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**It takes two to quango: post-Soviet fiscal relations,  
political entrepreneurship and agencification from  
below**

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## **Abstract**

The paper analyses the mushrooming growth of quasi-independent public agencies in the public sector of post-communist states. What at first glance seems to be a faithful transfer of institutions from the arsenal of New Public Management upon closer analysis turns into a very distinct phenomenon of post-communist transition. In the course of the 1990s, the amorphous public-private mix that was the Soviet political economy became increasingly differentiated as ex-apparatchiki turned political entrepreneurs branched out to create new commercial, collective, and even quasi-state regulatory bodies. The dividing lines between these new forms of organization, however, often remained quite blurry. This problem was further exacerbated by the severe underfunding of executive agencies that had become a notorious problem in post-Soviet countries. As a result, many agencies were forced to resort to private and semi-private sources of funding, and to commercialize their activities in order to support their official operations.

In the second decade of transition, post-Soviet governments have increasingly been trying to control the worst such excesses through various forms of public management reform, such as the introduction of Single Treasury Accounts or various forms of revenue and expenditure audits. However, such efforts have met many setbacks and reversals; in some cases – such as for instance in post-Rose Revolution Georgia – the very new managerialist arsenal designed to enhance cost efficiency and separation between policy, regulatory and services tasks have instead with the government's tacit approval been used to camouflage continuing hybridization and ballooning public sector employment. In other cases, such as Russia's, growing restrictions on one form of organization have simply stimulated a shift to different legal forms, in this case state unitary enterprises.

## **Keywords**

Post-communist transition, agency reform, New Public Management, Russia, Georgia.

# It Takes Two To Quango<sup>1</sup>

## Post-Soviet fiscal relations, political entrepreneurship and agencification from below

### 1 Introduction

Customs services run by private companies. Traffic tickets collected by private agencies. The Ministry of Health operating a pharmaceutical factory. A research institute subletting space in one of its buildings to a brothel. Real-world examples, all of them, and all of them either current or from within the past fifteen years. The countries or regions in which they took place were, respectively, Mozambique, the United States, Turkmenistan, and the Republic of Georgia ((Hibou 2003; Mikesell & Mullins 2001, p. 448, *The Messenger*, October 21, 2005). As these examples show, the recent past has been characterized by radical transformation of public administration worldwide focused on privatization, service delivery, outsourcing and greater financial autonomy to individual government agencies, rapidly spreading from its first adopters among OECD countries to large parts of the developing and transition world. (See among others Gill 2002; Laking 2005; Schick 2002).

Agencification has been particularly virulent in the post-Soviet world. Thus, just within tiny Georgia the number of officially recognized public law agencies rose to over 3,400 after the Rose Revolution (George *et al.* 2006, p. 41-42; for a summary of the Latvian case see Pollitt 2004). But do these examples also demonstrate that post-communist ministries and agencies are merely following a worldwide trend? Or is there a peculiarly transitional dynamic at work? Yes and no. Contemporary public management fashion known as New Public Management or NPM in short has indeed influenced the course of post-communist transition, not least through the many administrative reform and legislative drafting projects sponsored by international donors and financial institutions.

But as argued in this paper, post-communist agencification during the first decade of transition was largely as a home-grown phenomenon, fostered by an incomplete process of extrication from the old “mono-organizational” public-private mix and largely following a bottom-up logic (albeit often with tacit to active encouragement by governments.)

In a second developmental stage, large-scale institutional transfer of agency forms of organizations and various forms of budgetary autonomy did indeed set in towards the end of the 1990s and continues until today. However, this has been a complex and very loosely coupled process in which outward conformity with international managerialist ideology has often camouflaged

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<sup>1</sup> Thanks to William Tompson, Eugene Huskey, Don van Atta, Leonid Polishchuk, Peter Rutland and several others for commenting on this and earlier versions of the same material. A special thanks as well to Lia Sanikidze for her contributions to the Georgian material referred to in this paper, as well as to Richard Lax and others for comments on the Georgian case.

very different motivations on the part of both bureaucratic actors and governments.

Structure of the paper: The spontaneous growth of semi-autonomous agencies in the first decade of transition has been closely linked to Soviet organizational patterns. Accordingly, Section 2 begins by examining the Soviet economic and budgetary system, in particular the organizational divisions between budget and off-budget organizations that were to acquire crucial significance in the post-Soviet period. Section 3 explores post-Soviet developments in detail, looking at both funding mechanisms and the extent and foundation of agency autonomy in both the immediate transition and consolidation periods. Section 4 turns to the overall response and strategies of governments, and compares the very different use of new managerial forms in Russia and Georgia.

## 2 The Soviet Legacy

Post-communist transition had as one of its main tasks the creation of “public” and “private” actors in place of the “mono-organizational” state-cum-society typical of the communist system. This implied sweeping institutional changes all across the political economy, from the fiscal system to state-enterprise relations to social welfare institutions. Unsurprisingly, such a complex undertaking has been fraught with difficulties. Even after formal organizational separation, boundaries between the two spheres have remained less than clear-cut.

The attention both of neoliberal enthusiasts and of their critics has for the most part been squarely focused on the emerging “private” part of the divide. In designing their reform program, standard-bearers of the Washington consensus had above all called for “depoliticizing the economy,” (Aslund 1995) while largely taking for granted the logical opposite side of the equation - de-commercializing and re-building the state as a system of universal rules and procedures. As the pitfalls and complexities of transition have become more apparent, sceptics in their turn have zeroed in on such phenomena as Russian “oligarchs” and their proximity to political power.

Yet while much post-Soviet business has retained its cosy relationship with the powers-that-be, relying on political influence rather than on competitiveness, the transition of the public sector itself has been equally fraught with ambiguity. Just as “commercial” entities have been slow to depoliticize, many executive bodies have been slow to divest themselves of tasks more properly performed by the private sector, retaining or expanding commercial activities in addition to their (old or new) administrative/regulatory functions.

This process of expansion was aided by two factors. One, the conflict between formal and informal levels organization, which had been at the heart of the Soviet economy of shortage, spun out of control with the demise of the Party-state. Secondly, this was greatly facilitated by the fact that the supposed “mono-organization society” had in fact been anything but. T.H. Rigby’s (1977, p. 53) original definition had been justified because “nearly all social activities are run by hierarchies of appointed officials under the direction of a

single overall command.” However, underneath this single overall command lay deep institutional divisions. Rather than a single form of organization extending across the whole of society, there were clearly separate organizational spheres within the command economy, often associated with the mode of financing (budgetary vs. self-funded or cost-accounting based).

## **2.1 Formal vs. informal in the Soviet economic and budgetary system**

New approaches to management in the post-Soviet sphere have to contend with entrenched traditions. Ever since its beginnings, Soviet administrative doctrine fell firmly in the traditional mold. Heavily influenced by Henri Fayol’s views on hierarchy in organization as well as by Frederick Taylor’s “Scientific Management” movement, Soviet management thinking has viewed organizations as mechanistic entities, subject to top-down optimization. At the same time, the messianic potential of Taylorism found perhaps its fullest expression in the Soviet Union, where it contributed to the futuristic visions of sci-fi thinkers such as Aleksandr Bogdanov, and combined with other countries’ economic planning experience during World War I to lay the foundations for the later Soviet economic planning project (Beissinger 1988).

The reality, of course, was rather different. As brilliantly described by economic historians such as Zaleski and Ellman as well as theorists such as Janos Kornai, actual economic reality was dominated by short term action and reaction, that is, by quarterly rather than annual economic plans on the one and day-to-day adjustments on the other hand (Kornai 1992; Zaleski 1971; Zaleski *et al.* 1980). Five year plans, so thoroughly mythologized not just in the USSR but among Western observers as well, were useful as mobilizational tool and – to use Michael Ellman’s (1989; 2007, p. 23) apt phrase – “rationality ritual,” but had little to do with the actual management of an economy operated by bargaining and informal priorities set by politics and patronage systems (on the political background of this development, see Lewin 1973).

This disconnect between theory and reality was not just a feature of physical economic planning, but carried over into the budgetary sphere. If anything, it was even more visible in this area given that all through the Soviet period budget policy and institutions were so firmly subordinated to the exigencies of the planning process.<sup>2</sup>

Soviet budgeting, in theory at least, was a very clearly top-down system. Gosplan and republic planning authorities were the central actors, with monetary flows subordinated to physical resource flows, and the budget system itself in a merely auxiliary role. Besides making possible monetary transactions, one of the main functions of the financial system from the 1930s on was to

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<sup>2</sup> Unfortunately, Soviet public administration as such has not been covered much. Both then and now, research on budgetary and expenditure issues has most often been either of an aggregate nature or else centered on the nature and position of Soviet enterprises. Executives, in contrast, were tacitly assumed to be executives everywhere, and thus did not merit further exploration.

provide an additional instrument of control over enterprises: *kontrol' rublem*, achieved by restricting enterprises to a single, unitary bank account and strictly monitoring incoming and outgoing payments (Weissenburger 1983).

As to executive agencies themselves, lower-level units were deprived of the chance to formulate their own, independent budgets from the bottom up. Instead, budget compilation was a mechanistic exercise based on given, externally imposed parameters: on overarching economic plans as well as on existing physical infrastructure levels and an intricate system of expenditure norms and coefficients. (Amongst the latter, the most well-known were probably the geographic coefficients: thus, the famous “Northern Coefficient” provided for higher salaries in northern, especially mining regions. There was also a coefficient tied to geographical elevation, which according to local lore motivated the builders of the observatory complex in Georgia’s Abastumani mountain resort to locate some of its facilities just slightly above the elevation in question, thus securing the priced coefficient, and with it, higher salaries to all employees of the complex).

However, if this extensive use of spending norms restricted the budget compilation process at lower levels, by no means did this imply a corresponding increase in control by higher-ranked agencies. On the contrary, they as well saw their scope for intervention into the budgets compiled by their subordinate bodies tightly restricted by the inflexibility of the process itself. As a result, Soviet authorities had only limited influence on the allocation of resources within ministries and between a ministry and its subordinate bodies. As Martinez-Vazquez and Boeck (2000, p. 9-10) claim in their review of former Soviet bloc budget systems, “(i)n contrast to modern budgeting techniques, expenditure requests remained essentially unscreened as they proceeded through the administrative chain.” Jack Diamond (2003, p. 16) similarly argues in a study of the Russian case that “emphasis [in the Soviet accounting system] was on recording the last stage of the spending process, and the [Ministry of Finance] only aimed for cash control over the spending ministries, but not of prior stages of spending by the lower-level spending units (SUs),” a fact which he claims contributed significantly to the post-Soviet arrears crisis: “Concentrating controls on cash disbursements without controlling the commitments of SUs not only led to disruptions in orderly resource allocation within ministries but also to SUs accumulating arrears to the rest of the economy.” One major reason for the impotence of higher-level agencies was the concrete structure of Soviet budget classification, which grouped expenditure items by sectoral categories, rather than by specific agencies or programs, and thus impeded agency-level accountability (Mikesell & Mullins 2001, p. 445-446, 453).

## **2.2 Organizational divisions in the Soviet budgetary system: off-budget funding**

Organizational divisions appreciably contributed to the disjuncture between formal and informal fiscal power. Chief among them was “the distinction between the government sector and the state sector” (Kraan *et al.* 2008, p. 16), which lay at the root of the many off-budget accounts that were to acquire huge significance in the immediate post-Soviet period. Many funds, even when



they formed an integral part of a specific ministry's spending, were not part of the official government budget, rendering the latter largely meaningless. For most of Soviet history, there were no attempts to present an overall framework for public finances, a fact that Hutchings' (1983, p. 16) classical study of Soviet budgeting does not consider an accident:

Remaining parts of any unified financial plan which may exist at present can be traced only indirectly, and often with even less consistency and detail than in the case of the budget proper. A main reason for this may well be the different degree and manner of control over parts of the financial plan which are not included within the budget. . . The lack of systematic elaboration of the non-budgetary parts of the unified financial plan cloaks that document with an extra veil of secrecy, as is probably the intention.

The largest and most significant extrabudgetary funds were the large-scale social funds which in the majority of post-Soviet countries have persisted to this day.<sup>3</sup> However, there were also all kinds of other funds affiliated with ministries and other agencies, often based on fee revenue, for instance from admission charges to cultural institutions that were directly channelled back into operating costs (Hutchings 1983, p. 36).

Such extrabudgetary funds became one of the most important legacies of the Soviet system and will be discussed at length in the following section. Their immediate effect in the context of the Soviet system was to reduce both central control and transparency. As Martinez-Vazquez and Boex (2000, p. 20-21) summarize, "the budget accounting systems that [countries in transition] inherited from the planned socialist era were so fragmented that in many cases it proved virtually impossible to accurately determine the true size of the public sector."

Special accounts were often associated with specific organizational sub-units of ministries and other bodies. An example of this was cited in the introduction regarding a case from Turkmenistan, where the Ministry of Health operated a pharmaceutical factory of its own (Mikesell & Mullins 2001). Such arrangements were far from uncommon. Their prevalence can be explained by several factors. On the one hand, the mixed regulatory and economic character of Soviet administration in itself meant that direct economic activity often went hand-in-hand with administrative tasks proper. Secondly, under the conditions of the shortage economy many ministries and enterprises had resorted to vertical integration in order to buffer against the uncertainty of supplies and – as with the many sanatoria operated by various state bodies – provide nonmonetary perks to their employees. In both cases, subunits were often set organizationally apart from their parent body, in

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<sup>3</sup> Note that stringent usage should differentiate between extrabudgetary funds (such as, above all, the large social sector funds that to this day remain outside of ordinary government budgets) and extrabudgetary accounts- that is, separate individual accounts by ministries and agencies, many of which have survived the official shift to Treasury single account systems (Lorie 2003, p. 9-10). However, while the distinction is analytically useful, following local parlance most of the literature including most IMF debates continues to use the single term "extrabudgetary funds" for both.

particular when Soviet fiscal institutions put them under a cost-accounting rather than budgetary umbrella. This was especially promoted by the 1965 economic reform; as Stephen Whitefield (1993, p. 37) explains, since that time “(m)inistry funds themselves must be divided into two kinds: those to cover the costs of the ministry apparatus itself, and to pay wages and bonuses to ministry employees; and those for stimulation of enterprise activity and for branch-level investment. In order to maintain the fiction that ministries were state rather than economic bodies – see the discussion below – expenditure on the ministry apparatus was nominally paid out of state budgets until 1986.”

### **3 Public Sector Bodies In Transition**

#### **3.1 The context: loosening control and fiscal crisis**

In summary, while lower-level units faced rigid restrictions in their operations, the effective absence of control by higher-level agencies coupled with the overall fragmentation of the system under post-communism became the foundation for quasi- entrepreneurial activities within post-Soviet executives.

Bureaucratic entrepreneurship after 1991 developed according to the genuine meaning of path dependence. Soviet patterns did not predetermine post-Soviet development. Rather, existing institutions provided opportunities and building blocks often used in ways that could never have been anticipated by their original designers. New organizations in their turn frequently adopted existing formal as well as informal organizational patterns and strategies, as will be seen in the following sections.

With the end of the Soviet Union and the emergence of rudimentary market principles, budget mechanisms – previously subordinated to the physical planning process – assumed a new and unfamiliar significance. This went along with a reconfiguration of economic policy institutions at the organizational level. The previously all-powerful Gosplan and the republic-level planning bodies were converted into variously named Ministries of the Economy and divested of much of their former significance. The previously second-rank Finance Ministries, on the other hand, suddenly found themselves thrust into a much more prominent, and consequential, role. Not surprisingly, especially in the initial stages Finance Ministries lacked much of the necessary resources (human as well as technological) and organizational knowledge to handle the magnitude of its new tasks. As a result, control over the sub-ministry level in particular was not significantly improved compared to before. Even in Latvia, “basic financial accountability was not strong, partly because the Ministry of Finance was not particularly powerful, and could not direct other ministries to follow a particular set of financial procedures for managing agencies” (Pollitt 2004).<sup>4</sup>

While new budgetary management capacities were slow and difficult to build up, old control mechanisms had vanished along with the collapse of the

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<sup>4</sup> For an excellent account of the respective position of Ministries of Finance in several Central European studies see Dimitrov *et al.* (2006).

Soviet system. This applied both to political control, embodied in the Communist Party hierarchy, and to the old *kontrol' rublem* through the Soviet banking system. Volumes have been written about the downfall of the former. As to *kontrol' rublem*, it collapsed in similar fashion; the resulting fragmentation and privatization of the banking system has been described exhaustively in Joel Hellmann's (1993) and Juliet Johnson's (2000) Studies. As a result, and in common with many political entities from the Russian Federation government on down, ministries and subministerial units took their business to a number of newly emerged "authorized banks" (*upolnomochennye banki*) which profited handsomely and paid handsomely for the privilege. The erstwhile control mechanism became a relationship based on mutual benefits.

The first decade of transition, thus, loosened an already loose regime of control over ministries' spending patterns. This was vastly enhanced by the general fiscal crisis as overall budget revenues collapsed alongside domestic industrial outputs. The result, on the institutional level, was a reproduction of the old "economics of shortage" translated to a very different setting. Thus, the budget process in most post-Soviet countries displayed an eerie similarity to erstwhile physical output planning. Just as the Five Year Plans of old, annual budget deliberations became an exercise in political theatre. The "real" budget, meanwhile, was shaped ad hoc through (rarely if ever published) quarterly or day-to-day revisions. Given the unrealistic and wildly inflated budget laws, sequestration became unavoidable. However, it usually proceeded not in across-the-board fixed percentage cuts but rather – just as planning adjustments of yore – depending on respective recipients' political clout and informal (and very few formalized) priority orders.

The consequences of this form of budget process for most ministries and agencies were predictable: they lost out. Pension arrears, in the game of priority allocations, carried much greater risk of electoral upsets and social unrest than state executive bodies which, if push came to shove, could always find other, informal ways of mobilizing necessary resources. In consequence of this impeccable political logic, even such powerful and consequential agencies as the customs authorities found themselves constantly operating under budget for much of the 1990s. Thus, in the first quarter of 1994 the Russian space industry received a miserly five percent of planned allocations (Conference to Discuss State of Russian Space Industry 1995), while timber producers, between January and September of the same year, "received no more than 66.8 billion rubles out of an earmarked 362 billion rubles in government allocations" (1995). Similar figures of budget underfulfillment can be found for many individual agencies as an all-too-familiar litany of woes. (It should be cautioned, however, that many such figures have to be taken with a grain of salt in view of their provenance: If post-Soviet agencies claim to operate at x percent of needs these calculations are invariably based on traditional Soviet budget norms and coefficients and without any regard to actual contemporary functions and program targets.)

### 3.2 Seeking to survive: fee revenue and commercial activities

Executive bodies responded to funding shortfalls in an entirely predictable way. In addition to lobbying for a higher rate of implementation of planned budget expenditure, they increasingly sought to access alternative sources of revenue such as various forms of fee income and – more rarely but no means infrequently – outright commercial ventures. Given post-Soviet fiscal straits such strategies were at least tacitly, sometimes openly condoned by governments - even if such practices may have contradicted deeply held normative convictions about the proper role of state and private spheres.

Revenue from fees and service charges over time came to constitute a considerable part of ministry and/or agency income. While user fees of various types – such as, for instance, enterprise payments into extrabudgetary Road Funds – had certainly been applied in Soviet times, after the Soviet collapse their use skyrocketed and extended to areas that had not known them previously. This was true in particular of sectors such as healthcare and education that traditionally were provided free of charge. According to Mikesell & Mullins (2001), for the Central Asian countries in 2001 “(f)ormal and informal fees typically amount(ed) to 10 to 20 percent of total institutional resources for health agencies, although in one country they (were) as high as 65 percent.”

The introduction of fees into public administration was a deeply ambiguous phenomenon. On the informal end of the spectrum many “fees” actually amounted to bribes. Formal, seemingly innocuous forms of fees can likewise be viewed through different lenses. As has often been alleged by scholars of corruption, the sheer number of fees and required permits – for many of which no concrete requirements were ever publicly accessible - may have formed part of an overregulation strategy intended to encourage the offer of bribes (see for example Karklins 2002, p. 25).

On the other hand, official fees may be an attempt to *obviate* the pressure for informal fees and bribes by introducing an element of marketization. They can thus be interpreted in line with such public management mantras as autonomy, efficiency and user and market orientation. It is clear that some forms of fees (along with retention of fee revenues) were newly introduced and encouraged by post-Soviet governments as a way to motivate and promote operational efficiency at the same time as ensuring ministry operation without committing too many scarce budget resources. This is certainly true of the mid-1990s incentivization scheme in which the Russians customs service was permitted to retain part of collected tariff payments for its own use (personal information from William Tompson, OECD Senior Economist.)

Whatever the reasons, fees in all shapes flourished and pinpointing real or alleged sources of fee income in various agencies soon became a form of popular sport among the post-Soviet intelligentsia. Thus, the Georgian Ministry of Justice according to unsubstantiated rumours received not inconsiderable sums from fees charged to other agencies as payment for publication of executive orders in the government’s official journal (confidential interviews, Tbilisi 2004 and 2005.) Whether in connection with

this or not, certainly the ministry demonstrated an unhealthy preoccupation with enforcing official publication even of private copyrighted material normally only available for direct sale to end users, such as Georgian adaptations of ISO norms.

Besides fees, executive bodies also engaged in **direct commercial activities**. Here, again, many such activities were based on practices established before the Soviet collapse. This was the case, for instance, with the Russian forest service. Under the 1997 Forest Code, funding for the forest service was provided out of stumpage fees. However, revenue from stumpage fees never amounted to much given that such fees were set at an artificially low level to begin with. In consequence, forest service units came to increasingly rely on their own, commercial sources of revenue. The possibility for such self-financing stemmed from one of Russian forest service units' core functions, that of conducting "sanitary cuttings", or forest thinning. As their share of all logging grew to a staggering 20 percent, a forestry expert in the Irkutsk regional administration reported in 2002, "sanitary tree cutting has increased sevenfold since 1993... In 1998 alone, forestry officials cut down 1.5 million cubic meters of timber under the pretense of doing necessary cleaning cuts" (Moscow Times, February 15, 2000.) As a consequence, forest service activities as a whole shifted focus. In some cases, regional forest management units came to maintain their own saw-mills, in some cases even creating separate commercial enterprises towards this purpose (*Lesnaia promyshlennost'*, February 1993.) As Greenpeace Russia claimed, as a result of these changes "the Federal Forest Service has thus been transformed from an independent controller of forestry to a competitor of the forestry companies, leading to serious problems in the control of forestry and the development of federal forest policy" (Lakehead University Faculty of Forestry and the Forest Environment 2003).

At the other extreme are commercial activities by newly founded state bodies patterned after Western models, such as the diverse Georgian regulatory commissions. Thus, as a 2003 IMF report (2003, p. 5) charges, both the Georgian Railway Commission and the Communication Commission were "also involved in providing commercial type service for a fee (and the revenue is earmarked for that agency)."

### **3.3 The organizational basis for hybridization: semi-autonomous agencies**

Commercial and fee revenue were routinely handled through separate accounts or sub-organizations, with the latter often a pre-requisite of the former (Remington 2004, p. 13). While both of these, had been part and parcel of the Soviet budgeting process, their mushrooming growth after 1991 would have been unthinkable in the old, semi-controlled environment. Thus, in early 1990s Central Asia "it was common to have many funds outside budgetary control. All tiers of government created extrabudgetary funds. ... For example, in 1995-96 ministries in the Kyrgyz Republic controlled more than 1100 extrabudgetary accounts or special funds... Known extrabudgetary funds in Kazakhstan (sic) accounted for 12 percent of GDP in 1993... In most cases, numerous special

funds of ministries have and, in some cases, still do exist” (Mikesell & Mullins 2001).

Semi-autonomous subunits, as argued in the preceding section, in many cases had existed within ministries and other bodies, often as part of their vertically integrated production and management patterns. In some cases these arrangements gradually became disentangled in the course of transition as former apparatchiki spontaneously privatized the more attractive operations among them; in other cases, ministries and other executive bodies held onto their cash cows.

An interesting case that developed largely in parallel across many former Soviet republics is the rising fortune of public but commercial protection police units. Based on the former Soviet “extra-departmental guard” units (*vinevedomstvennaia okebrana*) and of rather low prestige and skill (Shelley 1996, p. 140-141), these militia subunits had traditionally been paid not from the budget but by enterprises themselves (Juska 2009, p. 235). After the collapse of the USSR, this opened the doors to a lucrative business. With private business growing but far from established, demand for private or quasi-private security services blossomed. As to public security bodies, with budget funding to the public sector under severe pressure, this “extra-budgetary” form of funding suddenly made guard units much more valuable to their ministries. As Juska (2009, p. 235-236) described the Lithuanian situation, “(t)he Police Protection Office was retained by the national police primarily for budgetary reasons, whereby under conditions of chronic police budget shortages and underfunding, the protection office was and continues to be an important source of supplemental revenue. What makes this income especially attractive to the police leadership is that, unlike budgetary allocations, it can be spent at their discretion.”<sup>5</sup> However, it also created peculiar conflicts of interest, in particular in those cases where – as was the rule rather than the exception – public protection services were also charged with regulating private security providers (Hiscock 2006; Juska 2009).

### **3.4 Corruption or coping mechanism? The political and normative side of hybridization**

The hybridization of post-communist public sectors is still in need of thorough investigation. Despite that fact, or possible because of it, normative assessments of this kind of development vary widely. General social sciences accounts, both by sociologists and political scientists, tend to view hybridization through the prism of corruption and patron-client relationships. Thus, the Polish sociologist Antoni Kaminski (1997, p. 100) pinpointed rent-seeking and corruption as almost exclusive motives for the formation of post-communist agencies in Poland: “one way of obliterating the distinction between public and private consists in the creation of autonomous institutions, 'foundations' or 'agencies' of unclear status, with broad prerogatives supported

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<sup>5</sup> For detailed descriptions of the respective Russian and Ukrainian protection units see Favarel-Garrigues & Le Huérou 2004, p. 20; Hiscock 2006, p. 135 .

by administrative sanctions, and limited public accountability. The real aim of these institutions is to transfer public means to private individuals or organizations or to create funds within the public sector which can then be intercepted by the initiating parties.” Thomas Remington’s (2004, p. 13) nuanced and more politically astute analysis of Russian developments argues that “(a)t a time when the economic system was shifting from one based on the administrative control of physical resources to one in which money became a financial resource, off-budget funds enabled public entities to act as if they were private interests outside of any public accountability and to provide elected officials with politically useful slush funds.” In contrast, studies from within public finance and accounting – often elaborated in a public policy context – emphasize the deleterious effect of hybridization on public finance transparency, both in a fiscal transparency and anti-corruption perspective.

Overall, arguments focusing on the general phenomenon of commercialization have tended to be much more severe in judgment than sectoral studies dedicated to, for example, transformation in the health or higher education sectors. This reflects the fact that especially in the 1990s, agencies often resorted to commercial activity after exhausting other sources of support such as direct budget payments and fee revenue – betimes (as with the many academic institutions subletting space to commercial ventures) out of sheer desperation given the severe underfunding of academia in the post-Soviet context. In this sense, hybridization displays the same ambivalent traits – simultaneously fostering subversion of the system and system maintenance – as had the “old” late communist-era informal economy (for a brilliant example of this form of reasoning applied to Eastern Europe see Hankiss 1990).

Especially in the early years, hybridization in many cases was not even primarily about revenues, but about the constraints created by adhering to specific organizational forms, in particular the right to maintain a fully functional commercial bank account. As a consequence, exactly as in other areas of post-communist transition such as, for example, The formation of business interest groups, choice of organizational categories became an almost random process in which non-profit organizations, state bodies and joint-stock companies at times acquired an almost interchangeable character.

## **4 Governments and Agencies**

### **4.1 Top-down vs. bottom-up and the place of managerialist ideology**

As outlined in the introduction, agencification is commonly thought of as a top-down, technocratic process. Post-Soviet agencification clearly had very different origins. Built on Soviet-era institutional divisions, it thrived on a mixture of bureaucratic entrepreneurialism and sheer coping strategies.

That raises the question of what, precisely, was the role of governments in this process?

Certainly in the first decade of transition, given the general fiscal crisis there was not much choice. Governments ended up tacitly condoning hybridization. It was sink or swim: as governments typically were not in a

position to take on real control, they had little option but to grant de facto autonomy to agencies to use whatever means necessary in order to keep their organizations running. Corruption also played a role: obviously many at the top of the executive as well as legislative had a keen interest in arrangements that could benefit them personally as well as shore up their patronage networks. (For an excellent discussion with many details of 1990s Russian politics see Remington 2004, p. 13-14).

At the same time, this grudging assent frequently remained ambivalent. This is even more clear of the public attitude to commercialization. Although space reasons do not permit a detailed analysis and documentation, it is clear from following post-Soviet media that the hybridization of public administration contradicted deeply held convictions on the proper relationship of public and private functions.<sup>6</sup> And while many governments may not have objected to the corruption that oftentimes went hand-in-hand with commercialization, the public certainly did.

This is where managerialist discourse truly came into its own. Barely visible in the immediate transition period, in the longer run institutional transfer of the NPM arsenal held out a twofold promise. One the one hand, the superficial similarity between NPM and post-Soviet agency formation offered a way to legitimate a much more messy reality. At the same time, those disillusioned by this reality seized on new managerialist' promises of radical reform.

These two aspects partly overlap with the two stages of agencification mentioned earlier. While in the first stage, agency forms of organization grew and adapted in a chaotic, bottom-up fashion, the second phase of public management transition gets much closer to an actual transfer of institutions. However, this process was often more about legitimacy than effective organizational change, and hence, went hand in hand with considerable degrees of loose coupling. In this final section, this will be discussed by addressing the different ways two post-Soviet governments – Russia and Georgia – have used the arsenal of New Public Management.

## 4.2 Russia

The decentralization and commercialization described above as typical of the first decade of transition had taken a particularly virulent form in Russia, leading to an extreme degree of fragmentation. As of the early 2000s, “There [were] 31,000 [extrabudgetary] accounts at the federal level alone in the Russian Federation, with own resources estimated to amount to as much as 15-20 percent of budget expenditures” (Lorie 2003, p. 9-10). As to organizations themselves, in fiscal year 2000 the total number of budgetary spending units (including subordinate budget organizations receiving budget funding as part of a superior organization's budget line) were estimated at 5,000 in the defence

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<sup>6</sup> For the role such convictions played in the disastrous 2006 reform of the Russian Federal Forest Service, see Lehbruch 2012.



sector and around 50,000 for the rest of the executive (Diamond 2002, p. 127-128).

### ***Budget system reform***

Lack of control on the part of the Russian government, as well as pressure from international financial institutions which had been major donors throughout the 1990s prompted tightening up procedures.

This meant for one thing giving a larger de facto role to supportive institutions that had already been set up in the first years of transition but so far had failed to make much of an impact – the Federal Treasury (in 1992) and the Accounts Chamber (in 1994).<sup>7</sup> A big step towards that was the passage of the new Russian Budget Code in 1998. This cut down on administrative discretion within spending agencies by providing for audit and sanctioning procedures and enhancing the weight of Parliament in the budgetary process (Remington 2004, p. 12-13). On a technical level, it operationalized the Treasury system by making the treasury Single Account System mandatory, and explicitly abolishing the use of extrabudgetary accounts (Diamond 2002, p. 135).

Even considering just the Budget Code itself, tightening control came with some glaring gaps. Extrabudgetary accounts may have been abolished on paper, but this was not implemented in practice as the relevant provisions in the Budget Code contradicted those set up by the Civil Code which left market income by federal government sub-units off-budget; perhaps unsurprisingly, administrative practice has followed the latter rather than the former (IMF 2011, p. 89). Moreover, the Budget Code restrictions on extrabudgetary revenue did not apply to regional and local governments, for whom it was estimated at 20 per cent of their total revenue (Kraan *et al.* 2008, p. 16). It also exempted the most severely underfunded sectors of the Russian political economy – health, culture, science and education, although from 2001 insertions were made to annual budget laws in order to require full registration of all off-budget revenues (Diamond 2002, p. 135). Finally, Ministry of Defense organizations were also permitted to maintain extrabudgetary revenues (Diamond 2002, p. 135). This presumably included the infamous railway and construction troops maintained by , and fought about, by different “power ministries”: As the recent study by Brian Taylor (2011, p. 41) points out, “(c)ontrol over construction troops consisting largely of draftees provides a ready source of ‘slave labor’ for agencies that control it, and this labor can easily be converted into money. The commercial value of the power ministries was one of the key drivers of their ‘reform’ and activity.”

Paradoxically, tightening budget procedures raised the attractiveness of quasi-autonomous agencies for bureaucratic politics: While the Budget Code had in theory required commercial extrabudgetary revenues by federal entities to be integrated into the budget and the single treasury account system, this

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<sup>7</sup> Remington (2004, p. 12) mistakenly claims that it was only the 1998 law that “introduced a treasury system for the first time.”

was not true of their subordinate agencies such as state unitary enterprises (Kraan *et al.* 2008, p. 16).

### ***Organizational reforms: the Kozak commission***

Russian proponents of administrative reform were clearly influenced by international managerialist models which they had identified as the solution to their problems. They did succeed in adopting ambitious administrative reorganization proposals, but as ever, implementation was the weak link. This was certainly true of the 2003-2004 Kozak commission which elaborated the 2004 presidential decree 314 “On the System and Structure of Federal Organs of Executive Power” (see for example Golomolzin; Shevchenko 2004, p. 194; Timoshenko & Adhikari 2009, p. 499). At the heart of the reform was the idea of restructuring of public administration according to functional reviews. The main functional division was to be between the public sector functions of rule-setting, rule enforcement and rule implementation – to be entrusted, respectively, to ministries, services, and agencies (Konov). Although the actual government downsizing envisaged resulted in less of a bang than a whimper, the new classification – clearly inspired by New Public Management doctrines – did remain influential, and certainly has not been the last effort in this direction.

In the budgetary sector, one prime aim of the 2004 reform was to reduce the total number of budget institutions within the new three-tier system to – eventually – 1,500 rather than the 40,000 in existence at the time (Diamond 2005, p. 6). As to semi-autonomous bodies, the final goal of reformers was to either corporatize and later privatize them, or convert them into fully accountable public bodies as treasury enterprises (Tompson 2008, p. 13).

However, rather than with a decisive solution to the problem of quasi-autonomous agencies, Russian reformers ended up with a many-headed hydra of ever new organizational forms, none of which seemed to quite fulfill the expectations vested in it initially. With the creation of several new categories of public organization in the 2000s, the menu of options now included:

- Budgetary organizations - under Civil Code article 120 an “organization founded by the owner to conduct administrative, cultural and social, or other functions of a non-commercial character and financed by it in whole or in a part.” (Ashmarina & Kudryashova 2011, p. 4)
- joint stock companies in majority and sometimes minority government ownership,
- “state unitary enterprises” (*gosudarstvennye unitarnye predpriiatiia*), intended as a transitional category upon their creation (Tompson 2008, p. 13);
- “autonomous institutions”, a newer category created originally to replace state unitary enterprises; however, the most recent legislation also envisages the forced conversion of all budgetary organizations into autonomous institutions which would thus become a vehicle of performance budgetin mechanisms (Ashmarina & Kudryashova 2011, p. 5). According to Kraan *et al.* (2008, p. 17), “(s)tate unitary enterprises that would opt for the legal status of autonomous institutions would

keep their autonomy and be allowed to undertake commercial activities on an extra-budgetary basis. However, these institutions would belong to the market sector in public finance statistics and could no longer engage in (quasi-)fiscal activities without being formally subsidised (on budget).”

- “state corporations”, another new form of public organization intended primarily as a vehicle for public investment.

State unitary enterprises have attracted a great deal of criticism from advocates of public sector reform. The difference to ordinary budget establishments was in accounting models; as a 2008 OECD study explains, “(s)tate unitary enterprises are owned by the government but work on the basis of commercial accounts and commercial legislation. They are under ministerial responsibility, but off budget. They are auxiliary to a ministry’s activity, such as a printing house under the Ministry of Education or a production facility for police equipment under the Ministry of Justice. State unitary enterprises have a distinct legal status, different from regular market sector corporations. There are also many state unitary enterprises at the regional and local level.” (Kraan *et al.* 2008, p. 16) However, in practice the dividing lines between the two forms of organization often blurred; thus, many “budgetary” organizations – such as swimming pools and civil service canteens – were based entirely on paid services, while on the other hand it was not uncommon for unitary enterprises to operate on the basis of budget funds (Kovalevskaya 2005, p. 6).

It is precisely this fuzziness which has made unitary enterprises attractive to bureaucratic actors. As William Tompson (2008, p. 13) argues, with this category of organization “property rights are poorly regulated and monitoring is weak. This has made the GUP a popular organisational form for state enterprise managers and bureaucrats who oversee them; GUP managers and the state institutions that oversee particular GUPs have often put up fierce resistance when attempts were made to corporatise them. Even if no privatisation is envisaged, corporatisation involves a degree of transparency and accountability that GUP insiders and their patrons in the bureaucracy often wish to avoid.” Unsurprising, then, that the complete elimination of state unitary enterprises so far has turned out a failure, although their numbers have indeed gone down considerably, from 11,000 unitary in 2001 to 3,765 as of January 2009 (IMF 2011, p. 88; Kovalevskaya 2001).

### ***Performance budgeting reforms***

While the Budget Code and associated organizational reforms were intended to bring quasi-autonomous agencies under tighter control, the last few years have seen a countervailing tendency with Russia’s move towards performance budgeting and hence, a “more devolved system of budget management” (Diamond 2005, p. 9). This is a development currently still very much in progress, with much of the necessary legislation adopted only in the course of 2011 or still outstanding. Under this framework, not just state unitary enterprises but also “all the budgetary institutions are obliged to change their legal status and become one of the three types of institutions: autonomous, budgetary (new budgetary institutions) or government institution” (Ashmarina

& Kudryashova 2011, p. 7). In all three instances, they will also be subject to new strategic planning and monitoring mechanisms as well as functional reviews.

This is ambitious in the extreme, and many questions have been raised about it. Even during the planning phase, IMF experts – although broadly supportive – had warned of the accountability and control issues implicit in the reform, and also of the considerable degree of state capacity required (Diamond 2005, p. 13-15).<sup>8</sup> Russian accounting experts have evinced a great degree of skepticism on the feasibility of implementation, given the complexity of the required adjustment and retraining across a wide variety of public sector organizations (for example, see Timoshenko 2008; Timoshenko & Adhikari 2009).

What is perhaps even more interesting is the question why such a reform – ambitious even by the standards of OECD countries – is being attempted in the first place. This is even more curious as it contradicts the Putin-Medvedev era's general trend to greater state control and ownership in the Russian economy - thus, Tompson (2008, p. 3-4) cites the fact that “(a)ccording to one recent estimate, the state-owned share of Russia’s equity market capitalisation rose from just 20% in mid-2003 to 35% in early 2007.” Usual explanations of institutional transfer, such as IFI pressure and conditionality, plainly do not apply in a situation where the country last received assistance over a decade ago. Timoshenko and Adhikari (2009, p. 507) attempt to explain the development in terms of Powell and DiMaggio’s concept of normative isomorphism; as they argue, “the inclusion of new accounting and budgeting techniques into the political rhetoric, calling for better governance, accountability, efficiency, and effectiveness may be classified as a symbol of legitimacy, intended to bolster the image of the Russian state as more “progressive” and “modern” in the eyes of external parties and others.” If true, obviously this raises even more questions about the ultimate implementation of this very complex reform.

### **4.3 The Georgian government and the agencification drive**

The Georgian public sector in the Shevardnadze period, experts as well as direct stakeholders agree, had become famously corrupted. Writing about the pre-Rose Revolution Interior Ministry, Hensell (2010) justly describes it using the concept of “patrimonialism as the practice of the acquisition of offices and material resources.” After 2003, the new Saakashvili government came in bearing the placard of anti-corruption reform, promising radical liberalization as well as a managerialist overhaul of the public sector.

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<sup>8</sup> This cautious but supportive position is an interesting contrast to the rather different conclusions reached by a World Bank author team on the feasibility of NPM-style public management reform in Russia, given in particular the dangers inherent in management devolution below what the authors call the “threshold of formality” (Manning & Parison 2003).

Agencification was an integral and important part of this plan. As early as 1999, public law agencies had been given a statutory basis as an institutional transfer from the German “Körperschaft des öffentlichen Rechts,” *sajaro samartlis iuridiuli piri* in Georgian and usually rendered from Georgian to English as “legal entity of public law” (LEPL.) The choice of a German organizational category was apparently motivated by the fact that leading Georgian constitutional lawyers of the Shevardnadze era had been trained in the German law tradition (Interviews, Tbilisi 2004-2005.)

Little used at first, five years later public law agencies became the Saakashvili government’s vehicle of choice for civil service reform. At the level of overall administrative reform, both New Public Management in general and agency reform in particular formed a crucial part of the new team’s agenda. LEPLs were vigorously promoted by central government. The February 2004 Law on the Structure of the Georgian Government gave them a central role alongside ministries, and in Article 12 specifically envisaged the transformation of several, hitherto department-ranked units into agencies, including in some cases an (often ignored) timetable but leaving most details open for further determination by separate government commissions.

The agencification project did not stop at statements of intent. Over the next months, finance ministry officials visited different line ministries urging the transformation of departments into agencies, and underscoring the urgency of their request with alleged IMF demands – the latter promptly refuted by the IMF Resident Representative who upon enquiry pointed out that, in the Fund’s eyes, agencification posed risks to transparency (personal communication from Don Van Atta, Development Alternatives, Inc, Tbilisi, 2004). As a result of this campaign (but also partly due to the conversion of public schools into independent agencies) the number of officially recognized LEPLs rose from ca 700 as of 2003 to over 3,400 after the Rose Revolution (George *et al.* 2006).

Agencification, thus, was a project conceived with considerable zeal at the top and imposed campaign-style across a wide variety of public organizations. As it was initially rolled out, very likely the campaign may have been at least partly motivated by the desire to separate ministries from their cash cows. This conclusion is even more tempting given the persistent rumors floating around Tbilisi in 2005 and insisting the Ministry of Finance was considering consolidating all revenue-generating LEPLs into a single super-organization under its own roof. If this was indeed the plan, however, it was soon abandoned. Within the first two years of the Saakashvili government, reformers and ministries seemed to have reached a quiet accommodation for mutual benefit.

This is illustrated by the prospering of what was certainly one of the more mind-boggling new public law agencies created after the Rose Revolution: the former Soviet extra-departmental guards units, now the (public yet commercial) protection police SPD (for details on the following, see Lehbruch & Sanikidze, 2012 forthcoming). In accordance with the government’s general ideological stance, the stated intent of Georgian politician’s had been to privatize all or crucial parts of this notoriously corrupt organization. Since then, however, the protection police has instead been

gradually reinforcing its position, even acquiring a dual role as both regulator and competitor of private security services.

Agencification played a crucial role in this development. The stunning reversal of stated policy intentions was made possible by re-branding the protection police using the arsenal of neomanagerialist reforms, in particular the newly introduced status of public law agency, in order to camouflage a form of organization very much at odds with the proclaimed direction of public sector reform. What resulted was not – as demanded by NPM doctrine – a neat separation between regulatory tasks and services, but rather a hybrid body, both public and commercial, competitor and regulator. Its relationship with its parent ministry was not so much about managerial independence and accountability but rather one of mutual dependence, with the protection police serving as a buffering mechanism providing the ministry both with financial support and a way to cushion the radical layoffs undertaken in the course of police reform.

From the perspective of MIA, turning SPD into an agency had more advantages than disadvantages. On the negative side, agencification made it harder to maintain access to PPD's resources, and lessened overall management control. But at the same time, the looser connection between MIA and SPD removed accusations of impropriety and simultaneously made it the perfect buffering mechanism for the ministry. Besides financial resources, this was also true with regard to employment. After the radical downsizing of the 2004 police reform, SPD was the largest department in the MIA structure, with fully 40 per cent of total staff. SPD thus cushioned the impact of the overall MIA cuts. Even better for MIA, SPD helped to pad police employment without spoiling its radical reformist image: under LEPL regulations, agency employees generally are not counted toward overall public sector employment but rather listed under services (George *et al.* 2006, p. 43).

While SPD was certainly an extreme case of a post-Soviet public law agency, as well as unusual in the extent to which it was self-supporting, the general relationship between ministry and agency visible in this case mirrors the role of agencification for the country as a whole. From the beginning, the Saakashvili government has been very much bound up with its effort to project a poster child image of neoliberal reform. Public law agencies were a crucial part of this. On the one hand, the very radicalism of the initial top-down transformation helped to underline its – real or supposedly - radical approach to public management. At the same time, however, LEPLs provided crucial buffering opportunities, for example by hiding the true size of the government payroll, but also by camouflaging budget deficits. As an IMF review revealed in 2006, “(o)nce they have opened commercial bank accounts, LEPLs do not present information to the ministry of finance about their revenues or expenditures. Even when an LEPL has received a subsidy or transfer from the state budget, it is not required to report if or how those funds are spent.” (George *et al.* 2006, p. 43) This by extension also meant that international financial organizations, in spite of their very considerable presence in the country, lacked insight into the country's true fiscal situation (personal information from John Zohrab, IMF Treasury Advisor, Tbilisi 2006). At the same time, it is difficult to assess how much control and information the Georgian government itself actually has on public law agencies. It is indicative,

for instance, that there is still no comprehensive list of LEPLs operating in the country. The Ministry of Finance was reportedly working on such a list as far back as 2006 (George *et al.* 2006, p. 4), however its own “Public Finance Management Reform Policy Vision” of 2009-2013 still places this item on the “to do” list (Public Finance Management Reform Policy Vision 2009, p. 10).

#### **4.4 The end of transition? Agencies and commercialization from the late 1990s until the present**

For all the superficial similarity, a close chronological look at post-Soviet administrative development shows clearly that modern Western management doctrines has only limited influence over events and generally took second stage both to Soviet institutional legacies and ad hoc action by officials. In contrast, the second round of reforms has been much more targeted and also more ideologically coherent. However, as of today it is still unclear just how much actual change they have been able to accomplish. Since the late 1990s nearly all post-Soviet countries have begun to tighten the systems that made such excesses possible. Authorized banks have been largely abolished and consolidated into single Treasury Accounts, audit institutions have been strengthened or newly introduced, the functions of different types of executive bodies have been more sharply delineated and finally, governments attempt to connect agency functions, performance, and budgets through various forms of medium-term expenditure reviews.

However, many of these policies have encountered considerable problems during implementation. Thus, the much-vaunted creation of single Treasury Accounts has only gone so far. Well into the second decade of transition, even in EU candidate countries such as “there were instances of the holding of private bank accounts outside the centralised Treasury system.” (Pollitt 2004, p. 288). Other areas of fiscal reform similarly continue to be plagued with problems.

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