By law and by custom: Factors affecting small and medium-sized enterprises during the transition in Lithuania
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Chapter 2: Institutions and Entrepreneurship

2.1 Introduction

*It is easy to turn an aquarium into cold fish soup. It is more difficult to turn cold fish soup back into an aquarium*.

The switch to a market-oriented economic system in transition countries like Lithuania did not begin from scratch nor did it begin with all the necessary market institutions in place. From the outside, it seemed like the centrally planned system of the USSR had destroyed the spirit of private enterprise. But was it really cold fish soup or were there any ‘entrepreneurial’ fish still alive in the seemingly stagnant centrally planned fish bowl? Institutional and entrepreneurship theories provide useful tools for exploring the impact of the transition process on the development of entrepreneurship and private business in Lithuania.

Institutional theory is not new within Economics yet it has gained a new importance as a result of the difficulties encountered during the economic transition process in the former Soviet bloc countries. Unlike mainstream economists, institutional theory and institutional theorists give explicit attention to institutions and their effect on economic development in transition countries (Knaack 1995; Nørgaard 1996; North 1997a; Feige 1997; Yeager 1999; Hedlund 1999; Van de Mortel 2002). Within the institutionalist school there are two distinct approaches: the old institutionalists (such as Thorstein Veblen and John R. Commons) and the new institutionalists (such as Ronald Coase, Oliver Williamson and Douglass North). This thesis focuses on the new institutional approach as developed by Douglass North. In the following section, we present a description of the new institutionalist approach, its emergence as an approach within economic research and its relevance for transition countries. The specific case of informal institutions in post-Soviet Lithuania is highlighted.

The treatment of gender by institutionalist theorists has been mixed. T. Veblen emphasized the influence of socially created roles for men and women as illustrations of institutional outcomes and argued that the ideal of private property (1899) and women’s dress (1894) were expressions of a gendered value system. In his book (1990), D. North mentions women’s role in society as an example of an informal rule yet does not provide any further elaboration. Other studies have used the institutional
approach to analyze gendered issues such as male/female wage discrepancies (Greenwood 1984), pay equity (Mutari & Figart 1997), privatized pension schemes (Bernasek & Shwiff 2001) and increased likelihood of poverty for female-headed households (Pressman 2002). In section 2.3, the concept of gender in economics, in institutional theory and in Soviet and post-Soviet Lithuania is introduced.

Though both an exciting and important area of study, entrepreneurship research has been characterized by little consistency or concrete theory (Baumol 1968; Herbert & Link 1989; Kirchhoff 1991; Van Praag 1996; Wennekers & Thurik 1999; Verheul et al. 2001). As Wennekers and Thurik comment: Entrepreneurship is an ill-defined, at best multidimensional concept (1999:29). This complicates the development of a theory of entrepreneurship. As Kirchhoff observes: ...the absence of a widely held theory of entrepreneurship constrains not only economics but also all the disciplines that extend their interests into the entrepreneurship arena (1991:109).

Our aim is to develop a working definition for productive entrepreneurship in transition countries. We first begin with a summary of the development of entrepreneurship research within economics. Using aspects of existing definitions as a guideline, we develop a working definition and a model for productive entrepreneurship development in transition countries.

In addition, by reviewing recent literature on entrepreneurs and entrepreneurship in transition economies, characteristics that distinguish entrepreneurship in transition economies are systematically categorized. Distinct differences between Central and Eastern European (CEE) countries and Former Soviet Union (FSU) countries are further described. The specific case of Lithuania is highlighted as an example of a transition country that seems to incorporate elements from both CEE and FSU countries. This chapter ends with a conclusion in section 2.4.9.

2.2 Institutions and Economic Development in Transition

The inadequacy of economic theory is that it does not explain the persistence of millennia of what appears to be inefficient forms of exchange (North 1990:11).
Intuitively, most economists would agree that market institutions are important for solving the problems of coordination and reducing transaction costs in terms of both measurement and enforcement. However, for most economists, the existence of an elaborate framework of constraints, created and enforced by institutions is simply taken for granted and not specifically addressed (North 1990:66). In many cases, it is possible to 'ignore' the impact of institutions in an advanced market economy where for a large part, market institutions are present and functioning.

It is this type of institutional blindness that contributed to the implementation of economic policy recommendations that assumed market institutions would organically develop as a result of the introduction of free market forces in transition countries. Initially, the Bretton Woods institutions adopted a neo-liberal approach to transition countries. Stabilization, privatization and liberalization were prioritized. In general, the neo-classical school was optimistic that institutional and other impediments would not be a serious obstacle to the transition process (UNECE 2001). Further, there was an initial hope that transition country growth would result in the development of suitable political and economic institutions needed to support market activities, essentially 'leaving the market to create the market' (Feige 1997:29). It was expected that productive private businesses would flourish within the newly emerging market economies. But this approach has broadly failed to provide for needed institutional development and as a result created further opportunities for the development of non-productive economic activities. More than thirteen years after the collapse of the former Soviet Union ample illustrations of the detrimental effects of 'institutional vacuum' on economic development have been documented. As Feige writes: *The historical laboratory of the transition economies has revealed that liberalization, stabilization and privatization may be necessary but are by no means sufficient conditions for creating 'market economies'* (1997:21). The transition process in CEE and FSU countries has illustrated that institutions matter for economic development.

Neoclassical approaches to economics seem less suited for analyzing transition economies for three main reasons. Firstly, the collapse of the entire social, political and economic order such as occurred in the transition countries leads to very high levels of uncertainty. Two main types of uncertainty characterize the transition
process. Uncertainty in terms of the unpredictability of the future (i.e. Knightian uncertainty\(^3\)) and framework uncertainty\(^4\) (Van de Mortel 2002:18). Neoclassical theories are not designed for such situations since they concentrate on information problems and not extreme uncertainty (Knaack 1995; Van de Mortel 2002). Secondly, neoclassical theories focus on equilibria and not on dynamic processes. By definition, transition economies are not in equilibria and as such a dynamic approach focusing on process is needed (Knaack 1995; North 1997a; Van de Mortel 2002). Thirdly, the neoclassical behavioral assumption of income maximization fails to capture the influence of ideological attitudes and perceptions on economic performance (North 1997a: 3).

In recent years, the crucial role that institutions play in the development of an efficient market system has even caught the attention of Bretton Woods institutions such as the World Bank. In 2002, the annual World Bank Report entitled, *Building Institutions for Markets* stressed the importance of institutions for economic development. Other influential institutions have also begun to highlight the important role of institutions in transition countries in their publications (EBRD 1999; UNECE 2001).

Institutional theory is not without its drawbacks. Institutional approaches tend to focus on individual cases, are descriptive in nature, the results of which are often difficult to generalize and do not usually lead to unambiguous results (Van de Mortel 2002: 14). Given this shortcoming, little empirical work has been conducted using institutional theory.

### 2.2.1 Formal and Informal rules and constraints

The pioneering work of Douglass North has been illuminating in its identification of different institutional influences on economic development (1990, 1997). Institutions are defined as any form of constraint that human beings devise to shape human interaction. North makes a clear distinction between formal and informal institutions. Put simply, formal institutions are the visible ‘rules of the game’ such as constitutional law which can be altered quickly to adapt to changing economic circumstances. Formal rules are generally enforced by governments. In contrast, informal institutions are the invisible ‘rules of the game’ made up of norms, values, acceptable behaviors and codes of conduct (i.e. culture). Informal rules tend not to be legally enforced.
Change to informal rules occurs more indirectly and usually as a result of accidents, learning, natural selection and most of all the passage of time (North 1990:88). Informal rules most often evolve to complement formal rules. However North notes that there is a tendency for informal institutions to change more slowly and at times they can exhibit a counterproductive force to the more rapid formal changes in an economic system. North has identified the often-conflictual role between formal and informal institutions in both historical perspective (1990) and in transition economies (1997a).

Within North’s framework, organizations such as firms will adapt their activities and strategies due to the opportunities and limitations in the formal and informal institutions. According to North, entrepreneurs, both economic or political, are the main agents of change (1997a.). Though formal rules are designed to facilitate exchange, they are likely to affect individuals or groups in different ways. Further, formal rules and institutions are created by individuals and are not necessarily created in the interest of social well-being; private interests are important as well (North 1994).

In contrast to neoclassical theory, institutional theory asserts that formal rules can be maintained even if they are inefficient (DiMaggio & Powell 1983; North 1990). There are several reasons for inefficient institutional outcomes. First of all, even when they clash with new formal rules, informal rules have tenacious survival ability because they have become part of habitual behavior (i.e. culture) and informal institutions provide a sense of stability. Second, informal institutions may change more slowly due to the influence of path dependence. Though the past cannot be used to neatly predict the future, in transition countries pre-transition incentives structures can illuminate the direction in which institutions effect further economic development. This occurs because institutional change is usually incremental and is seldom discontinuous\(^5\) (North 1990:10). As a result, unproductive paths may persist and in that sense, history matters. Thirdly, lock-in can occur as a result of a symbiotic relationship between existing institutions and the organizations that have evolved as a consequence of the incentive structure provided by those institutions\(^6\) (ibid. 7). Even when the formal rules change, organizations which benefited from the outdated informal rules and which would lose their benefits if they adopted new informal
practices complementary to formal rule changes will continue to participate in detrimental informal rule practices in order to retain their position of power. Fourthly, when formal and informal institutions clash as in the case where formal rules are changed but informal rules have not changed, noncompliant behaviors proliferate and can result in the formation of underground economies (Feige 1997: 22). As North notes: *...the performance of an economy is an admixture of the formal rules, the informal norms, and their enforcement characteristics. Changing merely the formal rules will produce the desired results only when the informal norms are complementary to the rule change, and enforcement is either perfect or at least consistent with the expectations of those altering the rules* (1997b: 16).

North’s emphasis on the influence of formal and informal rules and institutions on economic outcomes is especially relevant for the transition context. He writes: *If the institutional framework rewards piracy then piratical organizations will come into existence; and if the institutional framework rewards productive activities than organizations and firms will come into existence to engage in productive activities* (North 1994:361).

**2.2.2 Informal institutions in Lithuania**

The situation in Lithuania has been characterized by a rather rapid switch in formal rules combined with the retention of numerous informal rules and practices. As in other transition countries, the legacy of informal pre-transition norms and behaviors continues to dominate the transition process in Lithuania even though these practices often counter the newly established legal environment. The clash of new formal rules such as regulations for private business combined with retained informal norms such as lack of responsibility amongst bureaucrats can have potentially damaging consequences. This reality is rather well depicted in the following quote by a well-known Lithuanian businesswoman who was elected into the Lithuanian Parliament in November 2000. Her motivation to switch careers conveys the high level of frustration felt widely amongst Lithuanian private business owners:

*Coercively collected money is squandered with total impunity on satisfying official whims. There is hardly any better business than that of bureaucrats, who are conceded the right to decide, to prohibit, to pry, to convict, to humiliate and to scorn*
without assuming any responsibility for their actions. Therefore, dear sirs and madams, I've quit business and am going into government! (Teiserskyte 1999).

Post-Soviet Lithuania has retained a number of negative institutional legacies from its period of Soviet occupation which include Soviet-style corruption\(^7\), a culture of non-compliance, employee theft, distrust of the government and a highly skewed distribution of wealth and information.

**Corruption** on a large scale was endemic to the former Soviet Union (FSU). Studies have shown that corruption forms a major constraint to development and has a strongly negative effect on economic development (Myrdal 1957; Wei 2001). However, the economic costs associated with corruption depend not only on the extent of corruption but also on its nature (Feige 1997:31). Shleifer & Vishny (1993) found that corruption is less costly when it is controlled by an effective cartel such as existed in the form of the Communist Party in the Soviet Union. The most costly form of corruption occurs when independent monopolists vie for bribes and this situation more closely approximates the situation in post-Soviet Lithuania. Corruption in the form of bribery is especially detrimental because it is secretive and arbitrary and the implicit contract is not enforceable in the courts. In economic and social terms, it is more damaging than an explicit tax (Wei 2001). The current situation in many transition countries which is characterized by a lack of transparency and excessive complexity of regulations, fosters the development of corruption (UNECE 2001; Puffer & McCarthy 2001). Corruption can be viewed as both a form of government failure (Feige 1997:31) and as a negative influence on the development of a functioning private business sector. In many cases, corruption tends to fall disproportionately on SMEs that are less able to bear the burden (Wei 2001).

Small-scale corruption such as payments for queue jumping, or payments given to officials to overlook a relatively minor breach of a given regulation (Bicanic & Ott 2001) were also widely accepted as a necessity in order to expedite the highly inefficient and bureaucratic, centrally-planned system of the USSR. Even after the change in economic orientation, small-scale corruption seems to be firmly rooted in formal and informal networks (i.e. social capital) and can lead to non-compliance with newly created formal rules.
The blatantly visible corruption of some high-ranking governmental officials in Lithuania seems to further erode social trust and a sense of social responsibility and may be a leading factor in increasing the pervasiveness and acceptance of corruption within society. Numerous cases of proven or alleged corrupt activities of high-ranking governmental officials have resulted in a generally negative and pessimistic attitude towards the integrity and effectiveness of elected officials.

Bad rules and non-compliance: Not all non-compliance is negative. Previous studies indicate that non-compliance with bad rules may actually have positive economic consequences especially when it facilitates economic exchange (Leff 1964; Huntington 1968; Feige 1997). In the FSU, the criminal code prohibited most private economic activities considered normal in Western market economies and carried heavy penalties (Feige 1997). However, these ‘illegal’ activities were commonplace such as petty trading and indeed virtually necessary to maintain ‘minimum living standards’ (Feige 1997:27). But widespread noncompliance can undermine the social fabric and jeopardize the fundamental principle of the rule of law (ibid.). Noncompliance in the Soviet regime contributed to a more efficient system and served to buffer some of the most costly consequences of allocation by administrative control.

During transition, non-compliance may also bring economic benefits for non-compliant individuals. But non-compliance has a generally negative effect on the morals and ethics of society and can erode the foundations for a market-based economy which functions according to formal rules.

Employee theft. Under Soviet rule it was common for employees to take production home with them. For example, a person working in a linen factory would regularly take spools of thread home with them or an employee at a confectionary factory would bring home candies. Even though it was against the formal Soviet regulations, it was considered by many to be a ‘fringe benefit’ of working in that particular factory. Employee theft became the norm, an informal code of conduct in Soviet production facilities. King and Zulauf comment that until the norms and values of the
employees change, it will be difficult to enforce rules against theft by employees (cited in Grennes 1997:19).

**Distrust of the government.** Most Lithuanian citizens like other former Soviet citizens, exhibit an inherited legacy of distrust of the state (Raiser 1999). During transition, this attitude seems to have been carried over to the democratically elected government. Though a certain level of skepticism and distrust may be seen as a healthy sign of a functioning democratic system, the level of distrust amongst most Lithuanian citizens seems extreme. This overly suspicious attitude can have a serious effect on informal institutional change since *...the informal norm of distrusting government policy militates against every effort to establish the formal rule of law* (Feige 1997:30).

In addition, as a part of the USSR, many Lithuanians felt subjugated, against their will, to foreign rule. The Soviet government was viewed by many, as an illegitimate power. As a result, evading Soviet control and regulations was a matter of individual national pride and identity. Even though the powers have shifted and Lithuania is an independent and sovereign state, the lack of experience in self-rule has led to a lack of responsibility for governmental and individual actions.

**Highly skewed distribution of wealth and information.** As Feige writes, *although incomes were distributed quite equitably* (in the USSR), *differential access to state resources and selective opportunities for illegal wealth accumulation created a highly unequal distribution of de facto property rights* (1997:30). In essence, though formal rules laid the foundations for an egalitarian society, informal rules dictated the unequal distribution of wealth. Further, it was considered the ‘right’ of Soviet elites to have special privileges such as access to luxury items and access to unbiased information that for the most part were not visible or available to the general population.

These examples of informal practices, based primarily on the inherited norms and attitudes of the Soviet state create a transitional situation in Lithuania in which new formal rules may be passed but are difficult to effectively enforce.
2.3 Gender as an informal institution

Though not discussed in detail, North uses the changing role of women as well as the changing attitudes towards slavery as examples of how informal constraints can change as a result of shifting norms within society (1990:8). With the exception of Veblen (1894, 1899), neither North nor other institutional theorists have devoted much attention to gender issues as informal rules. Since it is an important issue for our research, we introduce the concept of gender as an informal constraint in relation to economic theory and research and to the context of Lithuania both before and during transition.

Generally, in Economics, the term gender and sex are used interchangeably to mean the same thing i.e. to distinguish between male and female economic agents. In other social sciences, however, these two terms refer to distinctly different characteristics. Sex refers to the biological differences between men and women (male and female characteristics) while gender refers to socially constructed identities (masculine and feminine characteristics) that designate different roles, duties, rights, opportunities and expectations for men and for women. A gender analysis refers to the construction of social relations between men and women and therefore involves an analysis and comparison of the situation for men as well as women.

Gender differences have resulted in a hierarchical difference between masculinity and femininity. In most societies today, the social construction of maleness is of higher status and privilege than the social construction of femaleness. Not only does gender define individual roles, gender further relates to the ‘metaphorical connection of non-biological phenomena with a bodily experience of biological differentiation’ (Nelson 1996:5). In every society there is a general agreement within a particular culture, at a particular time, in a particular context, about which objects, activities, personality characteristics, behavior and skills are perceived to be masculine, which are understood to be feminine or which are more or less ungendered (ibid.). In many societies there are also visible contradictions between customs, norms and laws with relation to gender equity. Though the laws may promise gender equality, often implicit and ‘taken for granted’ biases result in de facto gender inequity. In addition to being economically inefficient, gender inequity is humanly corrosive and socially retrograde (Paci 2002).
The realm of economics is not free of such biases and blind spots. The tendency to view economic analysis as universal and gender neutral has overlooked the important social effects of gender as well as class and racial hierarchies on economic consequences. As Nelson writes, ... *economics has been heavily influenced by the confusion of masculinity ipso facto with high value, as evidenced in both contemporary definitions and in the history of economics as a science. The confusion has been to its detriment* (1996:20).

Not only have gendered attitudes affected economics, but economic arrangements and institutions have also been instrumental in creating gender biases. Further, economic theory has been used to justify or reinforce these biases.

Seemingly ‘neutral’ yet intrinsically gendered viewpoints continue to influence economic research not only in terms of the questions asked and the analysis used but also outcomes and research implications. For example, in addressing the question why women’s earnings are generally less than men’s earnings, neoclassical economists propose an explanation based on the theory of rational choice (Barker 1999:393). The wage gap between men and women is a result of women’s rational choices, an explanation that justifies the higher earnings of men. In essence women have a comparative advantage to prioritize unpaid domestic labor since their wages are lower. As a result, women choose lower paying jobs that are compatible with their unpaid household tasks. Besides providing a circular argument, this analysis assumes that all women will marry, that heterosexual marriage is the norm and that household income will be divided equitably (ibid.).

On the other hand, a gender analysis entails an examination of the ways in which gender-specific social expectations about women’s roles as wives and mothers affect their labor market experiences (ibid.). Neoclassical economics is not the only school of economics to suffer from androcentric bias, but it is perhaps the most resistant to integrating gender into its theories, models and policies (Barker 1999; Kuiper 2001).

Gender, however, is not the only factor influencing social and economic behavior. Other social constructs such as race, ethnicity, class and sexuality also play an
important role. People occupy multiple and often contradictory positions because they belong to different socially constructed groups (Folbre 1994). In essence, an individual's economic options depend on the interaction between the different dimensions of collective identity (Barker 1999:321).

Gendered social relations in practice have created a different gendered division of labor for men and women as economic agents. Women have traditionally been expected to prioritize the domestic sphere and unpaid activities while men have been expected to prioritize the public sphere and paid activities. Though both spheres are important, the gendered division of labor has resulted in gender inequality illustrated in terms of employment opportunities, wage differentials, labor force participation and occupational segregation (Jacobsen 1998).

Two aspects of North's institutional theory seem relevant for a discussion of gender issues as informal constraints. Firstly, North argues that the behavior of individuals and organizations in positions of power can have a strong influence on informal constraints. In practice, individuals can use and manipulate their positions in order to retain the existing power structure even if it is to the detriment of economic efficiency. North writes: Unproductive paths may persist; an initial set of institutions that provide disincentives to productive activity will create organizations and interest groups with a stake in the existing constraints (1990: 99).

This seems to be the case in both the former Soviet system where traditional gender roles continued to dominate even within an environment of legislative equality, and also seems to be the case in post-Soviet Lithuania where the democratic legislative environment provides for equality between the sexes but day-to-day informal practices seem to undermine its realization.

Secondly, North also classifies self-imposed codes of conduct as an informal constraint which affects individual behavior: Self imposed codes of conduct, unlike conventions and norms of behaviour, do not obviously entail wealth-maximizing behaviour, but rather entail the sacrifice of wealth or income for other values (1997a: 4). Gender, as an informal constraint, seems to embody not only an externally imposed constraint but also includes the element of internalized social values.


2.3.1 Gender in Soviet Lithuania

In Lithuania, since the beginning of the 20\textsuperscript{th} century, men and women have been ‘equal’ under the law\textsuperscript{13}. However, informal norms of behavior already in place in independent Lithuania emphasized different role expectations for men and women. Men were expected to be the main breadwinner and be active in the public sphere whereas women were expected to be homemakers and to prioritize the domestic sphere.

Under Soviet occupation, formal rights between men and women were further substantiated and according to the formal rules, Lithuanian women and men were considered ‘equal’\textsuperscript{14}. However prevailing attitudes under the Soviet regime introduced the new expectation for women to participate in the paid labor force without bringing about significant changes to the unpaid role fulfilled by women in the domestic sphere. In limited cases women were treated differently and entitled to paid maternity leave, early retirement and were exempt from compulsory military service.

Under Soviet rule, quota systems allowed women access to some of the higher levels in decision-making structures; but these position were largely ‘symbolic’ in nature. Both male and female Party members were represented in the Supreme Soviet but this was due to the quota system and not necessarily based on merit. Though the Supreme Soviet was formally recognized as an important decision-making organ, in reality, the Supreme Soviet’s powers were limited. In the entire history of the Soviet Union, only one woman (Mrs. Furtseva) ever served as a full member of the Politburo, which was the center of political power in the Soviet Union and the main de facto decision-making body. As Hesli & Miller comment: \textit{The fact remains that Soviet society was constructed and directed by men, with very little opportunity for a woman’s voice to be heard} (1993:509).

Though women were highly represented in the Lithuanian labor force (in 1989, 53 percent of the labor force was female\textsuperscript{15}), their overall position in the labor force vis-à-vis men was not ‘equal’. Females were under-represented in managerial and supervisory positions. Though women had increased access to professional positions under state socialism, there was a continuing gender segregation of the rest of the labor force (Einhorn 1993:125). Also even though women in general had access to
higher education and professional jobs, their salaries were significantly less than their male counterparts. On average, Soviet salaries for women were one third less than those for Soviet men (Rimashevskai a 1992:15). Many women were underemployed, working in positions below their educational or skill level (Hesli & Miller 1993:509).

In the Soviet labor force women were concentrated in certain job categories such as trade and public catering, health care, physical culture, social security, education and culture (Hesli & Miller 1993:509). Strikingly, even within female-dominated professions, such as light industry and textiles, the managers still tended to be male (Einhorn 1993:125).

Anastasia Posadskaya argues that 'equality' between the sexes was generated more from an economic standpoint than a gender-equality standpoint. She writes: Women's labor power was a means, a resource used to solve the problem of economic growth: the authorities alternately introduce the ideology of sex equality and the ideology of women's 'natural mission', depending on what suits them at that time (1994:9).

The so-called equality of women in the paid labor force did little to change the division of unpaid labor in the home. The majority of unpaid labor in the family continued to be seen as the duty of the Soviet woman (Posadskaya 1994). In essence, equality through the Soviet lens required women to carry the shovel (engage in paid labor) in combination with fulfilling all unpaid domestic duties\(^{16}\). In the USSR, a woman's right to paid labor inevitably became a requirement (i.e. duty) to engage in paid labor (Juiceviene 1998:20). The triple task of paid labor, domestic unpaid labor and the time and energy spent in the acquisition of household needs\(^{17}\) (including standing in queues) negatively influenced many women's career choices. As one Soviet woman commented: I'm glad that I do repetitious work, I use up so much energy and concentration on queuing and housework that I'm glad I don't have to think during work as well (quoted in Rimashevskai a 1992:14).

2.3.2 Gender in Post-Soviet Lithuania

Gender identities were frozen and gendered inequalities remained a structural feature of post-revolutionary society and this has not been posed as a problem for de-
socializing societies. There is therefore no reason to suppose that any democratization of the public sphere will ameliorate male dominance and female subordination. (Rai et al. 1992:6)

Males had always dominated in the lead roles in economic life and in this, and other respects, the post-communist economies became more extreme versions of their former selves (Roberts & Tholen 1998:63).

As these two quotes suggest, though transition brought about dramatic changes to the lives of both Lithuanian men and women, gender roles have tended to remain surprisingly stable. Embedded gender roles have had negative consequences for both Lithuanian men and women. In addition to other factors, the informal pressure to be ‘breadwinner’ in the face of extreme job loss and increasing unemployment has resulted in an increase in despair and hopelessness especially amongst young males throughout the FSU. In Lithuania, the result has been a very high rate of suicide and death by ‘accidents’ amongst adult Lithuanian males\(^1\). In general, we find that men in the FSU have ended up on the extremes: either extreme losers (e.g. homeless, jobless alcoholics) or extreme winners (e.g. successful businessmen)\(^2\). However in a less visibly, dramatic way, the majority of women have lost out in the transition process. Women as a group, have suffered disproportionately from job loss, increased labor market discrimination and domestic violence (Molyneux 1994; Unicef 1999). Furthermore, independence brought a reemergence of support for the traditional roles for men and women (Grapard 1997). For men this resulted in added pressure to become the sole ‘breadwinner’ and for women this has meant a glorification of the ‘housewife role’. Benefits enjoyed by women under the Soviet system have become handicaps. In Lithuania, many private businesses will refuse to hire women of childbearing age for fear that they will have to extend the generous maternity benefits\(^3\) inherited from the Soviet system. In addition, given the low level of Lithuanian state pensions, early retirement for women is becoming synonymous with early poverty\(^4\).

Further, the locus of power has changed due to the demise of the Communist Party. Old networks still exist between the former Communist elite but their focus has shifted from party-related privileges to the direct attainment of financial rewards
through private business activities (both legal and illegal) and political involvement. In Lithuania, the old male dominated networks are still intact and assist in obtaining successful results in either of these endeavors. The percentages of men and women in decision-making positions in governmental bodies and in private and public enterprises seem to reflect the influence of male-dominated networks. In general, the removal of mandatory quotas for women in elected positions seems to have had a negative influence on female representation in political bodies. In many transition countries, the number of women in decision-making positions has declined (Einhorn 1993; Grapard 1997; Lakhova 1998; Medvedev 1998). In Lithuania, the percentage of women in the Lithuanian parliament and other elected offices has decreased since 1996 (table 2.1).

Table 2.1: Lithuanian election results for parliament (Seimas) and municipalities councils (election year in parenthesis)

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Women</th>
<th>%</th>
<th>Men</th>
<th>%</th>
</tr>
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<tbody>
<tr>
<td>VIII Seimas (1996)</td>
<td>138</td>
<td>25</td>
<td>18.0</td>
<td>113</td>
<td>82.0</td>
</tr>
<tr>
<td>IX Seimas (2000)</td>
<td>141</td>
<td>15</td>
<td>10.6</td>
<td>126</td>
<td>89.3</td>
</tr>
<tr>
<td>Members on local gov’t councils (1997)</td>
<td>1484</td>
<td>326</td>
<td>22.0</td>
<td>1158</td>
<td>78.0</td>
</tr>
<tr>
<td>Members on local gov’t councils (2000)</td>
<td>1562</td>
<td>275</td>
<td>17.6</td>
<td>1287</td>
<td>82.4</td>
</tr>
<tr>
<td>Mayors (2000)</td>
<td>56</td>
<td>3</td>
<td>5.4</td>
<td>53</td>
<td>94.6</td>
</tr>
</tbody>
</table>

Source: Lithuanian Department of Statistics (2001)

In terms of unemployment, the raw figures in table 2.2 show little difference between levels of male and female unemployment. However these figures conceal a more alarming reality. A study conducted by Kanopienė (2000) indicates that the largest percentage of unemployed women in Lithuania is between the ages of 31-54. For male laborers, unemployment numbers are greater only in the ‘under 18’ age group (ibid.). Furthermore, these statistics conceal a relatively high percentage of the underemployed. Given the fact that more women are represented in the low wage state sectors experiencing severe budget constraints, it seems that women even if they are employed are at greater risk of underemployment. Privatization of SOEs has also resulted in reduced employment opportunities for women since many women find it difficult to obtain employment in the private sector, due in part to discrimination and lack of contacts (Spevacek 2001).

Table 2.2: Unemployment rate based on the Lithuanian Labor Exchange (in percentages)

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<tbody>
<tr>
<td>Total</td>
<td>3.8</td>
<td>6.1</td>
<td>7.1</td>
<td>5.9</td>
<td>6.4</td>
<td>8.4</td>
</tr>
<tr>
<td>Women</td>
<td>3.8</td>
<td>6.4</td>
<td>7.7</td>
<td>6.3</td>
<td>6.6</td>
<td>8.2</td>
</tr>
<tr>
<td>Men</td>
<td>3.8</td>
<td>5.8</td>
<td>6.6</td>
<td>5.6</td>
<td>6.2</td>
<td>8.5</td>
</tr>
</tbody>
</table>

Source: Lithuanian Department of Statistics (2000)
A number of authors writing about women in transition countries, have identified entrepreneurship in the form of small business ownership for women as a viable strategy to overcome joblessness and work-related discrimination (Posadskaya 1994; Khotina 1994; Mezentseva 1994; Bridger et al. 1996; Grapard 1997; Lakhova 1998; Unicef 1999). In essence, these authors argue that the creation of a private business based on an individual's skills, initiatives and personal resources may provide the possibilities to break free of underlying gender constraints. Undeniably, the transition process has provided new possibilities for enterprise creation for both men and women. To what extent 'gendered' informal constraints contribute to the characteristics of operating SMEs will be further addressed in Chapter 7.

Small-scale studies conducted in Lithuania have indicated that women encounter discrimination in the transitional business environment. A survey of business administration students in 1998 at the Kaunas Polytechnical University revealed that the students have an acute awareness of gender prejudice in the current business environment (Juceviciene 1998:30). Further interviews with twenty-one female business owners in 1997 indicated that the majority of business owners interviewed felt discriminated against as female entrepreneurs (Aidis 1998).

Given the existing findings, a form of gendered role 'lock in' and path dependence in Lithuania seems evident. Even within the new social, political and economic structures, the expectations of women's domestic responsibilities is higher than for men's while the valuation of women's paid labor is lower than for men's. Institutional theory provides us with an analytical framework to understand this seemingly paradoxical result and the ironic reality that for many women, even if you are highly educated, you still have to bring the coffee\textsuperscript{22}.

2.4 Entrepreneurship

*The entrepreneur is at the same time one of the most intriguing and one of the most elusive characters in the cast that constitutes the subject of economic analysis* (Baumol 1968:64).
Though there is no consensus as to the definition of entrepreneurship, the identification of the entrepreneur’s economic function has engaged economists for more than 200 years. In this section, it is not our purpose to provide extensive coverage to all the theorists and concepts that have been developed but to provide an overview of the most important contributions (table 2.3).

Table 2.3: Main contributors to entrepreneurship in economic theory

<table>
<thead>
<tr>
<th>Year</th>
<th>Economist</th>
<th>Entrepreneurial Role (ER)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1755</td>
<td>R. Cantillon</td>
<td>Introduced the term: Entrepreneur</td>
</tr>
<tr>
<td></td>
<td></td>
<td>ER as speculator</td>
</tr>
<tr>
<td>1800</td>
<td>J.B. Say</td>
<td>ER as coordinator</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1890</td>
<td>A. Marshall</td>
<td>ER as coordinator, innovator, arbitrageur</td>
</tr>
<tr>
<td>1907</td>
<td>F.B Hawley</td>
<td>ER as owner of output (uncertainty bearer)</td>
</tr>
<tr>
<td>1911</td>
<td>J. Schumpeter</td>
<td>ER as innovator</td>
</tr>
<tr>
<td>1921</td>
<td>F. Knight</td>
<td>ER as responsible decision maker in an uncertain environment</td>
</tr>
<tr>
<td>1925</td>
<td>F. Edgeworth</td>
<td>ER as coordinator</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1925</td>
<td>M.Dobb</td>
<td>ER as innovator</td>
</tr>
<tr>
<td>1927</td>
<td>C. Tuttle</td>
<td>ER as responsible owner in an uncertain environment</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1973</td>
<td>I. Kirzner</td>
<td>ER arbitrageur and ‘alert to profitable opportunities’</td>
</tr>
<tr>
<td>1982</td>
<td>M. Casson</td>
<td>ER coordination of scarce resources under uncertainty</td>
</tr>
<tr>
<td>1993</td>
<td>W. Baumol</td>
<td>ER innovator and manager influenced by existing incentive structure</td>
</tr>
</tbody>
</table>

Richard Cantillon has been credited with the introduction of the term ‘entrepreneur’. In his work ‘Essai sur la Nature du commerce en General’ published in the mid-eighteenth century, Cantillon defines an entrepreneur as a ‘speculator in an uncertain environment’. Jean Baptiste Say, another French political economist, described the entrepreneurial function as being comprised of coordination, supervision and decision-making.

From the end of the 19th century until the mid-20th century, Alfred Marshall played a crucial role in shaping neoclassical economic thought. Though Marshall recognized the important role played by the entrepreneur, he never precisely states the function of
the entrepreneur. Instead he describes the various roles entrepreneurs play including that of coordinator, innovator, arbitrageur (Barreto 1998:54). In the early 1900’s, Frederick Barnard Hawley identified the role of the entrepreneur as the owner of output and the bearer of uncertainty. For Hawley, enterprise was not a productive factor or means; enterprise was a motivational force (Barreto 1998:36).

Perhaps one of the best-known and most important contributions to the theory of the entrepreneur has been made by Joseph Schumpeter. In his book, *The Theory of Economic Development* (1912), Schumpeter identified the entrepreneur as an individual who introduces new combinations i.e. innovation to the economy. In his theory of business cycles, Schumpeter explains that innovations come in swarms i.e. the initial innovator is followed by a bunch of ‘imitators’ which results in an economic boom. Periods of innovation and lack of innovation are the main causes for the business cycle. For Schumpeter, an entrepreneur is not only an innovator but also a leader. Since the main characteristic of an entrepreneur is innovation and leadership, Schumpeter’s entrepreneur does not necessarily start his own business. Furthermore, the Schumpeterian entrepreneurial function does not include risk-taking or individuals engaged in management or decision-making based on established grounds.

In his PhD dissertation *Risk, Uncertainty and Profit* (1921), Frank Knight reintroduced the element of uncertainty to the function of the entrepreneur. According to Knight, entrepreneurs are the bearers of uncertainty in order to make a profit. In their role, entrepreneurs actively shield other individuals who are unwilling to take the same gamble for uncertain rewards.

Francis Edgeworth viewed the entrepreneur as a coordinator (combining factors of production) and arbitrageur or middleman (connecting product and factor markets). However he never fully developed a theory of entrepreneurship. Still as a leading neoclassical economist, Edgeworth’s recognition of the special role played by the entrepreneur is noteworthy since unlike other neoclassical economists, he refused to eliminate entrepreneurial considerations from his explanatory scheme.

In the mature neoclassical era, Maurice Dobb identified the entrepreneur as an agent who carries out innovations and as such is the source of economic development and is
the driving force behind the capitalist system (Barreto 1998:60). In this context, it is not necessary for the entrepreneur to be a capital owner, manager or the bearer of uncertainty. For Dobb, entrepreneurship is something essentially active and creative and in this sense, Dobb's entrepreneur played a central role in the capitalist market process (ibid.). In comparison to many other entrepreneurship theorists, Charles Tuttle applied a very strict definition of entrepreneurship. Tuttle viewed the entrepreneur as a responsible owner in an uncertain environment. Though Tuttle does not present an extensive theory on entrepreneurship, the entrepreneur plays an active role in his analysis (ibid.).

As Humberto Barreto writes in his book *The Entrepreneur in Microeconomic Theory: Disappearance and Explanation* (1998), entrepreneurs as a ‘function’ seem to have vanished from modern microeconomic theory. The modern theory of the firm contains three core assumptions: the production function, the logic of rational choice, and perfect information, which effectively bar the inclusion of the entrepreneurial role in economic analysis. As a result of ‘the logic of rational choice’ the entrepreneur can no longer be the innovator because the ends and the means are known and given. The role of the entrepreneur as uncertainty-bearer, coordinator and arbitrageur also disappears because of the assumption of ‘perfect information’ and ‘the logic of rational choice’. The entrepreneur’s disappearance from microeconomic theory seems to be directly related to consistency requirements. Entrepreneurial functions do not fit neatly within the modern theory of the firm. Only by relaxing the assumptions can the entrepreneurial function be included without compromising the model’s consistency.

In essence, ‘the entrepreneur has been read out of the model’ (Baumol 1968:67). Though the term ‘entrepreneur’ is still used in modern microeconomic theory, it has become synonymous with manager, owner, and capitalist: *In the orthodox firm, the entrepreneur plays an essentially sterile role, choosing the optimum values of the endogenous variables* (Barreto 1998:132). The formalization of neoclassical economics is another reason why entrepreneurship diminished in significance: *... as neo-classical economics became more formalized and as the mathematics of equilibrium theory became more important, references to the entrepreneur receded from the micro textbooks* (Wennekers & Thurik 1999:32).
The pivotal work of David Birch (1979), demonstrated the importance of SMEs for job creation and served as a catalyst for renewed economic interest in entrepreneurship and SMEs. More recent studies have found that small firms play an important economic role as agents of change through entrepreneurial and innovative activity (Acs & Audretsch 1990; Audretsch 1995), stimulating industrial evolution (Audretsch 1995), creating an important share of new jobs (Acs 1992 in Wennekers & Thurik 1999:28) and reducing unemployment levels (Audretsch & Thurik 2000). In sum, small firms can be viewed as a ‘vehicle in which entrepreneurship thrives’ (Wennekers & Thurik 1999:29).

The more recent development of the endogenous growth theory (Romer 1990; Aghion & Howitt 1992) has created new possibilities for including entrepreneurship, innovation and creative destruction into macroeconomic growth models. However, within endogenous growth theory, entrepreneurship remains largely implicit and the theory does not provide insight as to the underlying conditions of the entrepreneurial activity needed for (human) capital formation and innovation (Wennekers & Thurik 1999:36).

In the modern neoclassical period, important contributors to entrepreneurship research have included Israel Kirzner, Mark Casson and William Baumol. Following the tradition of the neo-Austrian school, in his book, *Competition and Entrepreneurship* (1973), Israel Kirzner defines the entrepreneur as the arbitrageur and someone ‘alert to profitable opportunities’. Kirzner’s entrepreneur is not the bearer of uncertainty nor does s/he fill the role of coordinator or manager in the production process.

In his book, *The Entrepreneur: An Economic Theory* (1982), Mark Casson defines the entrepreneur as an individual who has different skills which enables her/him to make judgments to co-ordinate scarce resources. According to Casson, the entrepreneur operates within a set of technological conditions and by making difficult judgmental decisions, the entrepreneur is able to enjoy the reward of profit. This allows the entrepreneur to coordinate demand and supply under uncertainty (Deakins 1996:13).

Baumol incorporates two functions of the entrepreneur: as a Schumpeterian innovator and as a manager. Baumol maintains that entrepreneurs do not appear and disappear; but the numbers of productive and unproductive entrepreneurs change in terms of the existing incentive structures. For Baumol, productive entrepreneurial activity refers to any activity that contributes directly or indirectly to net output of the economy. Productive entrepreneurship does not need to yield tangible products. However, a productive activity should yield a positive marginal product no matter how indirect the route the activity employed takes in achieving this (ibid: 30). Conversely, an unproductive entrepreneur engages in innovative activity but makes no contribution to the real output of the economy. In some cases the activity can also serve to reduce output or restrain its growth. Finally, a destructive or rent-seeking entrepreneur engages in innovative activity that leads to the misallocation of valuable resources into pursuits that from the viewpoint of the economy are useless and are carried out for the self-serving purposes of the entrepreneur (ibid: 10).

2.4.1 Towards a definition of Entrepreneurship

The Schumpeterian definition of entrepreneurship as linked to innovation i.e. s/he who carries out new combinations in its broadest sense is essential for defining entrepreneurship. In this sense, innovation is a phenomenon that occurs at a given 'moment of time' and entrepreneurship is the manifestation of the 'innovative spirit'. Entrepreneurship is a temporary condition for any person, unless they keep innovating (Van Praag 1996:22). As a result, entrepreneurs do not form a social class and are not necessarily engaged in new venture creation.

In addition to innovative spirit, risk-taking and Knightian uncertainty are also important elements for defining entrepreneurship. Even if the innovative activity does not entail new venture creation, the entrepreneur is involved in risk-taking. As Casson writes: ...even if the entrepreneur is a salaried employee, however, he is still exposed to risk. His reputation for 'good judgment' on which his future earning power depends is always 'on the line' (1993: 52).

A more recent definition proposed by Sander Wennekers and Roy Thurik (1999) blends together the concepts of innovation and uncertainty:
Entrepreneurship is the manifest ability and willingness of individuals, on their own, in teams, within or outside existing organizations to (a) perceive and create new economic opportunities (new products, new production methods, new organizational schemes and new production-market combinations) and to (b) introduce their ideas in the market in the face of uncertainty and other obstacles, by making decisions on location, form and the use of resources and institutions (1999:46-47).

Essentially, entrepreneurship is a behavioral characteristic of a person. A blend of internal (personality and skills) and external factors (social and economic incentives) provide the stimulus for innovative activity i.e. entrepreneurship to manifest itself. Further, entrepreneurship is not restricted to a given 'productive' economic activity. As in Cantillon's definition, an entrepreneur can be a registered business owner, a politician, a hustler, a racketeer, a corrupt tax inspector, or a manager in a large firm. What sets entrepreneurs apart from the rest is their engagement in innovative activities such as new combinations and non-routine activities. The entrepreneur's reward for engaging in innovative activity is a blend of power, prestige and profit (Baumol 1993). The economic and social incentives seem to determine what type of entrepreneurial activity are the most prevalent in a given setting.

2.4.2 Productive and unproductive entrepreneurship
William Baumol's main contribution to the theory of entrepreneurship was to expand the range of entrepreneurial activity and to emphasize the important role played by institutions, i.e. the 'rules of the game' (both formal and informal institutions) for providing the incentives for entrepreneurial activity. Like Schumpeter, Baumol defines an entrepreneur through his or her innovative activity. Apart from this core characteristic, entrepreneurs can vary in all other respects since it is the environmental incentives or disincentives that further shape the entrepreneurial activity. For example, Baumol observes that wars in the early Middle Ages in Western Europe could be viewed as unproductive entrepreneurship, i.e. expressions of 'violent' yet innovative economic activity primarily engaged in rent-seeking activity. The result of these activities led to the net reduction in social income and wealth but enriched the 'entrepreneurs' (1990). An example of productive entrepreneurship could be a Dutch merchant in 17th century Europe. The incentives and subsequent choice to engage in productive or unproductive entrepreneurial activities seem to depend on the socio-
economic context. In the modern context, an innovative productive entrepreneur could be found starting a high-tech business venture in Silicon Valley. An innovative but unproductive entrepreneur could be a governmental official drafting another bureaucratic procedure intended to increase his personal wealth within an authoritarian regime. In sum, an entrepreneur may or may not own their own business, may or may not be engaged in productive activity, but the distinguishing factor is 'innovative behavior'. Exploring the role of the socio-economic context on the development of productive and unproductive entrepreneurship seems especially relevant for the transition countries.

### 2.4.3 Aspects of entrepreneurship in transition countries

Entrepreneurship in transition countries can best be defined using a blend of existing definitions and concepts. Though little analytical work has been done on the specific types, roles and definition for entrepreneurship in transition countries, Richard Scase and Bruno Dallago have made more extensive theoretical contributions.

Richard Scase (2000) introduces a distinction between 'entrepreneurship' and 'proprietorship' for business activities taking place in the post socialist countries of Central Europe and Russia. The main difference between these two categories are the contrasting psychologies of the founder-owners, their attitudes towards trading, and their orientation to capital accumulation. According to Scase, entrepreneurship refers to a person's commitment to wealth creation, capital accumulation and to business growth. In the Weberian sense, the entrepreneur is willing to forgo direct consumption in order to expand the scale of the entrepreneurial activities (Weber 1920). On the other hand, proprietorships are likely to consume and utilize economic surpluses in order to maintain a specific standard of living or lifestyle rather than reinvest these funds into their business. As a result capital assets are not used by proprietors for the purpose of long-term capital accumulation.

The prime motive of proprietors is not capital accumulation or business growth but direct consumption needs. According to Scase, in the emerging markets of Russia and Central Europe, the greater proportion of small business traders are proprietors rather than entrepreneurs (2000:6). Scase however concedes that these categories are dynamic and not rigidly defined. It is therefore possible for proprietors to turn into
entrepreneurs or vice versa. Scase also identifies two types of 'entrepreneurs' in transition countries: the legitimate and the illegitimate entrepreneurs. Entrepreneurs and proprietors are examples of legitimate businesses while anarchistic, opportunistic hustlers or Mafia members are examples of illegitimate businesses. This categorization is similar to Baumol's classification of entrepreneurs into productive and unproductive categories.

Bruno Dallago defines the entrepreneur in a Schumpeterian way as 'any individual or organization who has new ideas and implements them through non-routine activities' (1997:104). For Dallago, entrepreneurship is not strictly an individual process but a 'collective, societal phenomenon' since 'innovation needs time and the cooperation of many individuals and organizations' (ibid.). Within the Soviet type of economy, Dallago identifies two distinct types of entrepreneurs: economic and systemic entrepreneurs. Economic entrepreneurs transform the structure and working of the system through innovative behavior so as to solve certain problems. Economic entrepreneurs may engage in both productive and unproductive innovative activities. Systemic entrepreneurs work within the existing system to further specific interests.

Within the centrally planned system, systemic entrepreneurs could be found generating innovative activities in order to serve the Party against society as a whole, to serve a specific social group, to enrich themselves or obtain privileges by taking advantages of shortages. Systemic entrepreneurs formed the elite (nomenclature) within the centrally planned system and are therefore more readily opposed to systemic change which would erode their former 'entrepreneurial opportunities'. Though both economic and systemic entrepreneurs could engage in productive or unproductive activities, systemic entrepreneurs had a greater stake in the former system and are more prone to path dependence and unproductive activities. Systemic entrepreneurs are a product of the transition process while economic entrepreneurs (productive or unproductive) are also fond in western developed economies.

Dallago also identifies four types of economic entrepreneurs in the transitional landscape: elite members, domestic, returning migrants and foreign entrepreneurs. The first type of entrepreneurs are from the 'old' political elite. Many of these elite entrepreneurs were managers of state-owned enterprises. Dallago asserts that most of
the elite entrepreneurs were very competitive in the redistribution process but not in production. For the most part, elite entrepreneurs can be classified as unproductive or rent-seeking entrepreneurs. The importance of elite entrepreneurs differs amongst transition countries with significantly higher levels found in Russia and lower levels in Hungary (1997:117). As the name implies, domestic entrepreneurs are indigenous individuals who were not members of elite groups. According to Dallago's definition, domestic entrepreneurs were already engaged in entrepreneurial activities before 1989. Though one would expect this group to make up an influential portion of all entrepreneurs, Dallago finds that they make up a small share of new entrepreneurs.

The third type of entrepreneur, classified as 'returning migrants' is comprised of former citizens who emigrated prior to 1989. The transition process opened up the possibilities for their return and active engagement in the economic process. Returning migrants may have a positive role in transition because they bring valuable capital resources in terms of both financial and human capital (1997:117). Though some returning migrants have positively influenced the development of productive entrepreneurship, their role has not been quantitatively important (ibid.). The fourth type of entrepreneurship are foreign entrepreneurs. Their role has, in general, been a positive one by introducing a healthy competitive atmosphere, innovative spirit and by contributing to foreign direct investment.

Dallago agrees with Baumol's concept that the 'rules of the game' are the main determinants of entrepreneurship in transition countries (1993). In this sense, it is not the supply of entrepreneurs that is of concern, but the rules that shape their behaviors. As Dallago writes: ...it is more the set of 'rules of the game' than the supply of entrepreneurs that determines the performance of an economy and the efficiency of an economic system via the allocation of entrepreneurship to productive or unproductive uses (1997:106).

2.4.4 A working definition for entrepreneurship in transition countries
Given the context of transition where entrepreneurial activities were not productive, often rent seeking and economically destructive, our working definition for entrepreneurship must emphasize the difference between productive and unproductive forms of entrepreneurship. Baumol argues that entrepreneurs will seek wealth, power
and prestige with their innovative activities and that positive environmental incentives can channel innovative, entrepreneurial behavior in a productive way (1993). Though entrepreneurial activity is not limited to productive business formation, given our interest in business development, we focus our definition on business creation. In order to make our definition appropriate for the transition context, it should also take into account the effect of the ‘rules of the game’ on the development of unproductive as well as productive entrepreneurship (inspired by Baumol and further discussed by Dallago). Furthermore our definition focuses on productive entrepreneurship and in doing so diverts the focus from the distinction between entrepreneurs and proprietors (Scase 2000) or systemic and economic entrepreneurs (Dallago 1997).

In addition, though solo self-employment (self-employed with no employees) may not always be viewed as a form of entrepreneurship in advanced western economies, it can be argued that solo self-employment in transition countries is a form of entrepreneurship (Chilos 2001). Given the utter ‘newness’ and lack of private business ownership in transition countries, solo self-employment demands a relatively high level of innovative behavior and risk-taking in the transition context.

Therefore, our definition should capture that notion that manifestations of entrepreneurship (i.e. innovative, risk-taking, market-oriented behavior) in the form of viable businesses, are influenced by both the existing and historically determined incentive structures (social and economic) within a given context. These incentive structures have a direct influence on the development of productive or unproductive entrepreneurship. In essence, we argue that productive entrepreneurship is a manifestation of the innovative spirit that occurs when the individual, social, legal, political and economic conditions are sufficient.

Thus our working definition, based on Wennekers and Thurik (1999) for productive entrepreneurship in transition countries focuses on innovative activity under uncertainty resulting in an economically productive business:

**Productive entrepreneurship is ... the manifest ability and willingness of individuals to (a) perceive and create new economic opportunities through innovative activity (new products, new production methods, new organizational schemes and**
new production-market combinations) and to (b) introduce their ideas in the market in the face of uncertainty and other obstacles; and (c) their efforts result in a viable business that contributes to national economic growth and personal livelihood.

2.4.5 A model for entrepreneurship in transition countries

In transition economies productive entrepreneurship cannot be taken for granted. Therefore, in making a model for entrepreneurship development (figure 2.1) we clearly indicate that the entrepreneurial outcome can be either productive or unproductive entrepreneurship. Our model distinguishes between two main levels of influence: environmental factors (such as macro- and microenvironment and the role of the state) and cultural and personal factors (such as norms and values, personal characteristics and skills). All these factors combined influence the individual’s decision-making to pursue either productive or unproductive entrepreneurship in the form of a viable business. It can be argued that some influencing factors are easier to change than others but all areas are open to some degree of change.

Government policy and programs can play an instrumental role in all four of the core factors influencing the development of either productive (legitimate) or unproductive (illegitimate) entrepreneurship. In this sense, our model highlights the important role governmental policy and programs can play in shaping the entrepreneurial outcome as either productive or unproductive. Personal characteristics are the least likely to change and most personal characteristics such as age, sex and ethnicity cannot be changed. However, carefully designed training programs and changes to cultural norms and values may have a positive influence on personal beliefs and values.
2.4.6 Entrepreneurship in the transition setting

Though transition countries differ in many ways, a number of similarities exist that influence entrepreneurial development. For example, studies of transition economies emphasize the existence of both productive (legitimate) and unproductive (illegitimate) forms of entrepreneurial business activities (Arendarski et al. 1994; Smallbone & Piasecki 1995; Dallago 1997; Frye & Shleifer 1997; Roberts & Zhou 2000; Scase 2000; Chilos 2001). Unproductive entrepreneurship is often seen as influenced by both path dependence (Dallago 1997) or the currently over-regulated and corrupt legal business climate (Arendarski et al. 1994; Chilos 2001).

Based on a literature review, a chart summarizing the main entrepreneurial characteristics in terms of factors such as the environment, the role of the state and business owner characteristics found in transition countries is presented (chart 2.1)
and a comparison of the characteristics of entrepreneurs in CEE and the FSU countries is presented in chart 2.2. Some transition countries do not fit neatly within these categories and the specific example of Lithuania is highlighted in chart 2.3. Though a number of the characteristics outlined below may also be applicable to SMEs in western developed countries (such as 'lack of external financing'), the distinguishing difference is one of degree. In transition countries some barriers may be similar to those experienced by SMEs in western developed countries however they tend to affect business more severely (Smallbone & Welter 2001a).
**Chart 2.1: Entrepreneurship in transition countries: General characteristics**

<table>
<thead>
<tr>
<th>Factor</th>
<th>General characteristics</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Environment</strong></td>
<td></td>
</tr>
<tr>
<td>Macro</td>
<td>Dramatic changes to socio-economic and political conditions</td>
</tr>
<tr>
<td>Micro</td>
<td>The reorganization of work</td>
</tr>
<tr>
<td>Lack of recent 'productive' entrepreneurial tradition</td>
<td></td>
</tr>
<tr>
<td>Hostile economic environment</td>
<td></td>
</tr>
<tr>
<td>Initial explosion of business activity followed by declining SME start-up rates</td>
<td></td>
</tr>
<tr>
<td>Absence of business infrastructure and support services</td>
<td></td>
</tr>
<tr>
<td>Lack of external financing</td>
<td></td>
</tr>
<tr>
<td><strong>The role of the state</strong></td>
<td>Neo-liberal governmental stance; hesitant to intervene in market processes</td>
</tr>
<tr>
<td>No previous experience with business tax system or legislation</td>
<td></td>
</tr>
<tr>
<td>Negative attitude towards entrepreneurs</td>
<td></td>
</tr>
<tr>
<td>Over-regulation, interference, corruption</td>
<td></td>
</tr>
<tr>
<td><strong>Business owner characteristics</strong></td>
<td>New Business, new career</td>
</tr>
<tr>
<td>Diverse social origins</td>
<td></td>
</tr>
<tr>
<td>Primitive business methods</td>
<td></td>
</tr>
<tr>
<td>Dependence on assistance through private networks</td>
<td></td>
</tr>
<tr>
<td>Government skepticism</td>
<td></td>
</tr>
<tr>
<td>Passive, bureaucratic attitude</td>
<td></td>
</tr>
<tr>
<td>No previous experience with business tax system or legislation</td>
<td></td>
</tr>
<tr>
<td>More progressive and market-oriented than the general population</td>
<td></td>
</tr>
</tbody>
</table>

**Environment.** The main characteristic all transition countries share is the transition process i.e. the switch from a centrally planned economic system to a more market-oriented system. Though different in terms of degree of change, all transition countries have experienced dramatic changes to socio-economic and political conditions on the macroeconomic level. On the microeconomic level, all transition countries have had to address the 'reorganization of work' (Johnson & Loveman 1995) which includes the acceptance of private forms of enterprise. Even though in some CEE countries limited forms of private enterprise were allowed even under
socialist regimes, most transition countries lack a recent 'productive' entrepreneurial tradition (Smallbone & Piasecki 1995). A 'hostile economic environment' (high inflation rates, persistently high unemployment rates, declining real earnings, etc.) again in various degrees, has characterized the transition process (Smallbone & Piasecki 1995; Smallbone & Welter 2001a). Given varying measures of market liberalization and excessive consumer demand, we observe an initial explosion of business activities in transition countries followed by declining SME start-up rates (Smallbone & Piasecki 1995; UNDP 1998; Kontorovich 1999; Glas et al. 2000). The lack of private enterprise tradition in most transition countries resulted in an absence of business infrastructure (Smallbone & Piasecki 1995). Furthermore, the initial growth of private business activity coupled with the implementation of neo-liberal transition programs resulted in a lack of private business support services (ibid.). A main barrier encountered by many private business owners is the lack of external financing (Smallbone & Piasecki 1995; Pissarides 1999, 2000).

Role of the State. In most cases, national governments took a neo-liberal stance (often under the guidance and pressure from the IMF) and exhibited a general hesitance to intervene in market processes (Smallbone & Piasecki 1995). As would be expected, policy mistakes were made especially in areas where there was little previous experience such as with the introduction of a business tax system and business legislation. However, national governments were hesitant to take responsibility for the effects of bad policies on private business development (ibid.). A later trend has been the tendency for transitional governments to over-regulate and interfere with private business activities reducing the expansion and growth of the private business sector. This has also led to increased corruption (Dallago 1997; Frye & Shleifer 1997; Bartlett & Bukvic 2001; Smallbone & Welter 2001a). Finally, a negative attitude towards private business owners and entrepreneurs in general continue to influence government officials (Marot 1997; Glas et al. 2000).

Business Owner Characteristics. For many business owners in transition countries, private business ownership signaled the start of a new career (Roberts & Zhou 2000). Business owners under these conditions tend to come from diverse social origins and backgrounds (ibid.). Given the underdevelopment of the private sector, many business owners in transition countries used quite rudimentary and primitive business methods
but still obtained profitable results (ibid.). The lack of developed business infrastructure and support services leads many business owners to depend on business assistance (financial, advice, etc.) through private networks (ibid.). Most business owners also exhibit skepticism towards the national government (Smallbone & Piasecki 1995). Though business owners are often critical of the government, they tend to adopt a passive rather than pro-active attitude\(^{26}\). In addition, new business legislation and taxes create difficulties for business owners in transition countries who generally lack experience with income and profit tax or private business legislation (Roberts & Zhou 2000). Finally, private business owners in transition countries tend to be more progressive and market oriented than the general population (ibid.). In that sense, they are greater supporters of market oriented changes and reform.

\subsection{2.4.7 Central and Eastern European and former Soviet Union countries compared}

\textbf{Environment.} As shown in chart 2.2, the affinity with Europe and the European Union countries has had a strong influence on the more western-oriented development chosen by CEE countries (Roberts & Tholen 1998). For many, the memory of private enterprise as well as the retention of a small and limited private sector even during the socialist period, has resulted in the rapid development of a private sector. Further, in most CEE countries, the profound changes to the existing socialist political and economic order has led to the replacement of old political elites.

The situation for business owners in the FSU is quite different. In many FSU countries we still see a dominance of the old Russian language networks that continue to link newly independent FSU countries to Russia (Roberts & Tholen 1998). As a result, the Mafia-style capitalism that developed in Russia is having a broader regional influence\(^{27}\) (ibid.). Most FSU countries have no memory of private business ownership and Soviet policies resulted in a non-existence of private business culture during communist rule. Even though the collapse of the Soviet Union resulted in the emergence of many new independent countries, most ruling elites remained in power, in many cases simply changing their name (ibid.).
The Role of the State. For the most part, CEE countries have ascribed to an ‘invisible hand model’ for the government that limits intervention or interference in private business development (Frye & Shleifer 1997). However, this is not the case for FSU countries. The Soviet state was built on an ideology that stifled independent innovative culture and allowed for a punishment-oriented ‘inspection culture’ to develop. The disintegration of the Soviet Union has led to a political and economic vacuum in many FSU countries which has facilitated the development of a ‘grabbing hand model’ of government intervention. This type of governmental structure is characterized by corrupt behavior occurring in a disorganized way that leads to the personal enrichment of governmental officials to the detriment of the government and the country as a whole (ibid.).

Business Owner Characteristics. Private business owners in CEE countries tend to be specialized in their business activities in a diverse array of business sectors and for the most part, view their businesses as a full-time endeavor (Roberts & Tholen 1998). In this context, business development is seen as a gradual step-by-step process. Individually run businesses versus business partnerships are the dominant form of private business engagement. For the most part, private businesses function in the official economy.

In contrast, given the unstable economic and political conditions in a number of FSU countries, many business owners focus on short-term get-rich-quick business strategies instead of long-term strategies (Roberts & Tholen 1998). Business owners in FSU countries tend to engage in generic business activities (many activities as once in order to spread risk) and are primarily involved in trade activities (ibid.). Many business owners are also still employed in the state sector and engage in their businesses as a part-time activity (ibid.). Business partnerships are the dominant form of business activity since they seem more effective in protecting business operations (ibid.). Also, many private businesses function in both the official and informal economy (Roberts & Tholen 1998; Kontorovich 1999).
2.4.8 Entrepreneurship in Lithuania

Environment. In many respects, the situation for business owners in Lithuania is a blend of the CEE and FSU country situations (chart 2.3). Though Lithuania was part of the Soviet Union, it also shares some similarities with CEE countries. As a Baltic country with historical ties to Europe, Lithuania feels an affinity with Western Europe especially with the EU countries. Lithuania also prioritizes western-oriented development. Further, during its brief period of independence between the First and Second World War, Lithuania was able to develop a market-oriented economy based on private business ownership. In this sense, Lithuania is similar to other CEE countries in its retention of a memory of private business ownership. Lithuania
regained its independence in 1991 and though many political, economic and social realities have dramatically changed, it can be argued that political (and subsequently economic) power was retained by the ex-Communist Party elite (a pattern observed in other FSU countries) (see also chapter 1.4).

**Role of the State.** The legacy of the Soviet-style inspection culture continues to play an influential role in independent Lithuania. In general, the Lithuanian State seems more focused on penalizing and punishing deviant behavior than promoting or providing incentives for exemplary private business activities. The role of the state in Lithuania has not regressed to a 'grabbing hand model' as in other FSU countries; nor has it reached the level of CEE countries in adopting an 'invisible hand model' (Frye & Shleifer 1997). Lithuania's situation falls somewhere in between with an 'interfering hand model' i.e. continuing governmental interference that hampers independent private business development.

**Business Owner Characteristics.** Many business owners in Lithuania tend to engage in generic business activities especially in the trade sector and focus on short-term business strategies to 'get-rich-quick' as in other FSU countries. However, for most business owners in Lithuania as in CEE countries, business ownership is a full-time activity (see chapter 3.13). It seems that most Lithuanian businesses function simultaneously in both the official and informal economy as do the majority of FSU business owners (Kontorovich 1999; Roberts & Zhou 2000). In addition, in Lithuania some business owners seem to form protective partnerships as in the FSU countries while others function as individual businesses as in the CEE countries.
Chart 2.3: Entrepreneurship in Lithuania: General characteristics

<table>
<thead>
<tr>
<th>Factor</th>
<th>Lithuania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Environment</td>
<td>Affinity with Europe and European Union countries</td>
</tr>
<tr>
<td></td>
<td>Western-oriented development</td>
</tr>
<tr>
<td></td>
<td>Memory of private businesses</td>
</tr>
<tr>
<td></td>
<td>During socialist period, private business culture non-existent</td>
</tr>
<tr>
<td></td>
<td>Communism collapsed with only partial rotation of political elites</td>
</tr>
<tr>
<td>The role of the state</td>
<td>Interfering hand model</td>
</tr>
<tr>
<td></td>
<td>Inspection culture</td>
</tr>
<tr>
<td>Business owner characteristics</td>
<td>Business development focused on the 'big strike' or getting rich quickly; coping with unstable market conditions</td>
</tr>
<tr>
<td></td>
<td>Generic business activities</td>
</tr>
<tr>
<td></td>
<td>Business activities primarily engaged in trade</td>
</tr>
<tr>
<td></td>
<td>Full-time private businesses</td>
</tr>
<tr>
<td></td>
<td>Businesses function in both official and informal economies</td>
</tr>
<tr>
<td></td>
<td>Both individual business and protective partnership businesses formed</td>
</tr>
</tbody>
</table>

2.4.9 Conclusion

*In the end it is the law that is written in the hearts of the people that counts*
(North 1990:60)

Institutional theory is useful for economists in order to understand the erratic economic development of countries undergoing dramatic changes such as is the case of the FSU countries. Though economists generally implicitly acknowledge the important role played by institutions in reducing transaction costs and facilitating exchange, the situation in transition countries has necessitated more explicit attention to institutions. Institutional theorists such as Douglass North (1990) and Edgar Feige (1997) have contributed greatly to explaining the effects of unequal changes to formal and informal rules on economic development both in the historical context.
1990) and in the transitional environment (Feige 1997; North 1997a). In general, though formal rules can be changed overnight, informal rules tend to be more firmly embedded and take much longer to change. Further as opposed to the neoclassical theory of wealth maximization, institutional theory takes into account the direct influence of attitudes and perceptions i.e. ideologies on economic performance. Furthermore, institutional economists emphasize the need to address each institutional setting as a unique set of circumstances requiring a unique strategic approach. As North writes:

*It is important for us to understand that even if we do have it right for one economy, it will not necessarily be right for another, and that even if we have it right today, it will not necessarily be right tomorrow* (1997b: 15).

Informal institutions widely practiced under Soviet rule continue to negatively influence economic development in Lithuania. Informal institutions such as corruption, non-compliance, distrust and the acceptance of a highly skewed distribution of wealth and information are examples of some of these Soviet legacies. Furthermore, lack of transparency and an over-regulated environment have fueled the existing culture of non-compliance and governmental distrust. Informal rules are mainly active in the ‘hearts and minds’ of the population and though not instantaneous, formal rules can have a positive effect on altering less desirable informal practices. In this sense, the role of government policy cannot be over emphasized.

In terms of gender relations in Lithuania, a lot seems to have changed and yet little has changed. Those are the paradoxes for gender relations in Lithuania during transition. For the most part, those men who were in the upper echelons of the Communist Party have been able to retain their dominance in economic and political life. Other men have suffered tremendously in terms of loss of income, identity and status that has resulted in destructive behavior towards themselves and others. Women, as a group have fared poorly. The reemphasis of traditional masculine and feminine gender roles has resulted in women encountering new forms of discrimination in the labor force. Benefits such as paid maternity leave have become barriers to private sector employment. Both men and women have suffered a lack of
employment but informal barriers have contributed to higher likelihood of unemployment amongst middle-aged women. In sum, the ‘lock-in’ of traditional gender roles that evolved during Soviet rule have resulted in increasing number of women being openly discriminated against in the paid employment market during transition.

A number of studies suggest that private business ownership may be a viable strategy for women to circumvent the discriminatory practices of the formal labor market and joblessness. However, available data suggest that Lithuanian female business owners may also encounter discrimination.

Within Economics, entrepreneurship research was an important area of study up until the early 20th century. Thereafter entrepreneurs seemed to disappear from mainstream economics. This disappearance of the entrepreneurial function within economics seems to coincide with the incorporation of the modern theory of the firm in orthodox economics. The main explanation for the entrepreneur’s disappearance from microeconomic theory has to do with consistency requirements. Entrepreneurial functions do not fit neatly within the modern theory of the firm. An important contemporary contributor to entrepreneurship theory has been William Baumol’s historical account of the influence of incentives on the development of productive or unproductive forms of entrepreneurship (1993). More recently, the economic importance of the SME sector has increased the interest in understanding and researching the entrepreneurial process.

As opposed to advanced western economies, transition economies seem to be characterized by a high level of unproductive entrepreneurial activities since traditionally entrepreneurial activities in the centrally planned system were focused on rent seeking and were economically destructive (Dallago 1997). In that sense, productive entrepreneurship in transition countries cannot be taken for granted. In constructing a working definition, we incorporate Schumpeterian innovativeness and Knightian uncertainty and do not limit entrepreneurship to new venture creation. Further we restrict our definition of entrepreneurship to describing the creation of a viable ‘productive’ business. Drawing from a definition proposed by Wennekers and Thurik (1999) and including a focus for productive business creation, our working
definition for productive entrepreneurship focuses on innovative activity under uncertainty resulting in an economically productive business:

Productive entrepreneurship is ... the manifest ability and willingness of individuals to (a) perceive and create new economic opportunities through innovative activity (new products, new production methods, new organizational schemes and new production-market combinations) and to (b) introduce their ideas in the market in the face of uncertainty and other obstacles; and (c) their efforts result in a viable business that contributes to national economic growth and personal livelihood.

A growing body of literature on entrepreneurship in transition economies seems to indicate that though not all transition economies are the same, general trends in the entrepreneurship characteristics can be identified for CEE and FSU countries. The special case for Lithuania is highlighted since it seems to incorporate elements from both CEE countries and FSU countries.
Chapter 2 notes

1 Following the collapse of the Soviet Union, a Polish diplomat commenting on the difficulties of reviving an economy after it had been so thoroughly changed and ruined by communist rule. Source: Daily Baltic News (http://www.balticsw.com).

2 For a comparison of the old and new institutionalist approaches see Hodgson (1993); Rutherford (1994); Groenewegen et al. (1995); Van de Mortel (2002).

3 See also Knight (1921).

4 Framework uncertainty results from the collapse of the formal institutional framework. For further discussion see Van de Mortel (2002).

5 Though there can also be revolutionary change (North 1997b).

6 Individuals make their decisions within an institutional framework, which implies amongst other things, that learning and innovation take place within this framework. In this way, the already existing institutions will be strengthened, regardless of their efficiency.

7 Corruption is not only a problem that characterized the Soviet Union but plagues the economic development of numerous countries under different economic and political regimes. However, Soviet-styled corruption seem especially incompatible with a market-oriented economy.

8 The exception is the former president Valdas Adamkus. His is seen as one of the few honest politicians.

9 Feige stipulates that ‘Permitting a pervasive underground activity served as a means of controlling political dissension, rewarding elites, and buffering the hardships imposed by the inefficiencies of central planning’ (1997:28).

10 In the USSR, official wages were relatively equal as was the access to education and basic health care.

11 Though not ‘officially’ sanctioned, this occurred through informal networks.

12 For example, the gender wage gap.

13 In December 1905, the Great Parliament of Vilnius acknowledged the principles of equality between women and men which should be put into practice in an Independent Lithuania, and in 1922, women’s right to vote and legal gender equality was confirmed in the Lithuanian Constitution.

14 New evidence is emerging that illustrates the legislative inequalities that occurred within the so-called egalitarian Soviet system. For example, in the Soviet Union, females applying for a driver’s license were required to pass a gynecological exam! Male applicants were expected to pass a medical exam. Apparently, the rationale was to enforce a mandatory and random health check. This law was finally revoked by the Lithuanian parliament in January 2002 (almost 12 years after independence). This rather bizarre example illustrates the contradictory practices of Soviet laws. The fact that it took almost twelve years for the independent government of Lithuania to revoke this discriminatory law indicates the resilience of Soviet practices.

15 Source: Rāi et al. (1992:12).

16 However, it is important to remember that individual experience for both men and women may diverge from general group experiences. Therefore, though women as a group are discriminated against, for some women, constraints may fall away as if they never existed. Also, some constraints may be individually negotiated, while others need political or social control. Age, education, ethnic identity, marital status and number (and age) of children are some of the main factors that help explain differences in women’s experiences.

17 Difficult and time consuming in the USSR where goods were scarce (see also Jucevičienė 1998:20).

18 The suicide rate amongst Lithuanian males is one of the highest in the world. In 2001, 77 males per 100 000 committed suicide and 84 males per 100 000 died accidentally (transport accidents, alcoholic poisoning or drowning) whereas only 15 females per 100 000 committed suicide and 19 females per 100 000 died accidentally in the same period (Lithuanian Department of Statistics 2002). The majority of suicides occur in rural areas.

19 This is similar to the situation in Russia. See Ellman (2000a) for further elaboration.

20 Though illegal, private businesses are known to require signed letter of resignation to be submitted upon hiring new female employees, which are then used in the event the employee becomes pregnant. For further discussion of how maternity leave acts against women seeking employment see Medvedev (1998).

21 In 1995, the Lithuanian policy of early retirement for women was changed and a slow increase of male and female retirement ages was initiated. By 2009 women’s retirement age will have increased to
60 years and men’s retirement age will reach 62.5 years. On average, women in Lithuania outlive men by 10 years and if retired at age 55, will live on average, almost 22 years on a pension (based on 1998 figures).

Due to their earlier retirement age, longer life expectancy and generally lower pensions (due to lower wages) more elderly women are at risk of poverty. Further given their duties as grandmothers (filling the gaps of lack of childcare facilities), pensioned women are less likely to seek re-employment (Einhorn 1993:66).

22 A female Bulgarian attorney’s response to the discriminatory environment in post-socialist Bulgaria (quoted in Medvedev 1998:26).

21 Here we are focusing on the individual, but it is also true that entities such as cities, regions and nations at the meso or macro level can also be entrepreneurial (Wennekers & Thurik 1999:47).

24 This definition is based on the assumption that the national government is striving for a benevolent role towards productive entrepreneurship development. If however, the government is of the rent-seeking variety then it may in fact be necessary at times for productive entrepreneurs to evade national regulations in order to continue their productive entrepreneurial activities.

25 We recognize that there are differences between countries that we have grouped into general categories. For the purposes of this analysis, the two categories (CEE countries and FSU countries) most clearly delineates the differences between transition countries.

26 This seems to be a legacy of the post-socialist state. See also Kobeissi (2001).

27 In Russia there is a gradual transition from Mafia-style capitalism to a market-oriented economy with 'Russian characteristics' (Ellman 2000b).