

# The Role of (In)formal Governance and Culture in a National Competition System: A Case of a Post-Socialist Economy

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*Research increasingly suggests that the effectiveness of competition laws and policies could be enhanced if their implementation is linked with a better understanding of the cultural influences on competition-related decisions. Moreover, the lack of competition culture has been considered one of the main barriers to the enforcement of competition rules. But the studies examining this interplay of competition policy and national culture appear to be rather limited. Based on interviews with key actors of the Croatian competition system, this study examines the interaction of the competition system and the national culture through the governance perspective of a European (post)transitional society. Our findings indicate three key features that are unlikely to support the competition system development: first, collectivism and high power distance in the society; second, a strong influence of planned economy legacy; and third, a clash between the process of Europeanization and inherited collusion-friendly (in)formal governance mechanisms. Based on a unique set of empirical evidence, the contribution of this article lies in the analysis of the relations between modes of governance, national culture, and competition system development in a post-socialist society. This study is expected to have broader resonance for other post-transitional countries and for other developing countries with similar cultural features.*

**Keywords:** competition law, competition culture, informal governance, trade associations, post-socialist countries, national culture, Central and Eastern Europe, South-East Europe, planned economy legacy, Europeanization

## 1 INTRODUCTION AND METHODOLOGY

In post-socialist economies,<sup>1</sup> competition systems reflect mostly a slow transformation from a relations-based to rule-based governance. The role of informal

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Email: [ruzica.simic@pravo.hr](mailto:ruzica.simic@pravo.hr). An early version of this article, available at <https://ssrn.com/abstract=3728601>, was presented at the Fifteenth ASCOLA (Academic Society for Competition Law) Conference, held on 25–27 June 2020. The authors would like to thank Spencer Weber Waller, Alexandr Svetlicinii, Maciej Bernatt, Marco Botta and Stefan Enchelmaier for their comments. Many thanks to Megan Havern for editing assistance. We acknowledge the funding of the University of Zagreb (Project: Genesis of the Competition System in Croatia – Legal and Economic Analysis, <https://pptn-projekt.net.efzg.hr/>).

<sup>1</sup> The term ‘(post)transitional countries’ is used for the group of countries that started their post-socialist transformation at the end of 1980s to the beginning of 1990s. Hereinafter ‘(post)transitional countries/

governance<sup>2</sup> is usually underestimated, even though the use of personal relations appears to be rising and has been shown to be an efficient way for ‘getting things done’. Socially embedded networks and informal practices appear to be a legacy from the previous system. That used to be and still is rather a usual way of obtaining necessary goods, services, or information. Still, it is also an instrument of reaching a collusive agreement, clientelism, nepotism, and state capture. Thus, even though most Eastern European countries are EU Member States, the gap between Western-like formal and (post)socialist-like informal institutions<sup>3</sup> appear to be considerable and results in additional transaction costs.

Informal institutions have shown to be more resistant to change and consequently have a long-lasting effect. However, existing research suggests that economic progress and more stable formal institutions (i.e., enforceable competition legislation) leads to less reliance on informal relations. That ‘tipping point’ is explored in the dynamics between formal governance, illustrated by effective antitrust enforcement, and informal governance, represented by reliance on collusive agreements.

Transitional economies have shown to be a ‘laboratory for understanding the dynamics of market evolution and for evaluating the impact of alternative policy frameworks’.<sup>4</sup> This study aims to scrutinize the links between efficiency of public authorities dealing with competition rules and the prevalence of the informal governance in post-socialist societies, as well as examine the interaction with dominant national culture in this context. In particular, for the EU Member States located in Central and Eastern Europe, the question is to what extent the lack of competition culture and traits unique to post-transitional economies continue to prevent a uniform enforcement of competition rules as envisaged under the ECN+ Directive, which aims to further harmonize the rules followed by

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societies’ and ‘post-socialist societies/countries’ will be used interchangeably for that group of countries. In this paper our focus is on Central and Eastern European countries, including Southeast Europe.

<sup>2</sup> Governance is defined as informal ‘when participation in the decision-making process is not yet or cannot be codified and publicly enforced’. In addition, ‘... informal governance works through informal relations which take place outside both the official structures and the semi-official arenas, and which shape or condition their operation from without by filtering access, setting the agenda, packaging deals and threatening retaliation’. Thomas Christiansen, Andreas Føllesdal & Simona Piattoni, *Informal Governance in the European Union: An Introduction*, in *Informal Governance in the European Union* 1 (Thomas Christiansen & Simona Piattoni eds, Edward Elgar 2003).

<sup>3</sup> North’s definitions are used: formal institutions present laws and rules whereas informal institutions include culture, tradition, and modes of behaviour. Douglass C. North, *Understanding the Process of Economic Change* (Princeton University Press 2005). Overall, the institutional approach to similar topics at the intersection of and contributing to both law and economics literature has already shown to be useful. The examples include Claude Ménard, *Maladaptation of Regulation to Hybrid Organisational Forms*, 18 *Int’l Rev. L. & Econ.* 403 (1998); Maria Ostrovnaya & Elena Podkolzina, *Antitrust Enforcement in Public Procurement: The Case of Russia*, 11 *J. Competition L. & Econ.* 331 (2015).

<sup>4</sup> Saul Estrin, *Competition and Corporate Governance in Transition*, 16 *J. Econ. Persp.* 101 (2002).

different national competition authorities (NCAs).<sup>5</sup> Although based on a country-specific research study, Croatia, this article aims to have a broader relevance, with more general conclusions that can be drawn for other post-transitional countries, in particular those in Central and Eastern Europe.

To the best of our knowledge, this is the first study, based on primary sources, focusing on the interaction of the competition system and national culture through the governance perspective of a (post)transitional society. The contribution of this Article lies in the qualitative analysis of the relations between modes of governance, national culture, and competition practices based on a unique set of empirical evidence.<sup>6</sup> Besides relevant secondary sources, this study relies on semi-structured interviews (coded as INT\_01 to INT\_39), taking place between July and December 2018 in Zagreb, Croatia, with forty-one persons, including past and current competition authority officials and key staff, judges, practitioners, corporate lawyers, journalists, and academics. The interviews were audio-recorded, transcribed, anonymized, and subsequently coded using content analysis software Atlas.ti 8. We expect the outputs of this study to be a robust starting point for future policy recommendations aimed at greater effectiveness of competition policies, particularly in post-socialist societies. Moreover, we hope that this research will motivate comparative analyses from other transitional economies.

In line with the novel approach to exploring the development of the post-socialist competition system, this study is structured as follows. In Part II, we will present the existing qualitative and quantitative analyses on the interplay between dominant national culture and enforcement of competition laws in the world, with an emphasis on Southeast Europe. In Part III, we will focus on the relations between informal relations and formal setting in the post-socialist countries and its possible implications on the competition system. Based mostly on the primary sources, Part IV disentangles the dynamics of the formal and informal governance in the Croatian competition system since the early 1990s. Those findings are deemed applicable to a larger group of European post-socialist countries, as well as possibly to some less developed countries. Part V discusses the clash between the Europeanization process and the collusive paradigm. The Article concludes in Part VI by highlighting the main findings.

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<sup>5</sup> Directive (EU) 2019/1 of the European Parliament and of the Council of 11 Dec. 2018 to empower the competition authorities of the Member States to be more effective enforcers and to ensure the proper functioning of the internal market, OJ L 11 (14 Jan. 2019), at 3–33.

<sup>6</sup> This paper builds on Jasminka Pecotic Kaufman, *On the Development of (Not So) New Competition Systems – Findings From an Empirical Study* (9 Nov. 2020), <https://ssrn.com/abstract=3727395>, and uses the same dataset.

## 2 CONTEXT: COMPETITION SYSTEM AND DOMINANT NATIONAL CULTURE

While cultural aspects are relevant to the endorsement of competition and the formulation of competition regimes,<sup>7</sup> the research on the interaction of competition policies and national culture appears to be quite limited, overlooked or even dismissed.<sup>8</sup> The lack of competition culture and little awareness, or even distrust, of the benefits of market competition among economic elites as well as in society at large, especially in countries that have recently transitioned from a socialist economy to a market economy, are recognized as one of the key features undermining effective competition law and policy.<sup>9</sup> Studies increasingly suggest competition laws and policies would be more effective if implemented with a better understanding of the cultural influences on competition related decisions.<sup>10</sup> Scholars have argued that this would help promote competition at a national and regional level and ameliorate the international coordination of competition policies.<sup>11</sup>

The research on competition culture has tackled selected Latin American countries,<sup>12</sup> South Africa<sup>13</sup> and some Asian countries.<sup>14</sup> Using examples from a number of countries around the world, Stephan illustrated the impact of collectivist business culture and challenges related to anti-cartel enforcement deriving

<sup>7</sup> Tamar Indig & Michal S. Gal, *Lifting the Veil: Rethinking the Classification of Developing Economies for Competition Law and Policy*, in *The Economic Characteristics of Developing Jurisdictions: Their Implications for Competition Law* 51, at 67, 77 (Michal S. Gal et al. eds, Edward Elgar 2015).

<sup>8</sup> Thomas K. Cheng, *How Culture May Change Assumptions in Antitrust Policy*, in *The Global Limits of Competition Law* 205 (Ioannis Lianos & D. Daniel Sokol eds, Stanford University Press 2012); Michal S. Gal & Eleanor M. Fox, *Drafting Competition Law for Developing Jurisdictions: Learning from Experience*, in *The Economic Characteristics of Developing Jurisdictions: Their Implications for Competition Law* 296, at 310 (Michal S. Gal et al. eds, Edward Elgar 2015); Indig & Gal, *supra* n. 7, at 66; Albert A. Foer, *Competition Culture and the Cultural Dimensions of Competition*, in *Reconciling Efficiency and Equity: A Global Challenge for Competition Policy* 295, at 296 (Damien Gerard & Ioannis Lianos eds, Cambridge University Press 2019).

<sup>9</sup> Umut Aydin & Tim Bütthe, *Competition Law & Policy in Developing Countries: Explaining Variations in Outcomes; Exploring Possibilities and Limits*, 79 *L. & Contemp. Probs.* 1, at 20–21 (2016).

<sup>10</sup> Cheng, *supra* n. 8; Jingyuan Ma & Mel Marquis, *Business Culture in East Asia and Implications for Competition Law*, 51 *Texas Int'l L. J.* 1 (2016).

<sup>11</sup> Ki Jong Lee, *Cultures and Cartels: Cross-Cultural Psychology for Antitrust Policies*, 21 *Loyola Consumer L. Rev.* 33 (2008).

<sup>12</sup> Marco Botta, *Fostering Competition Culture in the Emerging Economies: The Brazilian Experience*, 32 *World Competition* 609 (2009); Julián Peña, *The Limits of Competition Law in Latin America*, in *The Global Limits of Competition Law* 236 (Ioannis Lianos & D. Daniel Sokol eds, Stanford University Press 2012).

<sup>13</sup> David Lewis, *Embedding a Competition Culture: Holy Grail or Attainable Objective?*, in *Competition L. & Dev.* 228 (D. Daniel Sokol, Thomas K. Cheng & Ioannis Lianos eds, Stanford University Press 2013).

<sup>14</sup> Jong Lee, *supra* n. 11; Ki Jong Lee, *Promoting Convergence of Competition Policies in Northeast Asia*, in *The Global Limits of Competition Law* 221 (Ioannis Lianos & D. Daniel Sokol eds, Stanford University Press 2012).

from unsympathetic social norms.<sup>15</sup> Research on post-socialist countries has been limited so far by only marginally dealing with national competition culture and other informal influences.<sup>16</sup> Only recently, a very brief analysis of competition-related cultural characteristics in Southeast European countries became available.<sup>17</sup>

In the study on the correlation between national culture and competition policy, Jong Lee emphasizes three cultural dimensions, as developed by Hofstede: (1) Individualism/Collectivism (IDV), (2) Power Distance (PDI), and (3) Uncertainty Avoidance (UAI).<sup>18</sup> The study shows that the effectiveness in promoting competition at the national level (based on World Economic Forum survey of the business executives) has a strong positive correlation with IDV, while having a strong negative correlation with PDI and UAI.<sup>19</sup>

Power distance (PDI) as a cultural dimension is defined as ‘the extent to which the less powerful members of institutions [family, school, community] and organizations [work places] within a country expect and accept that power is distributed unequally’.<sup>20</sup> The research shows that most competitive countries have low PDI and more business-friendly laws and regulations and vice versa. Business friendliness and PDI demonstrate a negative correlation, i.e., more business friendliness is associated with lower power distance in the society.<sup>21</sup> Croatia, like most Eastern European transitional societies, is a high PDI country.<sup>22</sup> In terms of competition culture, it is claimed that in high PDI countries, small enterprises are more likely to follow the industry leader or the trade association’s direction, and that can rather easily result in tacit collusion.<sup>23</sup>

IDV in societies can be recognized by loose ties between people, i.e., ‘everyone is expected to look after him- or herself or her immediate family’.<sup>24</sup> On the opposite side, in collectivist societies ‘people from birth onward are integrated into

<sup>15</sup> Andreas Stephan, *Cartel Laws Undermined: Corruption, Social Norms and Collectivist Business Cultures*, 37 *J. L. & Soc’y* 345 (2010).

<sup>16</sup> See e.g., Marek Martyniszyn & Maciej Bernatt, *Implementing a Competition Law System – Three Decades of Polish Experience*, 8 *J. Antitrust Enforcement* 165 (2020); Rajmund Molski, *Polish Antitrust Law in Its Fight Against Cartels – Awaiting a Breakthrough*, 2 *Y. B. Antitrust & Reg. Stud.* 49 (2009).

<sup>17</sup> Paolo Buccirosi & Lorenzo Ciari, *Western Balkans and the Design of Effective Competition Law: The Role of Economic, Institutional and Cultural Characteristics*, in *Competition Authorities in South Eastern Europe: Building Institutions in Emerging Markets 7* (Boris Begović & Dušan V. Popović eds, Springer 2018).

<sup>18</sup> Jong Lee, *supra* n. 11, drawing on the work of Geert Hofstede et al., *Cultures and Organisations: Software of the Mind: Intercultural Cooperation and Its Importance for Survival* (McGraw Hill 2010).

<sup>19</sup> Jong Lee, *supra* n. 11.

<sup>20</sup> Hofstede et al., *supra* n. 18, at 61.

<sup>21</sup> Ružica Šimić Banović, *Is Culture an Underpinning or Undermining Factor in the Business Environment of the Transitional Countries?*, in *Economic Development and Entrepreneurship in Transition Economies: Issues, Obstacles and Perspectives 11* (Ivo Ateljević & Jelena Trivić eds, Springer International Publishing 2016).

<sup>22</sup> Hofstede, *Hofstede Insights – Country Comparison: Croatia* (2020), <https://www.hofstede-insights.com/country-comparison/croatia/> (accessed 5 Feb. 2020).

<sup>23</sup> Cheng, *supra* n. 8, at 217.

<sup>24</sup> Hofstede et al., *supra* n. 18, at 92.

strong, cohesive in-groups, which throughout people's lifetime continue to protect them in exchange for unquestioning loyalty'.<sup>25</sup> Most large power distance societies are collectivist, whereas small power distance societies are mostly individualist.<sup>26</sup> The majority of the countries in the world are collectivist, while wealthy countries are predominantly individualist.<sup>27</sup> A positive correlation is shown between individualism and a business-friendly legal setting, as well as with IDV and competitiveness.<sup>28</sup> Gorodnichenko and Roland demonstrate that IDV is the only cultural dimension with a strong effect on economic growth.<sup>29</sup> Croatia, like most post-socialist Central and Eastern European societies, represents a collectivist society.<sup>30</sup> In collectivist societies, the firms are more prone to tacit understanding as the level of predictability is quite high and the range of possible conduct is quite limited.<sup>31</sup>

UAI is 'the extent to which the members of a culture feel threatened by ambiguous or unknown situations'.<sup>32</sup> Business friendliness and UAI show quite a strong negative correlation. The same applies to the correlation between competitiveness and UAI.<sup>33</sup> Croatia, like most post-socialist Central and Eastern European societies, have a high UAI score.<sup>34</sup>

In the research empirically testing Županov's concept of Croatian egalitarian syndrome, the strongest link was found between egalitarian syndrome and risk aversion.<sup>35</sup> This finding is both in line with a high UAI score and supports Županov's statement on the egalitarianism hindering private incentives and consequently, negatively influencing economic growth.<sup>36</sup> Regarding competition in the market, Županov clearly states that it is predominantly managed by politics, whereas the main economic agents are political managers instead of entrepreneurs.<sup>37</sup> Thus, the state's paternal role is reflected in its position of a 'protector' from the competition and a 'nanny' to the employees whose primary goal is lifelong employment. Overall, it has been empirically confirmed that the egalitarian syndrome presents an

<sup>25</sup> *Ibid.*

<sup>26</sup> *Ibid.*, at 102–105.

<sup>27</sup> *Ibid.*, at 91–97.

<sup>28</sup> Šimić Banović, *supra* n. 21.

<sup>29</sup> Yuriy Gorodnichenko & Gerard Roland, *Culture, Institutions, and the Wealth of Nations*, 99 *Rev. Econ. & Statistics* 402 (2017); Yuriy Gorodnichenko & Gerard Roland, *Which Dimensions of Culture Matter for Long-Run Growth?*, 101 *Am. Econ. Rev.* 492 (2011).

<sup>30</sup> Hofstede, *supra* n. 22.

<sup>31</sup> Cheng, *supra* n. 8, at 213.

<sup>32</sup> Hofstede et al., *supra* n. 18, at 191.

<sup>33</sup> Šimić Banović, *supra* n. 21.

<sup>34</sup> Hofstede, *supra* n. 22.

<sup>35</sup> Aleksandar Štulhofer & Ivan Burić, *Je li egalitarni sindrom samo teorijska fantazija? Empirijski hommage Josipu Županovu*, 52 *Politička misao* 7 (2015); Josip Županov, *Od komunističkog pakla do divljeg kapitalizma (From Communist Hell to Wild Capitalism)* (Hrvatska sveučilišna naklada 2002).

<sup>36</sup> Štulhofer & Burić, *supra* n. 35.

<sup>37</sup> Županov, *supra* n. 35, at 60–64.

inherited set of national values that still affects everyday life in Croatia and impedes its socio-economic development.<sup>38</sup>

Somewhat surprisingly, Buccirossi and Ciari observed that the overall pro-competition culture in the Western Balkan countries seem strong.<sup>39</sup> Their analysis of the EBRD Life in Transition Survey III shows that between 50% and 65% of respondents in Southeast European countries think that competition is definitely good as it brings the best out of people. In comparison, in Germany, only 30% of respondents are positive about competition, and in Italy, around 40%.<sup>40</sup> Croatia is on the lower end of the spectrum, with approximately 50% of the respondents replying in favour of competition as a cultural trait. However, the results described above might be misleading, and not necessarily allowing a conclusion regarding overall competition culture. In fact, in the Western Balkan countries, competition *in abstracto* might well be regarded as a positive trait. After all, the mantra of the superiority of the market economy has been, ever since the transition occurred, widely disseminated in those countries – but weakly practised. However, the reality is imbued with state paternalism, a strong role of the state in the economy, the high administrative burden on businesses and collusive relationships among firms. Public policies that favour public, not private, market-oriented solutions still find support in the wider population. In this sense, we suggest that respondents in Southeast European countries regard competition as an elusive ideal, contrary to respondents in Germany and Italy where competitive markets are a reality.<sup>41</sup>

The explanation that in the abstract competition is good, but we do not want it around as much, seems to get its confirmation in the results regarding the question of attitudes towards the market economy. While approximately 85% of respondents in Germany think that the market economy is preferable, only 30% of respondents in Croatia think the same. In comparison, more than 30% of respondents in Croatia think that planned economy is preferred under some circumstances.<sup>42</sup> Except for Kosovo and Albania, who show more substantial market economy support and are clear outliers, other Western Balkan countries show less support for the market economy (in a range between 30% and 50%), with support for the planned economy in a range between 20% and 30% (with 35%–45% being indifferent on this issue, a very interesting result). Hence, the gap between competition as an ideal and market economy as a realization of that ideal in practice seems to be clear in the Southeast European countries. Indeed, this is of

<sup>38</sup> Vuk Vuković, Aleksandar Štulhofer & Ivan Burić, *Je li Županov imao pravo? Testiranje podrijetla i perzistencije egalitarnoga sindroma*, 26 Društvena istraživanja 207 (2017).

<sup>39</sup> Buccirossi & Ciari, *supra* n. 17, at 35.

<sup>40</sup> *Ibid.*, at 35–36.

<sup>41</sup> For a similar explanation see Indig & Gal, *supra* n. 7, at 75.

<sup>42</sup> Buccirossi & Ciari, *supra* n. 17, at 36.

direct relevance to the efficient running of the competition system. As Kovacic insightfully observed, ‘compared to their transition economy counterparts, Western competition authorities are compelled to spend considerably less energy defending the basic premises of a market system’.<sup>43</sup>

### 3 INFORMAL RELATIONS VERSUS FORMAL SETTING IN TRANSITIONAL CAPITALIST STATES

Three decades since transformation has started, the socialist legacy still plays an inevitable role in (post)transitional societies.<sup>44</sup> The use of personal relations to obtain goods, services, information, or jobs is perceived to be one of the most persistent and prevalent features of the previous system,<sup>45</sup> i.e., it is increasingly seen as strongly embedded in society’s structure. The ambiguous division between the public and private sphere appears to underpin the continuity of those informal practices despite new formal conditions.<sup>46</sup> High *nomenklatura* retention,<sup>47</sup> i.e., business and political elites that mostly converted their power from the socialist period into economic and political benefits in the transitional period present a resistant barrier for changing informal practices.<sup>48</sup> Yet, the informal practices are largely supported and used by ordinary people.<sup>49</sup> Key characteristics of the informal practices in post-socialist societies could be identified in omnipresence and

<sup>43</sup> William E. Kovacic, *Getting Started: Creating New Competition Policy Institutions in Transition Economies*, 23 *Brook. J. Int’l L.* 403 (1997).

<sup>44</sup> See e.g., Janos Kornai, *What Does ‘Change of System Mean’?*, in *From Socialism To Capitalism* 123–150 (J. Kornai ed., Budapest: Central University Press 2008); Gerard Roland, *The Long-Run Weight of Communism or the Weight of Long-Run History?*, in *Economies In Transition: The Long-Run View* 153–171 (G. Roland ed., United Nations University – World Institute for Development Economics Research, Basingstoke: Palgrave Macmillan 2012); Kosta Josifidis, Novica Supic & Olgica Glavaski, *Institutional Changes and Income Inequality: Some Aspects of Economic Change and Evolution of Values in C.E.E. Countries*, 56(6) *E. Eur. Econ.* 522–540 (2018); R. Šimić Banović, *Uhljeb – A Post-Socialist Homo Croaticus: a Personification of the Economy of Favors in Croatia?*, 31(3) *Post-Communist Economies* 279–300 (2019).

<sup>45</sup> Snežina Michailova & Verner Worm, *Personal Networking in Russia and China: Blat and Guanxi*, 21 *Eur. Mgmt. J.* 509–19 (2003); Deema Kaneff, *Making History, Making Politics: Socialist and Post-Socialist Elite Economies of Favor in Bulgaria and Ukraine*, in *Economies of Favor After Socialism* 140–160 (D. Henig & N. Makovicky eds, Oxford University Press 2017).

<sup>46</sup> Andrei Shleifer & Robert W. Vishny, *The Grabbing Hand: Government Pathologies And Their Cures* (Harvard University Press 1999).

<sup>47</sup> Ivan Szelenyi & Szonja Szelenyi, *A Circulation or Reproduction of Elites During the Postcommunist Transformation of Eastern Europe, Theory and Society*, 24(5) *Special Issue on Circulation vs. Reproduction of Elites During the Postcommunist Transformation E. Europe* 615–638 (1995).

<sup>48</sup> Alena Ledeneva, *Can Russia Modernise? Sistema, Power Networks And Informal Governance* (Cambridge University Press 2013).

<sup>49</sup> Adnan Efendic, Geoff Pugh & Nick Adnett, *Confidence in Formal Institutions and Reliance on Informal Institutions in Bosnia and Herzegovina*, 19 *Econ. Transition* 521–540 (2011); Colin C. Williams & Slavko Bezeredi, *Evaluating the Use of Personal Connections to Bypass Formal Procedures: A Study of Vrski in Republic of Macedonia*, 8 *UTMS J. Econ.* 169–182 (2017); Vlatka Skokic, Paul Lynch & Alison Morrison, *Veza: An Informal Network of Tourism Entrepreneurs*, 77 *Annals Tourism Res.* 26–37 (2019).



resilience; thus, their high degree of relevance is not surprising.<sup>50</sup> Despite the aforementioned list, the informal governance in the genesis of the post-socialist competition system is, to our knowledge and understanding, an under researched phenomenon.

The notion of the ‘economy of favours’ is based on favours of access and mostly originates in the redistribution of public resources.<sup>51</sup> The study of ‘economy of favours’ originates in the research of *blat* – the use of personal networks for getting things done in Russia.<sup>52</sup> The concept of the ‘economy of favours’ captures various aspects of clientelism, nepotism, and bribery as those favours usually imply the avoidance of formal procedures. Still, it is difficult to label them as illegal and to draw strict boundaries between those acts and illegal practices.<sup>53</sup> Scholars researching the role and value of informal practices strongly argue against the stigmatization of ‘economy of favours’ related practices.<sup>54</sup> They consider ‘labelling’ to be misleading if analysed context-free. Despite economic consequences, favours cannot be understood solely through transactional cost-benefit analysis<sup>55</sup> and have greater value and more dimensions than personal ties.<sup>56</sup>

Informal practices often reflect the underdeveloped or inappropriately developed formal institutions. In other words, they indicate structural constraints and as such change in different systems; they reflect political, social, and economic conditions and are strongly affected by historical and cultural factors. Whereas in the state planned societies, i.e., economies of shortage they usually served as tools for compensation, in the (post)transitional societies they are mostly used as vehicles for the use or misuse of the weaknesses of the system.<sup>57</sup> Informal practices played both subversive and supportive roles in post-socialist transformation.<sup>58</sup> Moreover, informal institutions defined as ‘socially shared

<sup>50</sup> Abel Polese, *Informality Crusades: Why Informal Practices Are Stigmatised, Fought and Allowed in Different Contexts According to an Apparently Understandable Logic*, 25 *Caucasus Soc. Sci. Rev.* 1–26 (2015); Rune Steenberg, *The Art of Not Seeing Like a State. On the Ideology of ‘Informality’*, 24(3) *J. Contemp. Central & E. Europe* 293–306 (2016).

<sup>51</sup> Alena Ledeneva, *Blat and Guanxi: Informal Practices in Russia and China*, 50 *Comp. Stud. Soc’y & Hist.* 118–144 (2008); Ledeneva, *Can Russia Modernise? Sistema*, *supra* n. 48.

<sup>52</sup> Alena Ledeneva, *Russia’s Economy Of Favors: Blat, Networking, And Informal Exchange* (Cambridge: Cambridge University Press 1998).

<sup>53</sup> Susan Rose-Ackerman, *Bribes and Gifts*, in *Economics, Values, And Organization* 296–328 (A. Ben-Ner & L. Putterman eds, Cambridge University Press 1999).

<sup>54</sup> Ledeneva, *Russia’s Economy Of Favors*, *supra* n. 52, at 39–59; Polese, *supra* n. 50, at 1–26.

<sup>55</sup> Nicolette Makovsky & David Henig, *Introduction – Re-imagining Economies (after Socialism). Ethics, Favors, and Moral Sentiments*, in *Economies of Favor After Socialism* 1–20 (D. Henig & N. Makovsky eds, Oxford University Press 2017).

<sup>56</sup> Caroline Humphrey, *A New Look at Favors: The Case of Post-Socialist Higher Education*, in *Economies of Favor After Socialism* 50–72 (D. Henig & N. Makovsky eds, Oxford University Press 2017).

<sup>57</sup> Ledeneva, *Blat and Guanxi*, *supra* n. 51.

<sup>58</sup> Alena Ledeneva, *Introduction: The Informal View of the World – Key Challenges and Main Findings of the Global Informality Project*, in *The Global Encyclopaedia Of Informality: Understanding Social And Cultural Complexity* Vol. 1, 1–27 (A. Ledeneva ed., UCL Press 2018).

rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels<sup>59</sup> are considered to be the most important ‘carrier’ of the artefactual structure and are deemed to play a crucial role in the evolution of the politics.<sup>60</sup> Strong informal institutions positively affect economic development, i.e., the top-performing countries ‘are able to successfully impose constraints conducive for economic development without the reliance on government creation or coercion’.<sup>61</sup> Thus, the informal institutions may strengthen or replace the formal institutions they appear to undermine<sup>62</sup> and that is linked with the level of economic development, i.e., ‘countries that built their formal institutions off of their informal rules are achieving a much higher level of economic development’.<sup>63</sup> However, informal practices may act as substitutes or as complements to the official structures; it is quite common that the same or very similar practice functions as a substitute in a developing country and as a complement in a developed country.<sup>64</sup> That is in accordance with the initial statement on the informal practices serving as indicators of society’s deficits and their variations being dependent on the changes of the system.<sup>65</sup> There is a salient time dimension to that phenomenon in post-socialist society: the informal practices were needed to compensate for the dysfunctionalities of the planned economy, and it appears that three decades after the beginning of transition they still play a very similar role in the post-socialist countries. Furthermore, according to Fidrmuc and Gerxhani, low levels of social capital in Eastern European countries are primarily linked with their weaker institutions and relative economic underdevelopment when compared to Western European countries.<sup>66</sup> Consequently, institutional and economic convergence of the Eastern European societies with the Western European societies should bridge the gap in social capital.

Stephan notes that in the absence of strong legal protection in a collective culture much reliance is on personal relationships.<sup>67</sup> Observing that ‘business firms in Eastern and Central Europe operate in an environment where corruption is

<sup>59</sup> Gretchen Helmke & Steven Levitsky, *Informal Institutions and Comparative Politics: A Research Agenda*, 2 *Persp. Pol.* 725, at 727 (2004).

<sup>60</sup> North, *supra* n. 3, at 50–51.

<sup>61</sup> Claudia R. Williamson, *Informal Institutions Rule: Institutional Arrangements and Economic Performance*, 139 *Pub. Choice* 371, at 376 (2009).

<sup>62</sup> Helmke & Levitsky, *supra* n. 59, at 728–731.

<sup>63</sup> Williamson, *supra* n. 61, at 378.

<sup>64</sup> Alex Dreher & Friedrich Schneider, *Corruption and the Shadow Economy: An Empirical Analysis*, 144 *Pub. Choice* 215–238 (2010); adapted by Paul Dragos Aligica & Vlad Tarko, *Crony Capitalism: Rent Seeking, Institutions and Ideology*, 67(2) *Kyklos* 156–176 (2014).

<sup>65</sup> Ledeneva, *Blat and Guanxi*, *supra* n. 51.

<sup>66</sup> Jan Fidrmuc & Klarita Gerxhani, *Mind the Gap! Social Capital, East and West*, 36(2) *J. Comp. Econ.* 264–286 (2008).

<sup>67</sup> Stephan, *supra* n. 15, at 361.

common, legal standards are often unclear, and the judiciary is unreliable', Rose-Ackerman argues that, 'reciprocal trust between market actors may be a substitute for one-sided trust in legal rules' and that 'when the law is weak, reciprocal trust may be difficult to maintain outside of existing links based on kinship and history'.<sup>68</sup> One of the most researched informal practices, that by its prevalence and persistence, in Croatia and several post-socialist Southeast Europe countries seems to be closely linked with a collectivist society, is *veza*<sup>69</sup> (literally: 'a connection').<sup>70</sup> The most common examples for the use of *veza* include speeding up administrative procedures (such as construction permit), obtaining a job in a public sector under privileged conditions and reaching a favourable agreement that would not be doable without an insider from the contracting organization. The most widely explored practices that are similar to *veza* are *blat* in Russia and *guanxi* in China. These practices are very dynamic and diverse in their nature, and their mutual operating mechanism is exchange of favours and resources.<sup>71</sup>

From our country-specific study we find that the interlocking relationship between the government and big business in the early development phases of a competition system had a detrimental effect on the ability of the competition authority to build long term credibility and negatively harmed enforcement effectiveness.<sup>72</sup> Informal links in that period, amid weak institutional capacity, prevented the authority to exercise its powers appropriately in the long run. Also, the explicit exemption of the privatization process from competition rules under the Croatian Competition Act 1995 reflected a strong influence of informal links in the formative phase of the competition system development. Although the competition authority was not discontent to be relieved from being involved in politically sensitive privatization cases, this exemption had a long-term detrimental effect on the competitive structure of the economy.<sup>73</sup>

<sup>68</sup> Susan Rose-Ackerman, *Trust, Honesty, and Corruption: Reflection on the State-Building Process*, 42 Eur. J. Soc. 526 (2001).

<sup>69</sup> It is defined as 'the use of informal contacts in order to obtain access to opportunities that are not available through formal channels'. Dragan Stanojevic & Dragana Stokanic, *Veza*, in *The Global Encyclopaedia Of Informality: Understanding Social And Cultural Complexity* Vol. 1, 58–62 (A. Ledeneva ed., UCL Press 2018).

<sup>70</sup> For Croatia see Skokic, Lynch & Morrison, *supra* n. 49. For Serbia and the Balkans see Stanojevic & Stokanic, *supra* n. 69. For Bosnia and Herzegovina see Karla Koutkova, *The Importance of Having štela: Reproduction of Informality in the Democratization Sector in Bosnia*, in *Informal Economies In Post-Socialist Spaces: Practices, Institutions And Networks* 139–153 (J. Morris & A. Polese eds, Palgrave Macmillan 2015). For Macedonia see Williams & Bezeredi, *supra* n. 49.

<sup>71</sup> Skokic, Lynch & Morrison, *supra* n. 49.

<sup>72</sup> Pecotic Kaufman, *supra* n. 6.

<sup>73</sup> Interview with the First NCA Director, Professor Deša Mlikotin Tomić (21 Sept. 2019).

#### 4 THE INTERACTION OF FORMAL AND INFORMAL GOVERNANCE IN THE POST-TRANSITIONAL PERIOD

In order to discuss the dynamics of the formal and informal governance in the post-transitional period, we address two issues which we identified as relevant for the discussion of the challenges faced by the Croatian competition system.<sup>74</sup> First, we address the impact of planned economy legacy, which according to our research plays a prominent role in impeding a swifter recognition of market competition as a desirable value, as well as a more efficient competition enforcement. To support this finding, we provide several interview excerpts collected in our research study. Second, we explain the significance of public trade associations in the context of competition system development, as well as their – still poorly recognized – institutional contribution to preserving collusive culture in Croatia. For this purpose, we also provide insights from the interviews.

##### 4.1 PLANNED ECONOMY LEGACY

In the decades following 1990, changes to specific features of the market economy system created an impact on post-socialist countries' competition systems. These specific features point to an unfinished transition.<sup>75</sup> Josip Županov with his theory of radical egalitarianism creates the most comprehensive attempt to explain this phenomenon of postponed modernization, in Croatia, as well as in other ex-Yugoslav countries.<sup>76</sup> Large public sectors, in particular as regards state-owned enterprises (SOEs),<sup>77</sup> and a heavy reliance on the state to provide economic solutions, with SOEs as significant market players,<sup>78</sup> reflect the holding on to the old, well-known but inefficient patterns,<sup>79</sup> with a petrifying effect on

<sup>74</sup> As identified by Pecotic Kaufman, *supra* n. 6, the competition system development in Croatia for the 1995–2018 period encompassed four distinct phases: inception (1995–2000); withdrawal (2000–2003); pre-accession (2003–2013); and post-accession phase (2013–2018).

<sup>75</sup> However, not all the post-socialist countries are the same, with Poland and Hungary, e.g., undertaking strong market reforms early on and showing a different trajectory. See e.g., Martyniszyn & Bernatt, *supra* n. 16.

<sup>76</sup> Županov, *supra* n. 35.

<sup>77</sup> In Croatia, the share of employees in state-owned enterprises (SOEs) in relation to the total number of employees is probably the largest in the EU. Siniša Petrović & Velimir Šonje, *Je li privatizacija državnih poduzeća nužan uvjet njihovog uspješnog poslovanja u Hrvatskoj?*, 25 *Privredna kretanja i ekonomska politika* 37, at 16 (2016). In 2012, SOEs in Croatia employed five times more workers than in Sweden (3.8%), with 56.8% working in the private sector, 19.6% working for state companies and 23.7% working for the public sector. Danijel Nestić, Ivica Rubil & Iva Tomić, *Analiza razlika u plaćama između javnog sektora, poduzeća u privatnom vlasništvu i privatnog sektora u Hrvatskoj 2000.-2012.*, 24 *Privredna kretanja i ekonomska politika* 7, at 16 (2015).

<sup>78</sup> Velimir Šonje, *1000 najvećih, Lider*, nr. 503 (22 May 2015).

<sup>79</sup> In its 2015 Report, the European Commission lists fragmented and incomplete management system, widespread unprofessionalism, a lack of clear strategic instructions, a lack of benchmarking and

the market.<sup>80</sup> The background is important here. The socialist economic model present in Yugoslavia was successful until 1980. From 1952 until 1980, Yugoslavia experienced an average growth of 5% per year.<sup>81</sup> Hence, while Soviet occupation prevented modernization in other Central and Eastern European countries, this was not the case in Yugoslavia.<sup>82</sup> Until 1952, Poland, Slovakia, and Hungary were more developed than Croatia (a republic within Yugoslavia at that time), however by the end of the 1970s Croatia became more developed. In the 1980s, Croatia outstripped Greece, Spain, and Portugal in terms of economic growth.<sup>83</sup> The reforms in the early 1990s – the process of democratic and economic transition – must, in the case of Croatia, be looked at taking into account specific circumstances. As Polšek and Šonje argue, communism in Croatia was abandoned primarily in order to establish itself as an independent country. Coming closer to the capitalist West was not a reflection of the deeply ingrained belief in a society founded on more individual and economic freedom.<sup>84</sup> Unlike in Prague, Budapest, or Warsaw, in Zagreb economic, political, and civil freedoms were not in the limelight. Instead main actors on the political scene being ex-communists, intellectually and politically formed on Marxist foundations, which had massive implications when it came to economic issues.<sup>85</sup> The distaste for more intensive market reforms after the turbulent 1990s was probably a reaction to the murky privatization process, which was widely perceived as significantly contributing to the economic downturn in the 1990s.<sup>86</sup> Idealized perception of the state as an entrepreneur (state companies as ‘our companies’) has its origins in the period from 1950 until mid-1970, when state companies, as ‘communal’ companies, under the worker self-management model, giving the illusion of participatory management, were drivers of infra-structural and industrial growth.<sup>87</sup>

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oversight systems, and a lack of transparency in the director appointment system as chronic problems in Croatia’s SOEs. European Commission, *Macroeconomic Imbalances – Country Report Croatia 2015*, 49 (2015).

<sup>80</sup> The economic landscape is surely not the same now as it was in the early 1990s, but the socialist system legacy still strongly influences economic life. The landscape in Poland around 1990, very similar to the situation in Croatia at that time, was aptly described by Martyniszyn & Bernatt: ‘... a heavily concentrated economy dominated by largely inefficient state-owned enterprises and a business culture of close collaboration, required by law for decades’. Martyniszyn & Bernatt, *supra* n. 16, at 5. However, unlike Poland, which undertook strong market reforms in the 1990s, Croatia had a different trajectory.

<sup>81</sup> Velimir Šonje & Darko Polšek, *Prešućeni trijumf liberalizma: o praktičnoj važnosti slobode 1989.–2019*, 53 (Arhivalitika 2019).

<sup>82</sup> *Ibid.*, at 53.

<sup>83</sup> *Ibid.*, at 54.

<sup>84</sup> *Ibid.*, at 47.

<sup>85</sup> *Ibid.*, at 48.

<sup>86</sup> However, the real causes are still under-researched. See Petrović & Šonje, *supra* n. 77, at 9–10.

<sup>87</sup> *Ibid.*, at 9.

The planned economy legacy, including the strong role of the state, is still widespread and deeply embedded in the fabric of the society. The following two excerpts from the interviews with former high-level NCA officials illustrate this point.

‘Q: What is the impact of the planned economy legacy ... ?

A: Citizens, consumers, still behave in line with the previous system ... I thought one generation would be enough for a change, but no ... at least two are needed’. (INT\_06)

‘Q: Is competition in Croatia a common societal value?

A: I don’t think it is yet.

Q: Are things changing?

A: Well, a little bit. I think it’s ... a process that simply follows from changing the mindset ... I think it will come more to the fore with some more substantial generational shift. So, most people still have a planned economy in their heads, not liberal capitalism’. (INT\_16)

Planned economy legacy conditions a low competition culture, and includes examples of rent-seeking behaviour, such as shown in the excerpt from an interview with an NCA official below.

‘Q: What is the culture of competition in Croatia?

A: Low, inadequate, I think it is low, I think it is a consequence ... of a legacy ... planned economy ... state interventionism ... for example, taxi drivers have sought protection from the city [of Zagreb], protect me from the competition. ... It may be a matter of existence, people are afraid of the market, and when the market in the end, open market, competition, shows positive effects for those entrepreneurs themselves then they are no longer afraid of it’. (INT\_17)

Valuable insights on the lingering impact of the past economic model are provided in the following excerpt with an NCA official.

‘Q: ... what about entrepreneurs? Is there an acceptance of the market and competition as a given?

A: I think that they still have in their heads this kind of socialist model in which the state is expected to ... not to encourage competition, but to protect them ... These are various trade associations ... we live in a kind of guild system where every trade association essentially wants to limit competition in some way, and that is normal for everyone. That is a common perception ... is it because most people who operate in the market today grew up in that system ... and that they have a different understanding of the state and society? I do not know, but even today I think that it is normal for people to sit down and agree on ... prices, and they do not see any problem there. ... Maybe some of [the competition authority] activity ... whatever it is ... [the competition authority] existence distracts them from being completely transparent, but I think that even today, if

most of these things are resolved by some kind of agreement, why would we attack each other? Whenever you come, when you talk to people in that kind of direction, everyone would always defend their [turf]. ... Protecting ... their professions as if they were given by God, and that is the mentality of people who are used to the state enabling them everything. So ... not for them to move and do something on their own'. (INT\_15)

As the following excerpts from interviews with former and current high-level NCA officials illustrate, an inherent ingredient to the planned economy legacy is the 'culture of agreeing' – a specific way of doing business which includes direct and regular anti-competitive contacts between market participants in order to make the market transparent.

'Q: Is competition a universal value in Croatia?

A: I don't think it is yet ... because everyone is used to 'agreeing'. Unfortunately, that habit of 'agreeing' and that planned [economy] from the past ... I believe there are still some negative consequences today. I think that even these cartel decisions of ours are not taken too seriously in public ... maybe it's because they were smaller entrepreneurs, but if [it was] maybe [some] big, strong name with some other strong name ... there would probably be more awareness ... I think still in public, that perception is not what ... it should be'. (INT\_09)

'A: [In the early days of the competition system] it was considered – it was, I think, a legacy of socialism – that it was perfectly fine for those who should compete to agree on prices. That was, for example, the case of driving schools. So, they think it's perfectly fine for them to meet, decide that they'll have ... minimum prices and even make a minute of the meeting, or they publicize it and brag about it ... . This was also the case of Croatian marinas ... it was always an idea ... to eliminate unfair competition ... : let's agree and we will all be happy ... it will be quality service, and we will not compete with too low prices. It was, so to speak, a kind of ... a culture of agreeing on market sharing and prices. ... Especially at that time. ... They discuss that during their team building events, some informal meetings or hiking trips ... they coordinate their business plans ... At that time, there was always the idea: Let's get together and reach an agreement, and we'll all be happy that way. We will offer high-quality services and won't compete by offering low prices. That was ... the culture of making deals regarding market shares and price levels'. (INT\_04)

The price alignment mindset finds its support on the side of politicians, in particular as regards some basic products, such as bread and milk, as the next excerpt from an interview with a high-level NCA official shows.

'Q: How does the Agency deal with our legacy of a planned economy?

A: That is very difficult. That mindset has remained in the minds of many, especially in politics. Politicians think that [it would] be excellent ... if, in fact, prices were the same everywhere ... for some products. So, Croatia is obsessed with bread and milk ... Although ... I think more beer is consumed than milk ... So food is a very sensitive area where they want to do it'. (INT\_08)

As our research shows, both on the basis of primary sources (i.e., interviews) and secondary sources (i.e., competition authority decisions), in Croatia, planned economy legacy remains, even thirty years after the transition, an important factor adversely impacting competition system development. The embedded collusive practices show a high degree of resistance and are slow to disappear. The majority of cartels, as prosecuted by the competition authority, were formed within a trade association, with the idea of 'stabilising' the market as 'business as usual'. There is an absence of awareness on the side of mostly small and medium undertakings that price-fixing and other cartelising conduct was illegal. The public trade associations still seem to function on the premise of getting together the competitors with the opportunity for agreeing on the terms of competing in the market. An additional factor, still largely unrecognized in the literature, is the absence of a vibrant consumer protection NGO scene, with NGOs initiating a case before the competition authority in a very small number of instances, which we think shows a lack of awareness of the benefits of competition enforcement for consumers, and further points to a low competition culture.<sup>88</sup>

Some authors argue that legacy is only part of the explanation and that the causes of today's situation should be sought primarily in (1) exogenous shocks of war and transition due to which SOEs were designed and evolved as shelters from risk and uncertainty, (2) the design of the political system in modern Croatia with a crucial role of party leaders democracy, enabling party leaders to fight for more and more jobs to be allocated after the election, (3) the erroneous policies after 1990 (e.g., infrastructure investments that unnecessarily burdened the country's fiscal position), (4) delays in reforms, (5) the lack of alternative market opportunities due to delays in EU accession, and (6) other factors that have contributed to the emergence of a clientelist political system of illiberal democracy.<sup>89</sup>

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<sup>88</sup> For the importance of the NGO involvement, arguing that their success depends on a healthy relationship with other key stakeholders in an effort to promote and enhance competition, see Pradeep S. Mehta, Udai S. Mehta & Cornelius Dube, *The Role of NGOs in Competition Law Enforcement*, in *Research Handbook on International Competition Law* 136 (Ariel Ezrachi ed., Edward Elgar 2012).

<sup>89</sup> Petrović & Šonje, *supra* n. 77, at 55–56.



#### 4.2 THE ROLE OF TRADE ASSOCIATIONS

Social norms can either reinforce or undermine the formal rules protecting competition in the market.<sup>90</sup> As Fehr and Fischbacher noted, ‘Legal enforcement mechanisms cannot function unless they are based on a broad consensus about the normative legitimacy of the rules – in other words, unless the rules are backed by social norms’.<sup>91</sup> A variety of cultural and historical factors can influence the development of social norms.<sup>92</sup> As described by Stephan, historically, cartel practices were not universally treated as objectionable or harmful, and their treatment outside North America has been favourable, mainly because of the past treatment of such behaviour by governments and the judiciary.<sup>93</sup> As Harding and Joshua explained, for most of the nineteenth and twentieth centuries, European governments treated many cartels as furthering the public interest. For example, in Germany, membership of cartels was sometimes compulsory – particularly in times of economic stability when collusive agreements were viewed as a useful way of stabilizing spiralling prices.<sup>94</sup> As part of the Austro-Hungarian Empire for centuries, Croatia shares this historical context.<sup>95</sup> Not much has changed after 1918, when Croatia entered the Kingdom of Serbs, Croats and Slovenes, and subsequently the Kingdom of Yugoslavia: cartels were not only allowed but were actively encouraged by the law as a matter of industrial policy.<sup>96</sup> The challenges related to competition system development in post-socialist European countries after 1990 can be poorly understood if we neglect the historical, political, and economic context that had shaped the underpinning social norms and institutions supporting cartelization.

Our research shows that, even after the socialist period ended, social norms conducive to collusion between firms were apparently preserved through the vehicle of public trade associations. Historically, trade associations had no direct decision making power but rather held power through their lobbying activities.

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<sup>90</sup> ‘Social norms are difficult concepts to define, but they ‘instinctively inform people’s first reaction to a given activity’, Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. Penn. L. Rev. 1697 (1996).

<sup>91</sup> Ernst Fehr & Urs Fischbacher, *Social Norms and Human Cooperation*, 8 Trends Cognitive Sci. 185 (2004).

<sup>92</sup> *Ibid.*

<sup>93</sup> Stephan, *supra* n. 15, at 354–355.

<sup>94</sup> Christopher Harding & Julian Joshua, *Regulating Cartels In Europe: A Study Of Legal Control Of Corporate Delinquency* 76 (Oxford University Press 2003).

<sup>95</sup> The establishment of trade associations, which would have advisory role to the government and act as facilitators of economic growth, was widely encouraged in mid-nineteenth century, under the auspices of Karl Ludwig von Bruck, the Austro-Hungarian minister of commerce. See Ivana Žebec Šilj, *Zagrebačka industrija 1935.-1939. u kontekstu međuratnog gospodarskog razvoja* 267 (Institut društvenih znanosti Ivo Pilar 2017).

<sup>96</sup> Žebec Šilj, *supra* n. 95, at 264, 255.

Through a formalized structure, trade associations enabled a forum for regular contacts including discussions between firms on issues of economic policy, a direct role played in the economic life, and obvious influence on the market.<sup>97</sup> This hardly changed throughout the socialist period, but also continued in the post-transition era, with public trade associations in modern day Croatia providing institutional framework nurturing the culture of agreeing. Public trade associations, with their mandatory membership status, which requires all firms established in Croatia to become members, are naturally not illegal per se. However, as an easy contact point, public trade associations create ample collusion opportunities.

After the first Competition Act was adopted in 1995, the legitimacy of such a role for public trade associations was de facto challenged by the competition authority. A line of cartel infringement decisions sheds light on the contribution of the trade associations, both public and to a lesser extent private, in preserving cartelization culture status quo in Croatia, by exposing collusive activities taking place within trade associations.

The Croatian Chamber of Economy (CCE), a public trade association, requires mandatory membership for all firms established in Croatia and groups members in various industry sections. The CCE importance is significant to the economic life of the country. This is best illustrated by the fact that in 1995, when the competition authority was first established, the Parliament appointed the CCE Chairman as one of the Competition Council.<sup>98</sup> Early on the conflict of interest was recognized, even before the NCA started properly functioning.<sup>99</sup> The following excerpt from an interview with a high-level court judge helps to contextualize the process of emancipation of the newly established competition authority.

‘The first law was passed in 1995, when the Agency for the Protection of Market Competition was established, as an independent legal entity. Attempts were immediately made to separate it from the Chamber of Economy on the one hand, and the Government of the Republic of Croatia on the other’.

(INT\_29)

However, the competition authority and the CCE mismatching goals were obvious from the beginning. The clash between the collusive paradigm of old and

<sup>97</sup> For example, in 1935, reacting to new market entry in the shoe industry, the Industry Section of the Zagreb Chamber of Commerce and Industry suggested that the establishment of new shoe factories, as well as the enlargement of existing ones, should be prohibited. Žebec Šilj, *supra* n. 95, at 271.

<sup>98</sup> Competition Council, an eight-member body, an advisory body with no formal decisional powers but highly influential in advising the Agency Director on deciding in individual cases. Decision on the appointment of the President and members of the Competition Council, Official Gazette of the Republic of Croatia no. 109/1995.

<sup>99</sup> Decision on dismissal of the President and part of the members of the Competition Council, Official Gazette of the Republic of Croatia no. 66/1997.

the newly established market economy paradigm is best described by an interview excerpt with Deša Mlikotin Tomić, first competition authority Director, describing a reaction by the CCE Chairman to the information that price-fixing was prohibited by the law:

[O]ne of our first cases [was] ... a company importing orthopaedic aids ... Prices [were] negotiated in a special Chamber Committee and [Mr] Vidošević [the then CCE Chairman] was probably present at the [Competition Council] meeting. When they [at the Competition Council meeting] said it was forbidden, he was shocked and said: “Do you know how hard it is for us sometimes to reach agreement on prices, because one entrepreneur prefers a higher and another [entrepreneur] a lower [price]? And how hard work it is! And you are now explaining to us that it is forbidden?” They could not get it at all. Also, we had a legacy of self-management agreements and social agreements where markets were monitored and prices negotiated. (INT\_01)

The absence of awareness of competition rules and low competition culture were all present in CCE industry sections. The following excerpt from an interview with a former high level NCA official sheds additional light on the ‘culture of agreeing’ as put into practice by various CCE sectoral groupings.

‘A: ... there were even cases when ... [the CCE] ... sectoral associations, that even those decisions that were illegal were either formally adopted by those sectoral associations ... Formally, the [CCE] was ... explicitly in favour of encouraging competition and it also supported the work of the Agency ... it was ... the legacy of socialism when ... there were some self-managing agreements and social agreements and ... entrepreneurs felt that they were simply allowed to connect, to agree in any way they wanted’. (INT\_04)

From 1997 until 2018, most of the cartels prosecuted by the competition authority were established during the trade association’s meetings. This indicated a systemic issue with public (as well as private) trade associations as facilitators of anti-competitive contact. Arguably, the model itself is problematic: mandatory membership as a perpetuating force for enabling collusion. The following excerpt from an interview with a former high-level NCA official further illustrates the role of the trade associations as collusion petrifiers.

‘A fascinating thing for me is that no one in the ... CCE understood ... we must abolish them, what kind of associations are they now, why do they have to be there? What interests do they promote? They discuss their prices and the problems they have in doing business ... The CCE was formed on the basis of some, today anachronistic, opinions that the state must provide entrepreneurs with some kind of protection, a framework for action and so on’. (INT\_03)

The issue of trade association facilitated collusion breaks open in the Bus Operators case, indicating its systemic nature.<sup>100</sup> In the proceedings before the competition authority, one of the parties, a bus company accused of cartelising the market, stated that:

there is a long-standing practice of business communication, exchange of information and experiences, commercial analysis, etc. among carriers in the field of public scheduled passenger transport in the Republic of Croatia, through mutual business contacts or institutionalized activities through the CCE Road Carriers Grouping.

Indeed, the director giving the statement argued that due to ‘the specificity and sensitivity of road passenger transport’ it was necessary to ‘continuously monitor and provide directions on how to proceed regarding questions of transport safety, service conditions, fuel problems, and certainly ... the price of services’.<sup>101</sup> Furthermore, the CCE Road Carriers Section even sent a letter to the competition authority confirming that ‘a meeting of the Passenger Transport Group was held to discuss “problems in passenger transport operations, and in particular transport prices”’.<sup>102</sup> This statement was later denied by the CCE central office as ‘clumsily drafted’, assuring that ‘the CCE expert staff informed all entrepreneurs that each of them can and must independently determine the prices of services’.<sup>103</sup> Despite contradictory statements coming out of the trade association in this case, it was clear that one of the usual tasks of an industry grouping within a trade association was to come up with a price calculation that was shared with all members of the relevant grouping.<sup>104</sup>

Frequent informal contacts in a small market coupled with low competition culture obviate a need for formal agreements within trade associations, and nevertheless, as the following excerpt from an interview with a competition law practitioner shows, such formal agreements abound.

‘A: Given that the market is small and ... because of that, very transparent, and for other reasons, it seems to me that it is inevitable that cartelization exists. ... I think that the task of the Agency is even more difficult because the cartels in our country, it seems to me, are quite easy to implement. Everyone ... knows each

<sup>100</sup> Decision of the Croatian Competition Agency of 24 Sept. 2007, *Competition Agency v. Autobusni promet d.d. Varaždin et al.*, UP/I-030-02/2006-1/39.

<sup>101</sup> *Ibid.*

<sup>102</sup> *Ibid.*

<sup>103</sup> In its final decision, the competition authority decided not to go against CCE, holding that its previous statements were ‘clumsily formulated and as such represented an isolated submission of the Passenger Transport Group’. *Ibid.*

<sup>104</sup> The CCE stated that ‘carriers do not have a harmonised cost calculation’ and that ‘prices are determined by market supply and demand’, and that ‘the price calculation proposal, made by the expert staff of the CCE’s Transport and Communications Grouping, shows that the level of one’s own price depends on one’s production and is different for each carrier and each transport’ and that ‘there is a dependence of the price on the kilometres travelled’. *Ibid.*

other. Everyone communicates and often in very informal ways. ... The situation is, of course, similar abroad ... people know each other, communicate by phone and one way or another, but still, there is some compliance, the system is much stricter, and the penalties are much stricter, cases are much more common. Here, given some shortcomings in terms of implementation, it seems to me that entrepreneurs are much more comfortable in that sense, and not only more comfortable but oftentimes my impression is that they are not even aware that what they are doing is, that is impermissible. ... I think it is completely conceivable that [firms are] also not aware that the competition agency exists at all ... if the Agency [finds infringements] in CCE industry groupings whose members are ... practically everyone who participates in a market, and ... are certainly not all best friends and best acquaintances ... so, if [the Agency] founds infringements of this type in a broader and more formal environment, then it is evident that such violations, and even more serious ones, must be found also in narrower ... and more connected circles'. (INT\_23)

The following excerpt further illustrates the pervasiveness of trade association facilitated collusion, as perceived by a competition law practitioner.

'Q: Do you ... have experience with associations of entrepreneurs ... competitors that talk about prices?

A: I do. ... There are a lot of these associations and ... they need to be made aware ... how to behave there, how to react, what to talk about. ... The practice of foreign companies that already have ready-made rules on how to act benefits me a lot. So, if someone comes, picks it up, it is not enough to be silent ... you need to get up, leave. These are complex procedures, how to act in these ... situations because here [in Croatia] it is simple ... it is most normal for people to come, agree: C'mon you take this from me, I will take this, we will agree on the prices, we won't go below that, and he's aware that it ... and they're not even aware that it's basically a problem, on all sides'. (INT\_25)

Some progress is visible in the perception of the competition authority as an institution to turn to in order to check the legality of trade associations' internal statutes, as the following excerpt from an interview with an NCA official shows.

'A: What is happening to us now slowly is when an association ... wants to pass its own internal act, that we are perceived more as ... an educational body that will help them from the beginning to draft that code or internal act in accordance with competition rules. ... when drafting their internal statutes, [they] either make an inquiry or want to consult us ... it seems to me quite a big shift compared to before [when] not even the [government] institutions drafting a bill did not recognize us fifteen years ago; now already some professional associations recognize us. ... It has been like this for about the last three years'. (INT\_20)

However, success is still elusive. Raising the awareness of anti-cartelization issues demands constant attention and effort, as a high-level NCA official noted.

‘A: [I]n the [CCE] the leadership changes ... department heads ... or directors of sectors, new people are coming ... there is always a need to re-educate ... what matters is constant education ... we have worked very hard to develop that awareness that trade associations must not ... be sponsors of a price agreement ... that they have to warn their members what is forbidden, what is allowed, what agreements are permitted, what absolutely forbidden ... by the law ... and I think we should work even harder on that ... now we are trying to establish good contact with the CCE ... we still have the opportunity to hold conferences, seminars at their premises, so that members of the CCE can come, to ask us freely to give an opinion in some situations ... but there are constant attempts to mooch ... I think it is mostly related to the changes in [CCE] staff and to ... knowledge about the consequences of such agreements’. (INT\_09)

As the following excerpt from an interview with a high-level NCA official illustrates, raising awareness through education of entrepreneurs is a way forward, despite potential misunderstandings on what is allowed and what is not.

‘Q: Are sectoral associations in trade associations a problem?’

A: To some extent, they are because, we have seen from many of our examples of prohibited cartel agreements, that they were concluded within the association.

Q: [W]hat should be done?

A: ... we need to come to the association and give them an education so that they understand when entrepreneurs come to their meeting ... where is the limit, what they may or may not discuss ... it is difficult with the associations, because it is easy to tell them what they cannot do, but [not] what they can do ... There is a thin line, but that is the only way you can help them ... I definitely think what should be done the same thing we did through [another advocacy project] at the local level, really people there do not know ... I taught in [a town in Northern Croatia], and I talked for two hours and after that, and it was all these small entrepreneurs ... and after two hours that I was explaining to them, a man says to me ‘What are you telling me now, that I cannot talk with my competitor at all?’ (INT\_12)

Lenient enforcement, through trade associations being fined only exceptionally, is undoubtably not a workable remedy for trade associations supporting collusion. As the competition authority continues to curbe collusive culture, at least through declaratory support of the CCE central office, various CCE industry groupings continued with ‘business as usual’, practically undermining the work of the competition authority and the efforts of CCE leadership to, at least formally, instruct its members to act in accordance with competition rules. This mismatch

between the official position of the public trade association and its inner-core workings creates a continuous tension, reflecting a bifurcated picture of Europeanization-driven normative demands on the one hand and pre-market economy, collusive paradigm, on the other. It serves as a fitting illustration of the unfinished transition to the market economy.

Anti-competitive collusion facilitated by trade associations as a phenomenon is not only pertinent to post-socialist economies. In the case of Croatia, the smallness of the country, along with its cultural traits, does not help to draw direct comparisons. Nevertheless, the eradication of cartel seeking conduct at associations' meetings as 'business as usual' will be a litmus test for a move to a more efficient competition system and a more deeply embedded competition culture. Nudging trade associations towards a more productive relationship with competition law, for example through compliance certification requirements or through plain language compliance guides from the competition authority, would probably be a step in the right direction.<sup>105</sup> However, it has been argued that 'if there is a perception within the industry that collusion is acceptable or that the chances of detection are low, then compliance programmes may simply serve to highlight how low the stakes are in relation to the enormous illegal profits that might be realized through a cartel'.<sup>106</sup> In a context of a low competition culture, and a low activity enforcer, the latter might unfortunately prevail. Besides compliance efforts, it has been shown that continued competition advocacy directed at the society at large is important to explain and gain public support for the anti-cartel agenda,<sup>107</sup> and that media coverage of cartel cases helps increase competition culture.<sup>108</sup>

## 5 THE EUROPEANIZATION PROCESS VERSUS THE COLLUSIVE PARADIGM

The discussion on the factors influencing the development of a competition system on the basis of the underlying country specific study was so far informed by two factors: the planned economy legacy and the role of the trade associations. However, a wider question still needs to be addressed of if and how the process of Europeanization, which started in the early 2000s, helped to transform the

<sup>105</sup> For a discussion of a relationship between corporate compliance and competition law see Spencer Weber Waller, *Corporate Governance and Competition Policy*, 18 Geo. Mason L. Rev. 833 (2011). For a practical discussion on corporate compliance programmes in the US context see Theodore L. Banks & Frederick Z. Banks, *Corporate Legal Compliance Handbook* (2d ed., Wolters Kluwer 2020).

<sup>106</sup> Andreas Stephan, *Hear No Evil, See No Evil: Why Antitrust Compliance Programmes May Be Ineffective at Preventing Cartels* 15 (ESRC CCP Working Paper 09-09, July 2009).

<sup>107</sup> Umut Aydin, *Attitudes Toward Collusion in Chile*, J. Competition L. & Econ., 00(00), 1-26 doi: 10.1093/joclec/nhaa022 (17 Sept. 2020).

<sup>108</sup> Emmanuel Combe & Constance Monnier-Schlumberger, *Public Opinion on Cartels and Competition Policy in France: Analysis and Implications*, 42 World Competition 335-353 (2019).

culture. The short answer is that the influence of the EU imposed conditionality requirement has been limited, due to a complex web of factors impeding the progress to a more mature system.

We believe that the example of Croatia shows how the transition to an effective competition system can be long, hesitant, and volatile. This process is intertwined with the unfinished transition to market economy, despite the strong effort on the side of the European Commission in the pre-accession period to support setting the necessary institutional and normative foundations in the country. In this regard, we observe a clash between the planned economy legacy and low competition culture, on the one side, and the almost two-decade long Europeanization process on the other.<sup>109</sup> In particular, in the post-accession period, we observe significant challenges to making legal transplants work, with the enforcement levels backtracking and with non-deferential courts adopting a hostile attitude towards the cartel prohibition.<sup>110</sup> This appears to contrast with more competition-friendly developments in the pre-accession period, when conditionality pressures arguably attenuated more competition-unfriendly voices.<sup>111</sup>

The fact that overt cartel activities persist even twenty-five years after the competition system was first established and that trade associations still act as collusion facilitators are red flags. The underlying reasons for the sluggish track record goes deep in the cultural and socio-economical patterns of society. It has been argued that the fight against cartels, which is counter-cultural, risks leading to

<sup>109</sup> For the example of another, older EU Member State struggling with instilling competition culture, see Vasiliki Brismi & Maria Ioannidou, *Criminalizing Cartels in Greece: A Tale of Hasty Developments and Shaky Grounds*, 34 *World Competition* 157 (2011).

<sup>110</sup> In the Private Security case, the Constitutional Court 'had disregarded several substantive presumptions developed by the EU Commission and the EU courts when applying competition rules in relation to anti-competitive agreements', see Alexandr Svetlicinii, *The Judicial Review of the Standard of Proof in Cartel Cases: Raising the Bar for the Croatian Competition Authority – Case Comment to the Judgment of the Constitutional Court of the Republic of Croatia No. U-III-2791/2016 of 1 February 2018 (Sokol Marić d.o.o.)*, 11 *Y. B. Antitrust & Reg. Stud.* 311, at 8 (2018). The divergence between the Constitutional Court's decision and the standard of proof according to the case-law of the Court of the European Union was also criticised by Siniša Petrović, *Tržišno natjecanje u praksi Ustavnog suda Republike Hrvatske – osvrt na recentne odluke Ustavnog suda (U-III-952/2017/'Presečki'/i U-III-2791/2016, U-III-6196/2016, U-III-2826/2016, U-III-2820/2016/'zaštitar'')* (2018), <https://hdppn.hr/wp-content/uploads/2018/06/usud-trz-natj.pdf>

<sup>111</sup> In the pre-accession period, the Constitutional Court played a supportive role in relation to the competition authority, when it held that the application of EU competition rules, prior to the EU membership, as interpretative instruments in competition cases before national competition authority, was in line with the Constitution. See Jasminka Pecotić Kaufman, *The Croatian Constitutional Court Upholds the judgment of the Administrative Court Confirming Its Previous Position on the Application of EU Competition Rules (Tisak)*, e-Competitions Bull. N° 36693 (2011); Alexandr Svetlicinii, *The Croatian Constitutional Court Affirms the Constitutionality of Certain Provisions of the Competition Act and Its Application in Conformity with the EU Standards (P.Z.A.)*, e-Competitions Bull. Art. N° 26123 (2008); Vlatka Butorac Malnar & Jasminka Pecotić Kaufman, *The Interaction Between EU Regulatory Implants and the Existing Croatian Legal Order in Competition Law*, in *Economic Evidence in EU Competition Law* 327 (Intersentia 2016).



unenforced criminalization.<sup>112</sup> Also, it was argued that the negative effects of transplants could be seen in a mismatch between those imported concepts and any special characteristics of the following jurisdiction.<sup>113</sup> This is precisely the case in Croatia. We find that a stark mismatch between the formal prohibition of cartel conduct and the dominant collusive culture plays a vital role in obstructing anti-cartel efforts in Croatia. In this regard and considering the lasting planned economy legacy, one of the relevant issues seems to be the legitimacy of the cartel prohibition.<sup>114</sup>

Weaknesses discussed above demonstrate how post-accession backtracking can be a significant challenge for the evolution of the competition system. Doubts remain if the Europeanization process, despite its intensity, had a lasting impact in post-transitional countries when it comes to the competition systems' effectiveness. More generally and concerning Southeastern European countries, Mandelski argued that Europeanization had a negative impact in countries with a weak rule of law – rather than being transformative, its impact was sadly reinforcing systems' deficiencies.<sup>115</sup> Somewhat pessimistically, he opined that 'despite empowering change agents and newly created structures, the EU does not transform the fundamental logic of political and judicial behaviour'.<sup>116</sup>

The ensuing question is how Croatia's institutions and players could be nudged toward a more developed culture of competition, minimising the legacy we effectively documented in this article. Nudging the system is a long-term and uncertain process, requiring, as Kovacic and Lopez-Galdos wisely noted, 'a mix of realism and ambition', with 'the sustained commitment to a virtuous cycle of experimentation, assessment, and improvement' yielding 'steady incremental improvements'.<sup>117</sup> More research is needed on the real impact of Europeanization on competition systems in post-transition economies. It feels as if the process of EU rapprochement allowed for a paradigmatic change *in abstracto* but fell short of reality. The fragility of the success of building a robust competition system, illustrated by Cseres on the example of Hungary, is eye-opening.<sup>118</sup>

<sup>112</sup> Ariel Ezrachi & Jiří Kindl, *Cartels as Criminals? The Long Road from Unilateral Enforcement to International Consensus*, in *Criminalising Cartels: Critical Studies of an International Regulatory Movement* (Caron Beaton-Wells & Ariel Ezrachi eds, Hart Publishing 2011).

<sup>113</sup> Gal & Fox, *supra* n. 8, at 300–301, 303.

<sup>114</sup> Stephan, *supra* n. 15.

<sup>115</sup> Martin Mandelski, *The EU's Pathological Power: The Failure of External Rule of Law Promotion in South Eastern Europe*, 39 *Southeastern Europe* 318 (2015).

<sup>116</sup> *Ibid.*, at 342.

<sup>117</sup> William E. Kovacic & Marianela Lopez-Galdos, *Lifecycles of Competition Systems: Explaining Variation in the Implementation of New Regimes*, 79 *L. & Contemp. Probs.* 85, at 122 (2016).

<sup>118</sup> Katalin J. Cseres, *The Implementation of the ECN+ Directive in Hungary and Lessons Beyond*, 12 *Y. B. Antitrust & Reg. Stud.* 55 (2019).

Evolution of the system is a long-term event, with its ups and downs.<sup>119</sup> The organic growth of the system, a process in which all the stakeholders are continuously involved in a learning-by-doing exercise of competition rules being steadily enforced, is much needed to discover one's potentials after the intensive pre-accession nursing period. The seeds were planted, the seedling is now out of the ground, however allowing it to grow requires constant attention.

## 6 CONCLUSION

During the last thirty years or so, competition rules were introduced in many jurisdictions all over the world, clashing with the 'inimical culture'.<sup>120</sup> In the early nineties, the ex-socialist countries in Europe felt a pressing need to pair the embrace of the market economy with a comprehensive set of antitrust rules to safeguard the competitive process. Many challenges were seemingly solved by taking over EU legal transplants in the pre-accession period, and by entering – post-accession – into a symbiotic competition enforcement ecosystem put into force in 2004 by Regulation 1/2003.<sup>121</sup> However, still significant are poor track records in some countries, in particular when it comes to anti-cartel enforcement, and struggles with institutional effectiveness, including challenges related to independence and resources.

Despite post-transitional economies having its country-specific, cultural and otherwise, peculiarities, they can still be treated as a group because these countries share specific common traits from the planned economy experiment implemented in the second half of the twentieth century. We believe that issues detected in one jurisdiction may be indicative of possible similar problems in other jurisdictions in the group. In this sense, we argue that the experience of Croatia, where our empirical study was done, is relevant for not only the group of countries that joined the EU in 2004 and 2007, but also for Southeastern European countries still waiting to accede.

In this article, using our country-specific insights from the qualitative research study as well as from the secondary sources, we attempted to identify the main underlining sources of frustration for a transition to a more mature level of enforcement. Along this line, there seems to be a need for more country-specific empirical research, but also for comparative studies regarding the post-transitional

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<sup>119</sup> The time frame for building a well-established competition law enforcement system is likely 'several decades', as 'consistent with the experience in the United States, Canada, Japan, the European Union, etc.', see Frederic Jenny, *Cartels and Collusion in Developing Countries: Lessons from Empirical Evidence*, 29 *World Competition* 109, at 111 (2006).

<sup>120</sup> Lewis, *supra* n. 13.

<sup>121</sup> Council Regulation (EC) No 1/2003 of 16 Dec. 2002 on the implementation of the rules on competition laid down in Arts 81 and 82 of the Treaty, OJ L 1 (4 Jan. 2003), at 1–25.

countries. Detailing competition systems development, since their inception, identifying and discussing their main developmental phases and characteristics, can help understand main drivers of their evolution.

This article contributes to the currently limited, yet promising, literature on the role of culture and (in)formal governance in a post-socialist society. Our first conclusion, related to the context, deepens the debate on the interaction between the dominant features of the national culture and the competition system. We provide empirical evidence to the claim on the previously examined negative correlation between selected dimensions of the national culture (collectivism, large power distance, and high uncertainty avoidance) and effectiveness of the competition enforcement. In a somewhat bigger picture, that finding based on qualitative evidence is in line with the listed cultural dimensions being negatively correlated with business-friendly legal setting and competitiveness of the EU countries (both 'old' and 'new' ones), i.e., studies analysing quantitative data. Our second conclusion tackles the modes of governance found in societies with weak or inappropriately developed formal institutions. Our research shows the relative primacy of the informal agreements within formal (trade) associations over prescribed (formal) rules and norms. Our third conclusion seeks for a more nuanced approach to a clash between the process of Europeanization and inherited collusion-friendly (in)formal governance mechanisms. Namely, a vast majority of evidence draws the attention to the influence of the socialist legacy on the competition system (and as such is partly linked to the first conclusion). This implies the need for the functioning formal institutions to be organically developed. That again requires taking into consideration the existing dimensions of the national mindset that has not shown to be susceptible to an efficient competition system. Hence, the outputs of this analysis are expected to be a starting point for future policy recommendations aimed at greater effectiveness of competition policies, particularly in post-socialist societies.

