does not depend on the decision of the state or the market’s incumbents (already entered market participants).

- **Closed market** is a type of market where the entry of new competitors depends on the decision of the state or the market’s incumbents (already entered market participants).

In economic terms, the definition of open market is closest to that of perfect competition, the main difference being that in perfect competition there are no barriers to entry whatsoever, whereas in an open market there can be barriers which are not set by the state or the incumbents (such as the cost of training or buying equipment to set up a business). On the other hand, the definition of closed market is closest to that of monopoly, the main difference being that a monopoly implies a single seller, whereas a closed market can have many sellers if the privilege of entering the market is granted to a high number of actors. Indeed, “closedness” implies not a single situation but a range of situations: the higher the barriers the state or incumbents create, the more closed the market is.

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146 For a meta-analysis, see Dal Bó, “Regulatory Capture.”
While our definition allows for the possibility of private actors closing a market, we now focus on state intervention and the cases when closed markets are brought about by regulations. Regulatory intervention favors incumbents, who can reduce production and increase prices—in short, can reach higher profits, other things being equal—as a result of the (partial) protection from potential competition. Based on the idea of Szelényi and Mihályi, we can call the difference between the profit reached in the market when it is open and when it is closed rent.

- Rent is the profit stemming from the lack of competition. More precisely, rent is the difference between (1) what income would have been in an open market and (2) the actual income, resulting from closing the market to certain participants.

Understood in this sense, rent is “an opportunity cost measure. This means that both revenue and production cost must be understood from the vantage point of opportunity cost. [Thus], the revenue from the sale of the resource is to be understood not as the actual revenue received from the sale but the potential revenue if the resource were sold at the market price. In other words, it is what would be obtained if the resources were used efficiently. Although it might be assumed that the difference between what could potentially be received from the sale of a given quantity from the resource and the actual revenue received is forgone earnings and therefore not subject to analysis of total rent, we emphasize that this ‘forgone’ amount is an essential element of the rent, and its very existence reflects decisions that are made concerning the deployment of the wealth” (emphasis added).

Several definitions of rent in the literature are broader than this and closer to Adam Smith’s notion of “reaping without sowing,” that is, getting wealth without creating wealth. However, most of the opportunities for this stem from the government closing open markets and rent-economists indeed predominantly analyze such cases. Thus, using our definition of rent does not imply a rejection of the existing literature. Rather, we find this definition more adequate for the purposes of our framework, which focuses on regimes and how the political power structure affects the workings of the economy.

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150 The obvious case is when the entry depends on the ownership of a type of asset which cannot be obtained by anybody else but the market’s incumbents, such as a patented technological innovation or a privately owned natural resource (which has no reasonable substitutes of). Szelényi and Mihályi, Rent-Seekers, Profits, Wages and Inequality, 64.

151 Varian, Intermediate Microeconomics, 445–51.

152 Szelényi and Mihályi, Rent-Seekers, Profits, Wages and Inequality, 57–58. Indeed, our definitions of “open” and “closed” market, while similar, are not the same as those of Szelényi and Mihályi. Yet the market we understand as closed is regarded as closed by them, too.

153 Gaddy and Ickes, “Russia’s Dependence on Resources,” 311.

154 For a meta-analysis, see Szelényi and Mihályi, Rent-Seekers, Profits, Wages and Inequality, 25–51.

155 Congleton and Hillman, Companion to the Political Economy of Rent Seeking.
5.4.2.2. From normatively to discretionally closed markets

In a regulated market—that is, a market closed by the state via regulatory intervention—who gets the privilege of competing depends on the decision of the state. If the state’s decision is based on normative criteria, we can speak about a normatively closed market. Normative criteria are predefined in formal laws and, while they institute a barrier to entry, anyone who meets them is automatically let in the market to compete. Examples for normative criteria include various licenses, such as occupational or import licenses, the possessors of which get rents resulting from the artificially lowered intensity of competition.\(^\text{156}\)

In a constitutional state with no corruption, no one is excluded from competing who meets the formal criteria. If a public actor can discriminate among entrants, that is, he can (a) let in an actor who does not meet the criteria (positive discrimination) and (b) exclude someone who does meet them (negative discrimination), we can speak about a discretionally closed market. In a corrupt state, one needs to bribe a public administrator to enter and is excluded if he refuses to pay, irrespective of compliance with the formal criteria. Thus, instead of normative rent-collection under a non-corrupt administration, opportunities for rent-seeking become custom-made.\(^\text{157}\) However, in a corrupt state the amplitude of arbitrariness is relatively low, which means that there is a limit as to how much of a bribe can be asked and also whether the public administrator can change the terms of the deal and refuse to let in someone, discretionally, who has paid the prearranged kickback. The political reasons for this are that (1) no corrupt actor can disable every control mechanism or use the agencies of state coercion as servers of a corrupt network, and (2) every public administrator is granted autonomy, meaning they receive no orders from the top as to who to advantage or disadvantage specifically and they can engage in corrupt transactions “freely.” This leads to the economic reason of limited bribes and the relative security of corrupt contracts, namely the competitive nature of free-market corruption. Basically, as there are many public administrators with similar competences, the supply of the corrupt service is not monopolistic but can be numerous. As Holcombe writes, “if […] import licenses can be granted by dozens of customs houses in multiple ports of entry, rent-seekers can approach a second (or third) customs house if they are turned down by the first. The multiple customs houses will be competing with each other in the granting of rents […], which will reduce the payoff they can demand.”\(^\text{158}\) Indeed, in such cases, the high level of competition and the low level of discretionality political actors can afford in closing markets might even tame corruption to become an informal but fixed barrier to entry, which entrepreneurs can calculate with as a “special customs levy,” almost as if it was a legally enforced barrier.\(^\text{159}\) Yet the fact that decision-making is still in the hands of a corrupt public administrator implies the presence of risk of discretionality, which means the market still counts as discretionary—although it is rather close to a normatively closed market.\(^\text{160}\)

\(^{156}\) Stigler, “The Theory of Economic Regulation.”
\(^{157}\) Kaufmann, “Corruption.”
\(^{158}\) Holcombe, Political Capitalism, 2018, 115.
\(^{159}\) Weber also writes that corruption is mostly problematic when the bribes are “highly variable” and corrupt deals are “settled from case to case with every individual official.” Weber, Economy and Society, 239–40.
Discretionary closing is markedly different in a captured or criminal state, where corrupt actors have the opportunity to carry out **discretionary regulatory intervention** (on the subregime- or the regime-level). As opposed to normative intervention such as licensure, discretionary intervention targets certain actors and provides rewards or punishments to them. There are four ideal typical ways of discretionary regulatory intervention, using informal as well as formal means (in actual cases, the ideal types can be combined):

1. **Formal discretionary treatment.** The state can issue a discretionary law like a custom-tailored lex (→ 4.3.4.2) in which it grants a competitive advantage (or disadvantage) to a certain firm, such as exempting it from (or forcing to) a preexisting or newly introduced regulatory requirement the others—active and potential competitors—must (or need not to) meet.

2. **Informal discretionary treatment.** The competitive advantage (or disadvantage) can also be given by using informal means, such as combining regulations with selective law enforcement (supervisory intervention). *De jure*, all firms need to comply with the laws but supervision is, *de facto*, either inactive (positive discrimination) or more active against the rivals of the oligarch or front man (negative discrimination).

3. **Monopolization of a market.** A simple way of making favorable regulations discretionary is to exclude everyone from an existing market besides the ones to be favored. After the market is cleared by regulatory intervention, the oligarch or front man is granted a monopoly right, enforced by state coercion, to be the sole suppliers of the given product.

4. **Creation of a market.** Finally, the state can create a market by commissioning a previously non-existent economic activity from private actors. Afterwards, in a formally normative but informally hampered competition for getting the right to produce (and reap the rent) the oligarch or front man is given the monopoly right to carry out the activity.

As we explained in the previous chapter, the use of direct discretionary law, while not unprecedented, is less typical than the use of indirect discretionary law, that is, custom-tailored lexes. The creation of such lexes and formal discretionary treatment in general usually requires a deactivation of regime-level controls, such as the constitutional court, which might nullify rules that violate the principle of competitive neutrality. Therefore, such treatment is possible typically in a criminal, but not a captured, state. At any rate, the aim of discretionary regulatory intervention is to close markets discretely: activities are allowed to chosen clients while others are either excluded from the market or need to comply with such rules and regulations the clients are exempted from.

Up to this point, we compared normative and discretionally closed markets on the basis of the form of state intervention. A second aspect they can be compared by is the **benefits of the incumbents.** In case of normative regulations, the benefits and losses are

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161 For example, in Russia in 2007 “a fundamental revision of the law on state corporations granted [oligarch’s] conglomerates tax preferences, wide-ranging regulatory exemptions, and operational independence from local state bodies.” Markus, “The Atlas That Has Not Shrugged,” 111.
normative and non-excludable. Let us take the example of a tariff, which is the textbook case of rent creation in liberal democracy and indeed is none other but a regulatory requirement of paying a fee (tax) for entering a domestic market.\footnote{Tullock, “The Welfare Costs of Tariffs, Monopolies, and Theft.”} A tariff sets a barrier to entry to some kind of product, affecting everyone who produces it (normativity) and benefiting all the domestic producers who face competition of lower intensity (non-excludability). On the other hand, in case of the four ways of discretionary regulatory intervention we identified, as well as discretionary treatment resulting from occasional corrupt deals in a corrupt state, benefits are narrowed to the demanders of corrupt services. Only those who pay, or are appointed by a patron, for preferential treatment are treated discretionally, while other market incumbents indeed face losses (normatively) vis-à-vis the corrupt actor who got a competitive advantage. Thus, we can say that in discretionally closed markets benefits are discretionary and excludable.

A third aspect to compare normatively and discretionally closed markets is by the character of payments of private to public actors for various services related to the obtainable rent. Indeed, there are three of such payments for state services: (1) payment to enter a closed market, (2) payment for creating a rent, and (3) payment for maintaining the rent, that is, to not to change the—normatively or discretionaly beneficial—status quo.\footnote{In the literature, the request for this third kind of payment is called rent extraction. McChesney, \textit{Money for Nothing}.} In a normatively closed market, (1) implies a normative fee to be paid to the state administration, such as for registering in a certain profession (issuing a license or certificate etc.).\footnote{Sometimes states do not require payment for these administrative services. In such cases, we can say that the requested payment is normatively zero.} As for (2) and (3), politicians might request minor personal benefits or bribes but they mainly use these relations to strengthen their political position \( \rightarrow \text{5.3} \). Political benefits usually include campaign contributions from interest groups, which thus provide a competitive advantage to a politician or political party.\footnote{For a seminal paper, see Grossman and Helpman, “Protection for Sale.”} In a discretionally closed market of a corrupt state, only (1) appears as a payment of bribes to corrupt public administrators. In cases of top-down state capture or a criminal state, however, where informal patronal networks are developed, bribes as well as campaign contributions disappear. Indeed, as Grigory Yavlinsky points out, “using private business resources to secure elected positions [in a patronal autocracy] is rather difficult, both because elections are controlled by the authoritarian ‘power vertical’ and because very few elected positions confer any real power and freedom of action in the first place”\footnote{Yavlinsky, \textit{The Putin System}, 103–4.} \( \rightarrow \text{4.3.3, 4.3.4.4} \). Instead, three other kinds of payments may be requested in (1)-(3) by patrons:

1. personal benefits in the form of protection money;

2. economic benefits in the form of informally getting partial ownership rights of the preferred economic actor’s property (that is, making him, at least to a part of his property, a front man \( \rightarrow \text{5.5.3.5} \)).
3. **patronal benefits** in form of loyalty towards, and obedience to the informal orders of, the patron.

Finally, normative and discretionally closed markets can be defined by the nature of rent-seeking. Although “rent-seeking” has come to denote the activity of reaping rents as well, in its original economic meaning the term refers to the efforts of market incumbents to persuade the government to erect barriers to entry and create rents for their benefit in the first place (hence they show “seeking” behavior). In a constitutional state, although markets do become closed due to the use of regulatory intervention and outlawing some potential competitors, rent-seeking remains open and competitive, that is, there is no state-imposed barrier to entry to rent-seeking per se. Anyone can lobby for favorable regulations—in a bottom-up fashion—whereas the government does not have a predefined list of winners (and losers) who would be given benefits—in a top-down fashion, regardless of their lobbying efforts. However, this leads to what rent-seeking literature refers to as rent dissipation. Interest groups spend resources on lobbying to capture the rents, and this constitutes a cost which decreases their benefits. Simply put, they do not just get the rent but have to pay a price for it, which in a competitive market, where several interest groups bid for the opportunities, might even reach the amount of the rent itself. In other words, the profit the rent-seekers eventually get from their state-protected position must also include the cost of acquiring the position with a negative sign, and therefore rents are diminished as a result of the competition—that is, rents get dissipated.

The obvious way to reduce rent dissipation is to institute barriers to entry to rent-seeking, that is, to make the market for rent-seeking closed and non-competitive. As Holcombe points out, “[rent-seeking] that works to the advantage of those who create the rents must limit competition for those rents so that all the rents are not dissipated. […] The creation of such a barrier to entry is easy to envision in an autocracy, because it is to the autocrat’s advantage to do so” (emphasis added). As for the exact form of this barrier, Holcombe opines that it can be established “by limiting the grant of rents only to people who are close associates of the autocrat […] or to those who offer an explicit payment to the autocrat in exchange for the opportunity to capture a rent.” Indeed, the latter option fits the cronyism or bottom-up state capture pattern of corruption, whereas

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167 For the seminal work on the field, see Buchanan, Tollison, and Tullock, *Toward a Theory of the Rent-Seeking Society*.

168 Holcombe argues that, in a democratic environment, the high transaction costs of the masses are (non-state imposed) barriers to entry to rent-seeking, and this is why it is virtually always the elite that gets the rents at the expense of the masses. Holcombe, *Political Capitalism*, 2018, 111–15.


171 Mainstream literature on rent-seeking argues interest groups are willing to spend up to the value of the rent (so normal profit is reached, just like in perfect competition). Holcombe, relying on behavioral economics, argues that this outcome would require risk-taking behavior and that is unlikely, so smaller dissipation of rents is more probable. Holcombe, *Political Capitalism*, 2018, 107–10.


the former one can happen when an autocrat is able to dispose over all branches of power and close markets discretionally at will (that is, in a criminal state).

To sum up, Table 5.7 shows the main characteristics of normatively and discretionally closed markets. Our terminology can be well linked to that of North and his colleagues, whose comparison of open and limited-access orders (“natural states”) apply to regimes with normatively and discretionally closed markets as well [→ 2.4.6]. Indeed, we are less optimistic about rent-seeking in liberal democracy than the authors, but we agree with their contention that rent-creation “that benefits only a narrow interest is […] much less likely to occur in an open access society than in a natural state. Conversely, rent-creation that benefits large and encompassing groups […] is much more likely to occur in an open access society than in a natural state.”

### Table 5.7. Comparing normatively and discretionally closed markets.

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<thead>
<tr>
<th></th>
<th>Normatively closed market</th>
<th>Discretioneally closed market</th>
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<tbody>
<tr>
<td>Decision about entry or exclusion</td>
<td>normative</td>
<td>discretionnal</td>
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<td>Formality of regulations</td>
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<td>Benefits and losses of incumbents</td>
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<tr>
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<td>• normative fee</td>
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<tr>
<td>Payment for rent-creation (and maintenance)</td>
<td>• political benefits (e.g., campaign contribution)</td>
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<tr>
<td></td>
<td>• personal benefit (bribe money)</td>
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</tr>
<tr>
<td>The nature of rent-seeking</td>
<td>open/competitive (no state-imposed barrier to entry)</td>
<td>closed/non-competitive (state-imposed barrier to entry)</td>
</tr>
</tbody>
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5.4.2.3. The rent-seekers: from interest groups to patronal networks

Typically, rent is obtained by those who seek it. In other words, it is worth recalling the basic premise of relational economics, namely that policy decisions follow from relations: actors who might benefit (or lose out) from a regulation are incentivized to act for (or against) it and they influence and try to shape state functioning accordingly.

**In a liberal democracy**, such action is typically undertaken by interest groups, the main function of which is interest representation carried out in a legal and (ideal typically) transparent way [→ 4.3.2.3]. In theory, communal actors (such as citizens or churches), political actors (such as mayors or governors) and economic actors (such as employers or employees) can form interest groups in a liberal democracy. In practice, ac-

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175 Berry and Wilcox, *The Interest Group Society*. 
tors that tend to be most active are economic actors and big business, exerting influence on the sphere of political action. One of the reasons—besides the above-explained difference in the transaction costs of participation—is that it is less obvious for ordinary people how a change in the regulatory framework affects their everyday life, given that such changes often affect the industries directly whereas the people experience the effects indirectly. As Holcombe explains, “regulations often facilitate group formation, because it is easy for those in a regulated industry to see that they have a common interest in avoiding the costs imposed by regulation, and by enjoying any benefits that might be produced by it.”

Accordingly, we now focus on economic interest groups of major entrepreneurs, which may also be called business groups. We can derive important characteristics of these groups from the definitions as well as Holcombe's analysis. First, business groups are made up of entrepreneurs from the same industry. In other words, business groups are homogeneous by the activity of their members, from which it follows that business groups are sector specific. Furthermore, the members and the sector, by definition, are situated in a separated sphere of social action, namely the economic sphere, which is in formal/legal relation with the sphere of political action via lobbyists.

Second, we repeat what has already been stated in the analysis of normatively closed markets: that regulatory intervention as well as the benefits and losses of the group's members are normative. We repeat this point not only because it is crucial in distinguishing rent-seekers in normatively and discretionaly closed markets, but also because non-excludability of benefits can be fully comprehended only in this context. From the point of view of a business group, non-excludability means that a member of the industry who may not even have entered the business group (or did enter but did not participate actively) will still receive the benefits of successful lobbying, given the same new regulations are going to apply to his firm as to those of the more active members. Therefore, non-excludability may lead to free riding, which is often cited as a hindrance to interest group formation. Yet this is typically a less significant problem with business groups where individual participation of entrepreneurs carries greater weight in the competition for governmental favors.

The fact that regulations and benefits are normative in a liberal democracy is well illustrated by a famous article by George Stigler, which identifies four ways of using a constitutional state's power for interest group benefit. Stigler finds that (1) direct cash transfers, (2) regulation of control of new rivals, (3) regulation of suppliers of substitute products and (4) price fixing are the ways by which the state can help market participants reach higher profits. From these, (2)-(4) are normative interventions, benefiting everyone who produces a given product or belongs to a certain economic sector. The only one of these which can indeed be given to certain companies or people discretionally is (1), direct cash transfers. However, Stigler notes that “an industry with the power to obtain governmental favors usually does not use this power to get money,” for “unless the list of beneficiaries can be limited by an acceptable device, whatever amount of subsidies the industry can obtain will be dissipated among


178 For a meta-analysis of the theories of interest group influence in liberal democracy, see Gilens and Page, “Testing Theories of American Politics.”

179 Stigler, “The Theory of Economic Regulation.”
Beyond that he himself talks about “an industry” and not “a person” or “a company,” Stigler’s observation is ideal typical to liberal democracies, where effective formal laws as well as the competition of various factions limit the constitutional state in determining specific individual targets for governmental benefits.\footnote{Stigler, “The Theory of Economic Regulation,” 5.}

The final characteristic feature of ideal typical business groups is that they are horizontal alliances of autonomous actors. In other words, while some members of the group may be more important in a given lobbying process, no one subordinates others in the group. Also, unlike some other interest groups, like the associations (“chambers”) created and/or maintained with the help of the state, membership is not compulsory in business groups. Major entrepreneurs have the free entry (and free exit) option if they are part of the respective industry.

The character of rent-seekers is vastly different in patronal regimes. This follows from the lack of separation of the spheres of social action in general and that entrepreneurs disappear and are replaced by oligarchs as the main economic actors in particular [\cite{3.4.1}]. Theoretically, it is possible that autonomous oligarchs form a horizontal alliance and organize an “interest group,” which will be different from the interest groups of market economies only in their means of pressuring the government (for they will employ informal as well as formal means). However, (1) this is possible only in transitional regimes, such as the oligarchic anarchy of transitions, or a patronal democracy, where no political actor gets unconstrained political power (and there can be autonomous oligarchs [\cite{3.4.1.3}]), and (2) it is more likely even under such circumstances that oligarchs get embedded in rival patronal networks and fight instead of forming an autonomous “interest group.”\footnote{Markus, “The Atlas That Has Not Shrugged,” 106.}

It is worth comparing business groups—the basic unit of which is the entrepreneur—with informal patronal networks—the basic unit of which is the oligarch (Table 5.8). In contrast to the above outlined features of business groups, patronal networks are made up of oligarchs from different industries. In other words, patronal networks are heterogeneous by the activity of their members, from which it follows that business groups are sector neutral. Indeed, informal patronal networks are “all-eaters” in the sense that they are ideal typically not confined to a single economic sector but hold large portfolios of any sector they can seek rents from.\footnote{Hale, Patronal Politics, 98–110.} Furthermore, patronal networks are composed of actors of colluding spheres of social action, which includes poligarchs as well as oligarchs (and front men), who employ different types of corruption brokers as mediating actors, who carry out interest collusion.

Second, we repeat what has already been stated in the analysis of discretionally closed markets: regulatory intervention as well as the benefits and losses of the group’s members are discretionary. As for the former, regulations target not specific sectors or industries but specific people, and only those who accept the authority of the chief patron can enter a preexisting network. This is in sharp contrast with business groups, where entry to a market in general and the business group and lobbying process in particular is normative and (ideal typically) can be done by anyone who has the right material means.

\footnotesize
\begin{itemize}
  \item \textsuperscript{180} Stigler, “The Theory of Economic Regulation,” 5.
  \item \textsuperscript{181} Holcombe, Political Capitalism, 2018, 112.
  \item \textsuperscript{182} Markus, “The Atlas That Has Not Shrugged,” 106.
  \item \textsuperscript{183} Hale, Patronal Politics, 98–110.
\end{itemize}
Moreover, while benefits and losses for interest groups were non-excludable, they indeed are excludable for the members of a patronal network. This means that the chief patron, who ultimately disposes over favors and punishments, can favor specific oligarchs while not favoring the others as a result of discretionally regulatory intervention as well as the wide amplitude of arbitrariness associated with the chief patron.

To sum up, ideal typical patronal networks embody vertical patron-client relations of dependent actors, as opposed to the horizontal relations of interest groups. Indeed, in a liberal democracy, where the spheres of social action are separated, business groups are the associations of the economic elite, whereas the members of the political elite are organized into a different type of groups: parties \[\Rightarrow 3.3.7–9\]. In contrast, in a patronal autocracy, where the spheres of social action collude, political and economic elites merge and an informal patronal network, the adopted political family is formed. Therefore, while lobbying is clearly distinguishable from corruption in a liberal democracy, in a patronal autocracy the two fade into each other.\footnote{Cf. Laki, “A trafikpiac folytatódó átalakítása 2014 és 2017 között” [The continuing restructuring of the tobacco-shop market in 2014–2017].}

### 5.4.2.4. Governmental rent collection: the rent-seeking state

Having dealt with state-created rents and rent-seeking, we can now reflect on a concept we introduced in Chapter 2—the rent-seeking state. Using the terms introduced in the previous part, we can say that a rent-seeking state is a state that shows rent-seeking behavior, meaning that it closes markets for its own benefit.\footnote{Conybeare, “The Rent-Seeking State and Revenue Diversification.”} The state is the local monopolist of a number of (public) services and it collects taxes to finance them. If this way it sets
a higher price in tax than what would have been if the services were on an open market, the state overtaxes and starts collecting rents [→ 2.4.4]. Spending these extra resources for private gain, cronyism or nepotism—services which the public would not pay for—is called favoritism. Common examples include expanding state bureaucracy/companies and offering positions with high salaries therein to friends or fellow party members; spending tax monies on extra benefits for politicians; or giving bailouts to particular firms. While such benefits are discretionary, neither these nor overtaxation are necessarily illegal. They are often created with the expansion of the state sector and positions related to the state, forming positions to give to party members (like positions in state-owned and state-controlled enterprises).

It is important to note that the “rent-seeking state” is not the same as the “rentier state,” used in the literature when a state derives a substantial portion of its revenues from oil or from similar, “freely accessible” lucrative sources. This is the most important divergence between our definition of rent and the mainstream one: in traditional understanding, exploiting a natural resource—such as oil or natural gas—counts as “reaping without sowing” and therefore pure rent collection. In our understanding, exploiting a natural resource is not rent collection per se, for rents exist only to the extent of the difference between the actual and the open market profits. Nevertheless, a “rentier state”—understood in the traditional way—can still be rent-seeking in our terms, too. This is shown by Clifford G. Gaddy and Barry W. Ickes, who analyze natural-resource rent seeking in Russia by our definition of rent. According to them, Russian energy rents are generated by five elements: reported costs excess of the open-market cost, which they call the “natural cost” of production; price subsidies; formal taxes; informal taxes, which in our terms are protection monies [→ 5.3.3.1] that are given out in overpriced contracts; and the after-tax profit of the enterprise. The authors explain that these benefits are shared among several actors, including Putin and regional patrons as well as the state budget and the formal owners of the energy company, who hide some of the profit to keep it for their own purposes and prevent its collection by the adopted political family.

On the other hand, rents are generated by the fact that international energy-markets are closed, following the myriads of regulations and agreements in every country of interest, and therefore resource-owner states are able to collect rents in our sense as well (albeit not in that amount as if we counted their entire profit as rent). One might even claim the international energy market is, in fact, discretionally closed, as beyond normative regulations, entry to a national energy market by another nation often depends on political considerations and the prevailing geopolitics of the energy market, too [→ 5.3.4.4]. In some cases, even transit countries for energy can become rent-seekers: as Alexei Pikulik notes, the

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186 On party favoritism, see Kopecky and Spirova, “Jobs for the Boys?”
187 Kozarzewski and Baltowski, “Return of State-Owned Enterprises in Poland.”
188 Schlumberger, “Rents, Reform, and Authoritarianism in the Middle East.”
189 Pikulik, “Belarus, Russia, and Ukraine as Post-Soviet Rent-Seeking Regimes.”
190 Or rather a more formalized version of it. See Gaddy and Ickes, “Russia’s Dependence on Resources,” 311–12.
geographical location of Belarus and Ukraine “allowed both countries significant leverage over Russia, and the ability to extract significant rents,” which they pursued as “a rather deliberative strategy. […] One illustration of this was the proposal during the 1993 Massandra summit to write off Ukraine’s gas debts to Russia, in exchange for the lease of the Sevastopol port and the sale of the Black Sea fleet to Russia. Another illustration is the purchase of Belarusian willingness to participate in integration projects with Russia (the Union State of Russia and Belarus, the Customs Union, and so forth) with generous energy grants.”

Possible combinations of the rent-seeking state and other states we have worked with so far in this chapter (corrupt/captured/criminal state) are shown in Table 5.9. Following the definitions of each state type, we can say that the ideal typical “state” as well as a corrupt state can be rent-seeking. On the other hand, a corrupt state as well as a captured state may involve illegal acts of rent creation/collection as well, which makes them potential kleptocratic states. Finally, a more extreme captured state or a criminal state reach the predatory state level [→ 2.4.3, 5.5.4–5].

Table 5.9. Intersections between interpretative layers of state action targeting property and legality.

<table>
<thead>
<tr>
<th>Legality</th>
<th>State</th>
<th>Rent-seeking state</th>
<th>Kleptocratic state</th>
<th>Predatory state</th>
</tr>
</thead>
<tbody>
<tr>
<td>State</td>
<td>+</td>
<td>+</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corrupt state</td>
<td></td>
<td>+</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>Captured state</td>
<td></td>
<td>+</td>
<td>+</td>
<td></td>
</tr>
<tr>
<td>Criminal state</td>
<td></td>
<td></td>
<td></td>
<td>+</td>
</tr>
</tbody>
</table>

5.4.3. Budgetary Intervention: The Forms of Taxation and Spending

5.4.3.1. General definitions

Budgetary intervention refers to the coercive redistribution of wealth, money or monetary property, by the state. Unlike regulatory intervention, which prohibits certain forms of market transactions in a single act, budgetary intervention is more of a linked action where coercive acts of state intervention are combined with non-coercive acts of budgetary spending. As for the coercive acts, we can identify the most important source of revenue for any state—taxation.

- **Tax** is a form of state intervention, compelling a private actor—the taxpayer—to transfer wealth to the state as part of his legal economic functioning (on a regular basis).

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193 Pikulik, “Belarus, Russia, and Ukraine as Post-Soviet Rent-Seeking Regimes,” 497.
Taxes can be classified by several aspects. However, as we are going to discuss budgetary intervention in terms of normativity and discretionality, the most pertinent aspect is **the target of the tax**, that is, the owners of the assets to be taxed. We may distinguish three types in this respect:

- **general tax**, which is a tax to be paid by the general public, that is, actors from multiple sectors of economic and communal spheres (income tax, value added tax etc.);

- **sectoral tax**, which is a tax to be paid by economic actors from a single economic sector (tax on banking, telecommunication, fast food etc.);

- **discretionary tax**, which is a tax to be paid by (a) a single economic actor or (b) a small group of actors (companies, NGOs etc.) within an industry.

In their legally codified form, all three types of taxes use normative criteria to determine who to tax. But the three types still differ in their effect, that is, who is the one who actually pays the tax in the given economy. We can speak of a sectoral tax if there is an industry of numerous economic actors who all have to pay indiscriminately. In the case of a discretionary tax, the normative criteria are specified and custom-tailored in a way that only a single actor or a small group of actors is compelled to pay it (or at least the tax burden is disproportionately more severe for them than for others in the same economic sector) \[\rightarrow 4.3.4.2\].

After tax is collected from private actors, the revenue is spent by the state. The acts of government spending may be divided into two broad categories: transfers and public services.

- **Transfer** is the form of government spending when tax monies are given directly to certain (groups of) people, either in form of cash—which can be spent on anything the recipient wants—or some kind of voucher—which can be spent only on predefined goods or services.

- **Public service** is the form of government spending when tax monies are given indirectly to certain (groups of) people, in form of a (public) good or service the state spends the monies on.

Although neither of the two forms of government spending involve coercion per se, they are part of the linked action of coercive redistribution and therefore count as part of state intervention.

**In a constitutional state**, budgetary intervention is normative on both the taxing and the spending side. Indeed, even business groups in liberal democracies mainly seek to get favorable regulatory intervention and not budgetary one, because the latter tends to be more diffuse and it mostly targets the general population rather than certain economic sec-

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196 Acocella, *The Foundations of Economic Policy*, 329–49. Naturally, the state can also save money, which, however, is going to be spent at some future date.
Box 5.7. Tax reforms in Russia under Putin.

“The Russian state’s resort to revenue extraction by [taxation] was not initially successful. As the state fell deeper into the abyss of fiscal crisis in the late 1990s, the Yeltsin administration raised the threat of coercion against the largest corporate tax delinquents but could not strike sufficient fear to reverse the revenue decline. After the 1998 fiscal collapse, however, […] a former tax police chief who insisted that ‘people must learn to be afraid of us’ led the government. […] The political decision to keep coercion on a loose leash was visibly apparent in [the following] areas of tax collection: [first], the tax administration underwent an internal restructuring to strengthen extractive capacity, especially in relation to the large corporations that had previously been protected by political patrons. […] Second, the police played a more prominent role in revenue extraction. […] Third, the fine line of legal technicality that separates evasion from avoidance was smudged over by the police and prosecutors who determined that any violation of tax law […] would bring punishment in equal measure. […] In Putin’s first term, the Russian state reassessed its fiscal interests in the transitional economy and by unleashing state coercion reverted back to revenue extraction by taking.”


5.4.3.2. Taxation: the functions of levying taxes

Focusing on the income side of budgetary intervention, various states can be distinguished by what functions they levy taxes for. Among the possible functions of taxation, we may distinguish two groups. On the one hand, there are normative functions, which can be fulfilled by using taxation as normative state intervention, with target groups chosen on the basis of normative criteria and applied to everyone who meet those criteria. In the literature of mainstream economics (public finance), which focuses on normative state intervention, two such functions are identified. The first and most important one is generating revenues. As we mentioned earlier, taxation is one of the main sources of income for the state for financing various transfers and resources-using activities (public services). The second normative function of taxation is inter-sectoral discrimination, which may also be dubbed as economic penalization. Here, the state deems a certain economic activ-

tors.\textsuperscript{197} Also, even when sectoral taxes are levied, the revenues they yield are often “earmarked,” that is, dedicated to specific purposes related to the industry where they were collected from. Therefore, such redistribution is not particularly suitable for an interest group which aims at funneling tax monies from another sector to its own.\textsuperscript{198}

In a corrupt state, budgetary intervention remains normative but its implementation becomes discretionary, mainly through bribing tax collectors and the related control agents of the state. As taxation is the primary source of revenue for a state, it is crucial that it can fight this tendency, although it does not often have the power to do so. This was the case under Yeltsin in Russia, where the state was too weak—and also partially captured—so the central administration could not enforce tax regulations properly. Indeed, it was not until the Putin era that measures to improve the efficiency of tax collection were implemented (see Box 5.7). But besides protection from tax inspections by turning off higher-level controls, corrupt actors in a captured state can also offer discretionary budgetary intervention, including handing out funds from subregime-level budgets to specific cronies or clients and trying to change regime-level tax rules from within the legislation. Discretional budgetary intervention is the easiest in a criminal state, where the chief patron has control over all branches of power, can levy taxes and also disposes over the budget and spending decisions of the state.

\textsuperscript{197} Holcombe and Boudreaux, “Regulation and Corruption.”

\textsuperscript{198} Wyrick and Arnold, “Earmarking as a Deterrent to Rent-Seeking”; Magyar, Post-Communist Mafia State, 160–61.
ity (sector) socially harmful and disfavors it vis-à-vis other alternatives. This manifests in state levies on the harmful activity to make it more costly for people to choose it; and as a consequence similar but non-harmful activities (sectors) get a competitive advantage. In a constitutional state, examples can be roughly divided into two groups, on the basis of whether the state deems the activity harmful (a) from the perspective of the individual or (b) from the perspective of the society (negative externalities). For the former, an example is taxing fast food and thus giving healthy food a competitive advantage; for the latter, we can think of taxing gasoline or cars and thus making more environmentally friendly ways of travelling more attractive. Also, in case of taxes on addictive goods such as alcohol or tobacco, while they belong to group (a), they are often levied to generate revenue, too, for the state can tax them at a high rate without pushing demand back (as demand for addictive goods is inelastic).

On the other hand, there is the group of discretional functions of taxation, which can be fulfilled by using taxation as discretional state intervention. We may distinguish three such (ideal typical) functions:

- **intra-sectoral discrimination**, referring to the aim of creating a non-level playing field for competitors within a single economic sector, where some actors are taxed and others—the discretionally chosen beneficiaries—are not (or significantly less);

- **market acquisition**, referring to the aim of driving the incumbent actor(s) out of a market, clearing it for the entry of a discretionally chosen beneficiary;

- **political penalization**, referring to the aim of penalizing certain actors for political purposes, either to win the sympathy of the voters or to subjugate an autonomous or rival oligarch into a patronal network.

It is worth comparing taxes used to fulfill discretional functions to fines. For fines, which appear in every kind of state, are none other than discretional payment obligations, imposed on specific people for contravention of the law. This means that fines (1) are occasional obligations and (2) need to be paid for the violation of formal, normative rules, and (3) they are imposed in a normative process that afflicts everyone who meets the normative criterion of wrongdoing. On the other hand, taxes levied for discretional purposes, though also discretional payment obligations, entail (1) continuous obligations for (2) the violation of informal, discretional rules (of the informal patronal network), and (3) imposition in a discretional process that afflicts those who are chosen discretionally by the chief patron.

Table 5.10 shows how normative and discretional functions can be fulfilled using different types of taxation. Starting with **general taxes**, they can be used primarily to

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200 There are several taxes that are hard to categorize clearly as (a) or (b). For instance, a tax on fast food is usually communicated as belonging to group (a), whereas fast food consumption also has negative external effects: if more people need to use state healthcare, the state needs to spend more of the people's money on it. See Varian, *Intermediate Microeconomics*, 302–4.


202 This applies to the ideal typical "state" with no corruption. In a criminal state, fines can also be used systematically against a certain target, as part of discretional supervisory intervention.
generate revenues. This is the case not only because general taxes can be spread over a large number of people, each of whom has to pay a trivial sum compared to total revenue collected, but also because this way it is impossible to fulfill any other functions, as a general tax does not discriminate either between sectors or actors. Second, sectoral taxes can primarily be used for inter-sectoral discrimination while they secondarily generate revenues and can be used for market acquisition as well. Finally, discretional taxes are the most suitable to fulfill any of the three discretional functions. In terms of the budget, such taxes generate negligible revenues, and they only affect negatively target companies or individuals. What is essential is that these taxes’ objective, beyond that of an interest in increasing the budget revenues, does not serve the societal interest but rather the elite interest of the adopted political family, its grip on power and accumulation of wealth.

Table 5.10. The possible functions of the three types of taxes.

<table>
<thead>
<tr>
<th></th>
<th>Generating revenue</th>
<th>Inter-sectoral discrimination</th>
<th>Intra-sectoral discrimination</th>
<th>Market acquisition</th>
<th>Political penalization</th>
</tr>
</thead>
<tbody>
<tr>
<td>General tax</td>
<td>+++</td>
<td>–</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Sectoral tax</td>
<td>++</td>
<td>+++</td>
<td>–</td>
<td>++</td>
<td>–</td>
</tr>
<tr>
<td>Discretional tax</td>
<td>+</td>
<td>–</td>
<td>+++</td>
<td>+++</td>
<td>+++</td>
</tr>
</tbody>
</table>

Legend: +++: primary function; ++: secondary function; +: tertiary function
White background refers to the normative and grey background, to the discretional functions.

While in the ideal typical “state” taxes are levied only to fulfill normative functions, taxes with discretional functions appear in captured and criminal states.\(^{203}\) This is not to say that all taxes become discretional: even mafia states collect a substantial part of their revenues from normative taxation, and they rely heavily on the redistributive methods used by constitutional states, too.\(^{204}\) Indeed, this follows from the fact that, as we indicated above in Figure 5.11, states with higher forms of corruption do not abandon the interventions of states with lower forms but supplement them with new ones. In the cases examined above, the new methods added to the criminal state’s arsenal are (1) the discretional tax and (2) the sectoral taxes of the new function of market acquisition.

5.4.3.3. Spending: modes and patterns of state expenditure

Turning to the expenditure side of the budget, to be able to distinguish the redistributive policies of different regimes, it is necessary to analytically divide two levels: (1) the modes of state expenditure, which refers to certain directions of money flows—that they benefit which groups of people—and how tax monies are spent on transfers and public services, and (2) the patterns of expenditure, which are made up of certain modes of redistribution depending on the given situation and regime. In other words, while the modes are the

\(^{203}\) In a corrupt state, there is no discretional budgetary intervention, only the discretional implementation of normative intervention.

\(^{204}\) This point was made in a perceptive review of one of our earlier publications on the mafia state. Váradi, “Nothing But a Mafia State?”
“means,” all of which can be used in various regimes in different combinations, the patterns will signify those combinations of modes that are particular to certain regime types.

Table 5.11 summarizes the three ideal typical modes of government expenditure. First, there is the egalitarian mode, where wealth is redistributed from the rich to the poor, that is, from the wealthiest half (or fifth, tenth etc.) of the population to the other, poorer part of the society. In constitutional states, the aim of such redistribution is not reaching equality of wealth but approaching equality of opportunity, or “limiting the domain of inequality.”205 This is expressed by the form of government expenditure connected to the egalitarian mode: direct transfer payments (e.g., subsidies and other means-tested benefits to the poor), on the one hand, and healthcare, education and other public services focusing on equality of opportunity in general and the needs of disadvantaged groups in particular, on the other hand.206

Second, there is the opposite of the egalitarian mode: the elitist mode. Here, state power is used to redistribute wealth from the poor to the rich, using direct payments (e.g., subsidies to major entrepreneurs), indirect payments (e.g., tax cuts to people down to the upper middle income groups), and such forms of public services which increase inequalities, rather than decreasing them, in the society. Comparing the egalitarian and the elitist modes, we may say that the egalitarian mode serves, whereas the elitist mode perverts redistributive goals—meaning the proper goals not from a normative egalitarian perspective but from the perspective of the general justification of redistribution as such.207

Table 5.11. The ideal typical modes of government expenditure.

<table>
<thead>
<tr>
<th>Beneficiaries</th>
<th>Form of government expenditure</th>
<th>Public services</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Egalitarian mode</strong></td>
<td><strong>the poor</strong> (up to the lower middle income groups)</td>
<td><strong>direct payment</strong> (e.g., subsidies for the poor)</td>
</tr>
<tr>
<td><strong>Elitist mode</strong></td>
<td><strong>the rich</strong> (down to the upper middle income groups)</td>
<td><strong>direct payment</strong> (e.g., subsidies to major entrepreneurs)</td>
</tr>
<tr>
<td><strong>Cash-cow mode</strong></td>
<td><strong>the leading political elite</strong> (subre-gime- or regime-level)</td>
<td><strong>direct payment</strong> (e.g., subsidies to the members of the leading political elite, overpricing)</td>
</tr>
</tbody>
</table>

Grey background refers to the discretional mode.

The third ideal typical mode of redistribution is the cash-cow mode. “Cash cow” in corruption literature refers to the source of money that corrupt actors tap into.208 In our case, the

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205 Tobin, “On Limiting the Domain of Inequality.”
207 Barr, Economics of the Welfare State, 22–40; Ferge and Tausz, “Social Security in Hungary.”
208 Jávor and Jancsics, “Corrupt Governmental Networks.”
cash cow is none other but the state, be it a local government on the subregime-level—in cases of captured states—or the national government on the regime level—in cases of criminal states. As far as expenditures are concerned, in contrast to the egalitarian and elitist modes, which had normative spending targets—the poor and the rich, respectively—in the cash-cow mode there is a discrentional spending target, whereby tax monies are diverted and spent discretionally for the benefit of the leading political elite. Therefore, we can say that the egalitarian and the elitist modes are normative, whereas the cash-cow mode is a discrentional mode of government expenditure.

Diversion of state revenues to the beneficiaries’ hands in the cash-cow mode is done via direct transfers (e.g., subsidies and overpricing in public tenders) and indirect transfers (e.g., tax exemptions). And the cash-cow mode transforms public services into de facto transfer payments, meaning it is interested in public goods and services as far as they can be tapped and the leading political elite can divert monies from them. Thus, here redistributive goals are neither served nor perverted but neglected.

Ideal typically, leaders change the patterns of state expenditure when elections are approaching. For elections constitute a kind of “state of exception” in politics when those who usually, within a term, do not have direct access to political decision-making—the masses of ordinary people with suffrage—get a chance to vote about the leaders. In contrast, within-term periods constitute a more ordinary state of affairs, when the leading political elite can focus on narrower groups (normatively) or even individual actors (discretionally) rather than the whole electorate.209

In terms of government spending, we can express the difference between electoral and within-term periods by contrasting regular support to occasional gifts. Regular support appears in the within-term periods, when the leaders can decide by their principle who they want to prefer and set their policies accordingly. On the other hand, the leaders must focus on the electorate with a stronger emphasis during the election period, and they need to meet their expectations by supporting them—hence, we can say they give gifts on this occasion.210

In a constitutional state, the ruling political elite supports normatively selected societal groups by normative modes of state expenditure in within-term periods. The leaders may be either egalitarian or elitist (or even in favor of universal welfare services, giving both to the poor and the rich), depending on their ideological standpoint as well as the interest group pressure. But they define their spending targets by normative criteria.211 In such states, the cash-cow mode might appear only as a deviance for the state is dominantly subordinated to the principle of societal interest. The electoral periods are characterized by gifts but also via normative budgetary spending: either poor or rich groups that have not been favored (or less-favored) receive favors in the form of direct or indirect transfers so they can be convinced to vote on the incumbents.

On the other hand, in a mafia state, the adopted political family runs on the principle of elite interest, which means the twin motives of power and wealth accumulation.

209 de Mesquita et al., The Logic of Political Survival, 37–76.
210 For a seminal paper on electoral business cycles, see Rogoff and Sibert, “Elections and Macroeconomic Policy Cycles.”
211 Esping-Andersen, The Three Worlds of Welfare Capitalism; Barr, Economics of the Welfare State.
From this, it follows that in within-term periods they utilize as regular support (1) the cash-cow mode to the benefit of the members of the single-pyramid patronal network, where the chief patron wants to maximize the scope of discretionary budgetary favors and punishments, and (2) the elitist mode, which is needed to keep those societal groups at bay which are (a) too numerous for the chief patron to keep each of their members individually in a patron-client relation but they are (b) politically more active and (c) would have the means to confront the regime, to influence public opinion, to support opposition parties etc.\textsuperscript{212} As for those who do not belong to either of these groups—the people below the middle income groups and outside the patronal network—they are simply neglected by the regime, in line with the amoral familism of the adopted political family [\rightarrow 3.6.2]. Indeed, in the ideal typical mafia state the egalitarian mode appears only in the form of occasional gifts in electoral periods to those voting social groups who are neglected in within-term periods, such as pensioners and the rural poor.\textsuperscript{213}

5.5. Ownership

5.5.1. Political Reorganization of Ownership Structure in the Post-Communist Region

When economic actors interact, they do so as property owners. For actors can act only with what they have, that is, what they can use and control. Indeed, an economic system is an ownership system, and owners as well as the dominant form(s) of ownership are definitive features of an economy.\textsuperscript{214}

Since the collapse of the Soviet Union, both post-communist and Western economies have been regarded capitalist mixed economies, that is, the combination of the dominance of private property—i.e., most economic assets are owned by private actors—and extensive state activism.\textsuperscript{215} As for the latter, we have already discussed the differences between state intervention in liberal democracies and patronal regimes. But as for the former, in order to understand differences in terms of ownership, we need to consider how private property or, even more so, how large private property owners came into being in the first place.

In the West, after the 18\textsuperscript{th} century and the dusk of mercantilism, free trade and entrepreneurship allowed private capitalists largely independent from the political sphere to emerge. By the 19\textsuperscript{th} century, Western states had started protecting property rights more normatively and selecting the “winners” in the economy more sparsely,\textsuperscript{216} both of which

\textsuperscript{212} In general, we can say that the more wealth a voter has, the more the mafia state can deprive him of and thus the rulers can rely on methods of integrity breaking rather than the elitist mode of spending.

\textsuperscript{213} Golosov, “Machine Politics.”

\textsuperscript{214} For a seminal paper, see Demsetz, “Toward a Theory of Property Rights.”

\textsuperscript{215} Nelson, “Capitalism as a Mixed Economic System.”

\textsuperscript{216} Kemp, \textit{Industrialization in Nineteenth-Century Europe}. 
were of paramount importance to (1) the separation of the spheres of political and market action, and (2) a development of ownership structure driven mainly by market forces.\textsuperscript{217}

In contrast, the creation of private property and modern capitalism in the East was much more of a politically driven process. It was already like that at the time of the Industrial Revolution,\textsuperscript{218} and it could be nothing else when private property regime had to be reintroduced after the collapse of the Soviet Empire. For private ownership was not simply unsecure, like in the times Western states did not protect property rights properly, but forbidden in communist dictatorships.\textsuperscript{219} It was not enough to institute protection of private property rights (and even that was not achieved properly by regime-changing countries),\textsuperscript{220} former state property had to be transformed to private property so they could start operating as capital in the economic sense. In the state-institutionalized process of privatization, the state decided who may become the property owners, or at least those who could become owners (1) had to obtain their property from the state, according to the state’s rules, and they (2) had to operate in the legal environment created parallel to privatization. In theory, these could have also resulted, as a transition-expert economist put it, in “the separation of the private sphere of existence from the public domain, i.e. the relative autonomy of private economic activity from politics.”\textsuperscript{221} But in fact both of the previously mentioned features of obtaining ownership were far from normative and politically neutral.\textsuperscript{222} Consequently, the result was a lack of separation of the spheres of political and market action, with different forms and degrees in different post-communist countries.

While politics and economy in the countries of the region have always been entangled, the point where a Western-type process of separation of the sphere of social action became irrevocably arrested and frozen was the first political reorganization of the ownership structure—communist nationalizations. Getting into power, the communists launched programs of (1) ordinary nationalization, seizing the means of production and making them state-owned,\textsuperscript{223} and (2) collectivization, which meant the forced centralization of agricultural production into collective farms (kolkhoz).\textsuperscript{224} In line with the ideological and political goals of Marxism-Leninism, the capitalist class of owners of the means of production was targeted and liquidated, whereas newly created state property was put in motion under socialist central planning.\textsuperscript{225} The economic goal of communist nationalizations was forced industrialization and modernization,\textsuperscript{226} nominally under the Marxist-Leninist label of ending capitalism and the exploitation of the working class and peasantry.\textsuperscript{227}
After communist dictatorships collapsed, the then state-owned economies saw the region’s second political reorganization of ownership structure: regime-changing privatization. The adjective “regime-changing” is important enough, and not only from a historical point of view. For unlike privatizations of state-owned corporations in the West, which are transparent market transactions that take place in cases of inefficient/ineffective operation or if public policy goals were not served by state management, privatization is a matter of creating property owners and a private economy after communism (see Box 5.8). Regime-changing privatization was similar to communist nationalization in the sense that it was also a general ownership-type transformation, that is, the changing of the economic system by altering the dominant type of ownership. On the other hand, several actors wanted to benefit personally from the privatization process, the economic goal of which—ownership-type transformation—was therefore corrupted by a political goal of power transformation. This goal, of course, had different meaning for those who wanted to transform their nomenklatura-based powers and those who wanted to freshly obtain (political-economic) power as outsiders. Furthermore, privatization also had an ideological goal, namely justice-making for the people who had been robbed of their property during the time of the nationalization, on the one hand, and who had been robbed of their freedom by communist dictatorship, on the other hand.

Privatization was key in creating the property owners as well as the dominance of private ownership, which is one of the prerequisites of a Western-type market economy. However, besides not creating a separation of market and political spheres, privatization and the resultant capitalist environment also featured a legitimacy deficit in the public eye. First, the people generally identified privatization with robbery: the way of how the nomenklatura or people with the right connections laid their hands on state property for negligible sums, thus accumulating huge fortunes by “stealing the wealth of the nation at daylight.” In Russia, the word prikhvatizatsiya, which translates as “grabitization,” became a catchword in the related political discourse. Second, because of the lack of private savings in the domestic market, the new owners who had capital at their disposal and joined a business by buying up a company or increasing its capital were often foreign owners,

Box 5.8. The meaning of regime-changing privatization.

“In the context of transforming a command economy into a market-oriented one […] privatization means not only the privatization of a few, albeit large and dominant, state-owned enterprises. It includes the organic development of new private firms, which is far more important than the denationalization of existing state-owned ones, inherited from the previous communist system. It implies the privatization of the whole national economy. It is supposed to bring about fundamental change in enterprise behavior and the incentive structure for managers at the helm of private and state-owned firms alike. Privatization of the national economy means, therefore, that the profit motive and the creation of more and more market value for owners, as principal stakeholders, is now a concept and consideration of paramount importance. […] As a result, after privatization enterprises are supposed and expected to act, first and foremost, in the interest of their private owners […]. From that moment onwards individual economic organizations no longer existed as mere administrative units of a single monstrous state entity; they were reconstituted as enterprises.”


228 Frydman, Murphy, and Rapaczynski, Capitalism with a Comrade’s Face.
229 Klaus, Renaissance.
231 Galuszka, “Red-Handed Russia”; Granville, “‘Dermokratizatsiya’ and Prikhvatizatsiya.”
mostly multinational companies, especially in Central-Eastern Europe. This process could easily be seen by the people as the country being “sold off” to foreigners, whereas the privatizers as “servants of international capital.” Finally, privatization and the collapse of the communist system had serious collateral consequences for post-communist societies. For those who were directly affected by unemployment or fear of unemployment in the aftermath of the regime change, facing the negative consequences of a growing social gap, the need for a redistribution of wealth could be drummed up over and over again, since the property that had come about through “common sacrifice” had been taken over by “com-mies” and “alien multinationals.” Survey data collected by Frye and his colleagues in 2006 emphasize this point. Calculating weighed averages for the population of the three historical regions, only 18% in the Eastern-Orthodox and 17% in the Islamic region opined that the ownership structure created by privatization should be left unchanged, and the ratio of the same answer was only 20% in the Western-Christian region, too. Conversely, the ratio of those who urged the renationalization of formerly privatized property and keeping it in state hands afterwards was 22% in the Western-Christian, 34% in the Eastern-Orthodox, and 48% in the Islamic region.232

The legitimacy deficit of ownership relations in post-communist economies has often resulted in either active legitimation or passive acceptance from the people of the third political reorganization of ownership structure: post-communist ownership redistribution. While the communists abolished private property and the privatizers re-established it, chief patrons of single-pyramid patronal networks in the post-communist region patronize private property or property that previously belonged to other patronal networks (“repatronalization”). The most important difference compared to the first two types of political reorganization is that the primary focus of patronalization is changing informal, rather than formal, ownership. This often involves changing the formal ownership as well, using various means of predation [→ 5.5.3–4] to move assets from the hands of autonomous entrepreneurs or rival oligarchs to loyal family members or the state that is under the chief patron's neopatrimonial control [→ 2.4.2]. Predation is the most conspicuous manifestation of the ownership-reorganization process, and this is what requires the above-mentioned active legitimation as well.233 But the point of economic patronalization is to change the assets' informal ownership, or to make sure that no significant assets remain in the hands of competing patronal networks, and the assets belong to the ownership orbit of the adopted political family. Beyond formal owner-transfer, this can be achieved through the forced change of patronal allegiance as well, that is, subjugating oligarchs or major entrepreneurs (oligarch capture [→ 3.4.1]) and making them loyal actors, rather than taking over their property and giving it to someone already loyal. Either way is chosen, in the end the chief patron becomes de facto owner of the property as he can dispose over the booty from the top of the patronal hierarchy. The assets are no longer in autonomous/rival hands but in patronal ownership.

Focusing on formal ownership transfers, post-communist ownership redistribution is markedly different from other types of reorganization of property in history.

232 Own calculations (using country population for weighing) based on Frye, Property Rights and Property Wrongs, 191; The World Factbook 2006.

If we look at countries outside the region, the historical south European corporative autocratic regimes, for instance, did not replace the economic elite. True, the expropriation of Jewish fortunes formed an exception but no new layer of owners was brought about, and the plundered fortunes simply further enriched the existing Christian middle class. The expropriation of property was normative on racial grounds, and the distribution of property was also normative and widely dispersed among the non-discriminated groups of the population. Also, in dictatorships of the Soviet type all (productive) property was expropriated from capital owners, so the loss of property was normative on a class basis. The elite formed there was purely of a political nature. Their remuneration—as discussed earlier—was not in wealth, but in better provisions: higher pay, better living circumstances, allocation of flats or holiday homes, the possibility of shopping in stores operated in a system closed to others, access to things in short supply and various other privileges. But however keenly these appeared as desirable advantages and privileges in the eyes of those who were not offered them, they could not result in the amassment of significant fortunes. However, the situation is different in post-communist ownership redistribution: predation of wealth is not normative, but discretionary and arbitrarily incidental. Takeovers target specific owners and companies, rather than a group discriminated on normative grounds, and loyal members of the adopted family receive them also in a targeted manner. Those who are discretionally rewarded can accumulate massive fortunes from the booty that is redistributed to them (as well as from legal and illegal rent-seeking, often carried out with the booty companies).

Focusing on both formal and informal ownership transfers, post-communist redistribution differs from historical redistributions also in (1) magnitude and (2) timing. As for (1), in the previous, normative processes of reorganization the entire economy was transformed, either from private to public ownership (communist nationalization) and public to private ownership (regime-changing privatization). In contrast, in post-communist ownership redistribution usually not the entire economy is patronalized, only the relevant sectors that are politically and economically worth patronalizing and can be patronalized. This leads scholars like Mihályi, who focuses on formal ownership transfers in Hungary, to claim that the process is comparable to the previous reorganizations only because of its ideologically declared goals, not because of its economic significance. However, the comparison is valid even without considering its ideological label (see below). First, post-communist ownership redistribution involves informal transfers as well as formal ones, meaning its magnitude is bigger than if we considered, with a Western-type focus on informal property relations, only the formal changes in ownership. Second, post-communist ownership redistribution lays the foundations of relational economy, meaning new kinds of economic mechanisms for the entire economy. This is comparable

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234 Beker, The Plunder of Jewish Property during the Holocaust.
235 Aly, Hitler's Beneficiaries.
236 Madlovics and Magyar, "Post-Communist Predation."
237 The determinants of patronalization are discussed in our model of predation.
238 Mihályi, "Az Orbán-korszak mint a nemzeti vagyon 6. újraelosztási kísérete [The Orbán era as the 6th attempt at redistributing national wealth]."
to how communist nationalization grounds a planned economy and regime-changing privatization, the market economy.

As far as (2), or timing is concerned, what needs to be emphasized is two. First, **post-communist ownership redistribution has not happened in every post-communist country**, unlike the two other forms of political reorganization of ownership. Indeed, the process took place only where single-pyramid patronal networks were established (as well as predatory states), which can and do take over property discretionally, on the basis of patronal allegiance. Yet it follows from the lack of separation of the spheres of social action that, when an adopted political family comes to power, even in a multi-pyramid setting, changes in economic policy take place in favor of the leading political elite, and that might result in private-owner transfers. Second, **post-communist ownership redistribution does not end but it is a continuous process in a patronal autocracy**. This follows from that not the entire economy is patronalized. As some sectors can operate autonomously, new firms or entrepreneurs may appear at any time who can be selected as prey by the predatory state [→ 5.5.4]. More generally, as circumstances change, the factors that determine whether an asset is worth taken over also change. Therefore, an asset that remains unmolested in one period may be selected by the chief patron for redistribution in the next period, based on his current political and economic considerations.

To sum up, the **economic and political goals** of the process reflect the principle of elite interest, that is, **accumulation of wealth**—as patronalization redistributes property to relationally tied actors—and **accumulation of power**—as patronalization monopolizes patronal networks by taking away assets from outsiders in favor of insiders. The **ideological label** for post-communist ownership redistribution is “ending the regime change,” either by (a) “introducing a dictatorship of law” in place of the previous oligarchic anarchy or, if such anarchy did not exist, (b) “building a national bourgeoisie” and justice-making by “taking back the fraudulently privatized assets from the commies.” These characteristics, as well as the main features of all types of political reorganization of ownership structure are summarized in Table 5.12.

An alternative way to conceptualize such ownership-reorganizations has been to use the analogy of primitive accumulation of capital, as described by Karl Marx in the first volume of *Capital*. The analogy builds on the emergence of a new layer of owners, who use probably unscrupulous means to become dominant economic actors, as well as the basis of a new kind of economic system or regime. Yet we prefer the term “political reorganization of ownership” because (1) it puts the emphasis on the regimes’ action, more in line with the purposes of our framework, and (2) it is a broader concept and therefore able to encompass cases which are, in fact, quite different from primitive accumulation as Marx described it. Using the Marxian analogy for communist nationalizations would be confusing because

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239 Melvin, “Authoritarian Pathways in Central Asia: A Comparison of Kazakhstan, the Kyrgyz Republic and Uzbekistan.”

240 Kahn, “Vladimir Putin and the Rule of Law in Russia.”


those abolished, and did not create, private property, whereas the seized assets were further operated in a socialist economy and not a capitalist one (according to our terms [-> 5.6]).

Regime-changing privatization involved (1) the dismantling of public ownership and (2) the manipulation of a regime transition, whereas in Marx’s description (1) property is accumulated from private actors (peasants) and (2) with the help of a strong and stable regime, securing property rights in land (enclosure). Finally, during primitive accumulation of capital, according to Marx, a flow of capital takes place between a pre-modern (agricultural) and modern (industrial) sector accompanied by a change of owners. In the case of the post-communist ownership redistribution, however, there is no momentum of modernization, only the controlled change of owners of already accumulated capital. Moreover, the beneficiaries of predation do not become entrepreneurs but oligarchs or front men. In terms of their social function, they are only exactors of rents who appear in the cloak of businessmen, empowered by the chief patron and fortified by a variety of monopoly grants [-> 3.4.1.2].

Table 5.12. The three types of political reorganization of ownership structure in the post-communist region.

<table>
<thead>
<tr>
<th>Communist nationalization (abolishment of private property)</th>
<th>Regime-changing privatization (re-establishment of private property)</th>
<th>Post-communist ownership redistribution (patronalization of private property)</th>
</tr>
</thead>
<tbody>
<tr>
<td>ownership-type transformation (from private to public ownership)</td>
<td>ownership-type transformation (from public to private ownership)</td>
<td>private property transfer (from autonomous/rival to patronal ownership)</td>
</tr>
<tr>
<td>nationalization, collectivization</td>
<td>privatization</td>
<td>predation / adoption</td>
</tr>
<tr>
<td>targets selected by class</td>
<td>targets selected by ownership type</td>
<td>targets selected by patronal allegiance</td>
</tr>
<tr>
<td><strong>economic goal</strong>: modernization by forced industrialization</td>
<td><strong>economic goal</strong>: running enterprise on the principles of market economy</td>
<td><strong>economic goal</strong>: accumulation of wealth (running enterprise on relational principles)</td>
</tr>
<tr>
<td><strong>political goal</strong>: neutralization or liquidation of the ownership classes</td>
<td><strong>political goal</strong>: power transformation</td>
<td><strong>political goal</strong>: accumulation of power (monopolization of patronal networks)</td>
</tr>
<tr>
<td>ideological label: “dictatorship of the proletariat,” “ending the exploitation of the working class and peasantry”</td>
<td>ideological label: “justice-making,” “re-establishment of market economy”</td>
<td>ideological label: “ending the regime change,” “building a national bourgeoisie”</td>
</tr>
</tbody>
</table>

5.5.2. Making a Privatization Profile: Technocratic and Non-Technocratic Motives

Regime-changing privatization was an extremely complex process with great differences from country to country. Some of the differences were quantitative: although most of the transition countries had a private sector contributing more than 60% of their GDP by 2002, the extent of privatization varied from high—like in Hungary, Poland and Est-

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243 But see Burdekin, “Preobrazhensky’s Theory of Primitive Socialist Accumulation.”

244 We are indebted to Károly Attila Soós for his help and suggestions to this part.
nia—through moderate—like in Romania, Ukraine and Russia—to low—like in Moldova, Belarus, and Uzbekistan. More interesting, though, from the viewpoint of our framework are the qualitative differences, namely the wide variety of methods by which privatization was carried out.

In this part, we provide a typology of privatization methods, categorized by the motive of privatizing action. As mentioned above, there could be three such motives: economic, ideological, and political, and each of them entails several methods from which the privatizers could choose. Naturally, no ruling elite was confined to a single motive, and therefore in no country was all the party state’s property privatized by a uniform method. However, it is possible to analytically distinguish different ideal typical motives of regime-changing privatization and isolate ideal typical methods to fulfill those motives. This exercise yields a set of concepts that can be used to tell the story of privatization in every post-communist country or, in other words, to gather the privatization profile of a country of interest by identifying actual privatizing acts by the list we provide.

5.5.2.1. Technocratic dimensions: openness of the privatization market and the object of privatization

Economic goals of regime-changing privatization—and indeed any privatization—are threefold. The first goal is changing the system of incentives for the managers (owners) of economic units by instituting the profit motive. As Kornai explains, in a communist dictatorship “[none] of the profit from the state-owned firm passes automatically into the pockets of [the managers] and, conversely, they need not contribute out of their own pockets to any of the state-owned firm’s losses. Since the connection between the ‘personal pocket’ and the residual income of the state-owned firm is entirely absent, [the] automatic, spontaneous incentive noted with private property does not apply.” This situation was to be changed by privatization, so the managers (owners) would benefit or lose in line with their market success and therefore would be incentivized to produce for the wishes of the costumers rather than by the wishes of the central planner. Second, privatization is a way to raise budget revenues, which was essential to the state when tax incomes plummeted as the economy fell into recession after the transition. Third, privatizers may want to carry out privatization to restart economic growth, which could be fueled by productive investments that are made by interested private owners.

All of these goals center on the technocratic motive of economic efficiency. In this aspect, privatizing acts can be analyzed from two characteristics: (1) the object of privatization and (2) the openness of the privatization market to outsiders (outsiders from the point of view of the ruling elite). The object of privatization is important because of mainstream considerations of post-privatization regulatory treatment of an industry. Accordingly, different treatment is required for competitive industries—such as retail—than for natural monopolies or oligopolistic markets—such as natural resources or

245 Lane, “Post-State Socialism,” 22–23.
247 Bokros, Accidental Occidental, 84.
banking—which usually entail a stronger regulatory environment.\textsuperscript{248} As for the openness of the privatization market, this dimension is important because (1) competition between would-be investors by strict requirements should yield better production at lower price than if the market is closed to outsiders and the privatized asset is pre-assigned to a given economic actor, and (2) higher competition entails lower corruptibility potential, that is, the opportunity for turning the normative decision about who to privatize an asset into a discretion one. In principle, the more complex the procedure is and the more the state decides about the terms of the transaction discretionally, the higher the corruptibility potential is.\textsuperscript{249}

By the object of privatization, four methods can be differentiated (Table 5.13).\textsuperscript{250} First, when the state privatizes an activity, that is, when it commissions a certain good or service from the private market instead of carrying it out on its own, we can speak about contracting out. In many countries, roads, schools and government offices are constructed for governments by private contractors, and services such as transportation, public safety services and recreational services are also often commissioned by the state.\textsuperscript{251} In this case, the state takes the role of a customer on the private market, and the economic form of the given services is that of artificial monopoly. For the state, in case of contracting out, does not simply buy some goods or service that people usually purchase on the market but contracts out a governmental activity. One of the main arguments that the state should not carry out the activity by itself as a monopolist is that, in contracting out, there is competition among tender participants, which allows the state to reach lower prices and minimize governmental overtaxation [\textsuperscript{\rightarrow} 2.4.3].

Second, when the state privatizes a concession, meaning it gives a special monopoly privilege to private firms to produce and supply (some part of) a particular service, we can speak about franchising (licensing). Franchising is especially common in the case of goods which bear natural monopoly characteristics—such as public utilities—but it

\begin{table}[h]
\centering
\begin{tabular}{|l|l|l|l|}
\hline
What is privatized? & Special post-transfer relation of state to business & Post-transfer economic form \\
\hline
Contracting out & Activity & Customer & Artificial monopoly \\
Franchising (licensing) & Concession & Regulator & Artificial monopoly (oligopoly) \\
Direct privatization (partial) & Enterprise (+ assets) & Co-partner & Competitive firm (with potential state interference in the management) \\
Direct privatization (total) & Enterprise + assets & - & Competitive firm \\
\hline
\end{tabular}
\caption{Privatization methods by the object of privatization (technocratic dimension).}
\end{table}

\textsuperscript{248} Bokros, Accidental Occidental, 113–26.
\textsuperscript{249} Kaufmann and Siegelbaum, ”Privatization and Corruption in Transition Economies.”
\textsuperscript{250} Arakelyan, Privatization as a Means to Property Redistribution, 82–85.
\textsuperscript{251} Arakelyan, Privatization as a Means to Property Redistribution, 82.
\textsuperscript{252} Arakelyan, Privatization as a Means to Property Redistribution, 83–84.
can also take place if the state wants to keep a special eye on the given activity for public or other reasons—such as in the case of gambling or of the tobacco industry. In cases of franchising, the state takes the role of a special regulator of the given industry (special in the sense that it regulates the industry more and with different rules than ordinary private enterprises), while the economic form of the licensed activity will be artificial monopoly or oligopoly.

Third, when the state privatizes an enterprise and also its assets but only to a certain degree (so the state still remains—typically minority—shareholder in the new private company), we speak about partial direct privatization. Indeed, this method often results in uncertainty for the private management. As Károly Attila Soós explains, after the regime change “in Russia and Ukraine companies were privatized without the land they stood on, i.e., with the land kept in state property. In Slovenia a similar uncertainty was generated by a peculiar minority shareholder activism of the public administration, based on the combined application of the state’s and parastatal funds’ minority shareholder positions and the state’s role as policy maker, legislator and regulator.” Therefore, from a technocratic point of view, this method may be used only in the case of natural monopolies and so-called “strategic” industries. In cases of partial direct privatization, the state takes the role of a co-partner in running the company, which, however, does take the economic form of a competitive firm (with potential state interference in the management).

Last but not least, when the state privatizes an enterprise and does not remain a shareholder, we can speak about total direct privatization. As Lajos Bokros explains, from a technocratic point of view this method is used mainly in the competitive sector (manufacturing, food processing, retail etc.) as “the state is [...] incapable of restructuring, reorganizing, improving and then running a large number of business enterprises in an effective and efficient way.” Indeed, this was precisely the lesson of planned economies: that the state is unable to run competitive enterprises effectively, serving the interests of the consumers. In cases of total direct privatization, the privatized enterprise becomes fully private and there is no special post-transfer relation of state to the business. Thus, the now private enterprise takes the economic form of an autonomous competitive firm.

Turning to the dimension of the openness of the privatization market, there are five different methods, which we list in an ascending order from the lowest to the highest barriers to entry or in a descending order from the most to the least open (closed) markets to outsiders (Table 5.14). First, there is share issue privatization, when a state-owned enterprise is privatized not in one piece but by public share offering (on the stock exchange). In this case, the only barrier to entry is the minimal monetary requirement of buying a share. Second, when a state-owned enterprise is sold in one piece but in a transparent process where anyone can bid, we can speak about a public auction.

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253 Magyar, Post-Communist Mafia State, 188–95.
254 Soós, Politics and Policies in Post-Communist Transition, 150.
256 Bokros, Accidental Occidental, 93.
258 Jones et al., “Share Issue Privatizations as Financial Means to Political and Economic Ends.”
259 Arakelyan, Privatization as a Means to Property Redistribution, 85.
Table 5.14. Privatization methods by the openness of the privatization market (technocratic dimension).

<table>
<thead>
<tr>
<th>Method</th>
<th>Barriers to entry</th>
<th>Openness to outsiders</th>
<th>Corruptibility potential</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share issue privatization</td>
<td>Minimal monetary requirements</td>
<td>Open</td>
<td>Low</td>
</tr>
<tr>
<td>Public auction</td>
<td>High capital requirements</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public tender</td>
<td>Multi-criterion decision</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Restricted auction</td>
<td>Need for invitation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Negotiated sale</td>
<td>Need for appointment by the leading political elite</td>
<td>Closed</td>
<td>High</td>
</tr>
</tbody>
</table>

In the previous two cases, the privatization market was an **open market** in the sense we defined the term in Part 5.4.2.1, given that anyone could enter and compete for the to-be privatized property regardless of the state’s approval. The privatization market gets **normatively closed** in cases of **public tenders**, when the state does not let anyone bid but only those who meet multiple criteria (typically in cases of contracting out or franchising). Halfway between normatively and discretionally closed is the fourth method, **restricted auction**, when an invitation from the state is needed. In theory, invitations are made on the basis of normative criteria, but in practice this indeed already includes a high risk of discretionality. Finally, the privatization market gets **discretively closed** in cases of **negotiated sales**, when it is the leading political elite that appoints the one who shall receive the to-be privatized property.260

5.5.2.2. Non-technocratic motives: justice-making and power transformation

The technocratic motive of efficiency is more common in privatization in established market economies than it was at the time of the regime change. Besides the fact that several privatizers had different intentions than achieving economic efficiency,261 privatization by technocratic ideals was sometimes simply not achievable. This had four basic reasons:262

- a suitable legal environment was absent at the time of regime change—with a few Central European exceptions—that could have satisfactorily ensured the protection of private property and guaranteed appropriate and transparent rules of transition from state to private ownership;

- the collapse of the communist power structure often went hand in hand with the breakdown of functions of state control, with the result being that decisions

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260 Arakelyan, *Privatization as a Means to Property Redistribution*, 86. The level of openness is regarded “on default,” meaning without corruption of the state’s privatization process. If corruption enters the picture, it may turn any privatization market into a discretively closed one.


262 Frydman and Rapaczynski, *Privatization in Eastern Europe*.
about the distribution of state property were made through a political machinery and state apparatus that were neither stable nor conscious of their temporary position;

- **there was no financially sound internal demand**, for under the conditions of state monopoly and the command economy no one could have accumulated assets close to what would have been needed;

- when an administrative market and command economy are collapsing, it is **impossible to determine the exact value of a former state corporation** in a market environment that has not even been established. After all, neither the price of the products nor the costs of production—nor for that matter supply and demand—had been shaped by market forces. (Of course, it could be suspected that the raw materials industry, which had been selling at depressed rates compared to international rates, would bring significant profits to those who managed to grab it.)

In short, both deliberately and out of necessity, **non-technocratic motives of privatization** occurred. Among these, the two most important ones were **justice-making**—referring to rectifying the injustices of the communist dictatorship by giving the property to their rightful owners—and **power transformation**—referring to either transformation of the nomenklatura's communist political power into post-communist economic power or abusing the privatization process for the private gain of newcomers.

We can differentiate four privatization methods, which, although they have economic dimensions, are primarily concerned with the ideological goal of justice-making (Table 5.15). The first and simplest method is giving back property to those whom it had been taken from—that is, **reprivatization**. In cases of reprivatization, justice-making is based on the ownership structure of the pre-nationalization/pre-collectivization period, and the process aims at giving the nationalized properties to those who have a right to it as former owners. However, while this method seems simple in theory, it indeed is much more complex in practice. On the one hand, reprivatization is unlikely to lead to economic efficiency, as the (children or grandchildren of) those who the property had been taken from and were forced to make a living under the decades of a planned economy are probably not the most suitable actors to run these units in a modern and effective way. On the other hand—and perhaps, from the point of view of justice-making, more importantly—practically no property was left unchanged in the decades of communist nationalization: many old buildings were torn down or completely reconstructed; new buildings were built on some appropriated lands; appropriated capital goods were amortized etc. As a result, restoring the original state of the pieces of property was usually not practical (often not possible), and it was not always clear what exactly should be given back (and to whom). Therefore, opponents of restitution argued that “private claims can often be complicated and drawn out, bogging down privatization unnecessarily.”

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263 Cf. Nureev, “Power-Property as a Path-Dependence Problem.”

264 Arakelyan, Privatization as a Means to Property Redistribution, 82.
reprivatization was largely limited to real estate (such as agricultural land) and affected productive assets only in a limited manner.\textsuperscript{265}

Table 5.15. Privatization methods by dimensions of justice-making (ideological goal).

<table>
<thead>
<tr>
<th>Method</th>
<th>Temporal dimension of justice-making</th>
<th>Legitimation basis of privatized ownership</th>
<th>Scope of privatized property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reprivatization</td>
<td>Pre-nationalization / pre-collectivization period</td>
<td>Former owners</td>
<td>Former property</td>
</tr>
<tr>
<td>Compensation</td>
<td>Pre-nationalization / pre-collectivization period</td>
<td>Former owners</td>
<td>Optional property</td>
</tr>
<tr>
<td>Insider privatization (management-employee buyout, MEBO)</td>
<td>Pre-regime change period</td>
<td>Operators of the assets</td>
<td>Operated property</td>
</tr>
<tr>
<td>Free distribution among citizens (voucher)</td>
<td>Pre-regime change period</td>
<td>Citizens</td>
<td>Optional property</td>
</tr>
</tbody>
</table>

The second method of justice-making offers a solution to these problems. By \textit{compensation}, former owners get not the same property that was taken from them but some optional property, comparable in value to the former (nationalized) property. This “optional property” sometimes took the form of so-called compensation vouchers, like in Hungary and Slovenia, where these vouchers could be used in privatization deals. “These vouchers increased the demand for the shares of all enterprises,” writes Soós, “including medium-sized and large ones. However, their influence on the composition of the demand must have been negligible, because the compensation vouchers could be sold and purchased freely; they were even quoted at the stock exchanges […]. Prices of compensation vouchers fluctuated depending on the development of ‘privatisation supply’ and on the sometimes changing conditions of their use in privatisation. But the prices were always below the vouchers’ nominal values. They ended up in households or other entities that wanted to purchase privatised assets anyway. With the vouchers bought at discount prices, buyers could purchase these assets somewhat more cheaply.”\textsuperscript{266}

The third method may be called \textit{insider privatization}, but it has also been known as \textit{management-employee buyout (MEBO)}.\textsuperscript{267} Unlike in the previous cases, the temporal dimension of justice-making is not the pre-nationalization period but the pre-regime change one, on the principle that—paraphrasing the famous slogan—the company belongs to those who work it. Thus, by this method state-owned enterprises could be given to the operators of the assets, including management and employees. Employees had powerful positions in Poland and managers, in Russia, which gave this approach “the twin advantages of feasibility and political popularity.”\textsuperscript{268} However, in other countries, like Hungary, where MEBOs were carried out—sometimes through underhand means—the fact that

\textsuperscript{265} Bokros, \textit{Accidental Occidental}, 88–89.

\textsuperscript{266} Soós, \textit{Politics and Policies in Post-Communist Transition}, 29.

\textsuperscript{267} Arakelyan, \textit{Privatization as a Means to Property Redistribution}, 87–88.

\textsuperscript{268} Arakelyan, \textit{Privatization as a Means to Property Redistribution}, 87.
management would then come from the stratum of technocrats loyal to the previous regime contributed to the legitimacy deficit of the privatization process. Indeed, in such cases the process typically resulted in “red” and “green” barons emerging within the corporations who would either buy out existing management or remove the masses of the corporations’ workers. This process usually coincided with the diversion of certain units or corporate stocks into new businesses tied to the management, often leading to the collapse of the large state (mostly industrial) corporations and the layoff of a significant share of their workers.

Last but not least, free distribution among citizens or mass voucher privatization relied on the principle that the only possibly just owners of the nationalized property are the people, that is, the citizens of the country themselves. Thus, by issuing privatization vouchers or “coupons,” millions of domestic owners were created almost overnight whereby citizens could invest the received vouchers into companies or through so-called privatization investment funds (PIFs). PIFs were either under the control of still state-owned banks (like in Czechoslovakia) or under the supervision of the state privatization agency (like in Romania) or—if they managed to collect and concentrate citizens’ vouchers by the initiative of well-connected individuals—they were under unsupervised insider control. This latter arrangement represented the worst case and led to tremendous abuse. Furthermore, this process resulted in a high degree of fragmentation in ownership rights and thus did not result in any substantial individual growth in wealth. The market price of the properties dropped, enabling a few individuals to take advantage of downwardly spiraling prices to concentrate property in their own hands and then, later, politicize their assets.

This leads us to the political goal of privatization, namely transformation of the power of the nomenklatura to private hands. This goal of privatization did not entail specific methods, given the process had to be informal by its very nature. Rather, it refers to a corruption of the privatization process as a whole, meaning that several of the previously described—and initially normative—methods were turned discretionally from various directions.

<table>
<thead>
<tr>
<th>Way of corrupting</th>
<th>Graduality of corrupting</th>
<th>Beneficiaries</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bottom-up power transformation</td>
<td>Making use of superior social and knowledge capital</td>
<td>Single stage</td>
</tr>
<tr>
<td>Horizontal power transformation</td>
<td>Facilitating ownership concentration during secondary privatization</td>
<td>Multistage</td>
</tr>
<tr>
<td>Top-down power transformation</td>
<td>Direct transformation (“the state privatizes itself”)</td>
<td>Single stage</td>
</tr>
</tbody>
</table>

270 Arakelyan, Privatization as a Means to Property Redistribution, 95.
271 Bokros, Accidental Occidental, 90.
By the direction of corrupting the privatization process, we can distinguish three methods (Table 5.16). First, there is **bottom-up power transformation**. Here the intentions of the state were technocratic and privatization was an open competition, meaning there was no prior decision about who would be the winner of privatization bidding. There was no central will to coordinate a transfer of the power of the nomenklatura. Yet the assets were still grabbed, not necessarily by the most suitable economic actors with proper managerial know-how, but mainly by nomenklaturists as well as outsiders with the right connections because they had the competitive advantage. For, as we mentioned, there was no good way to determine the real market price of communist state property because it had been operated in a non-capitalist environment, outside the private market. Therefore, during regime-changing privatization, having good pieces of insider information, social capital or strong-tie networks could be utilized in laying hands on precious assets. As Szelényi explains, in Central Europe “social capital was unquestionably more important than political capital in acquiring wealth and obtaining positions under the post-communist regimes. Personal connections and information about the companies offered for privatization complemented the play of market forces. Privatization agencies often auctioned firms at prices below their actual value, and one needed contacts—both with the management of the enterprise and with the privatization agency—to get accurate information on what they were worth.”

Second, there was what we call **horizontal power transformation**. In this case, the power of the nomenklatura was transferred not in a single discreetional step but rather in a multistage process. First, a normative “primary privatization” was carried out, typically in the form of insider privatization or free distribution among citizens (voucher), which created a highly dispersed ownership structure. But in the following years, a so-called “secondary privatization” took place, which meant that people sold the vouchers and previously privatized assets concentrated in fewer hands. In countries such as the Czech Republic, this process took place normatively, meaning it was a free market process and the state did not interfere to make the nomenklaturists the beneficiaries of secondary privatization. In countries such as Russia or Ukraine where insider privatization was dominant, however, the legal environment created during the regime

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272 Szelényi, “Capitalisms After Communism,” 43. Also, see Eyal, Szelényi, and Townsley, *Making Capitalism Without Capitalists*.

change preferred former nomenklaturists—new enterprise managers—who could, as a result, transfer the power of the nomenklatura to themselves during secondary privatization (see Box 5.9). In this process, a relatively high number—tens of thousands—of former nomenklaturists became dominant owners of medium-sized and even large companies, and the power of some company managers even became unlimited as they acquired significant ownership stakes in their economic units. These latter actors were the first oligarchs after the regime change.274

Finally, the method of **top-down power transformation** included what Olga Kryshantanovskaya and Stephen White describe as “privatization of the state by the state.” In their analysis of the case of Russia, they point to several cases “when public officials, using their formal powers, [privatized] those sections of the state for which they [had been] themselves responsible. […] This kind of privatisation included wholesale changes in the system of economic management, banking and retail sale, and the sale of the most profitable enterprises. Ministries, for instance, were turned into concerns. The minister typically retired, or became a consultant to the concern that had succeeded the ministry. The president of the concern, as a rule, was a former deputy minister. The concern acquired the status of joint stock company. The shareholders were typically the most senior management of the former ministry, together with the enterprises for which it had been responsible. The ministry’s property, in this way, became the private property of its leading officials; and they themselves did not simply privatise the organisation for which they were responsible, but did so for their own benefit.”275 Cases of this kind took place before the mass privatizations, the scope of which was therefore narrowed. Indeed, when economist Vitalii Naishull told Yeltsin’s privatization minister that: “Your plans to privatize Russian Industry will never work. Everything has already been privatized and there’s nothing left to give away,” he was exaggerating, but not unfoundedly.276

According to Kryshantanovskaya and White, the party state granted five further privileges to the Soviet nomenklatura that helped them in power-transformation right before the regime change. Namely, they got exclusive rights in the first stages of economic reform in (1) the establishment of joint enterprises, (2) the conversion of assets into cash, (3) advantageous credits, (4) property dealings and (5) privileges in import-export operations.277 This leads us to one of the questions that caused the legitimacy deficit of privatization, namely **the survival of the nomenklatura**. Looking at the three historical regions, we can see that in the Orthodox region **the Russian nomenklatura**—because of the above-mentioned reasons—**was among the most successful communist elites in retaining their power in the post-communist environment**. Kryshantanovskaya and White found that 61% of the business elite under Yeltsin were recruited from the former nomenklatura, whereas the ratio of nomenklatura members was 74.3% in the government and 75% in the top leadership.278 Similarly higher numbers can only be seen in the **Islamic historical**

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274 Soós, Politics and Policies in Post-Communist Transition, 141.
275 Kryshantanovskaya and White, “From Soviet Nomenklatura to Russian Elite,” 720.
276 Quoted by Buiter, “From Predation to Accumulation?,” 606.
278 Kryshantanovskaya and White, “From Soviet Nomenklatura to Russian Elite,” 729.
region, or Azerbaijan and Soviet Central Asia. However, nomenklatura survival there was less due to privatization or other privileges but that (1) the first political leaders of the new regime were practically the same as the communist leaders and (2) they resisted mass privatization and argued for a “developmental state” (which, however, was indeed subordinated to the principle of elite interest and, thus, a criminal state).

Finally, in the case of the Western Christian historical region, we can rely on the research of Iván and Szonja Szelényi. Using a representative survey, they compared the successes of power transformation in Russia, Poland and Hungary (Table 5.17). According to them, out of those who were members of the economic nomenklatura in 1988, five years later 56.6% were in elite positions in Poland and 29.2% in Hungary. In contrast, they found a ratio of 81.8% in Russia. These ratios, or rather the differences between the three historical regions, can be explained by the differences in the level of separation of the spheres of social action, on the one hand, and the magnitude of the change of political elite, on the other. Among the political nomenklaturists of the communist system, 67.7%, 27.5% and 21.9% retained their positions in the new elite in Russia, Poland and Hungary, respectively. The change of economic elite, as we have seen, differed in relatively the same ratio in these countries. The reason for this is that, as in communist countries the political and economic spheres were merged, the lower ratio of political nomenklatura survival went hand in hand with the lower ratio of economic nomenklatura survival, and vice versa. The more the communists could preserve their political positions, the more they could transfer their former economic power as well.


<table>
<thead>
<tr>
<th>Class position of 1988 economic nomenklatura in 1993</th>
<th>Russia (N = 60)</th>
<th>Poland (N = 263)</th>
<th>Hungary (N = 82)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Elite</td>
<td>81.1</td>
<td>56.6</td>
<td>29.2</td>
</tr>
<tr>
<td>Non-elite with subordinates</td>
<td>13.2</td>
<td>12.6</td>
<td>18.3</td>
</tr>
<tr>
<td>Non-elite without subordinates</td>
<td>1.7</td>
<td>7.2</td>
<td>4.9</td>
</tr>
<tr>
<td>Retired</td>
<td>3.3</td>
<td>23.6</td>
<td>47.6</td>
</tr>
</tbody>
</table>

279 Luong, *Institutional Change and Political Continuity in Post-Soviet Central Asia*.

280 Melvin, *Uzbekistan*.

281 Szelényi and Szelényi, “Circulation or Reproduction of Elites during the Postcommunist Transformation of Eastern Europe.”

282 Szelényi and Szelényi use different numbers (and indeed define the economic elite differently) than Kryshtanovskaya and White. However, the numbers of the two pairs of authors are of the same order of magnitude and, thus, substantiate our point equally well.

5.5.3. Making a Patronalization Profile: Predation and Property Rights

While privatization created private markets in every post-communist country, a significant part of nominally private property ended up in the hands of patronal networks of oligarchs and poligarchs [→ 5.5.4.2]. This could happen in three ways: (a) by privatization, through one of the power-transformation methods described above; (b) by market acquisitions, buying up companies using the fortunes they accumulated through corrupt channels from the state (budget); or (c) by predation, meaning the coercive takeover of the non-monetary property (companies etc.) of other private actors using the state coercion or the services of violent entrepreneurs [→ 2.5].

Having described methods (a) and (b) already, we devote this part to method (c), predation. In Chapter 2, we defined predation as the coercive takeover of non-monetary property for private gain [→ 2.4.3]. It is important to emphasize that, in our terms, not every coercive takeover of (private) property counts as predation.284 On the contrary, the definition is already narrowed to takeover of non-monetary property, and the element of private gain appears in the definition, too. In contrast, takeover of non-monetary property for public gain can be called "expropriation:"

- Expropriation is the coercive takeover of non-monetary property for public gain.

Expropriation may happen with normative targeting, that is, when property is taken from everyone who meets certain criteria (which are not unique to concrete, targeted persons). For example, we can think of communist nationalization and collectivization as one example, when non-monetary property (land, factories etc.) was expropriated normatively on a class basis, from groups like capitalists or "kulaks." On the other hand, expropriation with discretionary targeting exists, too, meaning that the property is taken from some concrete, targeted persons. This happens in case-by-case nationalizations, like eminent domain in liberal democracies when chosen land for public purposes (like road building) is expropriated from those who happen to be its owners.285 Such coercive takeover is not done for the private gain of politicians, for their own consumption, but for public gain and for the establishment of a good or service for many people's use. Furthermore, such discretionary intervention in a liberal democracy cannot be done without just compensation, to quote the Takings Clause from the Fifth Amendment of the Constitution of the United States which says "private property [shall not] be taken for public use, without just compensation."

285 Stoebuck, “A General Theory of Eminent Domain.” Also, nationalization is a general term and refers to a method of state involvement in property takeover, and as such it will appear in both expropriation and predation [→ 5.5.3.3].
286 Sullivan, “A Brief History of the Takings Clause.”
Table 5.18. Different types of coercive takeover of non-monetary property.

<table>
<thead>
<tr>
<th>For public gain</th>
<th>For private gain</th>
</tr>
</thead>
<tbody>
<tr>
<td>Normative targeting</td>
<td>· expropriation (of industry/market or assets of a discriminated group)</td>
</tr>
<tr>
<td>Discretional targeting</td>
<td>· expropriation (of concrete assets)</td>
</tr>
<tr>
<td></td>
<td>· predation (of industry/market or assets of a discriminated group)</td>
</tr>
<tr>
<td></td>
<td>· predation (of concrete assets)</td>
</tr>
</tbody>
</table>

In case of communist nationalizations, there was no compensation, whereas in post-communist ownership redistribution—carried out mainly by predation—compensation ranges from zero to the market price of the asset, depending on the potential cost of seizing that property [→ 5.5.4]. Predation can be divided into two categories, just like expropriation, based on the normativity of targeting (Table 5.18). In the case of normative targeting, we talk about market raiding below, when complete industries are taken over by the predatory state and reserved, with discretional regulatory intervention, as the monopoly of a predefined actor. On the other hand, predation for concrete assets is discussed below in the following section, showing how private as well as public actors can take over companies of other actors by coercive means.

5.5.3.1. From violent entrepreneurs to the criminal state: a typology of reiderstvo practices

Post-communist ownership redistribution involves predation by the leading political elite, using the bloodless means of state coercion. But predation can be initiated by private actors as well, such as in case when the organized underworld and or oligarchs take over the companies of other private actors. The general term for company takeover in the post-communist region is reiderstvo:

- **Reiderstvo** is a type of predation that targets economic units (firms, companies, enterprises etc.).

*Reiderstvo* is a Russian word, derived from the English word “raiding.” However, it would be misleading to try and apply terms such as “corporate raiding” or “hostile takeover” here in their Western meaning. While **hostile takeover in liberal democracies** is often considered immoral, the term refers to actions that are usually legal, just opposed actively by the target firm’s incumbent management or board of directors. Hostile takeovers in the West are rarely characterized by the illegal use of public authority—and physical violence is even more rare.

On the other hand, reiderstvo always involves illegal practices and the use of violence for private gain, aiming at the takeover of targeted economic units. Types of reiderstvo can be differentiated on the basis of the level of coercion employed by the initiators (Table 5.19). First, when the actors use direct physical violence, meaning the targeted company’s owner hands out his property “at gunpoint,” we can speak about black raiding:

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287 Viktorov, “Russia’s Network State and Reiderstvo Practices.”
288 Schneper and Guillén, “Stakeholder Rights and Corporate Governance.”


Table 5.19. Types and certain features of reiderstvo in post-communist regimes.

<table>
<thead>
<tr>
<th>Strength of the state</th>
<th>Legality of raiding</th>
<th>The initiator or client of the corporate raiding</th>
<th>Organized underworld: chief patron (top level public authority)</th>
<th>Low, middle or high level public authority</th>
<th>Rival entrepreneurs or oligarchs</th>
<th>Organized underworld: criminal groups</th>
</tr>
</thead>
<tbody>
<tr>
<td>Strong state</td>
<td>White raiding</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Failed state</td>
<td>Gray raiding</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Black raiding</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Institutional environment and features of the raiding action</th>
</tr>
</thead>
<tbody>
<tr>
<td>Criminal state</td>
</tr>
<tr>
<td>Single-pyramid power network</td>
</tr>
<tr>
<td>Monopolized</td>
</tr>
<tr>
<td>Oligarch capture</td>
</tr>
</tbody>
</table>

- **Black raiding** is a type of reiderstvo which is carried out by the direct threat or use of physical violence (physical abuse, extortion at gunpoint etc.). Black raiding is typically initiated by (a) the organized underworld (criminal groups) or (b) rival entrepreneurs or oligarchs.

The widespread phenomenon of black raiding assumes weak state power (including failed states in some cases) as well as a murky legal environment governing ownership. The transformation crisis of the early 1990s stripped the masses of their meagre but secure earnings while at the same time opening the field for the violent redistribution of newly privatized property.

Black raiding is **carried out by members of the organized underworld**, taking on the illegal role of violent entrepreneurs. **When instead of private violence the initiators of reiderstvo rely on corrupted/captured state authorities**, we can speak about grey raiding:

- **Grey raiding** is a type of reiderstvo which is carried out by the use of state coercion in a corrupt or captured state. Grey raiding is typically initiated either by (a) rival entrepreneurs or oligarchs, (b) low, middle or high level members of public authority or (c) top level public authority.

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289 Legal violent entrepreneurs cannot be used for reiderstvo because reiderstvo is, by definition, illegal. In other words, if a legal violent entrepreneur is hired to carry out reiderstvo, he becomes illegal by definition.
Grey raiding is what Thomas Firestone identifies simply as “corporate raiding” in the post-communist region. As he writes, this phenomenon can be defined “as the seizure, or attempted seizure, of a business or a substantial part of its assets, through the corrupt reliance on a legal document, including, but not limited to, a court order, judicial decision, corporate resolution, corporate charter document, or state registration document. The execution of a corporate raid typically involves the following three stages: (1) the raider creates or corruptly obtains a legal document establishing faux legal title to some assets, usually shares or real property of a business; (2) the raider carries out a forcible takeover of the target property; and (3) the raider launders the seized property through a series of shell companies to an ostensible ‘good faith purchaser’ from whom it is essentially impossible to recover the property. […] Each stage relies on abuse of the legal system.”

The initiators of grey raiding are no longer necessarily criminal groups but may be business rivals or even members of the lower, local levels of organs of public authority. In the former case, we can speak of a form of state-facilitated corporate crime, whereas in the latter case, corporate-facilitated state crime. The necessary professional expertise is provided—in a fashion similar to that provided by corruption brokers—by raiding brokers, “professional service providers, such as lawyers or bankers, who charge a fee or take a percentage of the ultimate gain in exchange for facilitating a raid.”

Grey raiding prevails as a dominant form of reiderstvo when governmental actors lose control over the public administration and the bureaucrats start using state power over economic actors for their private gain (as it typically happens in weak states and did happen in Russia and Ukraine, during the post-transition period of oligarchic anarchy). Markus describes this phenomenon as disorganized state threats to ownership rights, meaning it consists of occasional, uncoordinated predatory acts of detached actors. These actors do not have a long time-horizon; they think in the short-term and predate on what they find tempting target at the moment. According to Markus, these bureaucrat predators act like “piranhas: voracious mini-beasts as lethal in groups as the shark, but also more vulnerable individually. Unlike sharks, piranhas never coordinate their attacks and habitually attack creatures larger than themselves. Predation in modern developing states is often conducted by high-powered mini-beasts: policemen, party functionaries, local administrators, directors of state-owned enterprises, tax collectors, or the agents at any of the myriad of departments with the power to halt productive activity (sanitation, fire safety, social security etc.).” Indeed, this description reveals that anarchy prevails not only outside the state—where there is no monopolist of the legitimate use of violence protecting property rights—but also inside it, resulting in a chaotic, rather unpredictable relationship between the state and economic actors.

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291 Friedrichs, Trusted Criminals, 159–62.
294 Thus, as Markus argues in a paper, these actors degrade into “roving bandits” from “stationary bandits,” using Olson’s categories. Markus, “Secure Property as a Bottom-Up Process.”
295 Markus, Property, Predation, and Protection, 11.
Further, Markus's description suggests that the survival of the economic functions of state administration after transition, which to some extent is necessary during the time of nascent capitalism, is another prerequisite of top-down administration capture (besides state weakness). Low level of codification can also be mentioned as a factor that facilitates—to use a mixed metaphor—“fishing in troubled waters” by “piranhas.” Indeed, poor codification is a well-known problem for several post-Soviet countries, especially in the Eastern-Orthodox historical region. Finally, we should note that bureaucrats in this situation can easily become violent entrepreneurs.296 Relying on the legitimate use of violence by the state, public administrators capitalize on their blackmailing power and appropriate economic actors’ property either (a) for their own private gain or (b) in exchange for bribe money from rival entrepreneurs or oligarchs, to whom they provide services at a price. Markus offers a list of services offered by Russian administrators in the mid-2000s (with prices), including:297

- inspection of a targeted firm by taxation agency ($4,000);
- court decision on property arrest / injunction against a shareholder meeting ($10,000-$30,000);
- opening of a criminal case against targeted owners ($50,000);
- closure of a criminal case through the Ministry of Internal Affairs ($30,000);
- a commercial court verdict against the targeted firm ($10,000-$100,000);
- arrest of a business competitor through the Ministry of Internal Affairs ($100,000);
- forcible office takeover ($10,000-$30,000).

In his book Red Notice, Bill Browder describes a case of grey raiding as follows. Answering the question “How do you steal a company?,” he explains that “a company’s owners can be illegally changed without you knowing if the person taking control of the company has the company’s original seals, certificates of ownership, and registration files.” In Browder’s case, the police seized the necessary documents during an office raid. Later, three companies were fraudulently reregistered to another company, using the name of a man convicted for manslaughter in 2001. “Those documents were then used to forge a bunch of backdated contracts that claim your stolen company owes seventy-one million dollars to an empty shell company that you never did any business with. […] Those forged contracts were taken to court, and a lawyer who you didn't hire showed up to defend your companies. As soon as the case started, he pleaded guilty to seventy-one million dollars in liabilities.”298 This case is congruent with our description of grey raiding. It is no longer the criminal underworld that takes over the company, but neither is reiderstvo initiated by

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297 Markus, Property, Predation, and Protection, 62. We do not cite every element from the list for the sake of brevity.

298 Browder, Red Notice, 204–5.
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As the transition period of oligarchic anarchy is coming to an end, this free competitive mode of grey raiding gradually loses its predominance and grey raiding comes to be organized either (a) around competing patronal networks, if a patronal democracy stabilizes (Ukraine), or (b) around a single-pyramid network, if a patronal autocracy is institutionalized (Russia). In the latter case, to use Markus’s metaphor, the “piranhas” transform into “cleaner fish” who can eat food remnants out of the shark’s mouth, which tolerates this “theft” as the amount of prey lost to the cleaner fish is miniscule. In a patronal autocracy, non-centrally led grey raiding does not disappear: Markus cites expert estimates, according to which in the 2005–2011 period the number of successful raiding attacks proceeded at a yearly pace of more than 10,000 firms in Russia (and 1,300 firms in Ukraine). However, while “state agents may jeopardize some income streams that would otherwise benefit the state principal,” “attacks on more fundamental ownership rights are the prerogative of state rulers.”

This leads us to the case when reiderstvo is initiated by a predatory state, that is, the leading political elite, and carried out by the agents of state coercion at the leaders’ order. This is what we refer to as centrally-led corporate raiding, whereby property is appropriated by top authorities of the central state, typically at the command of and through coordination with the highest holder of executive power. This type of raiding becomes dominant in a regime when a multi-pyramid patronal system is replaced by a single-pyramid patronal system, and raiding becomes a tool for subjugating oligarchs who had enjoyed relative autonomy and fought their battles among themselves before. Here we can speak, not of state capture, but only of oligarch capture, which presumes the monopolization of political power by a patronal network.

Centrally-led corporate raiding can employ various forms of raiding from Table 5.19. First, it may involve grey raiding, when bureaucrats are not corrupted in a bottom-up but a top-down fashion by top-level authorities to facilitate reiderstvo against a target company. According to Sakwa, the “classic weapons” of centrally-led corporate raiding include: “the acquisition of a minority stake that is then used to disrupt the work of the existing management; the launching of civil proceeding against the company, combined with the commencement of criminal proceedings against senior management […]”; and various commercial approaches by groups connected in one way or another with the raider.

However, an autocratic chief patron who has control over legislation has ample opportunity to use the last type of reiderstvo as well: white raiding.

- White raiding is a type of reiderstvo which is carried out by the use of state coercion in a criminal state. White raiding is typically initiated by the organized upperworld, that is, (a) low, middle or high level members of public authority or (b) the chief patron as a top-level actor of public authority.

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299  Browder, Red Notice, 204.
300  Markus, Property, Predation, and Protection, 57.
301  Markus, Property, Predation, and Protection, 11.
By “white raiding”—breaking with the usual application of the term—we refer to a form of corporate raiding where instead of the legal environment being misused, it is adapted and tailored to individuals and single companies in a targeted manner. The single-pyramid patronal system creates white raiding’s “legal” room for maneuver—as described in Chapter 4—through legislation and decrees. On the one hand, a feature of the resulting regulations is that the laws, contrary to their publicly stated function—namely, that they apply impartially to everyone—have been tailored to individuals or companies. On the other hand, these laws set regulations (bankruptcy law, tax evasion law, various safety rules and environmental protection prescriptions etc.) that make it possible for the dominant patronal network to drive the companies selected for reiderstvo into bankruptcy through politically selective law enforcement \(\Rightarrow 4.3.5.2\). This is how the legal environment serving the predatory character of the mafia state is brought into being.

In actual cases of centrally-led corporate raiding, white and grey-raiding techniques are often combined. Indeed, this is possible only when the chief patron has complete control over the instruments of public authority, because smooth cooperation is required between institutions for legislation (including the passage of decrees) and the tax authorities, secret services, prosecutor’s office and police. The monopoly on power that is usually concentrated around the position of the president supplies the raw political force for replacing oligarchic anarchy with a form of criminal state, the mafia state. Such a switch took place in Russia, starting soon after Putin came to power (see Box 5.10), and it was attempted in Ukraine under chief patron Viktor Yanukovych as well, when “ministries have become weapons of the Presidential Administration against any business.”

Each post-communist regime has varied in traversing the spectrum from black raiding to white raiding, from spontaneously violent to centrally directed and “legalized” corporate raiding. Russia progressed through all three stages, ultimately (largely) monopolizing, centralizing and appropriating the means of expropriation by establishing a centrally directed form of corporate raiding that facilitates the accumulation of both power and wealth. Paradoxically, in accomplishing this centralization, it also created a certain form of property protection that is in some tension with the lower-level, guerilla actions characteristic of grey and black raiding. The preconditions for secure ownership in the mafia state are, first, loyalty to

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the chief patron, and, second, a situation whereby closer circles of the adopted political family do not feel like grabbing the property in question. According to surveys conducted in 2008 and 2011, Russian managers with immobile assets but personal connections to the adopted political family viewed their property rights as far more secure than those who did not have such connections. However arbitrary the system may be, it creates more predictable security for private property than existed in the earlier period of oligarchic anarchy. Where the size of the empire demands it, the chief patron may delegate the right of corporate raiding and corruption (excluding the realms of raw material extraction and strategic branches of industry) to regional governors in the adopted political family, where the national system is replicated on a smaller scale [2.2.2.2].

In Ukraine, the first two forms dominated, though corporate raiding directed from the presidential level became prominent when attempts were made by Leonid Kuchma and Viktor Yanukovyts to establish single-pyramid systems. The consolidation of these efforts was blocked by the Orange Revolution and the Euromaidan Revolution [4.4.2.3]. In fact, after the latter revolution, the vacuum left by the dissolution of the state and the emergence of civil war was filled at the regional level by temporarily granting positions of public authority to locally dominant oligarchs. In Hungary, by contrast, the black and grey versions of corporate raiding were never present due to the stability of its liberal political institutional system and the maturity of its legal institutions protecting private property. Skipping these first two “evolutionary” stages of raiding, centrally-led raiding was introduced directly by the mafia state that Viktor Orbán established after 2010. And while in the former Soviet republics of Central Asia the economy was privatized to a much smaller degree, most of these countries skipped the first two stages just like Hungary. In countries like Azerbaijan, Kazakhstan and Uzbekistan, it was not the institutional system of liberal democracy, but former communist leaders holding onto power at the highest level that secured a monopoly on corporate raiding for the chief patron.

5.5.3.2. Towards patronalization: exogenous and endogenous property rights

Centrally-led corporate raiding is only one form of predation that can be used by predatory states. In the post-communist region, a variety of other methods appear in post-communist ownership redistribution. To analyze these practices as well as the result of the patronalization process in terms of ownership, property rights provide a fine analytical framework. For (1) what happens in case of coerced private-owner transfers is the violation of the property rights of target owners, and (2) by examining which rights of a property are exercised by whom, we can construct the result of patronalization, where de jure ownership and de facto disposition over property do not coincide (as in the case of liberal democracies).

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305 Indeed, asset mobility is a decisive factor in predation [5.5.4.1].
306 Frye, Property Rights and Property Wrongs, 77.
307 Rojansky, “Corporate Raiding in Ukraine.”
308 Konończuk, “Oligarchs after the Maidan.”
309 Magyar, Post-Communist Mafia State, 179–95.
For the purposes of our framework, we differentiate between two types of rights:

- **exogenous property rights**, which refers to the rights of the owner vis-à-vis the state, or what the state is obliged to do (or not to do) with respect to his property;

- **endogenous property rights**, which refers to the rights of the owner vis-à-vis his property, or what he can actually do with what he owns.

It may be argued that this distinction is superfluous. For endogenous rights include exogenous rights: if I rightfully own a piece of property, that precisely means that I can act with it and others cannot, and this situation prevails only if others respect my rights and do not use what I own. However, we make this distinction not to make a normative philosophical point but to provide a positive analytical framework for description of real world cases. Indeed, it is analytically useful to make the distinction between exogenous and endogenous rights for two reasons. First, beyond leaving the rightful owner's property alone, further obligations of the state can be included in the bundle of exogenous rights which are universally respected by constitutional states but are violated by mafia states, bringing about predation and patronalization. Second, by the distinction we can elegantly split our description into two halves: the methods of predation by focusing on violations of exogenous rights of rightful owners, on the one hand, and the result of patronalization by focusing on the distribution of endogenous rights between oligarchs, poligarchs and front men, on the other.

5.5.3.3. Exogenous rights: types of nationalization

We use now “nationalization” as a general term for violations of exogenous rights of owners. However, **conflation of post-communist nationalization with (a) communist nationalizations and (b) nationalizations in liberal democracies should be avoided.** Nationalization, as practiced in post-communist autocracies—meaning the expropriation of private property through the coercive instruments of public authority—is fundamentally different in function from both its practice under capitalism and from how it works under the communist command economy, which is based on the monopoly of state ownership. Under capitalism, though non-economic objectives also appear among the motives of the regime, the operation of nationalized property nevertheless fits into the rationale of the market. In communist regimes, on the other hand, nationalizations constitute the entire system whereby the economy operates in a rather homogeneous way under the ownership of the party state, merging the spheres of political and market action. **In post-communist autocracies, however, nationalization is part of post-communist ownership redistribution and simultaneously serves (1) to increase the wealth of the adopted political family and (2) to provide regulated remuneration for those built into its vassal chain of rule.**

To avoid confusion, we introduce three categories for post-communist nationalizations.\(^{310}\) Each category refers to a group of practices, put together by the criterion of violating one of three exogenous property rights we differentiate (Table 5.20):

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\(^{310}\) It should be noted that reiderstvo is a subtype of post-communist nationalizations, referring to acts that target companies (economic units).
- **Hot nationalization** is a type of predation that violates an exogenous property right, namely the right to security and protection of property. This right refers to the obligation of the state normatively to provide the protection of private property rights to everyone living under its authority.

- **Monopolizing nationalization** is a type of predation that violates an exogenous property right, namely the right to carry out an economic activity. This right refers to the obligation of the state not to close the entrance to private markets for those who wish to enter and are in a position to do so, and not to take away the opportunity from those who have already entered.

- **Cold nationalization** is a type of predation that violates an exogenous property right, namely the right to fair treatment. This right refers to the obligation of the state to treat every economic unit in a normative manner, taxing and regulating them according to predefined rules and not discretionally or according to the leading political elite's whim.

We now continue with differentiating ideal typical subtypes (i.e., practices) of each nationalization type. Naturally, real life cases are not ideal typical, and the various forms can also be combined in certain actions. However, to be able to analyze such processes, we need to first distinguish the “pure” types of nationalization, from which the description of more complex cases can be built up.

**Among the types of hot nationalization**, the first one we need to define is renationalization:

- **Renationalization** is a type of hot nationalization involving the complete seizure of a formerly privatized company by the state for a longer-lasting period.

In the context of post-communist patronal autocracies, renationalization means using property-taking intervention for private gain. By a transfer of ownership, a company that had been privatized before becomes, through no intermediate stages, a public company. The second type, deprivatization, is similarly simple:

- **Deprivatization** is a type of hot nationalization involving the expansion of state shareholding among privatized companies.

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311 We model this expression after “cold collectivization.” In Polish agriculture at the time of the communist nationalization, the rulers did not feel they had enough power to collectivize the peasants’ lands, so what they did was nationalizing their market environment: the state prevented the concentration of estates, which meant that the ownership structure of the private farms remained essentially the same from 1945–1970; it upheld the system of compulsorily submitting produce until 1972; wide use of state-set prices; the trade in agricultural tools and seeds was in state hands etc. Therefore, while there was no collectivization of lands per se, the situation could be described as “cold collectivization.” Magyar, “Post World War II History of Polish Agriculture.”

312 Chernykh, “Profit or Politics?,” 1240.
Table 5.20. Nationalization methods (forms of violations of exogenous property rights) in predatory states.

<table>
<thead>
<tr>
<th>Violated exogenous right (type of nationalization)</th>
<th>Pre-transfer form of property</th>
<th>Mid-transfer form of property</th>
<th>Post-transfer form of property</th>
</tr>
</thead>
<tbody>
<tr>
<td>Renationalization</td>
<td>Private (formerly privatized) company</td>
<td>—</td>
<td>Public company</td>
</tr>
<tr>
<td>Deprivatization</td>
<td>Private shares in private companies</td>
<td>—</td>
<td>Public shares in private companies and state-led holding structures</td>
</tr>
<tr>
<td>Bandit nationalization</td>
<td>Private property</td>
<td>Private property under state threat or deception</td>
<td>Public property</td>
</tr>
<tr>
<td>Transit nationalization</td>
<td>Private company</td>
<td>Public company</td>
<td>Private company (patronal)</td>
</tr>
<tr>
<td>Market raiding</td>
<td>Private activity with normative license</td>
<td>—</td>
<td>Private activity with discrentional license</td>
</tr>
<tr>
<td>Market acquiring nationalization</td>
<td>Private market</td>
<td>—</td>
<td>Public monopoly (franchise)</td>
</tr>
<tr>
<td>Competency nationalization</td>
<td>Private activity commissioned by a municipality</td>
<td>—</td>
<td>Private activity commissioned by the central state</td>
</tr>
<tr>
<td>Cold nationalization</td>
<td>Private company</td>
<td>Private company with stifling economic environment</td>
<td>Private company (patronal)</td>
</tr>
</tbody>
</table>

However, the essence of the deprivatization policy lies in forcing state and private corporations in certain especially important strategic sectors (e.g., raw material extraction, military industry, or high-tech manufacturing) into a single state holding company. This method serves the power and financial purposes of the adopted political family, without completely blocking the economic operation of the companies belonging to this sector. This simultaneously serves a range of functions, from ensuring loyalty to the placement of front men and rents, in a sustainable manner.

In an empirical study, Lucy Chernykh analyzed 153 “champions” from the 200 largest Russian companies that were privately-controlled at the end of 2003. That year marked the starting point of patronal autocracy under Putin [→ 7.3.3.5], as well as the start of a large nationalization wave (post-communist ownership redistribution). For the aforementioned companies, which accounted for the 36.6% of the Russian GDP, Chernykh collected acquisitions data to identify companies that were targeted for a state takeover during the 2004–2008 period. He found 26 targets among them, 19 of which were taken over (14 majority—above 50%—and 5 blocking minority—at least 25%—control transfer); the remaining 7 takeovers were not finalized until the end of 2008. Chernykh found
that nationalization in Russia is dominated by political considerations, whereas firm-level profitability and economic importance were not systematically related to the likelihood of nationalization. Positive and significant relation between the tax evasion claim to a private company and its probability to be targeted for nationalization has been found, though, signifying the use of politically-selective law enforcement \(\rightarrow 4.3.5.2\). State takeovers in Russia were also not targeted against foreign investors as all taken over companies were majority controlled by domestic private owners.\(^{313}\)

In the two remaining methods of hot nationalization, there is an intermediary stage in the nationalization process between the ownership of the one without and the ownership of the one with patronal ties. The two types can be defined as follows:

- **Bandit nationalization** is a type of hot nationalization involving the nationalization of private assets after state threat or deception.

- **Transit nationalization** is a type of hot nationalization involving property-taking intervention against a target company, which is reprivatized to chosen actors at a later date.

"Bandit" in the label of bandit nationalization indeed refers to highway robbery, when the victim is called to hand over his property at gunpoint. Of course, this is not precisely what the leading political elite or the apparatus of a predatory state does, but the state indeed uses coercion, not in the form of violent but in the form of non-violent threats to carry out bandit nationalization. To illustrate this, let us take the example of nationalizing the private pension funds in 2011 in Hungary. To be able to liquidate the system of private pensions that had worked for more than a decade already, heightened emotions had to be aroused, eliciting the message about private pension funds that they were “laying waste to our money through speculations.” Since even such communications criminalizing the funds were not enough, the capture of a vast majority of the 3,000 billion forint (ca. €10 billion) fortune had to be ensured through intimidation, the blackmail of pension fund members, raising the threat of losing state guaranteed pensions and the installation of an array of technical hurdles to be overcome to stay members of the private funds. The members of the funds were stripped of their savings without notable social dissent, paid off with the precarious promise of a future state pension.\(^{314}\)

**In the case of transit nationalization**, the private company of an actor outside the adopted political family is taken into “temporary state care.” By means of the interim phase of (re)nationalization, private fortunes are forced into the ownership orbit of the adopted political family. This method is needed primarily when the adopted political family does not have enough (formally) private resources, wealthy front men and banks to simply buy up companies, which would be a simpler and less conspicuous way of taking over individual companies.\(^{315}\) Transit nationalization may be facilitated by prior actions of cold nationalization (see below), coercing the owner to surrender and eventually leave the market. A state

\(^{313}\) Chernykh, “Profit or Politics?”

\(^{314}\) Simonovits, “The Mandatory Private Pension Pillar in Hungary.”

\(^{315}\) For examples, see Várhegyi, “The Banks of the Mafia State.”
loan may be ensured to oil the reprivatization within the adopted political family. Indeed, it is a kind of “reprivatization what was defined as 'repeated privatization': nationalization of the already privatized companies followed up by the alternative 'fair' privatization.”

The second group of nationalization includes the types of **monopolizing nationalization**. Here, three types can be differentiated:

- **Market raiding** is a type of monopolizing nationalization involving (a) custom-tailoring the licensing requirements to certain economic actors or (b) the discreional revoking of the license of the competitors of the members of the adopted political family in a certain market.

- **Market-acquiring nationalization** is a type of monopolizing nationalization involving the nationalization of an economic activity or the right to it, making the previously private activity a state monopoly.

- **Competency nationalization** is a type of monopolizing nationalization involving the monopolization of an economic activity by revoking municipal governments’ competence to commission it from private actors.

By these practices, the state does not strip owners of their business directly but monopolizes the economic activity in question. A typical case of **market raiding** is stipulating that only companies in state or municipal possession are permitted to carry out certain activities (such as local public transport, water management, waste management, metal trade etc.). As for **market-acquiring nationalization**, it is indeed the inverse of franchising privatization as it involves making the continuation of an activity conditional on a concession. After market-acquiring, the predatory state can either (a) decentralize the activity, redistributing the concessions in a process of decentralization, (b) centralize the activity and make it the sole province of a newly established state company, or (c) centralize the activity but partially privatize it via contracting out \( \rightarrow 5.5.2.1 \) and therefore weaving lower-level private actors into the adopted political family’s patronal network as subcontractors and occasional winners of public procurements. At any rate, the activity is put in the hands of economic actors patronally subordinated in the adopted political family to the chief patron. Thus, market-acquiring nationalization is different from regulatory changes in liberal democracies which may also force out previous competitors from the market and violate their right to carrying out an economic activity \( \rightarrow 5.4.2 \), for there the activity is not carried out by the members of the leading political elite after the change.

**Competency nationalization** involves the centralization of municipal responsibilities in order to centralize the right to commission certain types of activity in the hands of the chief patron, who can thus give the state commissions to a discretionally chosen actor more easily. Indeed, competency nationalization should not be understood as “nationalization of competences” but rather as nationalization through competences. By centralizing the rights to decide who carries out an economic activity, the chief patron can dispose

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316 Chernykh, “Profit or Politics?,” 1240.
over the given economic sector, forcing out unwanted competitors and rewarding loyal members of the adopted political family.

The last type of nationalization is **cold nationalization**, which refers to creating a stifling economic environment for certain economic actors by state intervention. More specifically, the state can (1) use regulatory or budgetary intervention to make operation harder or/and (2) regulate or take over certain markets in the economic environment of the targeted actors. We do not distinguish subtypes, given there are way too many cold nationalization practices to create a useful typology. Rather, we explain the phenomenon in more detail. In cold nationalization, the state expropriates the market environs of a given economic sector without directly nationalizing the businesses involved in it. Techniques used for this include both direct and indirect means, described below in the context of predation [→ 5.5.4.1]. Measures like using state authority to determine prices, instituting discretionary taxes or regulating/restricting fields of activity through custom-tailored lexes serve to bleed dry owners of businesses, to prepare for a permanent or transit nationalization of a business, to ensure the subordination of key players in a sector. Moreover, they personalize and impose a politically directed chain of command on market relations that otherwise, on the whole, involve impersonal connections and economic calculus [→ 6.2.2.2]. Cold nationalization does not necessarily turn into permanent nationalization or transit nationalization but opens the way to many potential ways to extract resources from businesses.

Cold nationalization tends to accompany the process whereby the adopted political family brings more economic positions into its orbit and wealth accumulates within the organized upperworld. For example, among post-communist countries that later became EU member states, market and economic prerogatives were tied naturally to the ownership of property, with some of these then becoming part of the state’s domain through cold nationalization. Farther east, these prerogatives were only partially tied to nascent private property, if at all. In these countries, therefore, the task at hand for the mafia state is not the renationalization of entitlements but, rather, keeping them in state ownership.317

Comparing the Russian and Hungarian experiences, we can see that Orbán usually used transit-nationalization and monopolizing nationalization to redistribute markets on a relational base [→ 5.6.1.1],318 while Putin has relied more on renationalization and depredation. In other words, in Hungary more of the redistributed property is de jure private than in Russia, where Putin relies more on direct state ownership.319 With respect to the end result, the two methods are no different as they both bring property under de facto patronal ownership [→ 5.5.1]. That one chief patron prefers de jure private and the other, de jure public ownership may be explained by the level of regime consolidation. As we showed in Chapter 4, Hungary is the least while Russia, the most consolidated among patronal autocracies [→ 4.4.3.2]. **In a more consolidated autocracy, the chief patron can be confident that he will**

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317 Such entitlements may include the centralized disposal of raw-material distribution capacity and logistics, or the phenomenon often called overregulation, which makes it possible for the public authorities to harass and blackmail entrepreneurs in many unjustifiable ways.


not lose state power, and therefore control over state companies; in a less consolidated autocracy, it is safer to keep property in de jure private hands, so it will not change hands in case of a change in government. Therefore, it is rational for a chief patron in the latter case to use hot nationalization of private firms less, whereas a more confident chief patron like Putin can use the state more directly, exercising ownership rights in a more open way.

5.5.3.4. Endogenous rights: the result of patronalization

In the previous parts, we showed in what ways private property can be redistributed by the adopted political family to its members. Now we focus on the result of this process, that is, the ownership structure that is formed as a result of post-communist ownership redistribution.

An analysis of property relations within the single-pyramid patronal network can be done by considering the status of endogenous property rights. These are typically listed as “property rights” by scholars, describing what it means when someone “owns” a piece of property or what he can do with it. In a seminal paper, Edella Schlager and Elinor Ostrom divide property rights into two groups: use rights and control rights. Among use rights, they list:

- **access**, which is the right to enter a defined physical property;
- **withdrawal**, which is the right to obtain the ‘products’ (profit) of the property.

In contrast, control rights include the three following rights:

- **management**, which is the right to regulate internal use patterns and transform the property by making improvements;
- **exclusion**, which is the right to determinate who will have an access right, and how that right may be transferred;
- **alienation**, which is the right to sell or lease the rights of management and exclusion.

An important point is that we understand these rights as sociological descriptions and not as the legal rights of certain actors. In other words, we are interested in not what the owners are entitled to do de jure, according to the legal documents that certify ownership, but that what they are able to do with a piece of property de facto. In a liberal democracy, this distinction would be unnecessary, for there—in the ideal typical case—de jure and de facto rights coincide, meaning the owner can do exactly what he is formally entitled to do with his property. However, in a patronal autocracy or a single-pyramid patronal network that comes about as a result of patronalization, the de jure and de facto rights of actors

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320 Schlager and Ostrom, “Property-Rights Regimes and Natural Resources.”

321 In the literature, there exist more expansive lists of use and control rights than this. (For a classic example, see Honoré, “Ownership.”) The reason we stick to the work of Schlager and Ostrom in spite of this is that the five rights they list are satisfactory to underline the specificities of ownership of the members of a single-pyramid patronal network. This also means that one can use a more expansive list if he finds that necessary for the description of a given case.
diverge. That an economic actor is the *de jure* owner of a certain piece of property does not automatically mean that he can also use and control his property *de facto*.

To illustrate this, let us take ideal typical examples of economic units formally owned by economic actors in different regimes (Table 5.21). In a *liberal democracy*, that an entrepreneur owns a piece of property means two things: first, he can exercise all use and control rights associated with that property and, second, a politician (a political actor in a liberal democracy) cannot interfere with how he exercises his rights. This is what the *separation of the spheres of social action* means, that economic actors have full autonomy vis-à-vis political actors. True, politicians use state intervention, which regulates the use of private property. But these regulations—as we explained above—are normative and also persistent, meaning that they cannot be changed at the whim of a politician but rather by a complex, democratic process of lawmakers ([→ 4.3.4]). Indeed, regulations do not interfere with the executive decisions of economic actors but define the boundaries of exercising endogenous rights—they do not give orders what to do but specify what cannot be done. In other words, the regulations of a constitutional state create the playing field on which the economic actors can operate, and political actors do not come to exercise the endogenous rights of a private company.

In a *patronal autocracy*, the situation is different because of the lack of separation of the spheres of social action. Let us take the examples of the two ideal typical economic actors of the adopted political family: economic front man and the oligarch. As for the former, a low- or mid-profile front man has no use or control right over the property that he formally owns. Indeed, the endogenous property rights of the front man’s private property are exercised by his patron, an oligarch or a poligarch, and vis-à-vis his patron the front man has no autonomy. The low- and mid-profile front man’s main function is the legal personalization of the patron’s accumulated wealth, that is, to keep formally the wealth of a patron who could not legally own it. The situation is only slightly different in the case of a high-profile front man, who also takes on the role of operating shell compa-

Table 5.21. Endogenous property rights of actors in a liberal democracy and patronal autocracy.

<table>
<thead>
<tr>
<th>Endogenous rights</th>
<th>Liberal democracy</th>
<th>Patronal autocracy</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><em>De jure</em> ownership = <em>de facto</em> ownership</td>
<td><em>De jure</em> ownership ≠ <em>de facto</em> ownership</td>
</tr>
<tr>
<td></td>
<td>Normative, persistent intervention</td>
<td>Discretional, <em>ad hoc</em> intervention</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Use rights</th>
<th>Entrepreneur</th>
<th>Politician</th>
<th>Economic front man (low- or mid-profile)</th>
<th>Economic front man (high-profile)</th>
<th>Oligarch</th>
<th>Poligarch (chief patron)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>+</td>
<td>+</td>
<td>+</td>
</tr>
<tr>
<td>Withdrawal</td>
<td>+</td>
<td>-</td>
<td>-</td>
<td>-</td>
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<td>Management</td>
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<thead>
<tr>
<th>Control rights</th>
<th>Entrepreneur</th>
<th>Politician</th>
<th>Economic front man (low- or mid-profile)</th>
<th>Economic front man (high-profile)</th>
<th>Oligarch</th>
<th>Poligarch (chief patron)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exclusion</td>
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<tr>
<td>Alienation</td>
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</tbody>
</table>
Economic relations. Thus, the patron delegates him the right to access and manage his property, but the rights to withdrawal, exclusion, and alienation remain in the hands of the patron, who exercises them through the front man via informal ties.

To assess the situation of an oligarch in a single-pyramid patronal network, we need to recall that the oligarch is ultimately the high-profile front man of the chief patron. Therefore, on the one hand, oligarchs have the same rights as high-profile front men, meaning they have rights to access and manage their property. However, they also have some autonomy over exclusion, withdrawal, and alienation, yet this autonomy is limited. This stems from the fact that the chief patron can decide at his whim to take over the exercise of endogenous rights of his oligarchs' property. The intervention of the chief patron is discretionary and ad hoc: he does not have to follow any normative rule regarding with whom or when to intervene in the executive decisions of his clients. In addition, the chief patron sets informal limits, delimiting in a more or less normative manner what they cannot spend their formal wealth on. These limits are similar to formal state regulations in their effect and character but they are not codified and are enforced informally, through negative discretionary state intervention toward the disobedient. A typical informal limit for oligarchs in patronal autocracies is the prohibition of supporting political opponents and setting up new patronal networks, given such action would violate the single-pyramid nature of the adopted political family. Other informal limits may relate to capital flight and inheritance, that is, the movement of property abroad or to an heir's private hands.

From the previous paragraph, it follows that the chief patron is the ultimate owner of all the adopted political family's property. He does not always exercise his rights and delegates some of the executive decisions to his clients, oligarchs and lower-level poligarchs, if he finds that more decentralized management is more efficient. But the chief patron does have the de facto right to dispose over any of the property in the family's ownership orbit while he has no de jure right over any of the same property. From a legal point of view, or in the eye of an observer accustomed to liberal democracies, the chief patron is not significantly different from a Western-type politician; neither of them has legal right to access, withdrawal, management, exclusion, or alienation of the private property of economic actors. However, while in an environment of separated spheres of social action this means that the politician indeed has no such rights, in an environment of colluding spheres of social action the chief patron has every de facto right to use and control the adopted political family's private assets.

5.5.3.5. The system of power & ownership: from market economy to relational economy

We finished the previous part by saying that an observer—let us say, a political scientist—who is accustomed to Western democracies cannot differentiate a poligarch from a politician, given they have the same formal identities. Similarly, we can say that an economist who is accustomed to Western market economies cannot differentiate between an entrepreneur and an oligarch—and for the same reason. If the spheres of social action are

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323 “Billionaires in Moscow Try Building Dynasties for Post-Putin Era.”
treated as if they were separated and the matching of *de jure* and *de facto* identities is taken for granted, the phenomenon of poligarchs and oligarchs cannot be comprehended.

This also has consequences for the dominant type of ownership. **In mainstream economic thinking, the dichotomy of private and state ownership** is dominant and economies are compared on this basis, namely whether they are based on the dominance of private or state property. As a matter of fact, regime-changing privatization aimed precisely at normative ownership-type transformation, that is, changing the dominance of state property to that of private property, and introducing capitalism as a result. But the private-public dichotomy falls short when it comes to post-communist countries and colluding spheres of social action, producing such allocation of property rights as described above. Thus, it is worth introducing a specific concept of ownership that refers to the lack of separation—the concept of power-ownership.

- **Power-ownership** is a type of ownership which is operated and protected by the informal political ties of the owner. Political ties may mean that the owner is a client—when he owns his property as an economic front man of his patron—or that he is a patron—when he owns his property as an oligarch or poligarch and also exercises ownership rights in the formal/legal property of his front men.

Power-ownership (*vlast’n sobstvennost’*) is widely known and used in the Russian literature. Also, it has been recognized that the dominance of power-ownership indicates a new economic system, given it is the dominant ownership type that fundamentally defines an economic system. In the case of a command economy, we have seen the dominance of state ownership, whereas market economies are characterized by the dominance of private ownership. As for the economy where the dominant form of ownership is power-ownership, that can be called a relational economy.

We provide a comparative analysis of the three aforementioned types of economy in Part 5.6. At this point, it suffices to cite the work of Igor Berezhnoy and Vyacheslav Volchik, who analyze a developed regime based on power-ownership. According to them, such a regime has three fundamental characteristics: (1) “The granting of ownership rights for certain property is only possible with active participation of the state as the main agent of distribution (or redistribution);” (2) “Any property might be expropriated at any time if the authorities (at any level) become interested in its redistribution;” (3) “State or other authorities collect rent (either explicitly or implicitly) from the property within the framework of power-ownership.” Indeed, while feature (1) is characteristic of any relational economy, feature (3) refers to the ones which have kleptocratic states—where it is current incomes

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324 Ryabov, “The Institution of Power-Ownership in the Former USSR” Indeed, Ryabov defines power-ownership more broadly and uses it for all kinds of collusions and mergers of the market and political spheres, including feudalism and communist dictatorships. In that understanding, state ownership would be the formal and impersonal type of power-ownership, whereas what we denote by this term would be the informal and personal type of it. However, while etymologically such extension of the definition is justified (there is indeed “power” that is linked to “ownership” in each case), we narrow the definition down to informal relations for the purposes of our framework.

which are illegally appropriated—and feature (2) holds true under a predatory state—where it is the capital, or the source of current income, that is illegally appropriated. Predatory states may engage in illegal appropriation of capital for political as well as economic gains, and the two are indeed hardly distinguishable under a system of power & ownership.

5.5.4. Predation and Economic Dynamics: Stalking Value, Hunting Value, and Booty Value

5.5.4.1. Predators and prey: the dynamics of ownership transfers in grey and white raiding

As economist Harold Demsetz explains, in any economy “[when] a transaction is concluded […], two bundles of property rights are exchanged. A bundle of rights often attaches to a physical commodity or service, but it is the value of the rights that determines the value of what is exchanged.”

Using this understanding as a framework, we can say that various exchanges between market participants are none other than ownership transfers, and be it an exchange voluntary/coercive or formal/informal, it is bundles of property rights that change hands.

In a market economy of liberal democracy, the dynamics of ownership transfers is dominantly defined by bilateral, voluntary decisions of buyers and sellers. Regulatory interventions narrow the supply of goods and services to those that meet the state’s normative requirements and budgetary interventions redistribute wealth from some groups to others, but these do not determine the ownership structure. Rather, they institute a framework or starting point for the actors in terms of wealth and opportunities, and they can alter this “initial” allocation freely in voluntary exchanges. Redistributed property will not entail further state privileges, nor complete state protection from the mechanism of profit and loss on the regulated market. Thus, the ownership structure is formed dominantly by voluntary market transactions.

However, as the character of ownership transfers shifts from voluntary to coercive, buyers become predators and sellers become prey. When actors take up these sociological roles, the dynamics of ownership transfers is predominantly defined by the unilateral, coercive decisions of predators. In patronal regimes, predators can either be (a) autonomous oligarchs (if the system is not single-pyramid), (b) chief patrons of adopted political families, or (c) sub-patrons who are granted the right to predate by their chief patron. When the prey in question is an economic unit (company etc.), we speak about reiderstvo, and when the bloodless means of state authority are used to carry it out, we either speak about grey raiding—the predominant predatory method of (a)—white raiding—the predominant predatory method of (b)—or the combination of the two—the predominant predatory method of (c).

327 Poirot, “Ownership as a Social Function.”
328 We will use the term “prey” both for prey company and the prey company’s owner the sake of simplicity.
As predatory action is defined by the purposes of the predators, a descriptive model\textsuperscript{329} can be developed best from their perspective, that is, focusing on the factors the predators consider. This is precisely the viewpoint that is offered by economist Mehrdad Vahabi, who has analyzed in several works the political economy of predation.\textsuperscript{330} In an article entitled “A Positive Theory of the Predatory State,” Vahabi distinguishes the economic value of an asset—which refers to its attractiveness in the eye of the market, or the price at which the asset can be sold in a voluntary transaction—and the booty value of an asset—which refers to its attractiveness in the eye of the predator, or what can be transferred from the asset through coercive takeover.\textsuperscript{331} According to him, the booty value “depends on [the asset’s] exit option. This option is determined by two factors: (1) the degree of difficulty of appropriating an asset; (2) the ability of an asset to escape appropriation. From an anti-predatory perspective, the more an asset is mobile and invisible (i.e., either having hidden ability or being easy to hide or disguise), the more resistant it is to confiscatory (appropriative) policies” (emphasis in original).\textsuperscript{332}

While extremely useful, the notion of booty value needs further elaboration to describe adequately the dynamics of predation in the post-communist region. While we accept Vahabi’s point that we should look at assets—in our terms, pieces of property—as the leading political elite does, analytically it is worth distinguishing asset values on the basis of which stage of the predation process they refer to. Accordingly, we divide three consecutive phases of predation:

- the stalking phase, when the predatory state is looking for a prey (here, the targeted asset has *stalking value*);
- the hunting phase, which starts when a prey is selected and involves the “chasing” of the target by means of state coercion (here, the targeted asset has *hunting value*);
- the consuming phase, which starts when the hunting phase ends successfully and the prey asset arrives at the ownership orbit of the adopted political family (here, the targeted asset has *booty value*).\textsuperscript{333}

As we have seen above when we discussed different types of nationalization as well as grey and white raiding [➔ 5.5.3], a predator can choose from a variety of targets, and for each type the same triad of phases applies. Details of predation nevertheless vary, but in the following we are going to analyze possibly the most representative example—centrally-led corporate raiding. This example is representative not only in an empirical sense but, more importantly to our toolkit, in a theoretical sense. Pre-modern predators like various

\textsuperscript{329} We offer a less descriptive, more theoretical model embedded in the economic literature of the predatory state in Madlovics and Magyar, “Post-Communist Predation.”

\textsuperscript{330} Vahabi, *The Political Economy of Predation*. Indeed, Vahabi’s definition is broader than ours, but applicable to every case we focus on. Cf. Vahabi, 41–45.

\textsuperscript{331} Vahabi, “A Positive Theory of the Predatory State.”


\textsuperscript{333} Note that, in Vahabi’s paper, “booty value” refers to what we call “stalking value,” meaning the value considered pre-predation. We use a different formulation that fits to the three-phase predation process better.
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5.334 bandits did expropriate property for their own private gain, but they were interested in the property as loot: valuables, merchandise, food etc. that can be consumed or sold, gold that can be used as money, and so on. However, in the case of post-communist predators, the adopted political family does not take over a company for the reason to sell or consume its (physical) assets. Indeed, the predator is interested in the property not as loot but as capital: it wants to use it to enter a market and operate there, receiving various discretionary favors from state intervention in the booty phase. This is the perspective from which post-communist predation can be understood; or more precisely, this is the motive of predatory action that can be modelled within the three consecutive phases.

In the following, we describe the three phases of predation, always distinguishing the value of the company (1) in the eye of the market and (2) in the eye of the predator (Figure 5.12). First, in the stalking phase the predatory state has not intervened yet, therefore the would-be target still operates unmolested. The price at which the respective company can be sold in a voluntary transaction expresses its attractiveness in the eye of the market—the company’s market value—which is equal to its value without discretionary state intervention. Being subject to only normative, public policy regulations but no discretionally targeted intervention, a company’s value may be dubbed as unmolested value, which we will denote as $V_u$.

In the eye of the predatory state, however, what matters is whether the company is worth taking over or not. Indeed, what is relevant is not the value the predator is ready to pay in a voluntary transaction but (1) the costs of a coercive takeover and (2) the benefits which it can potentially enjoy after a successful takeover. In other words, what the predator considers is the company’s stalking value, expressing whether the potential target is attractive enough to become an actual prey.


5.5. Ownership

The stalking value of the company is composed of two parts. First, it includes the company’s forecasted value, which refers to the benefits the predator expects to realize once it seized the company and can use it as capital. The forecasted value is the sum of (1) the company’s market value and (2) the potential shelter-providing effect of state activity.\(^{336}\) What shelter provision refers to in this context is that the predator would become a protector after the transfer\(^{337}\) and he will be able to use various means at the adopted political family’s disposal to boost the asset and its value. More precisely, the asset can be supported by (1) direct means, meaning the employment of discretional state intervention in favor of the company, and—if the predator is a patron or sub-patron—(2) indirect means, meaning that the state and patronal media can boost the reputation of the company to make it more attractive for private actors in voluntary trades. Yet the effect of indirect means is rarely that private actors acknowledge a more advertised company as a better seller: rather, it will become clear for the private market that the company is now under the aegis of the adopted political family, meaning it will reach high profits as it is subject to boosting by discretional state intervention.

However, not every economic unit is equally suitable to benefit from discretional state intervention. From this respect, we may distinguish three kinds of company potential the predator considers: (a) market potential, which means that a single budgetary transfer or regulatory change can give the company such a boost that it can act more profitably on the market than before, even without further state support (one-time capital injection, a building permit with better conditions than otherwise etc.); (b) rent-seeking potential, which means that the market the company belongs to can be regulated in a way that the owner can reap (higher) rents (generating artificial demand for its products, using its technological capacity in a production chain that can produce rents etc.); and (c) kleptocratic potential, which means that the given company is suitable to illegal rent-seeking (it can receive public procurements that can be overpriced,\(^{338}\) it can operate as part in a money-laundering scheme to transform public money to private money etc.). When calculating with these potentials, the predator must also take into account the probability that he will be able to exploit these potentials. This probability is determined by the amplitude of arbitrariness \([\rightarrow] 2.4.6\). Therefore, if the predation is oligarchic, the probability of exploiting the potentials is low or moderate, because the oligarch can only have partial control over state interventions in the case of a captured state. If the predation is done by a sub-patron, the probability is higher if he can count on the discretional intervention of the chief patron in favor of the company in the adopted political family’s ownership orbit. Finally, if the predation is done by the chief patron, probability becomes certainty as he has unconstrained power to dispose over legislators in general and state interventions in particular (maximum amplitude of arbitrariness).

\(^{336}\) According to scholars, in Russia “reiderstvo is practiced for straightforward economic reasons—a corrupt official or businessman sees a profitable company, and simply decides to take it.” Lansky and Myles-Primakoff, ”Power and Plunder in Putin’s Russia,” 80. Also, see Higgins, ”Russia Wants Innovation, but It’s Arresting Its Innovators.”


\(^{338}\) In the case of the predatory state’s procurements (orders), any shell company that the chief patron founds may receive them. However, in the case of external (such as EU) funds, there often are eligibility requirements (legal, technical, or experience-related) which newly founded companies cannot meet.
In algebraic form, the forecasted value can be calculated as

$$V_f = V_{u,t-2} + S_{spp}$$

where $V_f$ is the company’s forecasted value, $V_{u,t-2}$ is the company’s unmolested value in the stalking phase (that is, its market value two phases before the consuming phase which we take as a reference period), and $S_{spp}$ is the potential shelter-providing effect of state activity.

Forecasted value becomes stalking value when three further factors are considered:

1. First, as Vahabi points out, the cost of appropriation decreases the value of the asset in the eye of the predator. In the stalking phase, when hunting has not started yet, the predatory state can calculate only the potential cost of appropriation, determined by the expected level of resistance the predatory state could meet should it enter the hunting phase. In other words, the potential cost includes (1) the resources the predator would need to spend to capture the prey and (2) the collateral damages hunting the prey down would cause.

   As far as the determinants of (1) and (2) are concerned, (1) involves, on the one hand, the price that the predator needs to pay the targeted owner for the prey. On the other hand, it rises in parallel with mobility and appropriability of the prey. According to Vahabi, mobility means the owners’ ability to escape predation by removing his property from the reach of the predatory state (by hiding it or displacing it geographically).339 Appropriability, however, is determined by (a) asset specificity, which in the case of a company means that “the continuation of particular investments requires specific entrepreneurial capabilities, including marketing, financing, monitoring, coordinating and networking abilities” which the predator might not have,340 and (b) the strength of krysha above the prey. Indeed, a non-corrupt entrepreneur may have no krysha at all (i.e., no illegal political protection), but even members of an adopted political family can experience a weakening of krysha if the chief patron decides so (e.g., as punishment or tactics to revitalize the competition of sub-patrons \[→ 2.2.2.2\]). As for (2), collateral damages are considered by the predator only if (a) it is on the national level (so it is not a local-level predator), (b) it is in power, meaning the chief patron of the network is also the head of executive, and (c) the damages risk the political positions and stability of the patronal network. Among the damages, we can distinguish three types. First, there are economic damages, meaning the macroeconomic problems a coercive takeover can cause for the national economy (i.e., the voters). The possibility of economic damages exists in case of so-called “too big to fail” companies, that is, economic units (typically financial institutions) which are so large and interconnected with the rest of the economy that problems in their operation would spill over a large part of the national

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339 Soós, “Tributes Paid through Special Taxes.”

340 Vahabi, “A Positive Theory of the Predatory State,” 157–60. Indeed, Vahabi lists four factors that influence appropriability (state accessibility, concentration or dispersal, asset specificity, and measurability) but from these only one—asset specificity—is relevant in case of modern predation.
economy as well. Second, there can be purely political damages, meaning either domestic problems—if the takeover per se would trigger strong social resistance—or international problems—if the takeover would cause diplomatic tensions as it would be resisted by interested foreign countries and/or international organizations. The third possibility is that of social damages, when takeover and improper operation of a business would result in such problems in the supply of social services that the leading political elite would lose its popularity.

2. Second, the predator needs to consider the potential integrity-breaking effect of state activity. As we explained earlier, “integrity breaking” refers to the use of coercion to compel the current owner to hand over the asset (with or without compensation) [→ 3.6.3.2]. If we were talking about black raiding, we might need to consider this effect as a negative because the direct use of violence that is involved in such cases of reiderstvo can potentially damage the prey, which could then be taken over only in an amortized state. However, in case of grey and white raiding, integrity-breaking is done by the bloodless means of state authority—indeed, the same arsenal of state activity which was described above, only used in a punitive way—which create a stifling environment only when the target is still a prey. Therefore, integrity-breaking in our case does not have a negative but rather a positive effect, which is a result of the fact that integrity breaking decreases the price the predator will need to pay to the targeted company’s owner for the prey. The strength of integrity breaking or the amount of decrease the predator can reach depends solely on the amplitude of vulnerability [→ 5.4.1.2].

3. Finally, while integrity-breaking as well as shelter-providing effects contribute to the economic worthiness of the target, it may also have political worthiness if the goal of predation is not (exclusively) economic but political. Therefore, predation has potential political gains, typically when the chief patron looks for a target (a) to weaken a rival oligarch or (nascent) patronal network, (b) to take back the property of an out-of-favor (disloyal etc.) member of the adopted political family, (c) to use the asset in the political machinery (especially media) or (d) to use the asset as a bargaining chip, to improve the positions of the predator in later political or economic bargaining.

In algebraic form, the stalking value—the value or attractiveness of a potential prey—can be calculated as

\[ V_s = V_f + S_{ibp} + P - C_p \]

where \( V_s \) is the company’s stalking value, \( V_f \) is the company’s forecasted value, \( S_{ibp} \) is the potential integrity-breaking effect of state activity, \( P \) is the political gain, and \( C_p \) is the

341 Stern and Feldman, Too Big to Fail.

342 True, often it is not the prey company that is damaged but the prey owner (physical abuse).

343 For examples, see Magyar, Post-Communist Mafia State, 198–99.
potential cost of appropriation. For an outside observer, it is difficult to quantify the political element of $C_p$ and also $P$, for they have no monetary manifestation per se and purely depend on the subjective valuation of the chief patron (what price in money he is ready to pay to weaken a rival oligarch etc.). However, when it comes to takeover as a response to disloyalty, we can say that for the chief patron it is worth bearing virtually any cost to carry out the predation ($P$ is virtually infinite). The simple reason is that, if the chief patron shows he does not punish disloyalty, his clients will not be loyal and he eventually becomes a “lame duck.” However, we can elaborate on this insight with the help of game theory as well, as we mentioned in the previous chapter. Namely, it is rational for the chief patron to adopt a so-called commitment strategy to crack down on disloyalty, meaning to show that he is willing to enter “a fight to the death” to make disloyalty unattractive for clients.

The equation of stalking value is simply a cost-benefit analysis: $C_p$ means the potential costs whereas all the other elements add up to the potential benefit. To mention the analysis’ technical side, counting the potential effects of state intervention requires intelligence acquisition. As Markus explains, “[the] following information about the target company is critical to the raider’s preparatory stage: ownership structure, detailed financial situation including outstanding debts, track record of company’s legal violations, information on industrial relation within the target firm, personal information about the company executives, and so on.” Indeed, many of these pieces of information are either readily available for state agencies or they are entitled to request them during routine business inspections. After everything is gathered, potential costs and benefits can be calculated. On the basis of the result, if $V_S > 0$, the predatory state chooses the respective company as prey (ideal typically). Usually, if predation is carried out for economic gain, large companies are chosen and most of the small and medium-sized enterprises are left alone (as far as predation is concerned), for the cost of appropriation would be higher than the potential benefit.

When the prey is chosen, predation enters the hunting phase. The hunting phase starts with an irrefusable offer. The irrefusable offer is the first price that is set, one-sidedly, by the predator and offered to the targeted company’s owner for the prey. If the owner does refuse, in spite of the obvious coercive capacity of the predator, the process of integrity breaking starts, at different points of which new offers (with lower and lower price) are made. As we mentioned, integrity breaking is carried out by the same arsenal of state activity that could be used to boost a company’s profits only now they are used for punitive purposes. Therefore, the adopted political family can use state intervention (direct means) and the state and patronal media (indirect means) to carry out or facilitate predation.

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344 Hale, Patronal Politics.
345 Markus, Property, Predation, and Protection, 58.
346 Markus, Property, Predation, and Protection, 58.
347 This is analogous to feudal times in Scandinavia, where agriculture was barely taxed because weather conditions made average crop yields so low that the cost of the tax collector apparatus would have been higher than the tax itself. Professor Zoltán Balogh in the ’70s called this—in Marxist language—“uncollectible surplus value,” which was the reason why an independent peasantry could develop in Scandinavia in the first place.
As for the **direct means**, their application can involve:

- **burdensome and ad hoc normative interventions**, such as abruptly introduced regulations (regulatory intervention), sectoral or discrentional taxes (budgetary intervention), renationalization (property-taking intervention), or expansion of red tape [→ 4.3.5.3] (supervisory intervention);

- **discrentional interventions**, such as informal discrentional treatment (regulatory intervention), stopping governmental spending to a certain company by not giving it state advertisements or excluding it—informally and/or discrentionally—from public procurements (budgetary intervention), or extreme fines and continuous molestation by courts, police, or the tax office (supervisory intervention).

A more concrete list of means is provided by the price list we cited in a previous part [→ 5.5.3.1], whereas Markus offers a survey of 516 Russian and Ukrainian firms (from 2007) revealing which means were perceived as most imminent. On average, the most serious danger from the state turned out to be “extortion by taxation agencies,” followed by “illegal inspections,” “illegal administrative barriers to obtaining licenses,” and “illegal administrative barriers to purchase or sale of land, real estate, assets, etc.”

According to Markus, it is common in the hunting phase of grey and white raiding that predators make attempts to **decrease the prey’s mobility**. First, they engage in **asset fixation**. “If raiders target specific assets of the enterprise, such as buildings, land, or machines,” Markus writes, “they aim to make it impossible for the victim to transfer or alter these assets once the attacks becomes apparent. The courts often play the main role […] by issuing temporary property arrests (obespechitel’nye mery) pending the outcome of ongoing or criminal cases against the enterprise or its owners.”

Second, the predators try to **neutralize the main owners**, that is, “to restrict the decision-making powers of the assets’ owners, anticipating the latter’s defense efforts. State inspections on the ground are critical in this phase: the sanitation agency, the fire safety department, and a few dozen other regulators can legally shut down a firm based on code violations.” Also, predators can “generate a cascade of lawsuits against the target to disorient the owners and distract them from the main attack on assets.”

As far as **indirect means** or the use of state and patronal media is concerned, we may use the term **reputation-dirtying**, defined as an act causing damage to the reputation of a targeted actor. The aim of reputation-dirtying is the opposite of boosting or laundering reputation: to make it harder for the targeted company to conclude voluntary deals with consumers on the private market. Indeed, **as the prey-status of the targeted owner becomes obvious, it immediately damages his market position**, for other actors who do not wish to get hunted down will try to avoid contact with the prey.

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348 Markus, *Property, Predation, and Protection*, 76.
352 MacLeod, “Reputations, Relationships, and Contract Enforcement.”
Each method of integrity breaking can be put on a scale of strength from threat through harassment to attack [\( \rightarrow \) 3.6.3.2]. **Threat** means the method is not applied yet, only the targeted asset's owner is informed that they will be put in use should he resist (blackmail through informal channels). **Harassment** is when the method of integrity breaking has been employed but only occasionally (occasional supervisions, a few acts of reputation-dirtying in the press etc.), so it is more of a “warning shot” rather than one that would kill the prey. **Attack** is when the method of integrity breaking is applied continuously and in a way that it makes the profitable operation of the hunted company impossible.

Threats, harassments and attacks can target either (a) the company or (b) the owner personally, who may be blackmailed for causes totally independent from the targeted company and only related to the owner’s past or personal life (kompromat [\( \rightarrow \) 4.3.5.2]). Indeed, the more the owner’s person can be blackmailed for, the lower the cost of appropriation is because the owner is more likely to give up his company at the first irrefusable offer and thus the predatory state does not have to engage in more costly harassment or attack. (Also, if the owner faces overwhelming coercive capacity—such as in case of a chief patron and a predatory state—it is rational for him to accept the first offer, because (1) the next offers will be lower, (2) if he cooperates, it is more likely that the predator will not treat him as inimical and will not choose other assets of the same owner for prey, and (3) it is less likely that his personal freedom will be harmed. Indeed, what the predator gives “in exchange” for the company might be only that he does not incarcerate the owner, who formally can even give up his property as a “gift” accordingly.)

In the eye of the market, the value of the prey begins to fall as the hunting phase starts. Indeed, in this case the company’s market value changes from unmolested to molested value, which can be calculated as

\[ V_m = V_{u,t-1} - S_{ib} \]

where \( V_m \) is the molested value, \( V_{u,t-1} \) is the unmolested value—the company’s value if it was not subject to discretional state activity—in the hunting phase (one before the consuming phase which we take as a reference period), and \( S_{ib} \) is the absolute value of the effect of integrity breaking.\(^{353}\) Indeed, the prey is in a trap in the hunting phase, for he is deprived of the possibility to sell his assets on an unmolested market value. Moreover, while the company still has a molested value on the market, it is likely that, if other market participants realize that the prey is in the hunting phase, they will refuse to buy the company even at its current price. Thus, the predator remains the prey’s only possible “buyer.”

In the eye of the predator, the prey’s hunting value equals the market value (as calculated above) adjusted with the political gain and the actual cost of appropriation. In algebraic form,

\[ V_h = V_m + P - C \]

\(^{353}\) Alternatively, we could also calculate with the actual effect of integrity breaking and then add this (negative) value to unmolested value. We decided to calculate this way—and put a minus sign in the equation instead of a plus sign—to make the message of the equation clearer.
where \( V_h \) is the hunting value of the prey, \( V_m \) is its molested value, \( P \) is the political gain (which may be zero if the predation is carried out purely for economic gain), and \( C \) is the actual cost of appropriation. By the latter, we refer to the real cost of appropriation, stemming from the realized part of the factors listed above as potential sources of cost.

The hunting phase can end in two ways. First, it can end without success, when the company is not moved to the ownership orbit of the predator (typically because the predator calculated wrong in the stalking phase and \( C > C_p \)). Second, it can end with success, when the company is moved to the ownership orbit of the predator (typically when \( C \leq C_p \)). In the case of successful hunting, the hunting phase closes with asset seizure—according to Markus, typically at 10–20% of the assets’ fair value—and asset anchorage—to make the obtained property rights legally irreversible. Through these steps, the prey property successfully enters the ownership orbit of the adopted political family and the predation enters the consuming phase. Without more appropriation cost to be paid or political gain to be reaped, the asset’s value in the eye of the market will equal its value in the eye of the predator. This also means that the asset that had been outside the ownership orbit of the adopted political family now has been brought inside its ownership orbit. In Figure 5.12, we used as an umbrella term for the value in the eye of the market when the asset is outside the predator’s ownership orbit—that is, the unmolested and molested value—“competitive market value.” In turn, we can say that the value in the eye of the market when the asset is inside the predator’s ownership orbit is the asset’s relational market value. Thus, the sentence above can be rephrased as follows: The asset’s relational market value equals its booty value.

In algebraic form, this means that

\[
V_r = V_b = V_{u,t} + S_{sp}
\]

where \( V_r \) is the relational market value of the asset, \( V_b \) is the booty value, \( V_{u,t} \) is the unmolested value in the consuming phase, and \( S_{sp} \) is the shelter-providing activity of the state. As for the latter, shelter providing is none other than the realized part of \( S_{sp} \), or the actual boost the company receives in reputation as well as in fulfilling its market, rent-seeking and kleptocratic potential. Ideal typically, if the predator is a sub-patron or a chief patron, this \( S_{sp} \) raises the company’s profit (and value) much higher than it was outside the adopted political family. Based on what kind of potential the acquired company has, we may distinguish four pure types of uses of the booty asset, any combinations of which in real world cases are possible:

1. **Competitive market functioning after one-time boosting.** This usually happens when the company does not have a substantial rent-seeking or kleptocratic potential but it has market potential, meaning a single budgetary transfer or change in the normative regulatory framework can give the company such a boost that it can act more profitably as an unmolested market participant than before. The means of boosting include one-time capital injection, a building permit with better conditions than otherwise, but also favorable (state) loans to allow more cost-efficient capital formation. Also, there are two possible scenarios after the boosting:

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a. the company is thereafter run by a member of the adopted political family, possibly through a front man (but still without further continuous state support);
b. the company is sold to an outsider at a price higher than the original, pre-predation market price (unmolested value).

2. **Rent-collection with appropriate discrentional regulatory intervention.** This usually happens when the company has substantial rent-seeking and/or kleptocratic potential. In this case, the company is not sold but it is run by a member of the adopted political family (possibly a high-profile front man), providing an access point to rents under the discrentional aegis of the state. In line with the forms of discrentional regulatory intervention outlined above [→ 5.4.2.2], there are different scenarios for the respective booty companies:

a. receiving competitive advantage by the state introducing punitive measures for competitors (sectoral or discrentional taxes, regulatory intervention etc.);
b. receiving competitive advantage by the state giving the company favorable discrentional treatment (custom-tailored lexes, inactive regulatory intervention etc.);
c. receiving market support by the state guiding artificial demand to the company, such as by (i) driving state companies' or departments' demand to the company by obliging them to do business with it (use equipment that is sold by the company etc.) or (ii) driving ordinary people's demand to the company (making employers to give certain percentage of wage in vouchers that can mainly be used at the booty company etc.);
d. receiving public procurements by discretionally (and illegally) making the company win them;
e. receiving an outright monopoly grant by the state to carry out the given activity.

3. **Building or solidifying patronal networks with the help of the company.** This usually happens when the company has high potential political gains, like when the company can be used in the political machinery (especially media), but we also include in this group the cases when the company is used to extend patron-client relationships to the lower reaches of the private sector through a network of sub-contractors and suppliers.

4. **Redistribution within the adopted political family.** This point refers to a potential stage where, if the oligarch who received the booty becomes out-of-favor, his own companies become prey. This happens in cases of renegade oligarchs, or in cases of mafia wars within the adopted political family [→ 3.4.1.4]. Unlike predation for prey outside the ownership orbit of the adopted political family, this indeed means a redistribution of property within the ranks of the adopted political family from the disloyal to the loyal actors. As a specific case of redistribution, we can also mention what may be called “shearing” when there is a surrendered or fellow-traveler oligarch whose assets are predated periodically but in a way that he is not killed (financially) in the process. On the contrary, the actor might even
receive discretional state benefits from time to time, while he is subject to cycles of feeding and shearing. This process helps the chief patron keep oligarchs in line and avoid them growing so big that they would threaten his unconstrained power [→ 4.4.3.2].

For an outsider economic analyst, quantifying the stalking and hunting values of companies is difficult because they involve subjective factors that have no monetary manifestation per se. However, what he is able to follow is the dynamics of the targeted company’s unmolested, molested and relational values throughout the three phases of predation (and he can calculate the values of $V_u$, $S_{ib}$ and $S_{sp}$ with the help of these data). Ideal typically, one who analyzes the process of predation from the outside should see a diagram similar to Figure 5.12. In the stalking phase, other things being equal, the market value of the company does not change; in the hunting phase, the market value of the company begins to fall; and in the booty phase, the company’s value starts rising as a result of shelter provision. Finally, the redistribution phase should manifest potentially, other things being equal, as a decrease of market value. In short, the dynamics that an economic analyst can see reflects a state of affairs when the success of economic actors is not decided in an invisible hand process of the free market but by the grabbing hand of the chief patron [→ 2.6].

5.5.4.2. Macro-level dynamics: structural and circular accumulation of wealth

The case of centrally-led corporate raiding demonstrates why we cannot speak of ‘politicians’ but instead must refer to ‘poligarchs’ in a patronal autocracy. In a democracy or even under a kleptocratic state and crony capitalism [→ 5.6.3], a politician may be bribed and involved in various types of corrupt acts. Typically, such cases are initiated by private actors like (major) entrepreneurs in a bottom-up fashion [→ 5.3.2.2], whereby the entrepreneur gets favorable treatment from the state and a bribe is given to the politician, who uses it for his own consumption or perhaps to reinforce his position in the public sphere. But the entrepreneur does not become a politician and the politician does not become an entrepreneur. They simply become corrupt. In centrally-led corporate raiding, however, the element of bribe disappears. It is the political actor who decides what should be taken over (stalking); he threatens, harasses and/or attacks the company (hunting); and he puts one of his high-profile front men in charge of it while still de facto exercising the respective property rights (consuming). In other words, the benefit of the political actor in the case of predation is the company itself, which becomes his de facto property in the sphere of market action where he is represented by the front man. He receives money not as a bribe but as a dividend, a legalized rent reached through the application of illegal means [→ 4.3.4.3]. Indeed, the very existence of front men shows the collusion of spheres of social action, and the political actor who reorganizes ownership structure to loyal front men and oligarchs is a poligarch, by definition. He does not receive money in a bag to intervene in the economy for someone else’s gain but decides to intervene for his own private gain, disposing over the economic as well as the political sphere.

In a patronal autocracy, predation is none other than an act of post-communist ownership redistribution. To understand when this method is applied, or how the dynamics of a relational economy in the post-communist region changes over time, it is worth differentiating two periods:

- **the period of structural accumulation of wealth**, which refers to accumulation of wealth and capital for an informal patronal network by taking from a different ownership type;

- **the period of circular accumulation of wealth**, which refers to accumulation of wealth and capital for an informal patronal network by taking from already established (private) owners.

These categories reflect the sociological concepts of structural and circular mobility. Structural mobility refers to the case when new employment in a certain occupation means an addition, that is, the already employed people can keep their jobs and the number of those pursuing the occupation expands. On the other hand, circular (or circulation) mobility means that new employment in a certain occupation means replacement, that is, newcomers get the jobs of those already employed and the number of those pursuing the occupation does not change.356 Similarly, by structural accumulation we mean that the basis of enrichment is the privatization of state assets that had long been under state ownership. As a result, the private economy (the number of private owners) expands and a change in the proportions of state and private property on a national level takes place. The extent of privatization (prikhvatizatsiya) partly circumscribes the potential circle of new owners, whereupon, when state power is weak or failing, bottom-up violent redistribution of property begins. However, if the extent of privatization has reached its possible limits, the field of centrally distributable property that could be privatized decreases. Therefore, if the adopted political family wishes to remunerate new owners with property, some existing economic actors have to be stripped of their wealth in order to extend the field of redistributable property. This is why the need for circular accumulation of wealth, carried out by the means of predation described above, appears. It does not result in a change in the proportion of state and private property on a national level, only in private-owner transfers from autonomous to patronally related hands (that is, it results in a change in power and ownership).

Structural and circular accumulations do not necessarily take place subsequently but they can also happen together. However, to analyze further the behavior of the adopted political family in these two phases, we need to introduce the dimensions of (1) patronal competition and monopoly and (2) economic strength and weakness of the adopted political family. By the former, we mean whether there are rival patronal networks, which may attack the adopted political family (patronal competition) or it already established a single-pyramid patronal network (patronal monopoly). In these cases, the predatory acts of the adopted political family happen as follows:

◆ in cases of patronal competition, it strives for monopoly, meaning its predatory practices during circular accumulation target primarily rival patronal networks (which are either eliminated or subjugated to the to-be-formed single-pyramid);

◆ in cases of patronal monopoly, it tries to maintain it, meaning its predatory practices during circular accumulation target primarily autonomous or out-of-favor oligarchs and major entrepreneurs (either because they are potential rivals or because they are the only rich businessmen left in the polity whom substantial property can be taken from).

On the other hand, the dimension of economic strength and weakness refers to whether the members of the informal patronal network are financially strong, that is, have already accumulated wealth—perhaps by structural accumulation—on par with the country’s major entrepreneurs (economic strength) or they have not and thus are financially weak (economic weakness). In these cases, the predatory acts of the adopted political family happen as follows:

◆ in cases of economic weakness, it needs to rely on state coercion and resources (such as state loans, subsidies, or transit nationalization), because it is unable to accumulate wealth by market acquisitions, that is, by simply buying up targeted firms;

◆ in cases of economic strength, it does not need to rely on state resources, only coercion, because it is already able to buy up targeted firms in exchange for “just” compensation.

That we put “just” in quotation marks is not only because we refer to the above-mentioned Takings Clause of the US Constitution, although what usually happens is precisely that the leading political elite sets a price at which the owner is forced to sell. In Hungary, for instance, businessmen who were surveyed in a study claimed that people connected to Orbán take over companies by “mafia tools,” such as blackmail and existential threats, whereas investigative journalists found that the predatory state has set up informal “agents” who check on every firm with a turnover above 1 billion forints (ca. €3 million) and decide whether it should be taken over or not. However—and this is the second reason we put “just” in quotation marks—such practices introduce peculiar incentives for economic actors and the prices themselves, while they appear to be market prices, are in fact distorted by the effects of predation. To use a metaphor from the natural sciences, the economic effect of predation is akin to that of the gravity of a celestial body: while other bodies are not connected to it directly, their movement is affected by the curvature of space-time it causes. In cases of predation, even the companies which are not targeted directly change their behavior, and one of the effects is that they are willing to accept oligarchs’ or front men’s offers easier, no matter how just they are. As a businessman said in the research cited above: “You make

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357 Sallai and Schnyder, “The Transformation of Post-Socialist Capitalism.”

358 Szabó, “Tiszteletben játék—Így születnek a sokmilliárdos NER-vagyonok” [Dishonest game: This is how billions of wealth of NER are made].
decisions that you would not make in a stable environment. I give work to this person, […] money to that person […] Just leave me alone! […] People get easily threatened or blackmailed. Look at the news; how many times were people taken away in handcuffs? The news never say [sic] whether they were innocent or guilty. So, CEOs are kept in fear.”359

5.5.4.3. Micro-level dynamics: entrepreneurial distortions and bubbles in the relational economy

The previous paragraphs indicate micro-level changes in entrepreneurial behavior. From this respect, in a relational economy with a predatory state what matters is not what portion of property is being hunted down, but that anyone’s property is a potential target. The predatory state can choose any company if its stalking value is higher than zero, and this is what entrepreneurs in a relational economy need to acknowledge to have an effect on their behavior. Indeed, predatory activity has a signaling effect that introduces perverse incentives in the relational economy, resulting in distortions of entrepreneurial behavior, as well as welfare costs for the public. What Hellmann and his colleagues write about the effects of state capture is certainly relevant here: “[while] substantial private gains accrue to the individual firms, negative externalities are generated for the rest of the economy.”360

Various ideal typical reasons that lead to entrepreneurial distortions can be distinguished:361

◆ **Mismatch of formal and informal rules.** This refers to the period when entrepreneurs have not yet realized that the state is predatory and economic success depends on informal patronal relations. Thus, economic actors allocate their resources in de facto wasteful ways, such as when they spend resources to enter public procurement tenders or rent-seeking competition while both of these markets are de facto (informally and discretionally) reserved for the members of the adopted political family.362

◆ **Uncertainty.** A subsequent period, when the actors realize that the state engages in predation they act in fear for their property. In the case of Russia, for example, surveys have found that managers of immobile assets found their property rights more secure when Putin’s party United Russia underperformed in elections, indicating they are well aware of the predatory nature of the state.363 Under such circumstances, economic actors—and especially highly mobile foreign capital—may judge the market too risky and move to other polities with more predictable markets, resulting in lower economic growth and outflow of working capital.

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360 Hellman, Jones, and Kaufmann, “Seize the State, Seize the Day,” 753.
361 For an analysis of distortions in the Russian economy, see Krylova, Corruption and the Russian Economy.
362 Indeed, in most of the tenders the adopted political family’s companies win, businesses offering more favorable terms are excluded by administrative means or they do not even bid in the first place. This means a socialization process in which private ventures learn not to apply for tenders that require significant material and intellectual input if they do not have any hope of winning.
Red tape. A specific problem of (outsider) small and medium-sized enterprises is that, as the predatory state custom-tailors regulations to boost certain companies, the regulatory framework gets extremely complicated and burdensome. This “external cost of predation” is born by outsider companies, who need to allocate resources to deal with bureaucracy (either legally or illegally, trying to circumvent the existing regulations).

Hiding. Eventually, entrepreneurs realize that the primary question of operation in a relational economy is not whether they can stay in fair market competition but whether they become part of the predatory state’s food chain. As a result, they get an incentive to allocate their resources not to maximize real production but to minimize stalking value. Ways to achieve this involve various methods of double accountancy and financial scheming [→ 5.6.1.4], while large companies may also engage in identity splits or breaking up their company into small or medium-sized units so it can blend into the environment of the SME-sector, hiding it from the stalking eyes of the predator.

Using Hirschman’s voice-exit-loyalty triad,364 we can identify hiding as a peculiar type of exit. However, exit can also be done in a more straightforward way: leaving the country, legally and/or physically, and either personally or by moving assets to (a) foreign land or (b) to the illegal shadow economy [→ 5.5.6.3]. Choosing the option of loyalty, “the firm,” as Markus writes, “appeases the aggressor; it may offer monetary payments or an equity stake in the firm to the state, for example hoping to retain most of its ownership rights and continue business.”365 In the case of a mafia state, loyalty either means the previously described brokered autonomy or asking for adoption to the adopted political family. Should he be adopted, the economic actor gives up some of his freedom (i.e., property rights) to the chief patron in exchange for the decreased risk of becoming a prey. Finally, much of the ability of voice that exists in liberal democracy is neutralized in a patronal autocracy, not only because of the dominated sphere of communication [→ 4.3.1.2] but, more importantly, because of the lack of an independent and also effective judiciary that private actors could turn to in case of unfair attacks [→ 4.3.5]. However, Markus argues that even under such circumstances “firms can resist […] ownership threats through alliances with stakeholders, who can impose […] financial or political costs on the potential aggressors. Accordingly, a firm’s defense can make the PR threat itself, or its consequences, more expensive and hence less profitable for the aggressors. For example, foreign investors as allies of the target enterprise can impose financial costs on the state agents through withdrawal of investment projects benefitting the state agents. Political costs, in turn, decrease the power of the aggressor […]]; this process can involve electoral pressure, public protests, or behind-the-scenes lobbying by the allies of the target firm.”366 Indeed, the foreign background of a company has historically been able to reverse even full-fledged attacks, like when the

364 Hirschman, Exit, Voice, and Loyalty. Also, see Yakovlev, “The Evolution of Business.”
Hungarian predatory state had to face unsuccessful hunting on the television channel RTL Klub (with its German background).367

A further, specific form of distortion stemming from the adopted political family being the dominant coordinating actor of the economy [→ 5.6.1.1] is the generation of various forms of bubbles. In economic literature, “bubble” is generally understood as an unstable situation, stemming from the overinvestment into an asset and/or rapid expansion beyond one’s means.368 Bubbles may be distinguished by various aspects, understood on scales running from being:

- **general**, meaning it is present in every market and its contraction affects the entire economy (global economic crisis), to being partial, meaning it entails a crisis effecting a single investor, asset or sector;

- **the result of impersonal market forces**, such as inflation or the uncoordinated acts of individual investors with excessive expectations (overproduction crisis), to being the result of a personal deliberate decision with the expectation of bailout;

- **corrected by the state**, meaning the state uses various means of economic policy to counter the effects of the crisis after the bubble’s contraction, to not being corrected by the state, meaning the effects of the crisis are not softened by state intervention of any kind.

In a market economy, the state is subordinated to the principle of societal interest [→ 2.3] and it may correct the failure of bubbles accordingly.370 Dealing with competitive-market bubbles, the state may employ normative intervention—as in the case of anti-cyclical fiscal policy—or discretional intervention—as in the case of bailing out a single company. But ideal typically even the “favoritism”371 of the latter case is performed because of the considerations of the economy-wide ramifications of letting the company—like a bank or a major employer—fail.372 Indeed, the state generally lets the market economy work by the mechanism of profit and loss, and it may exempt one from the consequences of individual risk-taking only in cases of large external effects of bankruptcy. In addition, the dimension of the leading political elite’s ownership in the given companies cannot even arise, as the spheres of social action are separated [→ 3.2]. The decision-makers may be approached by lobbying groups and particular policy decisions may be questioned, but the politicians are not bailing out themselves, their economic front men or members of their patronal network.

In contrast, the state of a relational economy is subordinated to the principle of elite interest, meaning—in a patronal autocracy—that it will decide on intervening in

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368 For an overview, see Brunnermeier and Oehmke, “Bubbles, Financial Crises, and Systemic Risk.”
370 Akerlof et al., What Have We Learned?
371 Mitchell, “The Pathology of Privilege.”
372 Akerlof et al., What Have We Learned?, 129–42.
a crisis situation only if it serves the power concentration and personal-wealth accumulation of the adopted political family. Bubbles that are specific to such an environment can be called **relational-market bubbles**, and they are also related to the activity of the predatory state. The first type among such bubbles may be called **corruption-expectation bubbles**. In this case, economic actors outside the adopted political family try to get a share from the extreme profits of the adopted political family’s companies by investing into them (buying shares on the stock exchange). Logically, this can yield the highest profits if done before the consuming phase when the prices are low. If many investors think this way, they invest in the to-be-boosted company and the price of its shares skyrocket as a result. In other words, expectations of investors are led not by what market performance can be expected from the given company but what discretion helps it can be expected to receive in the consuming phase. However, (1) the behavior of the predatory state is not perfectly calculable, therefore expectations may indeed fail, and (2) excessive amounts of investors who wish to profit create overinvestment. In such cases, we can speak about bubbles. If the adopted political family does not invest in the company of investors’ interest at all, the contraction of the corruption-expectation bubble brings the devaluation of prior investments. Indeed, corruption-expectation bubbles are similar to the competitive-market bubbles that are caused by exaggerated market expectations and overinvestment: namely, both bubbles are the result of market forces of decisions that are individually rational. However, the actors involved in corruption-expectation bubbles are led by exaggerated corruption expectations: they try to exploit not excess-market but extra-market returns, stemming from the corrupt functioning of the relational economy.

**Corruption-expectation bubbles can be a pyramid scheme of the adopted political family as well.** In this case, the ruling elite deliberately lets expectations grow but it eventually does not realize them. Then, a corruption-expectation bubble can function as a way of rent collection, as the adopted political family hoards or reinvests the money that is pooled during the initial rapid expansion of investments. This leads us to the other kind of bubble specific to relational economies—**booty bubbles**. Booty bubble is a partial bubble related to a single actor in the adopted political family, who generates the bubble by personal deliberate decision. To illustrate this, let us take the example of the Lőrinc Mészáros, the rapidly elevated gas fitter from the home village of Hungarian chief patron Orbán. “The Felcsút resident, known as a confidant of Viktor Orbán has risen to the foremost ranks of rich Hungarians in four years, as the winner of state procurements for water supply systems, roads, agricultural land leases and (monopolized) tobacco shop concessions.” When Orbán won elections in 2010, Mészáros had had a single company for nearly a decade and accumulated a modest wealth of ca. 30 million forints (ca. €90 thousand). However, the estimated value of his assets grew a hundred times in the years

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373 For example, see Simon, “What’s Boosting the World’s Best-Performing Stock?”
374 A third type of expectation bubble, the one typical to command economies and administrative markets, will be described below [5.6.2.2].
375 Gyenis, “Családi munkakör [Job for the family].”
377 “Húszmilliót tart Mészáros Lőrinc a párnacihájában [Mészáros keeps 20 millions in cash].”
under the Orbán regime, making him the 88th richest Hungarian with 6.9 billion forints (ca. €21 million) in 2013 and the wealthiest Hungarian with 381 billion forints (ca. €1.14 billion) in 2018. As Forbes Hungary reports, the family of Mészáros has produced five-fold wealth-growth from 2018 to 2019—the fastest the magazine has ever recorded—and they have become “unavoidable actors” in construction, tourism, heavy industry, energy and agriculture. According to Mészáros, what contributed to his success are “God’s will, good luck, and the person of Viktor Orbán.” Indeed, Mészáros is a pure product of relational economy—and also the economic front man of Orbán, according to more than two-thirds of Hungarians.

While Mészáros has gathered a staggering portfolio at incredible speed, he also used his economic empire as a “cash cow,” taking out the majority of profits as dividend. In the meantime, his forced expansion was financed from loans, sometimes from the banks of the adopted political family itself. In a market economy, such behavior without sound economic foundations would mean a bubble that is prone to explode—indeed, it would have probably exploded much before Mészáros’s holdings could grow to such astronomical size. However, this bubble is not a market bubble but a booty bubble, meaning it has grown in a relational economy under the discrentional aegis of the adopted political family. That is, as the predatory state becomes a protector and engages in shelter provision, it can “drain off” the booty bubble by means of discrentional state intervention. This is possible only under normal circumstances, when the chief patron has enough time to intervene before the bubble blows up (as it may do due to an external shock like a war, economic crisis, or pandemic). At any rate, the booty bubble is a deliberate one, whereas the adopted political family helps itself: it involves both the to-be-supported oligarch (front man) who owns the assets, and the head of executive, who controls the means of public authority with maximum amplitude of arbitrariness [

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378 Csurgó and Szémann, “Ő a valódi gazdasági csoda” [He is the real economic miracle].
379 “Magyarország 50 leggazdagabb embere—már nem Csányi az első” [The 50 wealthiest people in Hungary—Csányi is not the first anymore].
380 “Családi lista 2019—Forbes [Family List 2019—Forbes].” Mészáros’s personal wealth was 407.7 billion forints (ca. €1.23 billion) by the end of 2019. “Az 50 leggazdagabb magyar [The 50 wealthiest Hungarians].
381 “A jóisten, a szerencse és Orbán Viktor személye—így vagyonosodott Mészáros Lőrinc” [God, luck, and Viktor Orbán—this is how Lőrinc Mészáros got rich].
382 Magyar, “From Free Market Corruption Risk to the Certainty of a State-Run Criminal Organization (Using Hungary as an Example),” 477–85.
383 Fokasz and Oroszi, “Protestáló etika” [Protesting ethic]; Jandó, “Mészáros Lőrinc új rekordja: 25,4 milliárd forintot vesz ki a cégeiből” [Lőrinc Mészáros’ new high: 25.4-billion dividend from his companies].
385 Laki, “A Mészáros-vállalatcsoport” [The case of the Mészáros company group].
386 For further examples, see Magyar, Post-Communist Mafia State; Magyar and Vásárhelyi, Twenty-Five Sides of a Post-Communist Mafia State.
changing the regulatory environment (after Mészáros purchased campgrounds at Lake Balaton, building regulations were changed so he could build hotels there, whereas VAT on accommodation services was reduced from 15% to 8%);  

- giving discrentional state subsidies and loans (many of Mészáros’ buy-ups have been financed by state banks, including Eximbank and MKB, which were taken over earlier by predatory means);  

- channeling state monies to the company through state projects (most of Mészáros’ wealth-growth is due to public procurement projects, the vast majority of them being financed through EU funds);  

- channeling artificial demand to the booty company (the state created a program of subsidized holidays for poor families, who were accommodated in the hotels of Mészáros and Tiborcz, Orbán’s son-in-law).

In the end, we may sum up in more general terms the peculiar micro-level dynamics from the side of shell and booty companies. In a relational economy, those who have power&ownership can be distinguished from ordinary private property owners by the following features. First, they have an unusually fast ramp-up phase. The adopted political family’s businesses become “national champions” almost immediately after they arrive at the ownership orbit of the adopted political family, as a result of shelter-providing discrentional state activity. Shell companies are able to win huge state contracts without appropriate references or base capital, and secure loans if necessary—under rather favorable terms—without any capital cover. Second, the expansion or downsizing of their activities follows political cycles rather than economic ones. Given the success of these companies depends on the chief patron, they are extremely vulnerable to his whim, including the threats he makes good on in case of disloyalty. Third, as winners of state contracts and procurements, they are essentially administrative rent-seeking coordinators, and not technology coordinators. The companies usually function as gateways of accessing state contracts, and partner with such large subcontractors or associates in a consortium, who under proper rules of competition would be able to carry out the tasks specified by the procurement contract on their own. The rent-seeking coordinator normally establishes a sys-  

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388 Balla, “Nem kell több vendég Mészárosnak ahhoz, hogy újabb milliárdokat keressen a szállodáival” [Mészáros doesn't need guests to make billions with his hotels].  
389 Medvegyev, “Állami hitelekölből hízik Mészáros Lőrinc birodalma [The empire of Lőrinc Mészáros grows from state loans].”  
391 Erdélyi, “The Mészáros Empire Won Public Tenders Worth €826 Million Last Year, 93 Percent of Which Came from European Union Funds”; Dunai, “How Europe’s Taxpayers Will Bankroll Viktor Orban’s Friends and Family.”  
392 Tamásné Szabó, “Club Aliga.”
tem with more tiers of subcontractors than what the technology coordination of the given task would require. The vulnerability of those at the base of the pyramid of subcontractors is borne out by the fact that they work as pariah outsource companies, with virtually no profit margin. Moreover, nonpayment to subcontractors and other non-compliances to their contracts do not entail a ban from further public procurements.

Fourth, the scale of taxed profits within the total revenue significantly outpaces that of unsupported businesses in the same field. This disproportion in scale indicates the venture’s nature as tapper of public funds and rent-seeking. Fifth, the scale of dividends paid out of the taxed profits of the venture far outdo that of dividends taken out of politically unsupported ones that are exposed to the market. In the case of companies participating in fair market competition—especially the startups and developing ones—a decisive majority, if not all the profits are reinvested in the company, as would be only natural in the case both of an expanding field of activities needing investment and the likelihood of market fluctuation. However, in the case of the companies of the oligarchs or front men, the burden of necessary investments in equipment is transferred to the partner in the forced consortium, or the subcontractor. And any risks meant by possible market fluctuations are annulled by stable, politically directed contracts. These two factors in themselves indirectly indicate that these winning companies are largely there merely for rent-seeking, and can be liquidated without further losses if the political situation changes. Finally, while successful businesses without ties to the adopted political family are exposed to predation attempts, the companies owned by loyal oligarchs and front men are never. Indeed, the most prominent identifier of shell companies belonging to the poligarchs and inner circle oligarchs is that the company that has not been attacked yet apparently has a positive stalking value. In the case of outsider companies, positive stalking value constitutes adequate reason for predation; in the case of insider companies, the value we would see as “stalking” is indeed booty value, and we have not seen an attack against the company because it has never been outside the ownership orbit of the adopted political family.

5.6. Comparative Economic Systems

It was not only political scientists who presumed an “end of history” after the collapse of the Soviet Union. As Simeon Djankov and his colleagues explain in a famous paper, the discipline of comparative economics went a similar way as political science. In the Cold War era, comparative economics had been preoccupied with the comparison of capitalism—represented by liberal democracies of the West—and socialism—represented by communist dictatorships of the East. Then, the collapse of the latter as well as the change of virtually all socialist countries to capitalism was seen as a historic victory of market economy over planned economies. Djankov and his colleagues argue that this situation gives comparative economics

393 For a meta-analysis, see Avanzi, “Strategies for Dividend Distribution.”
economics a new raison d'être: instead of comparing the two great systems, capitalism and socialism, comparing the “varieties of capitalism” is the new, current agenda.\(^{395}\)

The “varieties of capitalism” approach was first developed for Western economies and then scholars started to use it as a universal framework, applicable to countries of other civilizations as well. Yet there are two reasons we cannot fully subscribe to this agenda. First, as communist dictatorship is an integral part of our conceptual framework as a polar type regime, we cannot disregard its economic system, socialism, and focus solely on the varieties of capitalism. Second, there is the problem we already indicated in Part 5.5.4.5—that the dominance of power&ownership indicates a new economic system, which is neither socialist nor capitalist in the Western sense. Formally, the new system features a dominance of private ownership, but informally the de jure private property is de facto intertwined with political power. Indeed, describing such a system in the “varieties of capitalism” paradigm is just as misleading as describing patronal autocracy in the “varieties of democracy” paradigm, that is, by a diminished subtype of democracy (in hybridology).\(^{396}\)

On the one hand, the categorization seems justified because—de jure, on the formal level—the system features similar institutions to the root concept. On the other hand, categorization is unjustified because—de facto, on the informal level—the system has markedly different characteristics, which are also system-constituting features that overrule the system’s formal identify. Thus, identifying a patronal autocracy as a variant of democracy or a system of power&ownership as a variant of capitalism carries the risk of conflating them, and their sui generis features, with Western-type systems, hindering the understanding of their actual nature.

To overcome this difficulty, we use separate terms for the description of the de jure and the de facto state of different ownership systems. As for the former, we define capitalism and socialism as follows:

- **Capitalism** is an economic system which is characterized by the dominance of de jure private ownership of the means of production.

- **Socialism** is an economic system which is characterized by the dominance of de jure public ownership of the means of production.

The reason we define the two great systems by their de jure characteristics was explained above: because comparative economics in general and the varieties of capitalism paradigm in particular define them by their de jure features. And indeed, focusing on those we can find a variety of capitalisms in the post-communist region.\(^{397}\) Also, differences between de jure ownership relations in socialist economies indicate “varieties of socialism” among

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\(^{396}\) See, e.g., Bogaards, “De-Democratization in Hungary.”

\(^{397}\) Lane and Myant, *Varieties of Capitalism in Post-Communist Countries*; Bohle and Greskovits, *Capitalist Diversity on Europe’s Periphery.*
pre-regime change countries, ranging from the classical Stalinist model to the Yugoslav and Hungarian reform models.\textsuperscript{398}

In contrast, our typology that focuses on the \textit{de facto} ownership types distinguishes the following economies:

- **Planned economy** is an economic system which is characterized by the dominance of \textit{de facto} public ownership of the means of production.

- **Market economy** is an economic system which is characterized by the dominance of \textit{de facto} private ownership of the means of production.

- **Relational economy** is an economic system which is characterized by the dominance of \textit{de facto} power\&ownership of the means of production.

In cases of communist dictatorships, \textit{de jure} socialism and \textit{de facto} planned economy are basically the same. In communist dictatorships, what is formally public ownership is indeed public ownership, and the leading political elite (the nomenklatura) controls the means of production not through informal channels but openly, through formal channels. On the other hand, \textbf{market economy and relational economy are two types of capitalism}, for both are formally characterized by the dominance of private property.

We make a small divergence. In the literature, “planned economy” is not the only term that exists for socialist economies. Other candidates include “command economy” and “shortage economy” (which we also use sporadically in this book). Indeed, one can use any of the three terms, however, each of them refers to a different aspect of the socialist system. “Planned” refers to the way the economy is designed (central planning); “command” refers to the form of rule, or the bureaucratic patronalism that characterizes these systems. Finally, “shortage” refers to the consequence of the system for the subjects of the socialist economy.\textsuperscript{399}

Going back to the three economies, we need to realize that they—and especially the capitalist ones—are rarely homogeneous. It is no coincidence we always speak about dominance when it comes to ownership relations; a relational economy, for instance, is composed of many different segments, some of which are indeed private and resemble Western-type market economies while others are only formally private and indeed operate according to the principles of power\&ownership. Thus, it is beneficial to distinguish a concept for the segment and a concept for the whole. For the former, we may use the term “market.” A market is a segment of an economy, a specific industry or economic sector that involves economic actors who produce for the same set of consumers (or supply for the same demand). These markets are the building blocks that constitute an economy, which is the concept we can use for “the whole.” Indeed, an economy is none more than the community of markets in a given polity, under the authority of the same state.

Accordingly, the three economies can be defined, not only by their ownership relations, but by the dominance of a market type as well. The planned economy is character-

\textsuperscript{398} This point was made by Kornai, “Foreword.”

\textsuperscript{399} Kornai, The Socialist System, 228–61.
ized by the dominance of so-called administrative markets; the market economy features the dominance of competitive markets. Finally, the relational economy is characterized by the dominance of relational markets.

5.6.1. Administrative Market, Competitive Market, and Relational Market

5.6.1.1. The dominant economic mechanisms

The coexistence of markets in general and economic actors in particular is described by what we call economic mechanisms. Simply put, an economic mechanism tells you who gets to own what, or how pieces of property (bundles of property rights) in a given economy are distributed. Indeed, economic mechanisms are not independent of the type of ownership: the latter greatly define the former, because different ownership structures create different incentives for the owners as to how to operate and coexist with other actors of the society.400

We are inspired in the conceptualization of economic mechanisms by Karl Polanyi, on the one hand, and János Kornai, on the other. As for the former, in his renowned essay “The Economy as Instituted Process,” Polanyi distinguishes, first, the “formal” and the “substantive” description of the economy (Table 5.22).401 As he explains, neoclassical economists provide a formal description of the economy in the terms of supply and demand, rational choice and, above all, prices. Thus, Polanyi argues, it is particularly suited to “price-making markets,” that is, modern economies which distribute goods and services—in our terms, answers the “who gets to own what” question—on open markets and to those who are willing to pay the price for them. But considering other kinds of economies (in Polanyi’s case, pre-modern ones), we need to realize that there are also other mechanisms, which are revealed only if we describe them by their sociological substance (hence “substantive description”). The “process,” as the essay’s title puts it, is none other than the micro-level “movement” of goods, including “locational movements” (production and transportation of goods) and “appropriational movements” (voluntary “transactions” and coercive “dispositions”).402 The way these processes are “instituted,” on the other hand, show the macro-level economic mechanisms. Among these, Polanyi distinguishes three types of basic structures: symmetry, centricity, and the market, and these are accompanied by three “forms of integration:” reciprocity, redistribution, and exchange, respectively. As Polanyi explains, “[reciprocity] denotes movements between correlative points of symmetrical groupings; redistribution designates appropriational movements toward a center and out of it again; exchange refers here to vice-versa movements taking place as between ‘hands’ under a market system.”403

401 Polanyi, “The Economy as Instituted Process.”
In our terms, Polanyi’s three forms of integration are economic mechanisms, as they denote three general ways by which pieces of property move from one hand to another. Turning to János Kornai, in a seminal contribution to the comparative economic systems literature he talks about “coordination mechanisms.” Defined by him as a joint product of the “nature of political power, the prevailing ideology, and the property relations,” a coordination mechanism in Kornai’s words “coordinates the activity of the persons or organizations involved in it.” Kornai defines every coordination mechanism by (1) “who the participants are,” (2) “what relation there is between them,” (3) “what communications flow between them to further the coordination,” and (4) “what motivations encourage the participants to take part in the coordination process.” On the basis of these, he distinguishes five main types of mechanisms:

- **bureaucratic coordination**, which is a subordinative relationship where an individual or an organization coordinates another one through (formal) vertical linkages (e.g., in an army or a large firm);

- **market coordination**, which is a lateral relation or horizontal linkage where individuals “rank equally in legal terms” and take on the role of sellers and buyers, the former voluntary agreeing to transfer something to the buyer (e.g., in a shop or the stock exchange);

- **self-governing coordination**, where participants are “laterally placed, equal members of a self-governing association” and various bodies are elected (and can be dis-

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404 Kornai, *The Socialist System*, 90–109. Also, he himself notes the similarities (as well as the differences) between his approach and Polanyi’s on page 96 (fn8).


missed) to fulfill certain coordination functions (e.g., in an autonomous university or a professional association);

- **ethical coordination**, where “donors” transfer resources voluntarily to recipients out of altruism or other source of goodwill (e.g., in a relief organization);

- **family coordination**, where kin-related members form a variety of linkages within the already given framework of family (e.g., in a household).

When we consider an economy, either in terms of Polanyi’s forms of integration or Kornai’s coordination mechanisms, there is always a dominant mechanism while the others are subordinate ones. In other words, every mechanism coexists in every society: neither reciprocity, nor redistribution or exchange is completely eliminated in favor of a single mechanism, and similarly, Kornai’s five main coordination mechanisms exist in every system without either one being fully eliminated. Rather, one mechanism becomes dominant, meaning it characterizes the majority of the exchanges, whereas others are confined to a subordinate rule and characterize only a minority of the exchanges. On the micro-level, the operation of any market can be described as working primarily by a dominant mechanism and secondarily by subordinate mechanisms, whereas on the macro-level the type of economic mechanism that is dominant in the majority of markets is the dominant mechanism of the economy.

Having defined dominant mechanism, we can identify it in the three economies we consider. First, the dominant mechanism of the planned economy is bureaucratic resource-redistribution. “Bureaucratic” refers to Kornai’s bureaucratic coordination, which he also identifies as the one that is applied in the socialist system “most widely and forcefully,” where the whole sphere of market action—that is, all the markets of the economy—is merged with the sphere of political action in a single bureaucratic entity.\(^{408}\) On the other hand, “resource-redistribution” refers to central planning of the distribution of resources. In a planned economy, the party state decides for the entire economy (1) what to produce, (2) what use the products are put, (3) who should work where and for what wage, (4) where investments should be made, (5) where technical developments should be made, (6) what amount of products should be sold abroad and (7) how financial institutions should operate.\(^{409}\) This means that, as a rule, most resources in the economy are distributed according to the central plan.

Second, the dominant mechanism of a market economy is regulated market coordination. “Market coordination” means the same in Kornai’s conception, namely the voluntary decisions of sellers and buyers that constitute profits and losses for enterprising people and therefore coordinate their activities by providing a scheme of incentives.\(^{410}\) However, when describing economies of the modern day we cannot disregard the fact that they are “regulated” by a central authority, and liberal democracies today feature mixed economies as a norm (see Box 5.11). The coordination of market participants—or more

\(^{408}\) Kornai, *The Socialist System*, 97.


\(^{410}\) Mises, “Profit and Loss.”
Box 5.11. Capitalism as a mixed economic system.

“In a capitalist economy, the general presumption is that for-profit business firms ought to be the principal economic agents responsible for the supply of goods and services. Wants are regarded primarily as a matter of individual and household needs and tastes, and it is presumed that potential customers for goods and services ought to decide what they will buy and from whom on the basis of their own preferences, using their own money. […] However, market organization is far from ubiquitous and seldom is employed in pure form. [Many] activities and sectors that generally are thought of as market-governed in fact have a mixed governing structure. Thus, both the products and production methods of pharmaceutical companies are regulated, and public monies go into the basic research that pharmaceutical companies draw from in their development work. Many aspects of airline operation are regulated, the government operates the air traffic control system, and airports are largely funded and often owned by public bodies. Most of the old ‘public utilities’ are still quite regulated and sometimes subsidized. […] Market organization is a widely used and useful governing structure. An important reason is that it can operate in a variety of different ways and be supplemented by other mechanisms in a variety of ways. However, just as one size shoe does not fit all feet, a single mode of sectoral governance cannot cope with the great variety of human activity. Modern economies are made up of many very different sectors governed in different ways. There is no way that a single form of organization and governance is going to be appropriate for all of them.”


precisely the supply of goods and services—is narrowed by regulatory intervention, whereby we understand market coordination as regulated in modern market economies.411

Finally, the dominant mechanism of a relational economy is relational market-redistribution. We may compare this mechanism to both of the aforementioned mechanisms. Starting with the other type of redistribution, bureaucratic resource-redistribution in a planned economy is done with physical targets: in the central plan, production targets are expressed in exact numbers of natural units and quantities.412 In contrast, in a relational economy it is markets and rent-seeking opportunities that are redistributed without physical targets (hence “market-redistribution”). In other words, the chief patron determines only the market and ownership structure, but not the production structure. Discretional intervention and centrally-led corporate raiding are two means of relational market-redistribution in a patronal autocracy. In the case of the former, it is easy to see this, as discretional regulatory intervention means precisely that patronally preferred actors get rent-seeking opportunities, discriminating (a) economic actors who want to enter the market and (b) non-preferred economic actors already in the given market (hence “re-distribution). In the case of centrally-led corporate raiding, a modern predatory state considers a company not as loot but as capital—as a means to access a market and operate there, under the discretional aegis of the chief patron. Therefore, centrally-led corporate raiding is a peculiar way of relational market-redistribution, where the market share that a company represents is taken over as a potential rent-seeking opportunity for a member of the adopted political family.

Compared to regulated market coordination, relational market-redistribution also creates incentives but the central actor is different: economic actors need to adjust, not to the buyers’ wants but the chief patron’s will. On surface, the logic is similar to the theory of rent-seeking entrepreneurs, which holds that, in economies with excessive state intervention, economic actors, realizing their profitability depends less on consumers and more on rent-giving politicians, start using their entrepreneurial talents of innovation and demand forecasting to please the politicians instead of the consumers. Yet this theory applies to liberal democracy and the market economy.

411 For further discussion, see Dahl, “Why All Democratic Countries Have Mixed Economies.”

412 Bokros, Accidental Occidental, 33.
as it presumes voluntary cooperation and voluntary decisions about market strategy [→ 5.3.1]. Relational market-redistribution, however, is based on informal patronalism, that is, a coercive network of corruption. This means that the actors, oligarchs and front men must comply with the chief patron's orders, who redistributes markets discretionally to clients based on loyalty and his own strategic (political) preferences [→ 7.4.7.2]. Market competition is replaced by competition within the adopted political family: while under regulated market coordination, A can outcompete B if the buyers deem B's product inferior, under relational market-redistribution A may receive B's market if the chief patron deems B's loyalty or strategic importance inferior. On the other hand, economic actors outside the adopted political family are constantly in the stalking phase of predation, and they may avoid centrally-led corporate raiding not by formal lobbying but informal adoption. In the theory of political entrepreneurship, the political sphere appears to economic actors as a normatively closed market for using political power for their benefit; in a relational economy, the political sphere is a discretionally closed market where one group—the adopted insiders—must compete for the chief patron's favor and the other group—the non-adopted outsiders—are constantly under the threat of becoming prey and having their markets redistributed to insiders [→ 5.4.2].

Speaking about economic mechanisms in the three types of economy, the emphasis is again on the word “dominance.” An economy may feature any of the above-defined mechanisms: a market economy usually has some bureaucratic resource-redistribution (most obviously in forms of state and municipal companies and investments) and perhaps even some relational market-redistribution. But these remain subordinate mechanisms vis-à-vis regulated market coordination that remains dominant. To cite just one piece of data, a study in 2016 showed that “[in] terms of the institutional control environments […] the potential for political influence over central government contracting decisions is limited in the UK; recent institutional reforms have generally made controls more robust and introduced greater transparency. Nevertheless, we find that around 10% of the market is controlled by companies that win under conditions indicative of partisan favouritism. In Hungary, by contrast, institutional checks and balances are far weaker, and have been unable to withstand systematic efforts to increase political influence over public procurement. The impact on procurement markets is evident in our quantitative analysis of contracts, which finds that around 50–60% of the market is controlled by companies that win under conditions indicative of partisan favouritism.”413 Indeed, the researchers find signs that Hungary is not “partisan,” as it is decided upon by Orbán’s adopted political family and not the Fidesz party (which is just a transmission belt); and it is also not “favoritism,” as the actors are not in voluntary relations with each other. What we do see is the dominance of relational market-redistribution (and the lack thereof in the UK), which previously analyzed data from Hungary also corroborate [→ 5.3.3.3].

The main characteristics of the three economies are summarized in Table 5.23. As noted, the planned economy is a socialist system while the market and relational economies are capitalist. In a planned economy, the “who gets to own what” question is answered by the central planning of the nomenklatura, bypassing market forces. Using the Polanyian concept of embeddedness, referring to the degree of separation of the sphere of market action from the spheres of political and social action, we may say that the economic sphere in a planned economy is bureaucratically embedded. For the entire economy is subordinated to the sphere of political action through the formal ties of the bureaucracy of the nomenklatura (the party state). In contrast, in a market economy, the “who gets to own what” question is answered by the invisible hand of the market, that is, by the impersonal sum of the voluntary decisions of private actors in a regulated environment. Here, as state regulations are normative and impersonal, and economic actors do not need to participate in politics to have their rights protected, the market can be considered politically disembedded. Finally, in a relational economy, “who gets to own what” is decided by the visible hand of the chief patron, who interferes with market forces and makes capitalism patronally embedded, that is, economically patronalized and therefore subordinated to the interest of the adopted political family.

5.6.1.2. Socialism: the administrative market

In the following parts, we discuss the modifying mechanisms of the dominant mechanism on the market level, in the three ideal type markets. We call modifying mechanisms every mechanism, economic or otherwise, that leads to the modification of the allocation the dominant mechanism resulted in. Thus, modifying mechanisms, while they too exist

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415 Scheiring and Szombati use the expression “authoritarian re-embedding” for the patronalization of post-communist economies (which previously went through “neoliberal disembedding” during the regime change). Scheiring and Szombati, “The Structural Trap of Labour Politics in Hungary.”
alongside the dominant mechanism, are not the same as subordinate mechanisms, for those are (1) necessarily also economic mechanisms and (2) do not necessarily interfere with the dominant mechanism but can exist outside of it. However, as we will see, in general the aim of modifying mechanisms is precisely to institute a new economic mechanism vis-à-vis the dominant one.

First, we examine socialism and the socialist economic system. Accordingly, the market type we consider now is the administrative market:

- **Administrative market** is a segment of an economic system which is dominated by *de facto* public ownership. The administrative market is the dominant market type of planned economies (where the main economic mechanism by which administrative markets operate is bureaucratic resource-redistribution).

Modifying mechanisms of the administrative market are indeed correcting mechanisms, which means they correct the allocative mistakes of the central planner and therefore contribute to regime longevity [→ 4.4]. As it can be seen in Table 5.24, correcting mechanisms include top-down corrections, meaning the mechanism aims at correcting an allocation that is found problematic by top-level nomenklaturists, but most of the correcting mechanisms are indeed bottom-up. The rigidity of central planning and the economic shortages that follow from it would practically paralyze the system and make it unbearable for the subjects if they could not correct the central allocation through certain mechanisms. This applies to both the ordinary subjects, one bottom-up correction of whom has already been mentioned above (blat), and to low- and mid-level nomenklaturists, such as state-enterprise leaders who need to employ tolkachi and engage in a variety of bottom-up corrections even to meet the expectations of the plan.

Among top-down corrections, the most important one is economic campaigns. Communist campaigns should not be confused with the campaigns of liberal democracies, which can indeed be considered as peculiar cases of marketing activity [→ 4.3.3.1]. In communist dictatorships, campaigns must be seen as a coercive mechanism of the political leadership towards the population that is used to fulfill those goals that cannot be demanded on a legal basis or the fulfillment of which cannot be insured with the routine legal operation of the apparatus. This happens when no one in a given social or administrative entity is directly interested in fulfilling a centrally determined goal. Therefore, for the duration of the campaign designed to solve a given problem, the everyday legal routine of the bureaucracy is suspended, while the apparatus in such cases exceeds its own legal authority and its own “ethical standards.” But this is not a simple violation of the law or an error on the part of a segment or member of the bureaucracy. Rather, it is a centrally initiated and coordinated, obligatory violation of the law which is to be committed by all

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416 Ledeneva, *Russia’s Economy of Favours*.

417 For existing literature in English, see Yu, “Campaigns, Communications, and Development in Communist China”; Liu, *Communications and National Integration in Communist China*; Soós, “Informal Pressures, Mobilization, and Campaigns in the Management of Centrally Planned Economies.” The description of campaigns in the next paragraphs is based on the research that one of the book’s authors made in Hungary as well as at the Woodrow Wilson International Center for Scholars in the late 1980s. See Magyar, “Kampányok a falusi térben az ötvenes évek elején” [Campaigns in the countryside in the early ’50s].
members of the designated segment of the apparatus and the scale and direction of which are centrally predetermined. A communist campaign is a series of actions taken by the leading political elite in order to direct state bureaucracy as if it were a (mobilizational) political movement, but one controlled from above.

Table 5.24. Correcting mechanisms in socialist markets.

<table>
<thead>
<tr>
<th>Modifying mechanisms in socialist markets</th>
<th>The essence of the mechanism</th>
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<tr>
<td><strong>Top-down</strong></td>
<td>Economic campaigns</td>
</tr>
<tr>
<td>From the supply side (mid- and low-level nomenklatura)</td>
<td>forcing out the central aims which cannot be achieved through the day-to-day, legal functioning of the bureaucracy</td>
</tr>
<tr>
<td>Plan bargain</td>
<td>extorting out extra resources via bilateral negotiations (bargains)</td>
</tr>
<tr>
<td>Under-planning</td>
<td>extorting out extra resources via unilateral “hidden methods” (fraud, false reporting)</td>
</tr>
<tr>
<td>Barter</td>
<td>voluntary exchange of goods between economic units of the same status</td>
</tr>
<tr>
<td>From the demand side (ordinary subjects)</td>
<td>Queuing, waiting lists</td>
</tr>
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<td></td>
<td>postponement of consumption (changing consumer preferences)</td>
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<tr>
<td></td>
<td>Blat</td>
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<tr>
<td></td>
<td>illegal and/or informal obtainment to goods and services with reciprocal favors or extra payments</td>
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</tbody>
</table>

The campaign is a special form of coercion applied from outside a given market, but aiming at reorganizing allocation on the market level in a normative way. At this aim, the most important types of campaigns are (1) extracting campaigns, by which the nomenklatura tries to extract a given resource (compulsory delivery campaigns, tax-paying campaigns, state-bond subscription campaigns and work-competition campaigns etc.); (2) regulatory campaigns, by which the nomenklatura tries to regulate some parts of production process in the centrally planned economy (sowing, harvesting and threshing campaigns, investment campaigns etc.); and (3) structural transformation campaigns, by which the nomenklatura aims at reorganizing certain economic sectors (collectivization campaigns, amalgamation campaigns to merge industrial companies, consolidation campaigns for agricultural cooperatives etc.). Each campaign of the three groups can be analyzed in several dimensions:

- **by the character of target group:** we can find campaigns when (a) the target group is within the apparatus that itself is executing the campaigns (e.g., vigilance campaigns or rectification campaigns), (b) the target group extends to the general citizenry and more institutions are involved (e.g., compulsory delivery campaign), and (c) the targeted general citizenry itself is forced to act as mobilizers against the rest (e.g., collectivization campaign);

- **by the time dimension:** we can find campaigns (a) with predetermined duration (e.g., compulsory delivery campaign) and where the campaign is without a pre-established endpoint (e.g., some collectivization campaigns), (b) which are short
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- by periodicity: we can find campaigns which are (a) irregular and occasional (e.g., vigilance or labor-force campaigns) and (b) regularly occurring, following either natural production cycles (e.g., agricultural-labor organizing campaigns) or political cycles (e.g., regulatory campaigns).

- by the punishments if the campaign goals are not achieved: we can make a distinction in terms of whether the lack of the expected results brings (a) collective punishment (e.g., when the right to market agricultural produce is withdrawn from whole villages temporarily if the village does not fulfill its compulsory delivery target) or (b) individual punishment (e.g., extra-legal sanctions or public humiliation).

The final dimension in which these campaigns can be examined is by which basic right of individuals or organizations—that are already legally restricted—they suspend. (Indeed, as all communist campaigns involve some rights violation of this kind, we may identify them generally as rights-suspending campaigns.) Extracting campaigns infringe upon one’s freedom to dispose of one’s legal property; regulatory campaigns attack the independence of the economic enterprises as well as of individuals. The structural transformation campaigns restrict or violate simultaneously a whole range of otherwise legally codified rights, from the right of association to the already tightly restricted right to private property.

Turning to bottom-up correcting mechanisms, they can come from the two sides of the bureaucratic market: from the supply side—that is, from within the nomenklatura and by those mid- and low-level members who have to produce goods and services according to the central plan—and from the demand side—that is, from ordinary subjects who wish to obtain goods and services from administrative markets.

As for the former, we should first mention the two tightly connected mechanisms of plan bargain and under-planning. In both cases, state enterprise leaders want to receive, as Kornai puts it, “as easy a production assignment as possible and as plentiful a supply of materials and labor as possible to carry it out.” In the first step, this leads to under-planning as state enterprise leaders report a smaller capacity and a larger input requirement than the reality. However, plan bargain perpetuates as central planners realize this tendency and start to prescribe a plan 10 or 20% tighter than they consider realistic. State enterprise leaders start, via tolkachi, negotiations (bargains) to achieve a looser plan, whereas the planners want to squeeze out the maximum of the firms and make them produce at least as much as they did in the previous year (“planning in”). As Kornai explains, a similar bargaining process “develops inevitably in any relation of superiority and subordination in the hierarchy […] over any decision in which a superior body expects something of and/or grants something to a subordinate one,” whereas the “actual outcome of the bargain depends largely on the power relations between the superior and the subor-

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Thus, under-planning and plan bargain are two basic mechanisms that exist on practically all subordinate levels of the nomenklatura.

Indeed, under-planning fits into the larger set of phenomena that was known as pripiski (false reporting) in the Soviet Union. Ledeneva summarizes Stephen Shenfield’s typology of pripiski as follows: (1) underreporting, which meant that accountants understated production output figures to safeguard against a potentially unsuccessful future production period; (2) overreporting, whereby plan fulfillment was overstated to avoid punishment or to win bonuses or promotions; (3) wage falsification, used to compensate for the lack of skilled labor; (4) shuffling of accounts, meaning that, if one planned item was overconsumed, it could be stated that the money had been used for the purchase of another material or service; and (5) borrowing of output, where instead of pulling numbers out of the air, the factory valued output that had not yet been completed at the end of the planning period at a considerably higher percentage of completion.

The final bottom-up correction mechanism from the supply side of the administrative market is barter. In this case, state enterprise leaders bypass the central planner and try to solve the problem of misallocation among themselves. Thus, voluntary exchanges in kind take place between economic units. From the demand side of the administrative market, two types of correcting mechanisms exist. On the one hand, the ordinary subjects can make correction by queuing or waiting lists, when they handle shortage by postponing their consumption until it becomes available. This way, the shortage problem is solved by the subjects changing their preferences: while they would normally want to receive the good or service at an earlier date, they adapt to the circumstances and accept the shortage by changing their time-preference. On the other hand, subjects can solve shortage without changing their preferences if they engage in blat. As we explained in Part 5.3.5.1, with blat people make informal (and sometimes illegal or corrupt) barter deals to obtain the product they want to obtain but would not be able to get under the circumstances of central planning.

5.6.1.3. Capitalism: from competitive market to relational market

The aim of every bottom-up correcting mechanism is to overcome the bottlenecks of the planned economy, especially shortage produced by the misallocation of resources compared to the people’s needs. In other words, we can say that these mechanisms aim at closing the gap between the central planner’s allocation and the allocation that meets the subjects’ demand. However, what needs to be seen is that the allocation that is fundamentally based on the subject’s demand, meaning it produces what the people are willing to buy and does not produce what they do not, is market coordination. Thus, the previous sentence in bold can be reformulated like this: bottom-up correcting mechanisms push bureaucratic resource-redistribution and the administrative market toward market coordination and the competitive market.


Based on Ledeneva, How Russia Really Works, 147–48. Also, see Shenfield, “Pripiski.”


In blat, we also include black markets that are ideal typical to planned economies.
The competitive market is defined as follows:

- **Competitive market** is a segment of an economic system which is dominated by *de facto* private ownership. The competitive market is the dominant market type of market economies (where the main economic mechanism by which competitive markets operate is regulated market coordination).

From this definition, we can see that, while its bottom-up correcting mechanisms try to institute market coordination, administrative markets do not become competitive markets as a result. For the *de facto* (and *de jure*) dominance of state ownership is not replaced by the *de facto* dominance of private ownership. However, in the case of competitive markets, (a) some modifying mechanisms do not change the *de facto* ownership type, and thus only count as distorting mechanisms, but (b) there are modifying mechanisms that change *de facto* private ownership to power-ownership. In the case of the latter, we can already speak about annexing mechanisms, which make initially competitive markets relational markets and therefore “annex” them into the relational economy.

Starting from distorting mechanisms, we can again distinguish top-down and bottom-up forms (Table 5.25). As for the former, the two types of state intervention that move property from one hand to another are regarded as distorting mechanisms: budgetary intervention and property-taking intervention. As we explained above in detail, budgetary intervention involves the redistribution of private (monetary) property via taxing and spending, whereas property-taking intervention involves moving private (non-monetary) property to public hands via nationalization. Thus both methods modify the allocation of bundles of property rights that would be produced by the dominant mechanism, regulated market coordination.424 Bottom-up distorting mechanisms are three. First, there is lobbying. It may be objected that understanding lobbying as a distorting mechanism is inconsistent, for we described lobbying above as an ideal typical process in liberal democracies by which the content of regulations is formed. This is the starting point of relational economics. However, we do count lobbying as a distorting mechanism because it marks a change in the behavior of economic actors: instead of profit-seeking, which would mean operation according to regulated market coordination, business groups engage in rent-seeking, which means they try to increase their profits not by serving the consumers—as in regulated market coordination—but by bending the dominant economic mechanism in their favor.425

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424 We regard regulatory intervention as one that defines the entire economic playing field and, thus, it is part of the dominant coordinating mechanism (hence “regulated” market coordination). As for supervisory intervention, some of its forms indeed result in distortion as well as annexation, but as it is used as a separate method of intervention in the case of discretionary interventions, we do not include it here and will discuss it as part of top-down annexing.

425 Buchanan, “Rent Seeking and Profit Seeking.”
Table 5.25. Distorting and annexing mechanisms in capitalist markets.

<table>
<thead>
<tr>
<th>Modifying mechanisms in capitalist markets</th>
<th>The essence of the mechanism</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Distorting mechanisms</strong> (of regulated market coordination)</td>
<td></td>
</tr>
<tr>
<td><strong>Top-down</strong></td>
<td>Budgetary intervention</td>
</tr>
<tr>
<td></td>
<td>Property-taking intervention</td>
</tr>
<tr>
<td><strong>Bottom-up</strong></td>
<td>Lobbying</td>
</tr>
<tr>
<td></td>
<td>Shadow economy</td>
</tr>
<tr>
<td></td>
<td>Voluntary corruption</td>
</tr>
<tr>
<td><strong>Annexing mechanisms</strong> (of relational market-redistribution)</td>
<td></td>
</tr>
<tr>
<td><strong>Bottom-up</strong></td>
<td>Bottom-up state capture</td>
</tr>
<tr>
<td><strong>Top-down</strong></td>
<td>Political patronalization + patrimonialization</td>
</tr>
<tr>
<td></td>
<td>Economic patronalization + patrimonialization</td>
</tr>
<tr>
<td></td>
<td>Societal patronalization (cold patronalization)</td>
</tr>
</tbody>
</table>

Second, there is the shadow economy, which is none other than the illegal cooperation of economic actors to bypass the state laws that regulate market coordination. These involve phenomena such as illegal trade, unlawful employment, and various ways of tax avoidance, among other things.\footnote{For an overview, see Schneider and Enste, *The Shadow Economy*.} Finally, we find as the third bottom-up distorting mechanism of regulated market coordination voluntary forms of corruption. Free-market corruption, cronyism and state enterprise collusion all aim at changing the way property is dominantly allocated to their own benefit, distorting the generally normative economic mechanism of competitive markets to serve interests discretionally \[\rightarrow\ 5.3.2.2\].

Turning to annexing mechanisms, we need to enumerate the processes that change de facto private ownership to power&ownership and regulated market coordination, to relational market-redistribution. In other words, we examine the mechanisms that turn, in a capitalist environment, a competitive market into a relational market:

- **Relational market** is a segment of an economic system which is dominated by de facto power&ownership. The relational market is the dominant market type of relational economies (where the main economic mechanism by which relational markets operate is relational market-redistribution).

Among bottom-up annexing mechanisms, we can find the first type of coercive corruption, bottom-up state capture. As we explained in Part 5.3.2.3, this mechanism involves the coercive capture of public actors by oligarchs or crime bosses, who use their influence to carry out relational market-redistribution: they want to use state power to redistribute...
markets, either by the means of discretionary regulatory intervention or by using the politician in schemes of grey or white raiding. Top-down annexing mechanisms are, on the one hand, political patronalization and patrimonialization and, on the other hand, economic patronalization and patrimonialization. As relational markets constitute a lack of separation between the political and the economic spheres, these two methods go hand in hand in forming and operating mafia states of patronal autocracies in the post-communist region. With political patronalization and patrimonialization, the chief patron achieves the concentration of state power in his hand, allowing him to reach the widest amplitude of arbitrariness in state interventions. Economic patronalization and patrimonialization follow from this, as the chief patron can use the power he obtained for relational market-redistribution. Simply put, the subjugation of the political sphere makes it possible for him to override the invisible hand with his grabbing hand \([\rightarrow 2.6]\), and dispose over the entire sphere of market action. Finally, this state of affairs causes what we call societal patronalization as well as “cold patronalization” in the next chapter, referring to the actors who are not directly patronalized by the adopted political family but decide to cooperate with it, given their alternative options are cut in a limited-access order \([\rightarrow 6.2]\).

5.6.1.4. Modifying mechanisms in relational economy: double accountability and financial scheming

As annexing mechanisms turn competitive markets into relational markets, relational market-redistribution prevails as the dominant mechanism of relational economy. Yet relational market-redistribution is accompanied by several modifying mechanisms, manifesting in the behavior of those outside the adopted political family. Indeed, this is not a negligible segment: the informal economy that represents these modifying mechanisms accounts for at least half of the gross national product of Russia, according to expert estimates.\(^{427}\) As Yavlinsky writes, the informal economy is characterized by “activity that is not necessarily hidden but still takes place outside of or in violation of legally established guidelines—for example, the use of sham payment defaults, illegal or exotic forms of payment, […] false exports, the use of undue benefits, and so on. These relations are prevalent in the part of the economy that is concealed from accounting and taxation, but also to a large extend in public activity. The unofficial economy does not exist separately from the official or legal economy. Rather, it permeates the legal economy, introducing corrections and peculiarities in the behavior of firms that are inexplicable in terms of legislation and official rules for economic activity” (emphasis added).\(^{428}\)

As the word “correction” suggests, one can draw parallels between these post-communist techniques and the correcting mechanisms of socialist markets. Yet we do not call these “correcting mechanisms” because, unlike socialism’s corrections, a relational economy’s modifying mechanisms are not necessary for the system’s survival—rather to the survival of economic actors outside the adopted political family. More precisely, Ledeneva mentions two motivations that generate these “grassroots practices:”\(^{429}\)

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\(^{427}\) Yavlinsky, Realeconomik, 109.

\(^{428}\) Yavlinsky, Realeconomik, 109.

\(^{429}\) Ledeneva, How Russia Really Works, 143–47.
to compensate for the shortcomings of state and market institutions, meaning the firms do what is necessary to survive, to stay in business or to be successful, based on their “common sense;”

◆ to avoid becoming prey to the predatory state.

In other words, we may say that the former motivation regards problems stemming from formal institutions (or the lack thereof), whereas the latter regards problems stemming from informal institutions of the ruling elite. To present related practices, we summarize a chapter from Ledeneva’s book How Russia Really Works. While she focuses on the Russian economy in general and the first 15 years after the transition in particular, her findings are not country or era-specific. Rather, they are regime-specific to patronal systems, characterized by grey and white raiding, unreliable legal and financial institutions, and low levels of trust in economic and political institutions in general.

To compensate for institutional shortcomings, economic actors often circumvent the state and (a) pay for a private actor for a service not provided by the state in the necessary quantity or quality, and/or (b) develop schemes to avoid burdensome regulations and arbitrary and confiscatory taxes that would make competitive economic functioning impossible. As for (a), Ledeneva identifies techniques “designed to organize [a company’s] external deals: outgoing capital flows and payments for the services of important external institutions such as the customs services, railway authorities, regional administration, or private protection companies. These schemes make use of intermediary firms in order to pay for services and protection, to offset taxes, or to transfer bribes and political payments. The most elaborate schemes involve multiple stages of transactions between upwards of a dozen ostensibly independent economic agents.” As for (b), Ledeneva describes one of the complex capital-flight schemes involving a web of companies and writes that “[a] general idea behind these financial schemes is to obscure any direct connection between the company and its operations. Asset ownership is hidden by channeling funds through intermediaries, while companies that bear liability are stripped of assets and have nothing to lose.” As she argues, such practices are not developed simply to raise profits in illegal ways, avoiding taxation and transferring funds to foreign land. Rather, “owners believe that maintaining foreign accounts is more secure than investing at home,” and also—as Ledeneva writes in agreement with a journalist—“taxes will be siphoned by corrupt bureaucrats, as happens with all government funds. However, if the money goes offshore, it will not be stolen but will find its way back to the enterprise.”

On the other hand, “asset stripping can be instrumental in defending a company’s assets from a takeover. When somebody tries to gain control over a company […], and it is known that the court’s decisions would certainly be prejudiced […], the company may

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430 Ledeneva, How Russia Really Works, 142–63.
431 Cf. Kornai, Rothstein, and Rose-Ackerman, Creating Social Trust in Post-Socialist Transition.
432 Ledeneva, How Russia Really Works, 149.
434 Ledeneva, How Russia Really Works, 152–53.
435 Ledeneva, How Russia Really Works, 155. Also, see Latynina, Okhota na iziubria.
opt to strip its assets. The ownership structure (controlling blocks of shares of this company and its subsidiaries) can be manipulated. Company buildings and residences will change hands (diversion of ownership). All contracts under which the company should receive payments will be consolidated in a ‘shift-a-debt’ contract […], so that any incoming funds will be transferred to some other firm belonging to the management indirectly (diversion of payment) […], and so on.”

This leads us to the second reason of modifying mechanisms, namely avoiding predation. As we explained above, a crucial point of the stalking phase is intelligence acquisition, that is, to know what the company is and how much it is worth. This is precisely what can be avoided by techniques like:

- **underreporting profits** (Ledeneva cites the post-Soviet saying: “If a company has a profit, it has a bad accountant”);
- **double bookkeeping** (“at a minimum, one set of books for corporate insiders and one for tax services”);
- **corporate identity split** (“firms […] insulate themselves within a sophisticated financial network made up of at least two front companies […] , created with the specific intention of channeling assets to an insiders’ club of shareholders or managers while obscuring the benefits of ownership. Such schemes are organized according to another ‘splitting’ principle (matrioshka), in which a bigger matrioshka is owned by a smaller one inside of it, which is in turn owned by a smaller one inside of it, and so on”);
- **asset stripping** (as described above);
- **financial scheming** (“taking the profits out of the books through the use of shell companies, offshore companies, insurance companies, and fake contracts”).

To sum up, Ledeneva writes that financial schemes “enable economic agents to protect their property and business operations from the exigencies of market reforms, from the arbitrary judgements of tax inspectors, corrupt authorities, and the deformed institutional framework in general. At the firm level, financial scheming is represented as a survival strategy. Whether the need-based argument is a genuine one, whether the boundaries between such necessity and manipulation can be defined, and whether the long-term effects of these necessary practices are not more harmful than helpful for the institutions exploiting them are issues that remain to be explored” (emphasis added). Indeed, Ledeneva suggests that “the answers will be sector-, size-, and manager-sensitive,” but at the same time she calls attention to general problems as well. Particularly, falsifying official documentation causes statistical problems, making it almost impossible to measure the size of informal economy by traditional means. She also underlines that “financial scheming

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on the current scale is indicative of a strong network of vested interests committed to its continued existence, which in turn replicates obscure ownership patterns and insufficiently defined property rights. […] The existence of financial schemes thus creates a vicious circle: they compensate for the deficiencies in formal institutions and enable business activities, but, by the same token, they undermine formal institutions and retard their effectiveness” (emphasis added). Thus, the “forced innovation” of post-communist entrepreneurs outside the adopted political family indeed undermines competitive market practices. Therefore, relational market-redistribution causes distortions in the behavior of the actors left alone, making even the directly non-affected sectors of relational economy move away from market coordination of market economies [→ 5.5.4.3].

5.6.1.5. Corruption: from modifying mechanism to dominant function

Unauthorized illegality is another modifying mechanism of relational markets. Indeed, it is a distorting mechanism, involving the action of independent criminals as well as the unauthorized abuses of public office [→ 5.3.2.2, 5.3.4.2]. Through actors who corrupt the initially corrupt environment for their own private gain, corruption appears in both relational and competitive markets, just as much as it appears in administrative markets when public offices are involved in blat. However, the status and function of corruption differs in the three systems.

As we mentioned in Part 5.3.6.1, in the case of socialist markets we can speak about system-lubricating corruption. This harmonizes with our term “correcting mechanism” as well as the colloquial expression “grease money,” which acquires its meaning in an administrative market: without lubricating the machinery, the planned economy itself would be paralyzed and subjects would need to endure constant shortages in practically all products (in all markets). Such a state would hardly be sustainable, while it is precisely correcting mechanisms such as blat and—as a part of it—system-lubricating corruption that make the system temporarily viable and livable.

On the other hand, we can speak about system-destroying corruption in competitive markets, mainly because corruption aims at destroying these markets’ competitive mechanisms. In market coordination, producers need to compete for the customers, for the latter are free to reject the former’s offers for exchange. Thus, those producers can survive and prosper on the market who can sell their products at a profit, whereas the magnitude of profits depends on how well entrepreneurs are able to meet market demand. However, corruption destroys this logic by using the state to provide corrupt actors certain discretionary benefits (regulatory intervention, supervisory intervention etc.). This way economic actors can gain a competitive advantage on the market, not on the basis of their ability to meet market demand and lobby in a transparent process—in short, competition—but because they are aided by illegal state intervention. Discretionary state favors discriminate

440 Ledeneva, How Russia Really Works, 161.
441 Cf. Laki, “Kényszerített innováció” [Forced innovation].
442 Simis, USSR: The Corrupt Society.
443 Mises, “Profit and Loss.”
among economic actors in favor of the one who corrupts public actors, and therefore they wreck the competitive logic and have a destructive effect on competitive markets.

Finally, while they have destructive corruption in forms of unauthorized illegality, the dominant form of corruption that relational markets are characterized by is system-constituting corruption. Here, corruption becomes systemic and monopolized, as well as a norm of the regime as discreitional intervention meets the intention of both the regulator and the dominant institution [→ 5.4.1.1]. The chief patron runs the state as a criminal organization, and the adopted political family reaps the various discreitional benefits of the corruption that has been made one of the dominant—though informal—functions of the state.


5.6.2.1. The economies of intermediate regime types

Each of the three economies discussed above fits one polar type regime. Liberal democracy has a market economy; communist dictatorship has a planned economy; and patronal autocracy has a relational economy. However, in cases of the intermediate regime types—patronal democracy, conservative autocracy, and market-exploiting dictatorship—the approach that describes them by the dominance of a certain market type is not satisfactory. Indeed, all of these regimes are market economies, meaning that the majority of their markets are competitive in the sense described above. However, these market economies are different than that of liberal democracy because of the different significance of other (subordinate) market types. In a liberal democracy, markets that are not competitive are marginal phenomena in the sense that their operation is largely subordinated and dependent on the operation of competitive markets. Simply put, it is competitive markets that “lead” the economy, whereas administrative or relational markets are following. In intermediate regime types, however, the dominance of competitive markets is not this robust, with non-competitive markets becoming more significant.

Conservative autocracies can be characterized as market economies, but the ratio of state-controlled markets in the economy is significantly larger than in the ideal typical liberal democracy. Their economy, therefore, can be described as a “mixed” market economy with a (more or less slight) majority of competitive markets and a (more of less slight) minority of administrative markets. Relational markets, however, do not appear in ideal typical conservative autocracies, and corruption reaches only the level where it is a distorting mechanism. The distinctive feature of conservative autocracies vis-à-vis

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444 We are indebted to Mária Csanádi for her comments and suggestions to this part.

445 About the growth of public sector in Poland, which is moving toward the conservative autocratic model, see Kozarzewski and Bałtowski, “Return of State-Owned Enterprises in Poland”; Rohac, “Authoritarianism in the Heart of Europe,” 5–6. Also, there are liberal democracies which have similarly large (or larger) share of state-controlled markets, although that is not typical.
patronal autocracies is precisely that the leading political elite does not show a patronal character and dominates only the sphere of political action through the formal channels of the governing party. In other words, top-down annexing mechanisms do not appear in conservative autocracies: while the leading political elite has the most important prerequisite—namely the monopoly of political power—to institute a criminal state, it does not use it to do so because it is not subordinated to the principle of elite interest but ideology implementation [→ 2.3.1].

**Patronal democracies** are the symmetrical opposite. While in a conservative autocracy the leading political elite could institute a mafia state but does not want to, in a patronal democracy the leading political elite wants to institute a mafia state but is unable to. The leading political elites of patronal democracies exhibit a patronal character and they are subordinated to the principle of elite interest, but they lack the monopoly of political power. Accordingly, top-down annexing mechanisms in general and economic patronalization and patrimonialization in particular are carried out only partially, whereas the state only reaches the captured state level. Competing patronal networks capture certain markets and turn them relational (and at this aim always the ruling patronal network is the most successful), but the economy as a whole does not become a relational economy. Rather, it can be described as a “mixed” market economy with a (more or less slight) majority of competitive markets and a (more or less slight) minority of relational markets.

The situation in **market-exploiting dictatorships** is more complex. While formally it is capitalist and also a market economy, meaning the majority of its markets operate according to regulated market coordination, this observation breaks down as a mere statistical fact with little explanatory value on its own. Indeed, the economy of market-exploiting dictatorships—of which the paradigmatic example in the post-communist region is China—shows a **dynamic balance of the three economic mechanisms**, where it is nearly impossible to tell which market type is dominant in the sense that it would “lead” the other (subordinate) types.

In the following parts, we are going to elaborate on this system in more detail. Theoretically, a market-exploiting dictatorship could evolve from several economies and regime types, but in the post-communist region it has always grown out of communist dictatorships keeping the party state and the lack of political opposition, on the one hand, while setting the economic sphere partially free, on the other. Thus, we will focus on this variant of market-exploiting dictatorship.

### 5.6.2.2. Bureaucratic resource-redistribution and regulated market coordination: model change without regime change in the party state network

A comparative analytical model for regimes with party states is offered by Mária Csanádi. Her **Interactive Party-State (IPS) model**, as she explains, “is a bottom-up construction that comprises the self-similarities and differences of party states as outcomes of the structural characteristics of power distribution, which are interpreted as networks. In terms

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447 For her seminal work on the subject, see Csanádi, *Self-Consuming Evolutions*. 
of both dependency and interest promotion, there are strongly intertwined relationships among decision-makers in the party, the state, and the economy. This leads to a specific process of decision-making [...] Main elements of the party-state network are as follows: 1. the party hierarchy, which monopolizes the political sub-sphere. 2. The state hierarchy, which monopolizes the economic sub-sphere and, therefore, the extraction and distribution of resources. 3. Interlinking dependency lines, which origin in the party hierarchy as its instruments of power that reach out to structures of positions, activities, and organizations in non-party hierarchies. 4. Structural feedbacks, within both party and state hierarchies as well as between state and party hierarchies.448

This model is adequate for the purposes of our framework because it allows us to map out and compare the interactions of the sphere of political and market action in communist dictatorships as well as market-exploiting dictatorships. Indeed, Csanádi identifies three ideal typical patterns of the party-state network that are differentiated on the basis of how bargaining power—defined as the capacity to extract, attract and distribute (economic) resources and to resist state interventions—is distributed among the actors (Table 5.26).449 In the pattern that she calls “self-exploiting” and fits to ideal type communist dictatorships, power is centralized in the hands of the top-level nomenklatura. Central planners coordinate the bureaucratic resource-redistribution process with few feedbacks, given the subjects below them have limited capacity to resist or bargain. We may add that the planned economy is also a closed totalitarian production structure in the sense that (1) everyone is allowed to produce only what he is assigned to (physical targets may be overfulfilled but new, private enterprises cannot be started) and (2) there are no formal markets where products that are produced beyond the plan could be sold and bought at market prices. In short, this is the ideal typical model of communist dictatorship and planned economy, which characterized the Soviet Union under Stalin, Eastern Europe and China in the 1950s, Romania until the revolution in 1991 and North Korea to date.450

At this point there is no need to elaborate on the self-disintegrating pattern, as it does not fit any ideal type regime per se (rather it is a pattern where communist dictatorships can shift, moving closer to the model of market-exploiting dictatorship).451 The model we need to focus on is the self-withdrawing one, which Csanádi regards as a mode of functioning of communist dictatorship but we understand it as the ideal typical model of market-exploiting dictatorships. As we stated in the title, the evolution of communist dictatorships to market-exploiting dictatorship means a model change without a regime change, with which we refer to the fact that the system remains a dictatorship and the party state retains its hegemony in the sphere of political action [⇒ 7.3.1]. However, while the main features of the party-state network in the self-exploiting pattern were (1) power centralization and (2) the closed totalitarian production structure, the process of transformation means that the party state gives up precisely these two features. In market-exploiting dictatorships, power—in our terms, planning of the bureaucratic resource-redistribut-

449 Csanádi, “Interpreting Communist Systems and Their Differences in Operation and Transformation as Networks.”
451 Csanádi, “‘The 'Chinese Style Reforms' and the Hungarian 'Goulash Communism.'”
tion—gets decentralized and the production structure opens within the framework of the party state system.

Table 5.26. Ideal typical patterns of power distribution in the IPS model. Source: Csanádi (2014, 21).

<table>
<thead>
<tr>
<th>Traits</th>
<th>Self-exploiting (e.g., North Korean and all initial)</th>
<th>Self-disintegrating (e.g., Hungarian from 1956 onwards)</th>
<th>Self-withdrawing (e.g., Chinese from 1979 onwards)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distribution of power</td>
<td>centralized extraction and distribution, centralized interlinking threads, few feedbacks</td>
<td>centralized extraction and distribution, centralized (or decentralized) interlinking threads with strong economic feedbacks</td>
<td>partially decentralized extraction and distribution and either centralized or decentralized interlinking threads with economic feedbacks</td>
</tr>
<tr>
<td>Bargaining capacities of actors in the network</td>
<td>faint attracting and resisting capacity</td>
<td>selectively strong attracting and resisting capacity</td>
<td>selectively strong attracting and resisting capacity, owing to feedbacks and decentralized alternative resources</td>
</tr>
<tr>
<td>Constraints of self-reproduction</td>
<td>rarely hard</td>
<td>occasionally hard</td>
<td>frequently hard</td>
</tr>
<tr>
<td>Modes of resource extraction</td>
<td>forced resource redeployment</td>
<td>resource mobilizing (decentralizing) reforms within the network</td>
<td>resource mobilizing and resource creating reforms within and outside the network</td>
</tr>
<tr>
<td>Economic development</td>
<td>forced growth of heavy industry to physical boundaries</td>
<td>economic recession and reform escalation within the network</td>
<td>economic growth outside the net, recession within the net and reform escalation outside the network</td>
</tr>
<tr>
<td>Legitimacy and retreat</td>
<td>tensions growing, no retreat, abrupt collapse</td>
<td>party legitimacy declining, relative and absolute gradual retreat from political sub-field</td>
<td>party legitimacy kept, relative and absolute gradual retreat from economic sub-field</td>
</tr>
</tbody>
</table>

In China, this process took place through a series of gradual reforms:452

- more decision-making power (about production, marketing, investment decisions, staff etc.) was delegated to sub-national levels and to state-owned enterprises resulting in the spread of horizontal links within the system;
- cooperatives in agriculture were dissolved and a household responsibility system was introduced, leaving the interlinking lines of the network formerly attached to cooperatives in limbo;
- the scope and quantity of compulsory production was narrowed, higher prices in state procurement were applied;

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a dual price system was introduced, allowing the subjects to sell their over-the-plan products at market prices (first in agriculture in the 1970s and then in industry from the early-/mid-1980s);

the market was “opened up” as entrepreneurship outside the network was allowed, both in the form of FDI and in the form of new domestic private enterprises (including greenfield investments).

This explains how bureaucratic resource-redistribution and regulated market coordination mix and form a dynamic balance. A private market economy emerges parallel to, or above, the existing planned economy as the party state—which managed production and redistributed resources in communist times—passes some of the production role to the private sector. Accordingly, regulated market coordination in the new competitive markets remains rather sensitive to the dynamics of the original network. To illustrate this point, we describe the investment overheating produced by the new economy, echoing the investment overheating typical to party-state networks. In communist dictatorships, central planners try to accelerate economic growth by expanding investment activity. If the plan overestimates the economy’s capacities—often because of plan bargain and false reporting—the network faces a hard production constraint, and the inadequacy of resources forces the party state to stop the expansion. This results in a pattern of investment cycle, which might even be recognized as an “administrative-market bubble,” led by exaggerated plan expectations in contrast to the exaggerated corruption expectations in relational markets and the exaggerated market expectations in competitive markets. In market-exploiting dictatorships, however, investment cycles are both amplified and used for the network’s expanded self-reproduction. On the one hand, they are amplified as the competitive markets outside the network try to adapt to the allocation priorities of the network instead of adapting to actual market demand. As a result, the amplitude—and, in case it happens with a lag, the duration—of investment overheating is expanded. On the other hand, the party state can now not only “step on the breaks” in terms of stopping investments but also taxing the emerging markets that are overheating. This means that hard production constraints are softened and the network is capable of expanded self-reproduction, accompanied by the growth of the equilibrated competitive markets. Figure 5.13 depicts this process in China in a stylized form, showing the consecutive waves of emergence of private markets as a result of the reforms. (Yet it is important to note that the waves are only analytically isolated and what we describe as second and third wave have appeared again and again, with different forms and intensity, in the subsequent waves as well.)

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454 Bauer, “Investment Cycles in Planned Economies.”
Table 5.13. Investment cycles in the Chinese market-exploiting dictatorship. Note: the first wave was a one-time expansion, whereas the other waves continued to expand the private economy parallel to the subsequent waves.

Nevertheless, the party-state network still heavily regulates the new economy and controls some strategic industries.\textsuperscript{455} According to Marc Szepan, the Chinese economy can be characterized by “the coexistence of and intense competition among state-owned enterprises and private companies,” whereas in both groups we can find (1) state-proximate and state-supported and (2) market-based and competition-oriented companies.\textsuperscript{456} He goes on to explain that \textbf{state bodies exert an influence on companies through the use of six typical mechanisms}.\textsuperscript{457}

- \textbf{profit transfers through state ownership}, meaning shares in a company owned by the central or local government are held by an asset management commission;

- \textbf{managerial appointments through the CCP (Chinese Communist Party) cadre system}, where (1) the State-owned Asset Supervision and Administration Commission (SASAC) is officially responsible for making appointments to top positions within the state-owned enterprises and (2) upper and even middle management positions in related firms are generally given only to CCP members;

- \textbf{lending by banks and financing}, whereby the state can wield significant influence over both public and private companies by means of capital allocations;

\textsuperscript{455} In China, these include banking, telecom, and natural resource extraction. Csanádi, “China in Between Varieties of Capitalism and Communism,” 16.

\textsuperscript{456} Szepan, “4.5 Government Involvement in the Chinese Economy,” 209.

\textsuperscript{457} Szepan, “4.5 Government Involvement in the Chinese Economy,” 210–12.
• funding through industrial policy, as the Chinese state pursues an active state-specific industrial policy;

• regulations (approvals etc.), similar to regulatory interventions in market economies [→ 5.4.2];

• public procurements when the state is the key customer.

Recently, party organizations have been implanted at 60–70% of private companies of foreign as well as domestic owners, and there have been instances of coopting heads of large private companies into the state party. Yet these are to be seen as guarantees, that is, opportunities for the party to intervene, augmenting legal accountability with an accountability regarding the party state’s substantive-rational goals (referring to the so-called “party ethics”). Thus, such measures do not revive central planning and a substantial market economy is allowed to grow outside the network.

As a result of letting competitive markets grow, the party-state network retreats in both absolute and relative terms vis-à-vis the private sector. According to Csanádi, this “systemic transformation process evolves as the party-state network is retreating as a social system from monopolized subspheres, and the sub-spheres of a new social system are emerging outside of the network. Transformation may be absolute, when physical changes in the network occur: bargaining through the channels declines (the network is emptied), weakened, constrained, or cut off. Transformation may be also relative, when either the network does not retreat but emergence and expansion of the new subfield (political or economic) is in process, or the speed of retreat is faster than the speed of emergence, or both are expanding but the speed of emerging subfield is higher. The dynamics of relative or absolute retreat and emergence develop in strong interaction.” At the same time, we can also see a dilution in the membership of the network, following that “alternative capital, actors and interests enter […] as owners in joint ventures, shareholders, members in Peoples’ Parliament or in inter-ministerial committees etc.”

The obvious question at this point is why the party state engages in such reforms. After all, while it arguably keeps its dominant position in strategic industries and influences the newly emerging markets, it loses the dominance it had in the planned economy in the totalitarian setting of communist dictatorship. Also, the appearance of a private economy and the turn of the majority of markets from administrative to competitive entail autonomy and individual sovereignty, which pose dangers for the indivisibility of power of the party state. The answer can be found in Table 5.26, if we compare this pattern with the self-exploiting and the self-disintegrating patterns. On the one hand, by opening up the market, while new private actors may indeed gain stronger bargaining capacity in the network, they also bring about an escalation of new resources and economic growth. These help the party-state network’s survival (in Csanádi’s terms, self-reproduction) as the

458 Brant, “Why Is Jack Ma a Communist Party Member?”
459 Yan and Huang, “Navigating Unknown Waters.”
more the economy grows, the more resources the party state can extract from it, the higher the people’s living standards become, and the state party’s legitimacy may be prolonged.

On the other hand, the reforms of self-withdrawing can be seen as top-down and economy-wide corrections, very much in the vein of bottom-up correcting mechanisms discussed above. Indeed, the new economic mechanism makes the market more sensitive to consumer demand as people can engage in voluntary exchanges more freely. This was the aim already of the so-called “market socialist” reforms in Central-Eastern Europe, the main difference being that there the production structure was opened to a much lesser degree. In the market-socialist reform model, administrative markets only simulated competitive markets and new incentives were not introduced in the form of genuine private property or market coordination (see Box 5.12). However, in the model of market-exploiting dictatorships, a genuine market economy with competitive markets emerges above the planned economy. Furthermore, the massive economic growth that takes place outside the network contributes to the continuous increase of living standards and creates jobs, all contributing to the legitimacy of the party state (as mentioned in the last row of Table 5.26).

To sum up, the two reasons to engage in such reforms explain why we call this regime type a “market-exploiting dictatorship: maintaining the formal monopoly of political power, the party state (partially) sets the sphere of market action free so it can reap its fruits in terms of political legitimacy, economic self-reproduction, and social stability.”

5.6.2.3. Regulated market coordination and relational market-redistribution: the trilateral pressure of informality on the reformed party state

While the introduction of regulated market coordination is a process launched by the party state deliberately, the appearance of relational market-redistribution is more of an unintended consequence of the model change to market-exploiting dictatorship. While competitive markets do emerge as a result of the process, the context in general and the

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463 Indeed, delegations of Chinese experts studied “market socialism” in Hungary extensively. Vámos, “A Hungarian Model for China?”

464 For further discussion of mechanisms of legitimacy in China, see Holbig and Gilley, “Reclaiming Legitimacy in China.”
reforms that create the markets in particular make them prone to be annexed by patronal networks.

The most important annexing mechanism in market-exploiting dictatorships is top-down state capture, that is, economic and political patronalization and patronialization on the local level. The model change, and especially its two main pillars—decentralization and opening up the production structure—contribute to the likelihood of this outcome in the following ways:

◆ **decentralization of power without party competition grants local party leaders a local monopoly of political power.** As Chinese corruption expert Jiangnan Zhu explains, “[the] delegation of greater responsibility to lower level governments to optimize economic growth […] inadvertently [leads] to the development of many closed ‘local or vertical kingdoms’ independent of central oversight and public supervision.”

465 On the local level of the bureaucratic patronal hierarchy, centrally assigned resources as well as the tax revenues of locally registered companies are being handled by the local party secretaries, who have authority over the public projects and contracts financed from these resources. Therefore, these “provincial leaders, especially in the more affluent […] provinces, control economic resources similar to that of nation states. With such wide-ranging responsibility, little oversight and lack of accountability in an authoritarian state […], provincial leaders and those close to them can more easily use their positions to develop large corruption networks;”

◆ **the lack of party competition leads to political patronalization and patrimonialization.** In the phenomenon Zhu calls “factionalism,” the bureaucracy of local governments transforms into informal patronal networks, “where patrons are higher-level officials and clients are their subordinates.” Indeed, this already marks the pattern of top-down state capture or even criminal state on the local level, and it follows the lack of party competition. As Zhu explains, “[without] democratic elections as a way to measure which political elites are more popular, a patron may need to signal power to others through his large group of followers and clients who can obtain preferential treatment or promotions from their powerful patron. Thus, both the patron and client will strive to provide each other with protection during political struggles;”

◆ **that competitive markets are built upon administrative ones makes market-distribution a discrecional power of party secretaries.** While competitive markets do start growing outside the party-state network as the production structure is opened up, the party state still “keeps tight control over most investment projects using its power to issue long-term credit and to grant land-use rights.” Simply put, it is up to the party to decide who can enter a newly established market and

who cannot. More precisely, this power is not exercised by the party state _per se_ but it is also decentralized, for local leaders are believed to know the situation in their locality better and accordingly to be more competent in judging investment decisions than the central party leadership. In line with this, in China—as Csanádi writes—“in 2009 investments in fixed assets undertaken, overseen and permitted by sub-national governments were overwhelming in all sectors, including manufacturing (95%), real-estate (98%), construction (92%), mining (68%) and different services (between 99 and 48%).” Combined with the previous two factors, while theoretically the local governments could bring normative regulations, regulations tend to be discretional and the delegation of economic decision-making powers to the local governments often leads to economic patronalization and patrimonialization. As Zhu notes, private entrepreneurs “may even become the local officials’ wallet to deliver bribes for political promotion.”

Depending on the corruption scheme they represent, we can speak about [_sub-sovereign kleptocratic states_ or _sub-sovereign mafia states_ as a result [→ 2.5.3]. In China, forms of corruption suggesting both types have been prevalent. On the one hand, Heilmann describes a specific form of corruption he calls “dividend collection,” which can be understood in our terms as a subtype of kleptocratic functioning. As he explains, party cadres “regularly demand a share of company profits in exchange for growth- and stability-enhancing administrative services; the involved companies often grow quickly for a period of time.” In this sense, dividend can be understood as a form of protection money [→ 5.3.3.1], one that is linked to performance targets. This creates a symbiotic community of interests between the cadre and the (private) company leader, as both become interested in the growth of the company. Thus, the cadre will try to manipulate state intervention and the regulatory environment to help the company’s growth, so he can collect higher dividends. These monies are then often removed from the country through capital flight and then re-invested, under new names, enriching the cadre as well as his family. On the other hand, Heilmann also describes “predatory” corruption in China, which he defines as “systematic theft of public and private assets; consumption or export of misappropriated assets (capital flight).” While this is broader than our definition of predation [→ 2.4.4], it does encompass what we call “predation,” too, suggesting that predatory practices as well as sub-sovereign mafia states exist in China.

In either case, the patronal networks of the corrupt sub-sovereign states annex the competitive markets under their authority and exercise relational market-redistribution on a patronal basis. As Zhu writes, in this pattern of top-down state capture “groups of officials working collaboratively like a mafia […]. Although some cases, such as collective embezzlement, only involve government officials, most collective corruption includes complex

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5.6. Comparative Economic Systems

Corrupt networks, which transfer interests among officials in different local bureaucratic systems and to actors outside the government […]. In these cases, the major players in the criminal networks [can be] private entrepreneurs, state-owned enterprise (SOE) managers, gangsters, local governors, party leaders, bureaucrats, and law enforcers."475

Corruption in China right after the reforms had started did not lead to this outcome immediately. Rather, what could be seen initially was the appearance of voluntary forms of corruption, such as free-market corruption and cronyism that are still present in China to this day. The corruption that had existed within the party state network expanded and took new forms as a private economy was established.476 In Heilmann’s words, “the Chinese state became an enormous illicit trading floor: company directors, party secretaries, and heads of authorities diverted the means of production and function from the state’s economic sector to supply newly created markets; leading political positions and official approvals were exchanged for shares of profits in lucrative private transactions […]. Major and minor holders of power at every level of the party […] enriched themselves by taking advantage of the opportunities provided by the still imperfect market and legal order.”477 However, since competitive markets were firmly established and the size of the private economy became comparable to that of the party-state network, top-down state capture has been the typical and most serious form of corruption in the country.478 This experience as well as the theory outlined above suggests that market-exploiting dictatorships are ideal typically prone to produce cases of top-down state capture, making relational market-redistribution a significant element alongside regulated market coordination and bureaucratic resource-redistribution.

The emergence of sub-sovereign mafia states and informal patronal networks is a problem for the top party leadership not simply because public funds are being misused. Rather, high-level nomenklaturists must bear in mind the bigger picture as well, which is the tendency of “mafiafication” of the party state. Informal patronal networks, even if they start on the level of sub-sovereign government, can grow and capture more parts of the party state if the chief patron gains access to new positions in the party-state hierarchy. In such cases, the top patron patronalizes every political institution under his authority, making his patronal network a nation-level adopted political family.479 Indeed, informal patronal networks have been created by some higher-level nomenklaturists as well, referred to as “princelings” in the Chinese literature. As Heilmann explains, these people are “[children] and other relatives of former or current party and army cadres [and] play a prominent role in politics, the armed forces, and the economy […]. Princelings of the CCP

475 Zhu, “Corruption Networks in China: An Institutional Analysis,” 29. Also, bottom-up state capture—as another annexing mechanism—is not uncommon in market-exploiting dictatorships, but it is much more sporadic as it does not follow from structural/institutional reasons. Bottom-up state capture in market-exploiting dictatorships is mainly initiated not by oligarchs but by crime bosses and criminal networks, that is, private elements that did not emerge as a result of the reforms but existed independently from them. See Wang, “The Increasing Threat of Chinese Organised Crime.”


479 This is well exemplified by the case of Zhou Yongkang, who is one of the highest-ranking officials indicted on corruption charges in China. See Zhu, 36–39.
can act as the heads of politically and economically active ‘clans’ that combine the leading positions in the state apparatus with entrepreneurial pursuits of profit for private gain. [...] As a result, they are often thought to be involved in organized corruption and capital flight—and there is indeed ample evidence of such activities” (emphasis added).480

Heilmann goes on to point out that “[an] astonishing number of princelings were elected to leading organs of the CCP during the 2007 and 2012 party congresses; the results of the voting indicate that there was no longer any evidence of resistance to their rise to power.”481 In our triangular framework of regimes, this tendency of mafiafication means a movement downward from market-exploiting dictatorship toward patronal autocracy: power is gradually “grabbed out” from the formal networks of the party state and moved into informal networks, carrying the risk of eventually transforming the state party into a transmission-belt party. This is a direct threat to the state party, which itself, as Wedeman reminds, does not organize corruption from the top and does not want to degenerate into a criminal organization either (see Box 5.13). No wonder Chinese scholars claim that the party leadership regards the containment of corruption in China as a “fight to the death” for the CCP.482 Indeed, mafiafication poses a challenge to the self-sustaining equilibrium of market-exploiting dictatorship that must build up effective defensive mechanisms to counter this challenge.

While the threat of system-destroying corruption is partially made possible by the lack of party competition, this very same factor explains why the phenomenon can be contained (and why the economy as a whole may not become a relational economy). In post-communist countries where formally democratic institutions and multi-party systems were established, informal patronal networks could launch autonomous patron’s parties and enter the party competition freely, using the parties as interface to the sphere of political action. In market-exploiting dictatorships, however, those who form the patronal networks are members of the state party, thus the state can penalize an informal patronal network as a violation of party discipline.483 In other words, the competition of patron’s parties would mean that there are multiple power centers in the state which are all interested in sustaining informal politics. In such an environment, a less-than-fully active, politically proportionate law enforcement

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would develop [→ 4.3.5.1] and no full strike against informal patronal networks could start until someone gets the monopoly of political power [→ 4.4.2]. But in a market-exploiting dictatorship the top-level nomenklatura already has the monopoly of political power and thus nation-level law enforcement is active.484

In China, crack down on relational markets and the mafification of the state takes the form of fierce anti-corruption campaigns. Such campaigns have been part of the political life for decades and just like classical communist campaigns they focused on the low- and mid-level nomenklatura and lasted for a predefined duration. The quantitative as well as qualitative change in the campaign that general party secretary Xi Jinping launched in 2012, while many regard as a crackdown on political opponents (and not without reason),485 indeed marks a fight against the tendency of mafification. As Zhu writes in agreement with other scholars, “Xi intends to attack corruption within the party and state by the particular means of breaking down collective corrupt kingdoms established by high-ranking officials at the national level […]. Consequently, a prominent feature of this campaign is the heavy attack on high-profile corruption committed by ‘big tigers’, or senior officials at or above provincial and ministerial levels, along with an unrelenting crackdown on lower-level corrupt officials, or the flies.”486 Along with a previously unseen number of officials being arrested, the campaign also attempted to root out sub-sovereign mafia states by attacking their capacity to disable control mechanisms. As political scientist Melanie Manion points out in a paper, in China as part of Xi’s campaign “investigations of corruption would no longer require approval of the party committee at the same level, but instead are initiated from above, by approval of the immediately superior DIC [disciplinary inspection committee]. Authority to nominate and vet (for appointment to office) DIC heads and deputy heads is now vested in the immediately superior DICs and organization department.”487 This situation means that it is no longer the authorities of the sub-sovereign state are asked to supervise themselves, but the higher-level nomenklatura took this right in their own hands.


<table>
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<th>Formal rules</th>
<th>Widespread informal rules</th>
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<td>Formalized system of cadre recruitment</td>
<td>Party patronage networks and the sale of political positions</td>
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<td>Bureaucratic hierarchy and the establishment of</td>
<td>Domestic lobbies and clientele-based economic regulation</td>
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<tr>
<td>universal rules</td>
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<tr>
<td>State property rights</td>
<td>Informal privatization and uncontrolled draining of state assets</td>
</tr>
<tr>
<td>Equality before the law</td>
<td>Manipulation of the judicial system to benefit party officials</td>
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<tr>
<td>Fiscal system with binding allocations of revenue</td>
<td>Revenue retained by local governments and continual negotiations over the division of revenue</td>
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485 Jiang and Xu, “Popularity and Power.”
Finally, we need to stress that market-exploiting dictatorships situated in the post-communist region also feature several cultural factors that make fighting informal networks harder. In case of China, this factor is none other than guanxi, which people often regard as more important than written contracts or obligations to the state.\footnote{Wang, “Extra-Legal Protection in China.” Also, see our previous description of guanxi in Part 5.3.6.} Combined with more business-like Western forms of corruption—such as free-market corruption and cronyism which have also risen parallel to the expansion of the private sector—and post-communist forms of corruption—particularly top-down state capture, as explained above—we can say that the Chinese leading political elite is indeed faced with a trilateral pressure of informality.\footnote{Cf. Chang and Tang, “Improve the Ruling Party’s Mechanism of Combating Corruption.”} Heilmann also provides a list of the tensions between formal and informal rules in Chinese politics (Table 5.27) and points out that corruption and informal practices “have had an erosive effect on the official institutions of the party-state.”\footnote{Heilmann, “3.7. Informal Methods of Exercising Power,” 182.}

5.6.3. From Crony to Mafia: Types of Political Capitalism

One of the lessons of the previous part is that, while defining the three economies by the dominance of certain market types leads to clear-cut categories, their explanatory value weakens as a subordinate mechanism in the economy becomes more significant. We may refer back to our analogy with the natural sciences above, saying that the movement of a celestial body influences the movement of other bodies even if it is not directly connected to them. In this case, while a subordinate mechanism does not become dominant, it becomes significant enough to influence the workings of the dominant mechanism. Accordingly, it is worth making the following differentiation:

- a subordinate mechanism is marginal if it does not influence the workings of the dominant mechanism;
- a subordinate mechanism is significant if it influences the workings of the dominant mechanism.

One of the reasons that can make a subordinate mechanism significant if it is initiated top-down, or at least if a high number of governmental actors engage in exchanges related to a subordinate mechanism. Given the exceptional status of the state in every polity, the actions of the leading political elite shape the expectations and actions of private economic actors even if the mechanism that the leading political elite introduce does not become dominant and the main character of the economy (in terms of the dominance of a market type) does not change.

Following these insights, a set of concepts can be outlined for capitalist economies, starting from more corrupt market economies, where governmental actors engage in corrupt actions but it does not become a dominant mechanism, and ending with full-fledged
relational economies, where corruption of the leading political elite is system-constituting. As an umbrella term, we use the term political capitalism:

- **Political capitalism** is a capitalist economic system which is characterized by collusive corruption of governmental actors in significant enough a number to influence the workings of the economy’s dominant economic mechanism.

As we mentioned in the beginning of the chapter, the expression “political capitalism” is the title of Randall G. Holcombe’s book, which we cite often as a piece of relational economics. However, the case that Holcombe uses the concept for does not qualify as political capitalism in our terms: he analyzes liberal democracies and lobbying, which we understand as legal and formal cooperation instead of collusion and corruption that our definition entails. At best, as we understand lobbying as a distorting mechanism of regulated market coordination, its institutionalization might be interpreted as a relational degeneration of the market economy but not something that changes the fundamental character of the system.491

In turn, we define four ideal types of political capitalism by the four patterns of corruption that involve governmental actors: cronyism, bottom-up state capture, top-down state capture, and the criminal state (Table 5.28). The first type, accordingly, is crony capitalism:

- **Crony capitalism** is a type of political capitalism where the collusive corruption involving governmental actors is cronyism. In crony capitalism it is cronies who initiate the corrupt transaction, resulting in (1) occasional corrupt transactions without vassal chains, (2) a rent-seeking state with free competition for rents (free entry, free exit) and (3) market capture.

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<th>Table 5.28. Types of political capitalism.</th>
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<td>Dominant form of corruption</td>
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<td>Crony capitalism</td>
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<tr>
<td>Patronal capitalism</td>
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<td>Mafia capitalism</td>
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“Crony capitalism” has been a catchword in the literature on corruption, describing virtually any states where the leading political elite was corrupt and gave discretionary favors to their friends or family members.\(^{493}\) But as we have explained already when we defined cronyism, “crony” is a word that implies friendship, that is, voluntary horizontal relations instead of coercive patron-client ones. Both parties enter into the corrupt relation freely, and there is free exit from the relation as well. Furthermore, cronyism also entails that the relation between cronies is used for corrupt transactions only occasionally, on a case-by-case basis and not as part of a corrupt network of regular chains of (bribe or protection) monies.

The second type is oligarchic capitalism:\(^{494}\)

- **Oligarchic capitalism** is a type of political capitalism where the collusive corruption involving governmental actors is bottom-up state capture. In oligarchic capitalism, it is oligarchs who initiate the corrupt transaction, resulting in (1) regular corrupt transactions with local/segmental vassal chains, (2) a rent-seeking or kleptocratic state and (3) market and state capture.

“Oligarchic capitalism” has also been used frequently to describe post-communist countries such as Russia and Ukraine.\(^{495}\) However, the point we need to emphasize is that patronal autocracies are not oligarchic capitalist by definition. For in oligarchic capitalism, it is oligarchs who capture the state in a bottom-up fashion, whereas in a patronal autocracy it is the chief patron, a poligarch (the head of executive power) who patronalizes and patronalizes the spheres of political and economic action in a top-down fashion and runs the state as a criminal organization accordingly.

Third, we define patronal capitalism:

- **Patronal capitalism** is a type of political capitalism where the collusive corruption involving governmental actors is top-down state capture. In patronal capitalism it is poligarchs who initiate the corrupt transaction, resulting in (1) regular corrupt transactions with local/segmental vassal chains, (2) a kleptocratic or predatory state and (3) market and state capture.

To the best of our knowledge, “patronal capitalism” has not been used in the literature yet (the closest equivalent may be the concept of “clan capitalism,” as used by Leonid Kosals for Putin’s Russia).\(^{496}\) However, it needs to be stressed that not every patronal country is also a case of patronal capitalism. **Patronal capitalism can be best associated with patronal democracy:** what we can see in such a system is top-down state capture, which in turn remains a partial phenomenon of either geographically limited patronal rackets or informal

\(^{493}\) For a seminal work, see Kang, *Crony Capitalism*.

\(^{494}\) We omit from the definition of oligarchic capitalism the dimension of the corruption market because it is a continuum, with clear points only in cases of crony and mafia capitalism.

\(^{495}\) Menshikov, “The Anatomy of Russian Capitalism”; Bojcun, “Ukraine.”

\(^{496}\) Kosals, “Essay on Clan Capitalism in Russia.”
patronal networks that are limited to the authorities that formally belong to their patrons. The similarity they share with the system of patronal autocracies is that it indeed is informal patronal networks or adopted political families that capture certain parts of the state, disabling local control mechanisms and using the power at their disposal in kleptocratic ways—for the illegal rent-seeking of the clients—or in predatory ways—to appropriate economic units of local entrepreneurs or oligarchs (if they are able to do so without the help of nation-level institutions of supervisory intervention).

Finally, the fourth type of political capitalism in our toolkit is mafia capitalism:

- **Mafia capitalism** is a type of political capitalism where the collusive corruption involving governmental actors is the criminal state. In mafia capitalism, it is the adopted political family who initiates the corrupt transaction, resulting in (1) regular corrupt transactions with monopolized and centralized vassal chains, (2) a predatory state with rents being distributed from above (adoption/casting out) and (3) market, state and oligarch capture.

“Mafia capitalism” derives from the notion of the mafia state, and indeed this is the only system of political capitalism that is by definition a relational economy, featuring a *de facto* dominance of power&ownership as well as relational market-redistribution. Mafia capitalism is characterized by the intrinsic logic of the accumulation of power and wealth, which primarily determines the leading political elite’s actions and which realizes a combination of political power concentration and the growth of fortunes in the hands of the adopted political family by means of mafia culture elevated on the rank of central politics.

Mafia capitalism is the ideal typical form of (political) capitalism in a patronal autocracy, where the chief patron captures: (1) the state, meaning political patronalization and patrimonialization; (2) the market, meaning economic patronalization and patrimonialization of competitive markets; and (3) the oligarchs, meaning the patronal subjugation of formerly autonomous oligarchs in a single-pyramid network of obedience [→ 3.4.1.3].

In his own polity, the chief patron has unconstrained power, which entails maximum amplitude of arbitrariness in state intervention from his part and maximum amplitude of vulnerability from the part of his clients. Furthermore, with the bloodless means of public authority the chief patron can initiate predation against any company with a positive stalking value, hunting it down and integrating it into the ownership orbit of the adopted political family as booty.

To sum up, the utility of these concepts can be appreciated by considering what would be seen from these processes if we focused solely on the formal identity of the actors and the formal processes of economic and political action. Indeed, to an observer accustomed to liberal democracies and the neoclassical synthesis even mafia capitalism would seem like a market economy. A mainstream analyst would see the cooperation of major entrepreneurs—autonomous actors with a focus on economic gains—and politicians—autonomous actors with a focus on political gains; he would see the regular means of taxation and state regulation, albeit used in somewhat “non-conventional” ways; and he would surely presume that the state acts in pursuit of the societal interest—with possible deviations, not unlike in liberal democracies. However, as soon as we put on the glasses of relational economics and consider the variety of informal as well as formal relations...
between political and economic actors, a completely different landscape can be seen. Not politicians interacting with entrepreneurs, but poligarchs using front men, subjugating oligarchs and establishing relational markets with discretionary state intervention, all in pursuit of their own elite interest. In this analytical framework, the reality of post-communism can be revealed and features such as power&ownership and top-down corruption can be situated in their rightful place—as essential elements which define the system, and not as some exotic side effects in a fundamentally Western-type capitalism.