

# Politics of Revenue Extraction in Post-Communist States: Poland and Russia Compared

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*Since the late 1990s, a consensus has emerged among scholars of the post-communist transitions that an enfeebled state is not an asset but a liability to a transition economy. Moreover, it is now accepted that underdeveloped fiscal capacity is a leading cause of state weakness in Eastern Europe and the former Soviet Union. This article compares the alternative revenue extraction strategies developed by state leaders in post-communist Poland and Russia. It stresses political institutional constraints to explain why Poland opted for a social pact with labor over household incomes, while Russia developed a system of elite bargaining over corporate profits.*

Since the late 1990s, a consensus has emerged among scholars of the post-communist transitions that an enfeebled state is not an asset but a liability to a transition economy. Moreover, it is now accepted that underdeveloped fiscal capacity is a contributing, if not leading, cause of state weakness in Eastern Europe and the former Soviet Union. Revenue extraction offers an insightful glimpse into the process of post-communist state building. This article compares revenue extraction in the post-communist Polish and Russian states. It seeks to explain why Polish and Russian state leaders opted for alternative strategies of revenue extraction. While Poland worked out a social pact with labor over household incomes, Russia developed a system of elite bargaining over corporate profits.

To account for this variation, the article introduces a political institutional explanation, emphasizing the structural constraints inherited from the old regime and the political constraints inherited from the old regime's breakdown. Post-

communist states emerge amid the makings of fiscal crisis. In finding a way out, state leaders must locate and gain access to reliable sources of revenue in the transition economy. But this is no easy task given the institutional inheritance of communism's command economy. A narrow revenue base and weak fiscal administrative capacity present serious obstacles to revenue extraction in a transition economy. Moreover, targeted societal actors may thwart the state's new revenue claims by mobilizing the power resources, which became available to them when the old regime fell. As a solution, post-communist state leaders strike bargains with those from whom revenues are claimed. These revenue bargains, in turn, help to shape the subsequent course of the transitions.

This article illustrates the crisis-like conditions that confront post-communist state leaders. In addition, it stresses the recombinant nature of post-communist state building as new policies interact with old practices to create hybrid institutional outcomes. Finally, it briefly suggests the way in which revenue bargains redefine state-society relationships. The article is organized into six sections: (1) a literature review on post-communist states and transition economies, (2) a discussion of the determinants of post-communist revenue strategies, (3) an overview of the Polish case, (4) an overview of the Russian case, (5) a comparison of the fiscal capacities of the Polish and Russian states, and (6) a brief summary of the theoretical implications of the empirical findings.

#### I. POST-COMMUNIST STATES AND TRANSITION ECONOMIES: ALTERNATIVE PERSPECTIVES

The debate over the roles of state and market in economic development is long lasting and wide ranging. The twentieth century has provided ample material to sustain the controversy—war economies, welfare societies, industrial latecomers, and liberated nations. To this list, add the post-communist transitions. Scholarship on the role of the state in the post-communist transitions has undergone a shift in the past ten years. Whereas market and state were at first viewed as mutually antagonistic entities, scholars have more recently recognized and sought to understand better their interconnectedness.

Socialism's command economy was an antimarket economic system. The state-directed command economy promised a more rational and egalitarian path to economic development than market capitalism. Efficiency and fairness aside, the command economy provided a bruisingly up-tempo, alternative means of industrialization for the agricultural-based economies of Eastern Europe and Asia. But the distinctive structural features of the command economy—insulating protective barriers, bureaucratically assigned values, soft budget constraints—had the effect of undermining the system's capacity to sustain long-term economic development. The command economy's inability to regenerate sufficient growth to sustain its bureaucratic phalanx, to maintain coercive capacity, and to

satisfy consumer demand ultimately led to its rejection, even in places where communist political regimes still ruled.

The early discussions on the post-communist transitions were dominated by the assumptions of neoliberal economics as espoused by a new cast of political actors who came with the international community's financial aid packages.<sup>1</sup> Intent on creating the appropriate structural setting for a market economy, the policy focus was on the implementation of macroeconomic reforms: stabilization, liberalization, and privatization. The command economy had failed, it was argued, because politics had subverted society's natural economic inclinations. Thus, the disentangling of the state from the economy to uncover the suppressed markets within became the priority task. "Many economic problems solve themselves," assured economist Jeffrey Sachs; "markets spring up as soon as central planning bureaucrats vacate the field."<sup>2</sup> Meanwhile, the issue of the state's role in the transition economy was accorded, at best, secondary consideration.<sup>3</sup>

The radical restructuring of post-communist economies was supposed to follow a U-curve along which a sudden downturn in production would occur as the old state sector wilted and that would soon be reversed as a new private sector blossomed.<sup>4</sup> But expectations for the spontaneous emergence of Western-like markets were dashed as East Central Europe only slowly improved and the former Soviet Union languished in depression. It was evident that unleashing individual incentive would prove to be a more complex task under post-communist conditions than had been originally foreseen. Economist Richard Ericson, once an advocate of the neoliberal approach, observed that "the economists' consensus insufficiently appreciates the built-in obstacles to system transformation in the Soviet legacy."<sup>5</sup>

Scholars identified two sets of "built-in obstacles" to the transition process: sociocultural legacy and the political-institutional setting. Those scholars emphasizing the sociocultural legacy argued that the disappointments and disparities of the transition resulted from the persistence of values, beliefs, and behaviors from the past that prevented market development in the present. They stressed such factors as the robustness of pre-communist commercial activity, levels of social capital and trust, ambiguity of attitudes toward private wealth, and pervasiveness of the economy of favors.<sup>6</sup> Those scholars emphasizing the political-institutional setting directed their attention to the post-communist state.<sup>7</sup> Since the mid-1990s, an increasing number of analysts have sought to explain how the state has contributed to post-communism's wayward development. Their efforts have yielded three alternative perspectives on the role of the state in a transition economy: the grabbing state, the captured state, and the incapable state.<sup>8</sup>

The first depiction projects an image of the state as a "grabbing hand," as opposed to the market's "invisible hand."<sup>9</sup> From this view, the state is strong and society is weak. The state possesses sufficient despotic power to make policy and set rules with minimal interference from societal actors. Moreover, it maintains

the infrastructural capabilities to implement policy and enforce the rules, at least when it so desires. Post-communism's protracted economic crisis is attributed to the state's resilient capacity for distortion and extortion through interventionist forays. The state has employed its coercive and rule-making powers to exact concessions from the business sector. In so doing, the state has undermined market development by creating perverse incentives to individual economic decision makers. To avoid the state's grabbing hand, transactions take cover in the shadows of the unofficial economy and investment capital searches out safe havens beyond the state's reach. By manipulating the redistribution of public sector assets, the state effectively deigned the victors and losers in the transition economy. The problem of the grabbing state is not that it is powerless; rather it is that it does not use its powers for the public good. It confiscates, coerces, and connives for its own advantage with little regard for its own rules.

The captured state sees political power as an instrument of economic forces.<sup>10</sup> The relationship between state and society is reversed from that in the grabbing state. The state is penetrated by particularist societal actors, who use its legal-administrative and coercive resources for their private benefit instead of the public good. The state, in effect, is captured by special interests. From this perspective, the state is weak and society is strong. The state possesses weak despotic powers since it lacks decision-making autonomy, although it is presumed to be sufficiently competent to employ its infrastructural powers. Accordingly, post-communism's economic reforms went awry when narrow cliques highjacked the transition for their own selfish ends. These cliques are epitomized by the "oligarchs" of the Russian transition, who managed to acquire the most valuable economic assets of the state sector through insider deals, imposed their interests on the policy-making process, and even occupied official positions in the government and legislature. Through their access to the state's despotic powers, these elite actors consolidated their newly acquired wealth and status by obstructing further market reform. Thus, the transition was derailed and recovery was delayed.

Finally, the incapable state redirects attention to the issues of implementation, enforcement, and compliance.<sup>11</sup> The incapable state cannot perform the most basic tasks associated with the modern state. Its claim as rule maker and arbiter of justice is disputed. Its claim to monopolize the means of violence is challenged. And its claim on society's resources and service is disregarded. From this view, state and society are both weak. But the weakness of the state is not a result of its capture by special interests. Instead, the source of weakness is a severe deficiency of infrastructural power, which prevents the state from realizing the claims it makes on society. As a result, the post-communist transitions have been hampered by the inability of the state to provide the institutional supports and legal safeguards for a functioning market economy. Economic transactions are badly regulated, contract enforcement is in doubt, financial investments are vulnerable, and property rights are unsecured. Criminal protection rackets and private police

forces have supplanted the state's coercive capacity. This situation is compounded by the state's chronic failure to gather sufficient revenues to restore its administrative and coercive capabilities.

These competing characterizations of the state in the post-communist transitions are not mutually exclusive. The state is not a single entity, nor is it Janus-faced. The state is a multifaceted institution whose representative human agents often act at cross-purposes. What is called the state for the sake of analytical convenience is a complex organization ridden with horizontal and vertical, external and internal, and formal and informal cleavages. Most analysts recognize that each of the above characterizations can be found in one place or another across the state's multiple spheres of activity and territorial levels of administration. Each conceptualization, however, highlights what is suspected to be the root political-institutional cause for post-communism's divergent transition outcomes. This article constructs a political institutionalist analysis that builds on the notion of the incapable state. It stresses the structural legacy of the old regime and the redistribution of power resources in the breakdown phase as the defining constraints on state capacity in the transition phase. Subsequently, post-communist state leaders devise political solutions to the dilemma of exploiting new sources for revenue extraction. These short-term revenue solutions, however, have a more lasting influence on the reconfiguration of state-society relations in the respective cases.

## II. CONSTRAINTS ON REVENUE EXTRACTION IN POST-COMMUNIST STATES

Since the early modern era, states have relied on three interconnected means of financing their activities: currency, credit, and revenue.<sup>12</sup> While currency and credit are certainly crucial components of state finance, this article focuses on revenue extraction as the foundation of fiscal capacity.<sup>13</sup> The capacity for revenue extraction directly affects currency and credit policies. The type of claims made on revenue as well as the nature of the means devised to realize those claims go a long way in determining the character and capabilities of a state. Moreover, revenue extraction is at the core of the state-society relationship. Social scientists and historians have long noted the symbiotic relationship between revenue extraction and state building. "The revenue of the state is the state," Edmund Burke succinctly surmised over two centuries ago.<sup>14</sup> "If finances have created and formed the modern state," economist Joseph Schumpeter noted, "so now the modern state forms them (finances) and enlarges them—deep into the flesh of the private economy."<sup>15</sup> Historian Gabriel Ardant asserted that "each increase in the power of states was linked to an increased possibility of levying taxes."<sup>16</sup> In short, revenue enhances state strength, and strong states claim more revenue.

For the post-communist states, the introduction of radical economic reform presents new untapped revenue sources and the demise of long familiar founts. State leaders have to learn quickly to adapt to the conditions of a transition econ-

omy. But the post-communist states are constrained in their ability to collect revenue by the structural legacy of the old regime's command economy. This structural inheritance includes, in particular, the revenue base and the tax administration. The command economy featured a narrow revenue base in which economic resources were concentrated into a small number of large, state-managed production units.<sup>17</sup> Poland began the transition with roughly seventy-eight hundred state enterprises providing over 80 percent of total tax revenues.<sup>18</sup> In Russia, the turnover and profits tax regularly accounted for more than two-thirds of all recorded state income.<sup>19</sup> Some important variation, however, existed with the Polish and Russian revenue bases. Poland's economy included a much wider distribution of semiprivatized small businesses and agricultural holdings, while Russia's economy included a much richer stock of valuable commodity exports, particularly metals, minerals, and energy resources.

Communist societies in the Soviet Union and Eastern Europe were among the most heavily taxed in the world. But the state did not have to locate, claim, and collect revenue from autonomous or dispersed economic actors. Instead, the production process of the command economy was structured in a way that gave the state direct access to society's economic resources. The tax administration focused its collection efforts on the large production complexes. The financial flows of state enterprises were transparent and closely monitored by the tax administration.<sup>20</sup> The bulk of tax revenue in the communist states came from a turnover tax and profits tax on state enterprises.<sup>21</sup> The communist states were able to extract revenue routinely, but their administrative-extractive capabilities were narrowly directed. Tax administration in the communist states never developed into a rational autonomous bureaucracy. Instead, tax administration was a subordinate department within the Ministry of Finance, and tax collection became just another form of interenterprise resource reallocation. In this system, revenue was not always automatically extracted; instead, tax administrators held discretionary powers to negotiate the state's claim with enterprise managers.<sup>22</sup>

The problem, as noted by economist Jozef van Brabant, is that "the state's tax administration is simply not set up to cope with taxation under a market environment; much less has it the capabilities to transform itself."<sup>23</sup> This structural weakness of the Polish and Russian post-communist states was exposed very early in the transition process. At the beginning of the 1990s, Russia and Poland embarked on programs of radical macroeconomic restructuring, including liberalization, stabilization, and privatization. In both cases, the implementation of these reforms contributed to a steep drop in revenue as hidden "fiscal traps" undermined state finances.<sup>24</sup>

The most common fiscal trap, the *Tanzi effect*, occurs early in the reform process as price liberalization sets off an inflationary spiral that consumes the revenue base.<sup>25</sup> It has been estimated for Poland that the *Tanzi effect* contributed to a drop in real fiscal revenue of as much as 25 percent during the first year of

reform.<sup>26</sup> Second, the implementation of monetary stabilization limits the resources available for subsidies and investments in the state sector. For state firms, reduced financial support is compounded by the severing of existing trade agreements and the elimination of previously protected markets. State firms tended to respond to this situation by scaling back production, which in turn caused a further reduction in the revenue base.<sup>27</sup> A third fiscal trap emerges from privatization reforms. As the private sector grows, it becomes more difficult for the state to collect taxes. This dilemma develops, in part, from tax policies that offer concessions to the nascent private sector to encourage growth and, in part, from the limited capacity of the tax administration to monitor transactions in the transition economy. The radical reform package is meant to induce firms to be more efficient and profitable. But the ensuing process of enterprise restructuring leads to a fourth fiscal trap, which occurs when firms pass on to the state social responsibility for excess labor and welfare benefits. Most post-communist states continue to exhibit high levels of public spending. Between 1989 and 1995, public spending in Russia declined moderately from just over 50 percent of gross domestic product (GDP) to 43 percent; in the same period, Poland saw its public spending actually increase from 47 to 50 percent of GDP.<sup>28</sup>

These structural and conjunctural factors combine at the outset of the transition to create the makings of a fiscal crisis for the new post-communist states. Given the limited fiscal-administrative capabilities inherited from the old regime, government leaders must resort to political solutions to avert fiscal crisis. These short-term political solutions, it is argued, become shaping influences on the course of transition. Poland and Russia make a good comparison of this process, since post-communist state leaders devised alternative strategies of revenue extraction. Whereas Poland placed the tax burden on the households of state enterprise workers, Russia sought revenue from large enterprises in the export commodity sector. By decade's end, preliminary evidence suggested that revenue extraction in Poland was increasingly based on a system of "quasi-voluntary" compliance, while Russia was heading in the direction of "bureaucratic-coercive" compliance. To explain why new governments in Poland and Russia opted for such divergent revenue extraction strategies, this article focuses attention on political constraints.<sup>29</sup>

In recent years, comparative theorists have sought to understand better how the structures of political power shape revenue extraction strategies. "Rulers maximize revenue to the state," stated Margaret Levi, "but not as they please. They maximize subject to constraints of their relative bargaining power vis-à-vis agents and constituents . . . [t]hese constraints determine the choice of revenue system."<sup>30</sup> In a comparison of three industrial democracies, Sven Steinmo argued that variations in tax benefits and burdens are best explained by "the structure of a polity's decision making institutions."<sup>31</sup> The early phase of the post-communist transitions, however, were marked by political-institutional conflict. The rules of the

game were simply not clear, even to the major players. Given the institutional fluidity of the early transition years, it is not surprising that scholars paid so little attention to the political determinants of revenue extraction. This article seeks to identify the way in which the reconfiguration of power resources that accompanied the process of regime breakdown created political constraints on post-communist state leaders in their attempt to devise new strategies of revenue extraction during the transition.

Communist states came close in their attempt to monopolize the power resources available in their societies. Communist regime breakdown is marked by the redistribution of power resources both within the state and between state and society. In some cases of regime breakdown, society was able to mobilize the power resource of collective action in contests against the state, successfully breaking the state's resource monopoly. In other cases, power resources were traded within the state and between state and society as part of a negotiated settlement. In still other cases, power resources were simply seized by renegade state actors or society-based movements. The process of consolidating and legitimating this redistribution of resources in new institutional forms is conflictual, changeable, and protracted.

In Poland, power resources were reallocated to formal representative institutions; however, in Russia, power resources were reallocated on the basis of informal elite arrangements. More specifically, Poland's breakdown and transition led to the rise of politicized trade unions, while Russia saw the emergence of parties of power cobbled together from political and economic elites. These alternative political institutional constraints affected the process by which the post-communist states sought to develop the capacity for revenue extraction. What potential revenue sources are available in the transition economy? Who stands between the state and these revenue sources? And what power resources can these actors mobilize to prevent the state from taking revenue? The answers to these questions reveal the political determinants that shape the strategies of revenue extraction in the post-communist Polish and Russian states.

### III. POLITICS OF REVENUE EXTRACTION IN POLAND: PROTEST MOVEMENTS AND SOCIAL PACTS

Stalin once said that imposing the Soviet command economy on Poland would be like fitting a saddle to a cow. He did anyway, and proved himself right. The collapse of communism began in Poland, where economic crisis and protest politics at last compelled the communist party to relinquish its monopolistic claim to rule. As a fiscal crisis began to unfold in post-communist Poland, the new state sought to enhance its extraction capabilities by breaking out of the inherited constraint of a narrow revenue base. To do so, the state needed to shift a share of the tax burden from industrial enterprises to worker households. Workers, in turn, tried to fend off this new revenue claim by mobilizing the power resource of collective action.

The revenue extraction system that eventually took shape in post-communist Poland was based, in part, on a social pact between state and labor. This section presents an overview of the redistribution of power resources during the breakdown phase, the making of a new revenue strategy in the face of fiscal crisis, and the state-labor bargain underlying this strategy for revenue extraction.

*Path of Regime Breakdown: Failed  
Reform and Protest Politics*

The breakdown of the communist regime in Poland offers a textbook case of a failed attempt at limited democratization from above. The events of the breakdown marked the culmination of a long-term, incremental process by which protest politics from below eroded the power resources of the communist regime. Across four decades, various social movements challenged the ruling party's monopolistic claim on policy making through collective protest actions. The regime responded to these challenges with a mix of coercion and concession. Demonstrators risked truncheons and bullets, while strike leaders were denied work and thrown in jail. But the regime tempered its punishments with policy concessions. This cycle of protest, punishment, and concession chronicled the major episodes of Communist Poland: the Poznan strikes of 1956, the student demonstrations of 1968, the shootings of scores of shipyard workers in Gdynia and Gdansk in 1970, the strikes in the central industrial regions of 1976, and the formidable challenge of the Solidarity movement in 1980-81. By the early 1980s, the regime could only contain the spread of movement politics by imposing martial law. But even this extreme display of coercion did not effectively remove the threat of protest politics. Thus, when strikes occurred again in 1988 in response to yet another ill-fated attempt to implement unpopular economic reforms, party leaders sought to break the cycle of protest, punishment, and concession.<sup>32</sup>

The breakdown of Poland's communist regime began in the spring of 1989, when Wojciech Jaruzelski, head of the Polish United Workers' Party (PZPR), opted for a negotiated settlement to the decade-long political stalemate with the Solidarity workers' movement. At that time, the regime offered formal recognition and a voice in the policy process to the outlawed trade union in exchange for political peace necessary to implement austerity reforms. Instead, the sequence of events that followed the signing of this accord made Poland among the most spectacular cases of failed democratization from above. The negotiated arrangement, by which the PZPR would remain in power, fell apart in practice. The party was badly shown up in parliamentary elections in June 1989 and President Jaruzelski was forced to accept a Solidarity-led government. Soon after, communist regimes were swept from power in dizzying succession across East Central Europe, spoiling once and for all the prospects for a communist-run power sharing scheme. In 1990, the PZPR dissolved into bickering factions, Jaruzelski resigned as presi-

dent, and the party's assets were seized by parliament. Poland's communist regime was vanquished.<sup>33</sup>

Poland entered the transition phase with a set of institutional arrangements designed to sustain a political party that no longer existed. This situation of political uncertainty coincided with the introduction of radical economic reform by the recently installed Solidarity-led government. New political conflicts and realignments followed. The loose alliance between workers and intelligentsia unraveled into rival political groupings. In December 1990, Walesa won the presidency running against the economic policies of his erstwhile ally, Prime Minister Mazowiecki. The first post-communist elections to the Sejm, in October 1991, produced political fragmentation and paralysis. For the next eighteen months, the institutional division of power remained unsettled as president, prime minister, and parliament vied for influence over policy making. Some order was finally restored to the process with the "Little Constitution," which curtailed the powers of the president and reformed the electoral system in 1992.

Despite the institutional flux of the early transition, policy makers were still subjected to political constraints shaped during the old regime. Protest politics did not disappear with the passing of the communist regime. On the contrary, given the unfamiliarity and incoherence of new institutions, collective protest provided society a familiar and tested strategy to engage in politics. The old regime's legacy of protest politics provided the "repertoires of contention and frameworks for collective action," which were employed in response to the adverse social effects of the new regime's policies of radical economic restructuring.<sup>34</sup> Industrial workers, farmers, and public employees resorted to various protest actions, ranging from work stoppages to street demonstrations to hunger strikes to force their opinions into the policy-making process. Unlike their predecessors, the new regime's leaders did not resort to coercion and selective punishments in response to protest actions. But like their predecessors, they engaged protesters in discussion and policy compromises. In this way, the new regime's leaders, many of whom had only recently been on the same side as the protesters, accepted protest politics as a legitimate form of interest representation. Collective action, thus, emerged as a political constraint on state actors in Poland's post-communist transition.

*Politics of Revenue Extraction: From  
Fiscal Crisis to Social Pacts*

In 1989-90, the Solidarity-led Mazowiecki government managed to accomplish what had long been unattainable to its communist predecessors—introducing economic reform without provoking immediate public protest. According to Leszek Balcerowicz, the withdrawal of the old regime while the opposition movement was still united created a situation of "extraordinary politics," providing a unique opportunity for the government to enact its package of radical economic reforms. But this situation, common to the post-communist transitions generally,

was temporary and would soon give way to a return to “normal politics.”<sup>35</sup> Polish society’s goodwill, indeed, did not last long as inflation soared, production plunged, and consumption dropped well beyond initial expectations. The new government was soon confronted by the threat of fiscal crisis.<sup>36</sup> The share of overall government tax revenue as a percentage of GDP dropped from 28 percent in 1990 to 23 percent in 1991. The central state’s finances deteriorated as the budget deficit reached 6 percent of GDP in 1992.<sup>37</sup>

The task of building fiscal capacity fell to Balcerowicz, the new finance minister. Appointed in October 1989, Balcerowicz took immediate steps to reduce the budget deficit. Taking advantage of the situation of “extraordinary politics,” he enacted a package of austerity measures. Budget expenses were slashed and investment projects were suspended for fifteen months. The zloty was devalued. Most important, the government succeeded in securing debt relief from Western creditors, who wanted to make a politically motivated goodwill gesture to the new regime.<sup>38</sup> Existing revenue sources already had proved insufficient to meet budgetary expenses and service the debt. Finding a way out of the crisis required new revenue claims on society.

The new state was confronted with the challenge of locating, claiming, and extracting new revenue sources. Where in society were economic resources to be found, and how could the state gain access to them? Poland’s existing revenue base did not offer a readily accessible and sufficiently lucrative revenue source that could be easily exploited. State-owned industrial enterprises were an encumbrance on state finances. The state needed to break out of the structural constraint of a narrow revenue base. In response, a new tax system was designed that featured a new personal income tax.<sup>39</sup> The new tax system was crafted to facilitate the transition away from state ownership to private entrepreneurship. New small businesses were initially exempt from corporate income taxes. As a consequence, the state shifted the greatest burden onto the households of workers in the state-subsidized public sector.<sup>40</sup> The new income tax was introduced at the same time that wage indexing was eliminated.<sup>41</sup>

To ensure that state expenditures did not accelerate, the government imposed a special tax on wage increases, the *popiwek*, on public sector workers (see Table 1).<sup>42</sup> The *popiwek* was an excess wage tax first introduced by the communist government to regulate the annual wage norms set for state enterprises. If an enterprise exceeded the norm, it was charged with the excessive wage tax penalty. While the *popiwek* was designed as a punitive measure to preempt an inflationary wage-price spiral, it became an important source of revenue for the cash-strapped government in the early 1990s.<sup>43</sup> The *popiwek* quickly emerged as a mobilizing issue in societal resistance to the state’s attempt to extend its revenue claims on worker households.

The government’s reinstatement of an excess wage tax quickly stirred resentment among workers in the public sector. But given the institutional flux of the

Table 1  
*Excess Wage Tax (popiwek)*

	1991	1992	1993	1994	1995
Excess wage tax as % of consolidated budget revenue collected <sup>a</sup>	7.8	3.3	1.3	0.5	0.1
Marginal excess wage tax rate (%) <sup>b</sup>	500	400	300		
Excess wage tax arrears as % of GDP	1.5	0.9	1.1		

*Sources: Poland: International Economic Report: 1996/1997* (Warsaw, Poland: World Economy Research Institute, 1997), 180; *OECD Economic Survey: Poland* (Paris: Organization for Economic Cooperation and Development, 1994), 63, 64; Stanislaw Owskiak, *Finanse publiczne: teoria i praktyka* (Warsaw, Poland: Wydawnictwo naukowe PWN, 2000), 451, table 56; Mark Schaffer, "Government Subsidies to Enterprises in Central and Eastern Europe and Tax Arrears," in *Tax and Benefit Reform in Central and Eastern Europe*, edited by David Newbury (London: Centre for Economic Policy Research, 1995), 128.

a. As of 1994, more than six thousand public sector firms were still being charged excess wage taxes by the government. The number of exemptions steadily increased, especially for firms in the exporting sector.

b. The penalty is based on violations by state firms of annually established wage norms. The wage norm was initially set according to a coefficient formula related to the consumer price index. In 1992, the task of setting wage norms was given to the Council of Ministers, which takes into account a wider range of indicators.

early transition, no formal political mechanism existed by which workers could voice their demands regarding tax policy. Consequently, public sector workers resorted to the familiar tactic of protest politics. The power resource by which Polish workers had effectively contested economic policy of successive communist governments was now deployed against their Solidarity-led successor.

In May 1990, protest politics returned to Poland in dramatic fashion when eleven railroad workers from Slupsk staged a hunger strike to publicize their demands for wage increases and the elimination of the popiwek. The hunger strike ended only after the intervention of Lech Walesa, who at this time did not hold formal political post. In November 1990, sixty-six out of seventy coal mines went out on strike to protest the government wage policies. Also that month, workers at the Gdansk port began a strike in opposition to the popiwek. In December, the head committee of Solidarity issued a public plea to the government to stop penalizing wage increases through taxation. And the postal workers joined the ranks of public employees demanding an end to the popiwek. Meanwhile, noncompliance with the excess wage tax grew. Throughout 1991, enterprises increased wages in disregard of the popiwek. By the end of the year, the Ministry of Finance was owed over 31 trillion zloty in unpaid popiwek fees from delinquent firms.<sup>44</sup>

The popiwek was an issue in the Poland's first post-communist presidential campaign. In December 1990, Lech Walesa defeated Prime Minister Mazowiecki after campaigning against the high social costs of radical economic reform. Following his poor showing in the run-off election, Mazowiecki announced his impending resignation as prime minister. Balcerowicz, the chief architect of the

government's fiscal policy, retained his portfolio as finance minister. But the election results and the swelling public protest increased the likelihood of policy concessions. Following a meeting with Walesa in early February, Balcerowicz announced that the popiwek would be gradually phased out of existence. While the government showed flexibility in its application of the popiwek in 1991, no effort was made to eliminate what had now become a valuable revenue source.<sup>45</sup>

In parliamentary elections in the autumn of 1991, Poland's former communists, reconstituted as left-of-center social democrats, won control of the Sejm and the government. Despite fears of economic revanchism, the new government did not break fundamentally with existing economic policy. The popiwek remained in place but became subject to increasing negotiation and lax enforcement. The maximum penalty rate for violation of the government's established wage norms decreased from 500 percent in 1991, to 400 percent in 1992, to 300 percent in 1993.<sup>46</sup> Beginning in March 1993, state enterprises that expected to make profits and were not in arrears were allowed to negotiate exemptions in the popiwek with local tax departments. More than five hundred firms concluded such agreements by year's end.<sup>47</sup> Meanwhile, many state enterprises that incurred excess wage penalties simply refused to comply with the tax. Of the main sources of tax income to the Polish budget, the popiwek was by far the deepest in arrears, accounting for nearly half of all unpaid taxes from 1991 to 1993.<sup>48</sup>

The popiwek was initially designed as an instrument through which the government would use tax policy to enforce wage ceilings on public sector employees. In practice, it also provided a needed source of revenue at a time of looming fiscal crisis. But the popiwek provoked protests and noncompliance. Poland's post-communist state lacked the capacity to overcome this widespread societal resistance by administrative or coercive means. In effect, the costs of implementation had grown too high for the benefits it yielded. In response, state leaders struck a political bargain with public sector workers, forming a social pact over wages and taxes.

#### *Negotiating for Revenue: State-Labor Bargain*

Through a social pact, the post-communist state succeeded in making a new revenue claim on society. At the root of this pact lay the entangled interests of labor, concerned with living standards, and the state, concerned with revenue extraction. The personal income tax provided immediate relief to the state's badly strained public finances. The social pact provided the conditions of political peace, which enabled the state to gain access to this new revenue source despite its weak administrative-extractive capacities. In turn, public sector workers derived benefits from the social pact.

The attempt by the state to use the popiwek to control wage increases in the public sector proved a failure. In the first year of transition, protest politics by workers led to policy concessions by the government. Over the next two years, a

pattern evolved of ad hoc and decentralized negotiations concerning the tax obligations of state enterprises. Finally, in 1994, this pattern gave way to a more formal and centralized process of negotiation. Instead of imposing wage norms on public sector workers, a special Tripartite Commission, composed of the government, management, and the trade unions, was created to work out a wage policy for the year. In December 1994, the Tripartite Commission became a permanent mechanism by which the state and workers negotiated wage rates and schedules.<sup>49</sup>

As the *popiwek* was repeatedly compromised in 1992 and 1993, the state moved away from the use of punitive taxes on state enterprises and toward a personal income tax on workers. The personal income tax represented a new revenue claim on the households of workers by the post-communist state. The implementation of the new tax was facilitated by certain compromises entailed in this social pact. First, with the establishment of the Tripartite Commission, labor was accorded a formal means for participation in the wage policy process. Second, as part of the bargain, workers' wages would keep pace with inflation.<sup>50</sup> As the personal income tax went into effect, wages were raised to offset an immediate adverse impact on worker households. Finally, in March 1994, the *popiwek* was abandoned by the government. At the same time, the Ministry of Finance canceled the excess wage tax arrears of many state enterprises.<sup>51</sup> Meanwhile, the state's revenue take from personal income taxes more than doubled in one year without provoking further tax-inspired protest actions.<sup>52</sup>

#### IV. POLITICS OF REVENUE EXTRACTION IN RUSSIA: CADRE DEFECTION AND ELITE BARGAINING

Despite many similarities with the Polish transition, Russian state leaders were presented with crucial differences in the structural and political constraints on revenue extraction. Like Poland, Russia inherited a narrow revenue base from the old regime. Unlike Poland, the base contained revenue sources that were lucrative and easily located. The Russian economy possessed export commodities in minerals, metals, and energy resources, which had already been developed during the Soviet period. But the ability of the new state to claim and collect revenue from these sources was complicated by the redistribution of power resources that occurred during the fall of the old regime. The Soviet collapse had less to do with movement politics from below and more with defecting cadres from above. The redistribution of power resources in Russia was an elite affair. When a fiscal crisis loomed in the first year of transition, the Russian state opted for a strategy of revenue extraction, which reflected these structural opportunities and political constraints. The post-communist state devised a revenue extraction strategy of elite bargaining. This section provides an overview of the process of cadre defection during the breakdown phase, the making of a revenue extraction strategy in response to fiscal crisis, and the state-elite bargain that supported this revenue extraction strategy.

*Path to Regime Breakdown:  
Failed Reform and Cadre Defection*

In explaining the Bolshevik triumph in the 1917 revolution, Trotsky expounded that “power was lying in the streets.” This was hardly the case with the revolution that toppled communism three-quarters of a century later. The centralized formal structures of the Soviet state did not simply melt away when Mikhail Gorbachev signed over control to Boris El’tsin. Instead, the formal structures of the Soviet state underwent a process of fragmentation or parcelization. Mary McAuley called this the “dispersal of power.”<sup>53</sup>

The roots of this process can be traced back to Brezhnev’s tenure, during which the formal powers of the central state were gradually weakened by a “diffusion of power” along informal elite lines.<sup>54</sup> The Soviet elite at this time became more insular and particularist and, it seems, more corrupt.<sup>55</sup> Egor Ligachev described this process as it applied to regional administration:

The line at the time was clear: promote local cadres to the provincial offices. At first glance, this principle didn’t seem so bad. But if you think about it, you can see it was insidious; it created a situation where it was hard for new major figures to rise. Being trapped within the bounds of a small district, only rarely coming to the center, was psychologically limiting. It narrowed horizons.<sup>56</sup>

These were the constraints of power that Mikhail Gorbachev inherited when he came to office in 1985. Gorbachev sought to restructure the Soviet Union according to his vision of reform socialism. His limited democratization and market socialism reforms initiated from above, however, could not be contained from below. The fall of communist regimes in Eastern Europe in 1989 stirred movement politics in Soviet society and exposed cleavages within the state elite. In this revolutionary situation, some state cadres chose to remain loyal, others voiced criticism, and still others headed for the exit. Defecting cadres tried to take with them the power resources with which they had been entrusted in the old regime. In effect, they were “stealing the state.”<sup>57</sup> It is important to stress that these defecting cadres had access to a particular power resource under the old regime but not a proprietary claim on that resource. Thus, defecting cadres seized the opportunity to switch loyalty to El’tsin’s rival “Russian state,” in which they sought to legitimate their claim on the valued resources of the collapsing Soviet state.

In place of the unitary framework of the Soviet state, the post-communist Russian state in the 1990s resembled a mosaic of conflicting power and authority. Political-administrative, economic, and coercive resources were seized and redistributed by the former Soviet state elite. The redistribution of power resources along informal elite lines led to hybrid institutional forms. In post-communist Russia, the parcelization of the state emerged as a major political constraint on revenue extraction.

*Politics of Revenue Extraction:  
From Fiscal Crisis to Elite Bargaining*

In January 1992, the newly independent Russian Federation launched a program of radical economic restructuring led by acting Prime Minister Egor Gaidar and modeled after the Polish reforms. Unlike in Poland, new state leaders did not attempt to break out of the inherited structural constraints on revenue extraction. During the initial transition, the Gaidar government sought to utilize existing sources of income. In particular, the state intended to exploit revenue generating commodity exports. This approach required minimal cost, since the large Soviet-built firms in the export sectors were already penetrated by the tax administration. As an indication of this continuity, in 1989, the turnover tax and the profits tax accounted for 64 percent of total revenue; in 1993, after the first year of radical reform, the value added tax (VAT) (which replaced the turnover tax) and the still unreformed profits tax accounted for 60 percent of total revenue.<sup>58</sup>

As in Poland, the introduction of radical economic reform spurred rising inflation and contracting production, and within a year, the Russian state was on the verge of fiscal collapse. The crisis in Russia, however, was even more severe. The state's overall take in revenue collections in 1992 amounted to nearly 30 percent of GDP. But in 1993, its take dropped to 25 percent of GDP, which itself had shrunk by more than 20 percent.<sup>59</sup> Between 1992 and 1993, the central government's share of revenues declined by a third from 17 to 11 percent of GDP. Collecting revenue through the state's fragmented administrative apparatus proved far more difficult than had been anticipated. In 1993, Viktor Chernomyrdin replaced Egor Gaidar as prime minister with the announcement that economic policy would now entail "less shock and more therapy."

Chernomyrdin was the former head of the Soviet gas industry, which had recently been reorganized into a quasi-private monopoly, Gazprom. Under Chernomyrdin, the threat of fiscal collapse was averted by the use of a new strategy for revenue extraction—elite bargaining. Elite bargaining was a hybrid system of revenue extraction that combined the new conditions of the transition economy with practices familiar to the command economy. It rested on a complex web of informal elite ties stretching across political and economic spheres and from center to regions. Given the structural constraints imposed by a narrow but selectively rich revenue base and limited administrative-extractive capabilities, as well as the political constraints imposed by the process of cadre defection, elite bargaining became the principal means by which the new state gained access to revenue sources in the mid-1990s.

The fall of the Soviet political regime and the introduction of radical economic reform had led to the rise of three sets of elite actors in post-communist Russia—regional governors, corporate directors, and private financiers. These new elite actors stood in between the central state and the revenue sources it claimed in soci-

ety. To gain access to claimed revenues, the state required the cooperation of these actors, who in effect became intermediary agents in the collection process. The elite bargaining strategy entailed the utilization of informal negotiations instead of formal mechanisms to obtain revenue.

The rise of the regional governors was a direct consequence of the political conflict between El'tsin's Russia and Gorbachev's Soviet Union. A decisive turn in this conflict came in the battle over tax revenues. In late 1991, El'tsin exempted Russia's regional governments from turning over their collected tax receipts to the central budget, effectively starving the Soviet state of revenue and hastening its demise.<sup>60</sup> After the collapse, the territorial division of power in the new Russian state was formally restructured into a federation. But precisely where the line was drawn between center and regions, particularly concerning claims on tax revenues, was never clear.

During the first two years of the transition, the central state claimed the most lucrative revenue sources for itself and continued to direct regional budgetary matters from above. Under Boris Fedorov, the Ministry of Finance aggressively pursued regional governments to fulfill their tax obligations to the center. But given its weak administrative capacity, the central state was in fact dependent on the cooperation of the regional governments to collect revenue. In the early 1990s, several of the more prosperous national republics and regions challenged the center with tax revolts. They disputed the center's claim on revenue sources and withheld tax payments from the center. As a result of their strategic location in the extraction process, these regional governments were able to force the center to renegotiate the division of tax spoils.

The directors of the large corporations were the second set of revenue intermediaries. These corporate heads emerged as a new economic elite, presiding over newly privatized or quasi-private industrial enterprises. While many firms in the industrial sector languished during the transition, others, particularly energy and raw materials, quickly became profitable and even quite prosperous. These corporate entities were earmarked to be the principal sources of revenue to the new state.

The tax reforms introduced at the outset of the transition placed the heaviest burden on these corporations through the VAT, corporate income taxes, and export tariffs. This arrangement was intended to facilitate the state's effort to locate and collect revenues given its limited administrative capabilities. But it also made the state revenue-dependent on the corporations. By the mid-1990s, Russia's twenty most profitable corporations accounted for more than two-thirds of central state income.<sup>61</sup> A handful of firms in the energy sector provided one-quarter of tax revenues collected at all levels of government.<sup>62</sup> Regional governments were even more revenue-dependent on large corporations than the central government. For example, Iukos Oil alone accounted for 25 percent of budgetary income for Samara *Oblast'*.<sup>63</sup>

The third set of revenue intermediaries was the newly arrived financiers who headed Russia's largest commercial banks. Many of these new private banks had originated as the former financial departments of large state-run corporations and economic branch ministries. As a result, they had access to enterprise funds and corporate accounts, which provided a pool of operating capital. During the high inflation of the early 1990s, commercial banks reaped enormous profits by borrowing from low-interest deposits and providing high-interest loans. This process soon gave rise to a small clique of financiers who proved to be particularly adept at accumulating capital. These financiers then used those profits to acquire the prized industrial and media assets of the old command economy in privatization auctions, thereby solidifying their status as transitional Russia's new economic elite.

By the mid-1990s, the financiers had become an integral part of the state's strategy for building fiscal capacity. The financiers, however, did not constitute a new source of tax revenue. Rather, they became the state's main suppliers of credit. Throughout the 1990s, the government ran chronic budget deficits as public expenditures outpaced incoming revenues. For political and economic reasons, the government resisted the inflationary option of increasing the money supply and instead chose to sell off debt through short-term, high-interest bonds to finance the deficits. These financiers became the principal purchasers of the government's short-term debt issues.<sup>64</sup> Indeed, the rules of the debt auctions were written so that Russia's commercial banks would not have to compete directly against wealthier international financiers.<sup>65</sup>

#### *Negotiating for Revenue: State-Elite Bargain*

Using elite intermediaries, the new Russian state was assured of access to revenue at low political-administrative costs. In turn, each set of elites benefited by negotiating its own special claims on and access to revenue sources.

The center managed to defuse the challenge of the regional governors through closed-door informal negotiations. To begin, in December 1993, El'tsin issued a decree that granted the regions increased access to revenues collected on their territory and greater autonomy over their budgets.<sup>66</sup> In effect, the decree formally recognized the claims of regional governors to the central state's main revenue sources. Also at this time, the chief nemesis of the regional governors, Boris Fedorov, was removed as minister of finance. In early 1994, Tatarstan, which had threatened to declare independence, established the precedent of a negotiated bilateral treaty. In this case, Tatarstan was allowed to withhold from the center an additional 25 percent of its VAT revenues, the principal source of the central state's income.<sup>67</sup> Meanwhile, Sverdlovsk *Oblast* unilaterally upgraded its political administrative status and claimed economic independence from the center in late 1993. The center negotiated a special treaty with Sverdlovsk, which reduced its total tax burden to the center by nearly 30 percent.<sup>68</sup> Eventually, more than half

of Russia's eighty-nine regions would strike their own individual deals with the center over revenue extraction as part of a central-regional bilateral agreement.

By design, the large corporations in the commodity export sector were meant to supply the bulk of tax revenues to the state. Under the Chernomyrdin government, however, Russia's corporate elite was given the opportunity to lobby for relief from this heavy burden. In exchange, these firms offered to supply valued goods and services to the public sector at little or no cost. As a result of such negotiations, favored firms and sectors received a variety of tax breaks, including special exemptions, rate reductions, payment deferrals, and barter offsets. By 1997, the Ministry of Finance estimated that negotiated privileges were costing the state nearly 30 billion dollars in revenue a year.<sup>69</sup> Meanwhile, the amount of uncollected taxes owed to the central state budget neared 10 billion dollars.<sup>70</sup>

Finally, through informal dealings, a select group of financiers emerged as the state's preferred private lenders. They orchestrated the "loans for shares" scheme by which they provided low-interest loans to the state in exchange for controlling interest in the most prized enterprises on the privatization block. The financiers also were used to supplement the limited fiscal administrative capabilities of the state. The new state lacked a unified and coherent network of bank accounts for collecting tax revenues and dispensing budgetary outlays. As a result, the state relied on the new private banks to administer a variety of budgetary funds. Thirteen banks were bestowed the status of "empowered agents" of the state budget, which in effect accorded them lucrative exclusive contracts to handle multi-million-dollar budgetary funds.<sup>71</sup> The government's most loyal financiers were rewarded with high-level political appointments.

#### V. REVENUE EXTRACTION AND FISCAL CAPACITY: POLAND AND RUSSIA COMPARED

Poland and Russia began their post-communist transitions under the threat of fiscal crisis. In both cases, crisis was averted. In the mid-1990s, Poland and Russia showed signs of economic recovery. To be certain, recovery in Poland began sooner and advanced much further than it did in Russia. But recovery was soon threatened by the contagion effects of the international financial crisis that ravaged East Asian economies in late 1997. Poland, for the second time in the decade, survived the threat of fiscal crisis and even managed to continue showing positive economic growth. In August 1998, the Russian state fell victim to the crisis and declared bankruptcy. This event set off an inflationary spiral and renewed political stalemate, thwarting recovery for more than a year.

This article contends that these variant transition outcomes were caused, at least in part, by the alternative revenue extraction strategies devised by post-communist state leaders in response to the first fiscal crisis.<sup>72</sup> These alternative strategies were shaped by variations in the structural and political constraints on state leaders. Poland's strategy was based on a social pact between state and labor. This

Table 2  
*Major Tax Reforms of the Transition Economy*

Year	Tax Reform	Note
Poland		
1988	Corporate income tax	Replaced profits tax.
1990	Excess wage tax ( <i>popiwek</i> )	Revived excess wage tax first introduced 1982, abolished 1989.
1991	Personal income tax	
1993	Value added tax	Replaced turnover tax.
Russia		
1992	Value added tax	Replaced and consolidated turnover tax and sales tax.
1930	Profits tax	Rates readjusted in 1992.
1993	Personal income tax	
1994	Energy excise tax	

Sources: Marek Danbrowski, "Macroeconomic Policy," *Russian and East European Finance and Trade* 33, no. 6 (November-December 1997): 7-12; D. G. Chernik, ed., *Nalogi* (Moscow: Finansy i statistiki, 1998), 49-53.

strategy enabled the state to break out of the structural constraints inherited from the old regime. More specifically, the Polish state was able to expand its revenue base by shifting a significant share of the tax burden from enterprises to households. In so doing, it gained access to a reliable revenue stream that enhanced fiscal capacity. In contrast, the Russian state adopted a revenue extraction strategy based on elite bargaining. This strategy could be deemed a short-term success in that it helped stave off the fiscal crisis of the early transition. In 1994, the central government reported an upturn of income to the central budget. The central state's budget deficit in 1994 was 10 percent of GDP, but this figure dropped to 4 percent in 1995. But as a long-term strategy, elite bargaining proved an ineffective means of strengthening fiscal capacity in the post-communist state. The inherent weaknesses of Russia's elite bargaining strategy were exposed during the financial crisis of 1998. The following statistical comparison provides a relative indication of the variation in fiscal capacity in the post-communist Polish and Russian states on the eve of the 1998 events.

To begin, Table 2 presents a comparison of the major tax reforms enacted in Poland and Russia. While the new tax systems looked similar, some unseen differences in application indicate the alternative revenue strategies. Poland, for example, introduced a wider array of tax exemptions for the newly emerging private sector and targeted the household incomes of public workers. Russia, meanwhile, exempted many public sector employees from paying the personal income tax and heaped the burden on new small businesses.<sup>73</sup>

The alternative revenue extraction strategies are evident in Table 3. Notable in the Polish statistics is an indication of the social pact struck with public sector workers. The decline in the *popiwek* as a source of budgetary income occurs concurrently with the rise of the personal income tax (PIT). Poland's success in shift-

Table 3  
*Main Tax Sources of Budgetary Revenue*

	1990	1991	1992	1993	1994	1995	1996	1997
Poland: % of total tax revenue collected								
Corporate income tax	21	28	18	14	13	9	11	11
Indirect taxes <sup>a</sup>	43	23	32	39	43	43	47	45
Personal income tax	1	2	20	25	26	29	27	25
Excess wage tax <sup>b</sup>	19	24	8	3	1	—	—	—
Russia: % of total tax revenue collected for consolidated budget								
Corporate profits tax			28	36	31	30	20	18
Indirect taxes <sup>c</sup>			40	28	28	30	40	41
Personal income tax			0.75	1	1	1	1	1
Energy excise tax <sup>d</sup>			—	—	—	7.5	16.5	12.5

Sources: *OECD Economic Survey: Poland* (Paris: Organization for Economic Cooperation and Development, 1994), 37; *Poland: International Economic Report: 1996/1997* (Warsaw, Poland: World Economy Research Institute, 1997), 103; *Poland: International Economic Report: 1997/1998* (Warsaw, Poland: World Economy Research Institute, 1998), 114; Stanislaw Owskiak, *Finanse publiczne: teoria i praktyka* (Warsaw, Poland: Wydawnictwo naukowe PWN, 2000), 451, table 56; David Newbury, "Tax and Benefit Reform in Central and Eastern Europe," in *Tax and Benefit Reform in Central and Eastern Europe*, edited by David Newbury (London: Centre for Economic Policy Research, 1995), 4; *Russian Federation: Recent Economic Developments* (IMF Staff Report no. 99/100) (Washington, DC: International Monetary Fund, 1999), 68; S. G. Sinel'nikov-Murylev and A. B. Zolotareva, *Rol' pravitel'stva i parlamenta v provodimoi biudzhethnoi politike v postsovetskoi Rossii* (Moscow: Institute for Economic Problems of Transition Economy, 1998).

a. Indirect tax includes the value added tax and excise taxes.

b. Excess wage tax and the capital tax (*dividenda*—a punitive tax on state firms).

c. Indirect taxes includes value added tax and non-energy excise taxes.

d. As percentage of total revenues to federal budget.

ing a share of the tax burden onto households is indicated by the sudden increase in revenues collected from PIT in 1992. Throughout the 1990s, PIT readily provided nearly a quarter of all revenues collected. As a result, the state was able to break its dependence on large corporations, as indicated by the decline in the corporate income tax (CIT) as a percentage of all revenues collected. In 1990, CIT accounted for 21 percent of all taxes collected, but by 1993, the figure had been reduced to 14 percent.

By contrast, the Russian state continued to rely on large enterprises for budgetary income. The elite bargaining revenue strategy is indicated by the figures for VAT, which was the state's principal source of revenue throughout the decade. In a figure reminiscent of the Soviet period, VAT and profits tax accounted for over two-thirds of all revenues collected by the central government in 1994. The dependence of the state on energy exports is especially indicated by the rise of energy excise tax revenues. The vulnerability of the elite bargaining revenue strategy is noted in the decline in profits revenues in the second half of the 1990s. Russia's figures for PIT are also noteworthy in that they suggest that households were not targeted as a source of income.

Since the revenue extractive strategies of Poland and Russia rested on bargains, the ultimate success of the strategy is indicated by levels of compliance. In this regard, Poland's strategy of a social pact would appear successful. In trying to shift the tax burden onto households, the state was at first confronted with workers' resistance through a revival of protest actions. By 1993, however, state-society conflict over revenue extraction had largely subsided and the state had successfully staved off the fiscal crisis. Notably, in 1992, the year that PIT first went into effect, the state received 10 million tax returns; in 1996, the number of returns reached 16 million. Russia did not receive 10 million income tax returns until 2000. Moreover, Polish compliance with PIT occurred without a strong coercive threat. The Polish state, instead, directed its coercive resources at corporations that were delinquent in paying their VAT obligations. The *popiwiek*, by contrast, was viewed as an illegitimate tax by public sector workers. In 1992, the *popiwiek* generated the largest amount of tax arrears owed to the state.

The Russian state was less successful in eliciting compliance from its elite bargaining revenue strategy. By using elite intermediaries, the state was assured access to at least a portion of total revenues claimed. But the state's dependence on these intermediaries came at the cost of having to share the revenues actually collected. Between 1996 and 1998, the flaws in the elite bargaining strategy were exposed as the central state's take from the collected revenue pool steadily declined in relation to that of its elite intermediaries. A sharp rise in tax arrears to the central government occurred after mid-decade. In Russia, the largest debtors to the federal budget were precisely the state's elite counterparts in the revenue bargain. The state's one hundred largest tax debtors accounted for 40 percent of all tax arrears to the central budget.<sup>74</sup>

A final indication of the relative success of each state's revenue extraction strategy is the endurance of the bargain. In 1998, the Polish state demonstrated sufficient fiscal capacity to withstand the contagion effects of the crisis of emerging markets. Since this time, the Polish state has continued to employ a social pact with labor. The Tripartite Commission has been relatively successful in containing state and society conflicts over wages and taxes.<sup>75</sup> Poland, in effect, had achieved quasi-voluntary compliance with the personal income tax on worker households.

In late 1997, the weakness of Russia's elite bargaining strategy was becoming more apparent as world commodity prices dropped and elite noncompliance increased. At this time, the state moved away from the elite bargaining strategy towards a bureaucratic-coercive strategy. Decrees were issued that made it more difficult for corporations to avoid taxes.<sup>76</sup> In January 1998, the federal government created a Temporary Emergency Committee on Tax and Budgetary Discipline to go after tax-delinquent corporations. In March, Prime Minister Chernomyrdin was dismissed and replaced by Sergei Kirienko. Under new leadership, the state moved forcibly to undo elite revenue bargains by challenging the large corpora-

tions and regional governors. The essence of the state's new bureaucratic-coercive strategy is aptly captured in the remarks of the new government's head of the tax administration, former finance minister Boris Fedorov: "The hands of the Tax Service will not for long remain empty. We'll arrest you, we'll take your property, we'll make bankrupt you. I will be like a tank."<sup>77</sup> But the new government's attempted show of force was not enough, and the Russian state was in fiscal collapse by the end of summer.

#### VI. CONCLUSIONS: REVENUE EXTRACTION, FISCAL CAPACITY, AND TRANSITION OUTCOMES

The post-communist transitions encompass over two dozen newly independent states across Eastern Europe and the former Soviet Union. These transitions present a valuable opportunity for comparative research in that so many of these cases began the transition with similar institutional forms, introduced similar policy reforms, and yet produced different transition outcomes. This article investigated the variant outcomes in efforts to build fiscal capacity in the post-communist Polish and Russian states. More specifically, the article sought to explain why state leaders in Poland and Russia devised alternative strategies of revenue extraction and to suggest how these choices influenced the course of economic transition.

The article developed a political explanation for the revenue extraction strategies of post-communist states. Since Russia's financial collapse in 1998, much criticism has been heard concerning the state's tax collection efforts. Less effort, however, has been expended toward explaining why the state devised the particular revenue extraction strategy that it did. This article stressed that revenue extraction was shaped by a configuration of structural and political conditions facing new state leaders. Revenue extraction options were limited by the institutional inheritance of a narrow revenue base and an incapable tax administration. As a result, state leaders were forced to strike political bargains to gain access to revenue sources in the transition economy.

The differences in the Polish and Russian revenue extraction strategies were attributed to the redistribution of power resources that occurred during the old regime's breakdown. Lacking lucrative and easily accessed revenue sources, the Polish state opted to make a new revenue claim on households. This claim was at first met with social resistance in the form of worker collective actions. The new government quelled this revival of protest politics through concession and compromise. The result was a revenue extraction strategy based on a social pact with labor. The Russian revenue base, by contrast, contained rich commodity exports to which the state had already established claim. But this claim was disputed by new elite actors who emerged during the breakdown of the old regime. Taking advantage of institutional fragmentation, they acted as intermediaries between state and society in the revenue extraction process. They found ways to withhold

revenue from the state center. The state resolved this conflict by sharing its claim on revenue with a select group of elite intermediaries. The result was a revenue extraction strategy based on elite bargaining.

In addition, the article's findings provide insight into the larger question of the role of the state in transition economies. Scholars of the post-communist transitions have increasingly come to recognize that state weakness adversely affects economic development. This article showed, more specifically, that variations in fiscal capacity have an influence on transition outcomes. The Polish strategy provided the state with a modest, but reliable, revenue stream. While budget deficits were still the norm in the second half of the 1990s, the state did not become dependent on short-term credit or resort to currency devaluation. By contrast, the Russian strategy exploited lucrative, but less reliable, revenue sources. The state's revenue take was dependent on the stability of world commodity prices and the cooperation of elite intermediaries. In the second half of the 1990s, the risks of this approach became clear when the Russian state experienced a severe revenue decline. Growing budget deficits were increasingly financed through short-term credit. The alternative revenue extraction strategies devised by Polish and Russian state leaders were put to the test in the financial crisis of emerging markets in the late 1990s. Poland survived the threat and continued to show signs of recovery. But the Russian state, low on income and deep in debt, declared itself bankrupt and devalued its currency. As the 1990s came to an end, the Polish state's social pact revenue strategy was sustained by society's quasi-voluntary compliance. The Russian state, by contrast, sought to abandon the elite bargaining revenue strategy in favor of a bureaucratic-coercive strategy.

#### NOTES

1. Poland's Leszek Balcerowicz, for example, received an MBA from St. John's University in New York City. Russia's Egor Gaidar graduated from Moscow State University but points out that he was most influenced professionally by Adam Smith. Egor Gaidar, *Dni porazhenii i pobed* (Moscow: Vagrus, 1996), 23-27.

2. Jeffrey Sachs, *Poland's Jump to the Market Economy* (Cambridge, MA: MIT Press, 1993), xiii.

3. For example, Anders Aslund and Richard Layard, eds., *Changing the Economic System in Russia* (New York: St. Martin's, 1993). This collection of articles evaluated the first year of reform and deliberated on the next stage in the process. In over two hundred pages of analysis and advice, the role of the state consumed all of three pages. Similarly, in an early assessment of the Polish reforms, Jeffrey Sachs identified "five pillars of an economic transition to a market economy," including stabilization, liberalization, privatization, social safety net, and Western economic aid. His analysis did not entail a role for the state, although he cautioned that politics, in the form of "demagogues ready to seek political power by playing on the public's fears," posed the "hardest part of the transformation." Sachs, *Poland's Jump to the Market*, 3, 79.

4. Oliver Blanchard, *The Economics of Post-Communist Transition* (Oxford: Clarendon, 1997), 1-3.

5. Richard Ericson, "Economics and the Russian Transition," *Slavic Review* 57, no. 3 (fall 1998): 611.

6. See, for example, Joseph Blasi, Maya Kroumova, and Douglas Kruse, *Kremlin Capitalism* (Ithaca, NY: Cornell University Press, 1997), chap. 5; Nicolai Petro, "Creating Social Capital in Russia: The Novgorod Model," in *Shaping the Economic Space in Russia*, edited by Stefanie Harter and Gerald Easter (Aldershot, UK: Ashgate, 2000), 249-70; and Alena Ledeneva, *Russia's Economy of Favors* (New York: Cambridge University Press, 1998).

7. One of the first systematic critiques of the transition from a "statist" perspective is found in Alice Amsden, Jaeck Kochanowicz, and Lance Taylor, *The Market Meets Its Match* (Cambridge, MA: Harvard University Press, 1994). Influenced by the East Asian model of the developmental state, they argued that neoliberal shock therapy policies had retarded the economic transition by undermining the role of the state. For a critique of sociocultural explanations also from a "statist" perspective, see Stephen Homes, "Cultural Legacies or State Collapse," in *Postcommunism: Four Perspectives*, edited by Michael Mandelbaum (New York: Council on Foreign Relations, 1996). More recently, see the collection of essays in Valerie Sperling, ed., *Building the Russian State: Institutional Crisis and the Quest for Democratic Governance* (Boulder, CO: Westview, 2000).

8. To provide a basis for comparison, this article employs concepts common in comparative theory on the state. The concepts of state "despotic" power, meaning policy making, and state "infrastructural" power, meaning policy implementation, are borrowed from Michael Mann, "The Autonomous Power of the State," in *States in History*, edited by John Hall (Oxford: Basil Blackwell, 1986). The imprecise concepts of "strong" and "weak" are used as a basic indicator for comparing states and evaluating state-society relations. A strong state is likely to possess institutional coherence, professional expertise, administrative competence, and decision-making autonomy. It is capable of making policy and implementing policy without interference from nonstate actors. A strong society is likely to exhibit the capacity for self-organization and collective action. In a strong society, the state does not monopolize access to economic, ideological, and status resources. For further discussion of these concepts, see Joel Migdal, *Strong Societies and Weak States* (Princeton, NJ: Princeton University Press, 1988); Joel Migdal, Atul Kohli, and Vivienne Shue, eds., *State Power and Social Forces* (New York: Cambridge University Press, 1994); and Peter Evans, *Embedded Autonomy* (Princeton, NJ: Princeton University Press, 1995). In evaluating state capacity, comparative theory tends to employ a "functionalist" approach in that the focus is on the "ends" of state policy. For a critique of this approach, which draws attention to the "means" of state policy, see Robert Jackman, *Power without Force* (Ann Arbor: University of Michigan Press, 1993).

9. See Timothy Frye and Andrei Schleifer, "The Invisible Hand and the Grabbing Hand," *American Economic Review: Proceedings and Papers* 87 (1997): 354-58. The grabbing state, or the "predatory" state, represents a variant of a "realist" approach, much like the notions of the state as a stationary bandit or a protection racket. In the post-communist context, the grabbing state might also be viewed as a kind of developmental state gone bad.

10. The captured state is akin to a Marxist approach in that the state is an instrument of powerful economic interests, although it need not assume a social class basis. The notion of a captured state underlies the "winners take all" explanations of post-communism's transition outcomes. See Venelin Ganey, "The Dorian Gray Effect: Winners as State Breakers in Postcommunism," *Communist and Post-Communist Studies* 34 (2001): 1-25; and Joel Hellman, "Winners Take All," *World Politics* 50, no. 2 (1998): 203-34.

11. The incapable state is described in Cynthia Roberts and Thomas Sherlock, "Bringing the Russian State Back In: Explanations of the Derailed Transition to Market Democracy," *Comparative Politics* 31, no. 4 (July 1999): 477-98.

12. Some examples of recent work on the development of fiscal capacity in early modern states include James Collins, *Fiscal Limits of Absolutism: Direct Taxation in Early Seventeenth Century France* (Berkeley: University of California Press, 1988); John Brewer, *The Sinews of Power: War, Money and the English State, 1688-1783* (Cambridge, MA: Harvard University Press, 1988); and Thomas Ertman, *Birth of the Leviathan: Building States and Regimes in Medieval and Early Modern Europe* (New York: Cambridge University Press, 1997).

13. The means of revenue extraction have evolved along with the modern state from plunder and tribute to rents and tariffs to today's sophisticated and penetrating tax systems. See Daniel Tarschys, "Tributes, Tariffs, Taxes and Trade: Changing Sources of Government Revenue," *British Journal of Political Science* 18 (1988): 7-20; and Carolyn Webber and Aaron Wildavsky, *A History of Taxation and Expenditure in the Western World* (New York: Simon & Schuster, 1986).

14. Quoted in Margaret Levi, *Of Rule and Revenue* (Berkeley: University of California Press, 1988), vi.

15. Joseph Schumpeter, "The Crisis of the Tax State," as quoted in W. Elliot Brownlee, *Federal Taxation in America: A Short History* (New York: Cambridge University Press, 1996), 169.

16. Gabriel Ardant, "Financial Policy and Economic Infrastructure of Modern States and Nations," in *The Formation of National States in Western Europe*, edited by Charles Tilly (Princeton, NJ: Princeton University Press, 1975), 174.

17. The system was epitomized by the collectivization of peasant small-holdings into state-managed collective farms. In the 1920s and 1930s, agricultural products constituted the main form of economic resources available to the state.

18. The 80 percent figure is based on turnover tax, profits tax, and social insurance tax returns for 1988. Peter Mieszkowski, Izabela Bolkowiak, Donald Lubick, and Hanna Sochacka-Krysiak, "Tax Reform," in *Stabilization and Structural Adjustment in Poland*, edited by Henryk Keirkowski, Marek Okolski, and Stanislaw Wellisz (London: Routledge, 1993), 93-95.

19. Raymond Hutchings, *The Soviet Budget* (Albany: State University of New York Press, 1983), apps. I, II.

20. David Newbury, "Tax and Benefit Reform in Central and Eastern Europe," in *Tax and Benefit Reform in Central and Eastern Europe*, edited by David Newbury (London: Centre for Economic Policy Research, 1995), 2; and Csaba Laszlo, "Twists and Turns: The History of Hungarian Public Finance," in *Public Finance Reform during the Transition: The Experience of Hungary*, edited by Lajos Bokros and Jean-Jacques Dethier (Washington, DC: World Bank, 1998), 129.

21. Janos Kornai, *The Socialist System: The Political Economy of Communism* (Princeton, NJ: Princeton University Press, 1992), 137, 138.

22. References to the process of bargaining over tax revenue are found for Hungary in Szabolc Vamosi-Nagy, Imre Kocsis, and Luis Alvaro Sanchez, "Tax-Policy Reforms in Hungary," in Bokros and Dethier, *Public Finance Reform during the Transition*, 481; and for the Soviet Union in Than Gustafson, *Capitalism Russian-style* (Cambridge, UK: Cambridge University Press, 2000), 195.

23. Jozef M. van Brabant, *The Political Economy of the Transition* (London: Routledge, 1998), 93.

24. The term “fiscal trap” is used by Janos Kornai, *Highways and Byways: Studies on Reform and Post-Communist Transition* (Cambridge, MA: MIT Press, 1995), chap. 5.
25. Vito Tanzi, “Inflation, Lags in Collection, and the Real Value of Tax Revenue,” *International Monetary Fund: Staff Papers* 24 (March 1977): 154-67.
26. Andrej Bratkowski, “Macroeconomic Performance,” *Russian and East European Finance and Trade* 33, no. 6 (November-December 1997): 19.
27. Kornai, *Highways and Byways*, 123; and Oliver Blanchard, Maxim Boycko, and Marek Dabrowski, *Post-Communist Reform: Pain and Progress* (Cambridge, MA: MIT Press, 1993), 117-19.
28. World Bank statistics reported in Luca Barbone and Rossana Polastri, “Hungary’s Public Finances in an International Context,” in *Public Finance Reform during the Transition: The Experience of Hungary*, edited by Lajos Bokros and Jean-Jacques Dethier (Washington, DC: World Bank, 1998), 158.
29. Other scholars have begun to look more carefully at the political constraints on revenue extraction. Notable in this regard are Andrei Schleifer and Daniel Treisman, *Without a Map* (Cambridge, MA: MIT Press, 2000); Hillary Appel, “Creating Fiscal Institutions in the Face of Domestic and International Constraints” (unpublished manuscript, 2001); and Lucan Way, “Informal Policymaking and Reform in Weak States: The Case of Post-Soviet Intergovernmental Fiscal Policy” (unpublished manuscript, 2001).
30. Levi, *Of Rule and Revenue*, 10.
31. Sven Steinmo, *Taxation and Democracy* (New Haven, CT: Yale University Press, 1993), 7. Also see the follow-up article, Sven Teinmo and Caroline Tolbert, “Do Institutions Really Matter? Taxation and Industrial Democracies,” *Comparative Political Studies* 31 (1998): 165-87. A recent cross-national study that emphasizes economic development as opposed to regime type to explain tax burdens is Jose Antonio Cheibub, “Political Regimes and the Extractive Capacity of Governments: Taxation in Democracies and Dictatorships,” *World Politics* 50, no. 3 (1998): 349-76.
32. For good political overviews of these events, see Joseph Rothschild, *Return to Diversity* (New York: Oxford University Press, 1989); Michael Bernhard, *The Origins of Democratization in Poland* (New York: Columbia University Press, 1993); and Grzegorz Ekiert, *The State against Society* (Princeton, NJ: Princeton University Press, 1996). For an economic overview, see Batara Simatupang, *The Polish Economic Crisis* (London: Routledge, 1994).
33. Raymond Taras, *Consolidating Democracy in Poland* (Boulder, CO: Westview, 1995), 123-60.
34. Grzegorz Ekiert, “Legacies of Struggle and Defeat,” in *Transition to Democracy in Poland*, 2d ed., edited by Richard Staar (New York: St. Martin’s, 1998), 40.
35. Leszek Balcerowicz, “The Interplay between Economic and Political Transition,” in *Lessons from the Economic Transition: Central and Eastern Europe in the 1990s*, edited by Salvatore Zecchini (Dordrecht, the Netherlands: Kluwar/Organization for Economic Development and Cooperation [OECD], 1997), 160.
36. Dariusz Rosati, *Polska Droga do Rynku* (Warsaw, Poland: Polskie Wydawnictwo Ekonomiczne, 1998), 135-39.
37. Andrej Bratkowski, “Macroeconomic Performance,” *Russian and East European Finance and Trade* 33, no. 6 (November-December 1997): 18-30.
38. Henryk Kierzkowski, Marek Okolski, and Stanislaw Wellisz, “The Polish Economy 1989-1991,” in Kierzkowski et al., *Stabilization and Structural Adjustment*, 29-33.
39. Andrzej Borodo, *Finanse publiczne: w swietle regulacji prawnych*, 3d ed. (Sopot, Poland: Wydawnictwo prawnicze, 2000), 94, 95.

40. The public sector included the essential social services of health, education, and transportation. It also included state-run industrial enterprises such as coal-mining and shipbuilding. Privatization of state-operated enterprises has moved more slowly in Poland than in other transition economies. In 1997, one-third of Poland's 16 million workforce was found in the public sector. *Poland: International Economic Report: 1997/1998* (Warsaw, Poland: World Economy Research Institute, 1998), 94.

41. *OECD Economic Survey: Poland* (Paris: OECD, 1992), 36.

42. For a general discussion of this form of tax in a transition economy, see Alan Tait and Nuri Erbas, "Excess Wage Tax," in *Fiscal Policy and Economic Reform*, edited by Mario Blejer and Teresa Ter-Minassian (London: Routledge, 1997), 181-222.

43. Stanislaw Owsiak, *Finanse publiczne: teoria i praktyka* (Warsaw, Poland: Wydawnictwo naukowe PWN, 2000), 451.

44. Slay, *Polish Economy*, 157, 158.

45. The government raised the ceiling at which penalties were incurred for excessive wages twice during 1991. *OECD Economic Survey: Poland* (Paris: OECD, 1992), 46. The Oleszewski government began to dismantle the *popiwiek* gradually in late 1991. Slay, *Polish Economy*, 115.

46. *OECD Economic Survey: Poland* (Paris: OECD, 1994), 63.

47. *Ibid.*, 64. This practice was strikingly similar to the manner by which enterprise managers and tax officials negotiated tax bills in the old command economy.

48. *Ibid.*, 68. This figure does not include delinquent social security payments.

49. *Ibid.*, 165.

50. In 1994, the wages of public sector workers were increased in January by 9 percent and in June by 13 percent. In 1995, wages rose in January by 10.5 percent, in July by 17 percent, and in October by 14.5 percent. In July 1996, public sector wages were boosted by 20 percent. *OECD Economic Survey: Poland* (Paris: OECD, 1997), 163-69.

51. *Ibid.*, 164.

52. Rosati, *Polska Droga do Rynku*, 157.

53. Mary McAuley, *Soviet Politics, 1917-1991* (New York: Oxford University Press, 1992), 107.

54. Gerald Easter, "Networks, Bureaucracies and the Russian State," in *Explaining Post-Soviet Patchworks*, vol. II, edited by Klaus Segbers (Aldershot, UK: Ashgate, 2001), 39-58.

55. For a good description of this process in industrial management, see Peter Rutland, *The Politics of Economic Stagnation* (New York: Cambridge University Press, 1993).

56. Yegor Ligachev, *Inside Gorbachev's Kremlin* (New York: Pantheon, 1993), 50.

57. For a rich description of this process, see Steven Solnick, *Stealing the State* (Cambridge, MA: Harvard University Press, 1998).

58. Pirooska Nagy, "The Fiscal Component of the First Russian Stabilization Effort, 1992-3," in Blejer and Ter-Minassian, *Fiscal Policy*, 235.

59. For the figures on state revenue in 1992 and 1993, see Lev Freinkman and Plamen Yossifov, *Decentralization in Regional Fiscal Systems in Russia: Trends and Links to Economic Performance* (Washington, DC: World Bank, 1998), 8. For the decline in gross domestic product (GDP) in 1992 and 1993, see *Russian Federation: Recent Economic Developments* (IMF Staff Country Report no. 99/100) (Washington, DC: International Monetary Fund, 1999), 37.

60. Nagy, "The Fiscal Component of the First Russian Stabilization Effort," 224, 225.

61. Interview with Aleksandr Pochinok, head of the State Tax Service, in *Ekspert*, 1 December 1997.

62. *Russian Economic Trends*, December 1997, fig. 5.

63. *Vlast'*, 26 May 1998, 41.

64. The state savings bank, Sberbank, held the largest amount of government-issued short-term debt, accounting for over one-third of the total debt in circulation in the spring of the 1996. Schleifer and Treisman, *Without a Map*, 63.

65. *Ibid.*, 64.

66. Presidential Decree (no. 2268, 1993). D. G. Chernik, A. P. Pochinok, and V. P. Morozov, *Osnovy nalogovoi sistemy* (Moscow: Iuniti, 1998), 197.

67. Lev Freinkman, Daniel Treisman, and Stepan Titov, *Subnational Budgeting in Russia* (World Bank Technical Paper no. 452) (Washington, DC: World Bank, 1999), 32.

68. "Dogovor mezhdru Rossiikoi Federatsei ii Sverdlovskoi oblast'iu" (Article 12). *Oblastnaia gazeta*, 24 January 1996 and 8 February 1996. Gerald M. Easter, "Redefining Centre-Regional Relations in the Russian Federation: Sverdlovsk Oblast' ", *Europe-Asia Studies* 49, no. 4 (June 1997): 617-36.

69. *Kommersant*, 20-21 February 1997. Remarks by Minister of Finance Aleksandr Livshits.

70. *Rossiiskaia gazeta*, 15 February 1997.

71. *Rossiiskaia gazeta*, 7 August 1998; *Delovoi kvartal*, 5 February 1998, 6.

72. It is notable that not all analysts would agree with the emphasis on revenue extraction to explain the events of 1998. It is also argued that Russia's financial problems in 1998 were caused by an overvalued currency. See, for example, the discussion in *Russian Economic Trends*, December 1997. In addition, the notion that Russia "fell victim" to financial crisis would not be accepted by analysts who are inclined towards either the "grabbing state" or the "captured state." Other analysts would stress Poland's success in gaining access to Western credit. Poland benefited greatly from debt rescheduling and write-offs early in the transition process, lessening the impact of the initial fiscal crisis.

73. "Tax Reform in Russia," *Russian Economic Trends*, August 2000.

74. *Russian Economic Trends*, December 1997.

75. The Tripartite Commission failed to reach a compromise on wage policy in August 1998. *OECD Economic Survey: Poland* (Paris: OECD, 1998), 145.

76. For example, a presidential decree banned the practice of canceling tax obligations through debt swapping. *Delovoi kvartal*, 19 February 1998, 30.

77. *Komsomol'skaia pravda*, 1 August 1998, 4; *The Economist*, 13 June 1998, 95.