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Capitalism theory in Central Eastern Europe. A critical review

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Introduction

At the beginning of the new century, a fundamental shift in the analysis of the political economy of Central and Eastern Europe occurred. The analysis moved away from a simple, more-or-less monolithic view of the transition from a planned to a market economy, with variations in the extent, speed, and role of historic legacies, towards attempts to grasp the patterns of institutional consolidation. This shift was accompanied by a recombination of theoretical ideas and approaches showing the limits of the original approaches and new insights, whose implications might extend beyond the post-communist space.

In this paper, I try to provide a critical review of this debate, due to the impression that it has reached a point where a new approach is necessary in order to continue to progress in the field. I do not mean to imply that a new conceptual framework is needed in this context, but rather a more detailed and comparative analysis of sectors, institutional spheres and company behaviour.

By the mid-2000s, the *Varieties-of-Capitalism* approach (VoC) had reached Central Eastern Europe (CEE) as interest grew in the recently emerging varieties of post-socialist capitalism. A fascinating debate on the transferability of the concept to less advanced market economies followed, while in the West, criticism of VoC approaches to Western contexts gained the upper hand, leading more and more to reject its use in studying capitalism. Wolfgang Streeck (2009, 2011) and other scholars went so far as to question whether the VoC approach could be considered a framework for studying capitalism at all, and associated it with neoclassic equilibrium theory and mainstream neoliberal economics. The financial crisis of 2007 and the consequent Euro crisis seemed to be the final nail in its coffin, as it offered little to explain the global crisis. Neo-Marxist and Polanyian-inspired concepts have instead become more *en vogue*, focusing again on *capitalism in general* (cf. Streeck 2009, 2012; 2013; Dörre 2013).

In critical distinction to VoC, Dorothee Bohle and Béla Greskovits developed their typology of *post-socialist regimes*, inspired by Karl Polanyi. I regard their book *Capitalist Diversity on Europe's Periphery* (2012) as the most sophisticated and encompassing analysis to date on the transition paths in the post-socialist EU. In the context of the crisis, the *growth models* of the countries come more to the forefront, which are related to the emergent institutional varieties. However, during the crisis, the question arose as to why some CEE countries were hit harder than others, for which additional explanations are needed. In this respect, the debate on CEE mirrors to some extent the German debate, which points to the limits of conceptualisations at nation-state levels. However, with the interplay between the new varieties of capitalism and growth modes having gained interest among researchers, this promising perspective is still far from exhausted and I would argue against giving up the idea of VoC. One encompassing attempt to explain varieties in the post-communist realm is the book by Jan Drahokoupil and Martin Myant (2011) which analyses variation among growth modes. This approach definitely avoids the problems associated with the transfer of VoC to CEE, though not without certain costs.

In the following sections, I will first briefly outline these three approaches with their strengths and weaknesses which I perceive as being the most intriguing for understanding CEE, from which I will then derive some lessons.

The VoC approach travels eastward

One of the first and best-known typologies of emerging post-socialist capitalisms, not related to VoC, is that of Lawrence P. King and Iván Szelényi in the *Handbook of Economic Sociology* from 2005. King and Szelényi distinguish three transition paths: ‘capitalism from without’ (Central Europe); ‘capitalism from above’ (Russia, Romania, Serbia at that time); and ‘capitalism from below’ (China and Vietnam). This typology combines the emerging order of ownership with Weberian and Durkheimian traditions of thought that suggest an intersection of modern capitalism and rational bureaucracy, and, as with Niklas Luhmann, the functional differentiation of the economic system from the political system as a fundamental innovation of modernity. The Central European ‘capitalism from without’ is characterised as ‘liberal capitalism’ (capitalism in a liberal democratic regime and comparatively highly developed rational state capacities) and as having a high influx of foreign direct investment, due to rapid liberalisation and markets opening to the West. In contrast, Russia is sketched as a neo-patrimonial, network and oligopolistic form of capitalism, following the lines of research that stress the continuity of elites, but without the continuity of power institutions and administrative capacities that have marked Chinese development.

The *first applications of the VoC* approach to CEE appear quite naïve, compared to the level of conceptualisation reached by the mid-2000s. This was especially the case as authors tried to measure the gradual increase in pre-market ‘strategic coordination’ (Hall/Gingerich 2004). They included in their analysis almost all post-socialist societies, regardless of the extent of transition already made towards a market economy. The outcomes were highly contradictory conceptually, as well as in terms of the various indicators used.

Table 1: Collection of VoC typologies for Central and Eastern Europe based on quantitative indicators

Authors	Typologies	Indicators
Lane (2007)	**(more state-led) continental type of market capitalism:** Slovenia, Czech Republic, Hungary, Poland, Estonia **Hybrid state/market uncoordinated capitalism**: Ukraine, Georgia, Moldova, Russia **Etatist economies:** Belarus	Private sector's share of GDP, privatisation index, stock-market capitalisation and provision of credit, participation in global economy, income inequality
Knell and Srholec (2007)	**Strategic coordination:** Belarus, Ukraine, Slovenia, Croatia, Romania, Czech Republic, Uzbekistan **(Liberal) market coordination**: Bulgaria, Georgia, Moldova, Poland, Slovakia, Hungary, Estonia, Russia	Coordination index: *social cohesion* (GINI, highest marginal personal income tax rate, government final consumption expenditure), *regulation of labour market* (World Bank criteria), *business regulation* (World Bank criteria for startups, insolvency, property registration, stock market relative to banking sector in the financial system)
Cernat (2006)	**Anglo-Saxon**: Estonia **Continental:** Poland, Slovakia, Bulgaria, Latvia, Lithuania **Developmental state:** Hungary, Czech Republic, Slovenia But in most countries with a significant degree of institutional incoherence. While the cluster analyses also subsumed Romania to the **continental type**, the case study revealed Romania as an unfortunate sort of **cocktail capitalism** of the two models and the legacy of state-centred clientelistic capitalism during the 1990s.	Dominant type of labour bargaining, state intervention, the role of the banking sector and financial institutions, degree of internal institutional coherence

Source: Bluhm (2010)

Knell and Srholec (2007), for example, considered Belarus to be the most strategically coordinated economy in Eastern Europe in the mid-2000s, followed by Ukraine, Slovenia and the Czech Republic, whereas Hungary, Russia and Estonia were regarded as market-coordinated. David Lane (2007) viewed Russia as an uncoordinated market economy which turned towards a state-coordinated oligopolistic form of capitalism under Putin (2011). For Cernat (2006) and other scholars, Poland was considered to be more liberal.

The simple application of the VoC approach to the East failed because the authors had ignored the *limitations* of this approach: Peter Hall and David Soskice (2001) explicitly designed their framework for advanced market economies. They did so because they wanted to show that *entrepreneurial* competitiveness of firms in a global economy could be reached within different institutional settings, producing different comparative advantages for them. In other terms, Hall and Soskice restricted their analysis to 'open access orders' (North *et al*.

2009), and the advantage of the approach is that it can explain an astonishing *variation* among such orders. Expressed in Neo-Weberian and Durkheimian terms, the VoC approach presupposes well-established rational state capacities and law enforcement, and a functional differentiation between politics and the (private) economic sector. Only under the conditions of this implicit assumption is it possible to conceptualise pre-market strategic coordination, corporatism and networks as *productive* resources for global *entrepreneurial competitiveness,* while the possibility of *rent-seeking, corruption* and *clientelism* is left aside. Otherwise, one could voice vis-à-vis the VoC approach the same criticisms once made of Robert Putnam: just as Putnam ignored the 'dark side' of social capital, the VoC approach does not reflect the ambivalence of strategic coordination (Bluhm 2010).

Not accidentally, country-case studies in the VoC tradition mainly refer to those post-socialist countries that have managed to adopt an 'open access order'. But once again, the claims are only partly convincing:

Buchen (2007) and Feldmann (2006) in their papers compared Estonia, the country closest to a liberal coordinated market economy (LME), with Slovenia, the only post-socialist country to have developed some similarities to the German/Austrian version of a coordinated market economy (CME). The two authors, in fact, reviewed the different institutional spheres relevant to the VoC approach, namely the financing of firms and corporate governance, inter-firm collaboration, labour relations and skill provision (*cf.* Hall/Soskice 2001). Yet, even these two supposedly prime examples deviate from the western model in serious respects. Estonia, for example, shares with most of the other CEE countries an extremely high penetration rate of majority-owned foreign bank affiliates in the banking sector, while the level of capitalisation of firms from capital markets, constitutive for LMEs, is low. The stock-market capitalisation of firms in the new EU member-states is highest in Poland and Croatia, where it reaches approx. 36 per cent of GDP but still lags behind most of the 'old' EU members (World Bank Indicators).

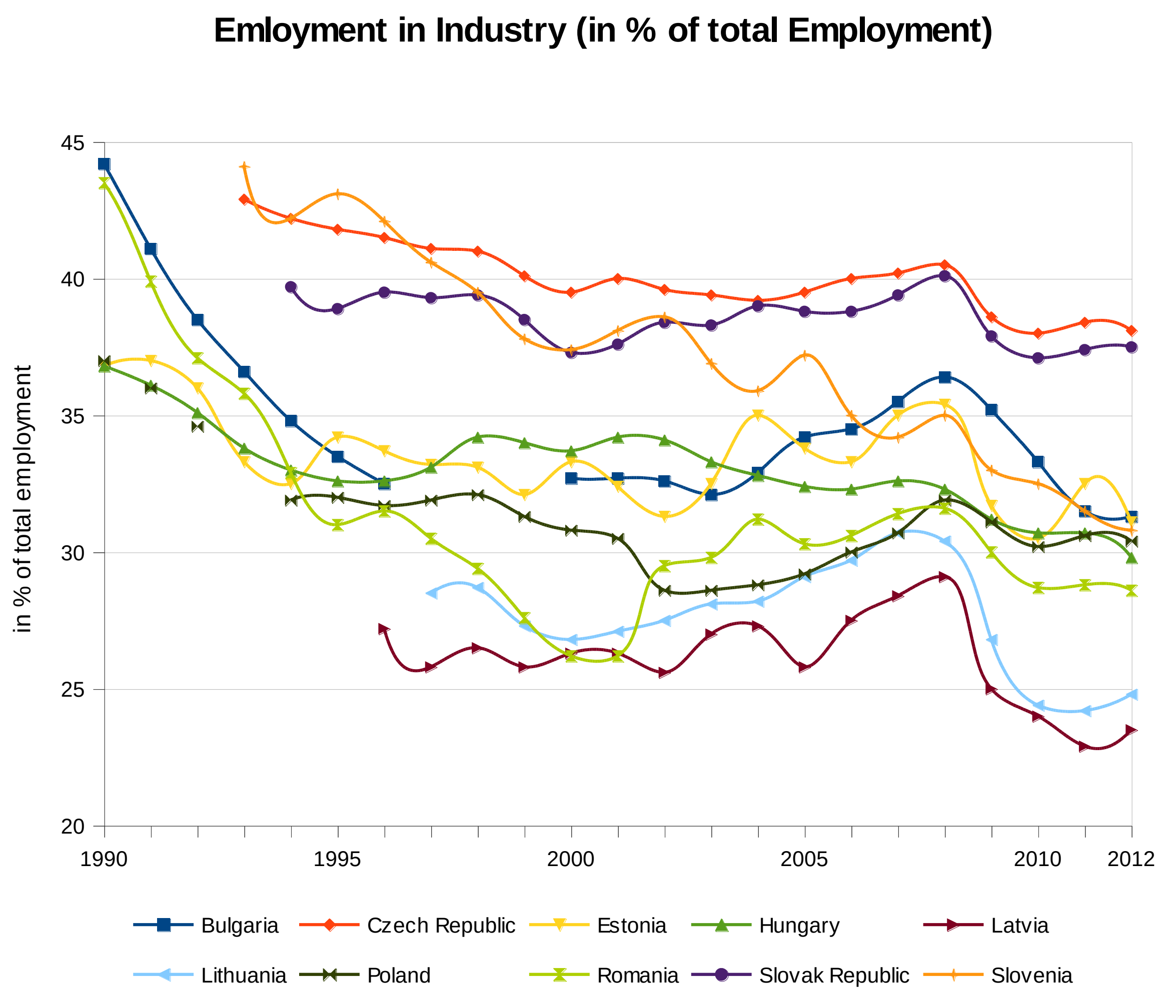
Moreover, identifying two 'extremes' – Estonia as a LME and Slovenia as a CME – tells us little about the rest of the countries who lie somewhere between the two, if one is not to simply just quantify the degree of 'strategic coordination' according to some broad indicators. There is too much unexplained 'noise', i.e. incongruencies among them, to be able to confirm that the VoC approach fits the entire region.

Poland, Hungary and the Czech Republic represent institutionally highly mixed systems, even if we add the classifications that have emerged in the critical debate over the original dichotomy of LME and CME to the VoC typology. Krzysztof Jasiecki (2013) considers Polish capitalism to be a premature hybrid of liberal, corporatist and 'Mediterranean' elements, with a weak capacity for innovation and a lack of state capacity for a consistent macro-policy that could produce institutional complementarities.

The institutional effects of the high degree of transnationalisation are often cited in critiques of the application of the VoC framework to CEE. One interesting attempt to fill the gap between the two poles (Estonia – Slovenia) *within* the VoC tradition was put forth by Andreas Nölke and Arjan Vliegenthart (2009), who proposed a third type of market economy alongside the LME-CME dichotomy, which they identified as a 'dependent market economy' (DME).

Nölke and Vliegenthart associate a specific combination of features with the DME that best describe the Czech Republic, Slovakia, Hungary and Poland. The authors see the high degree of transnationalisation in those political economies as a central institutional effect. In all four cases, western companies have strongly invested in the banking *and* manufacturing sectors, and in fact dominate these sectors. The influx of foreign direct investment led to the establishment of competitive, modernised, medium-tech, capital-intensive industries that provide semi-skilled to high-skilled jobs, relatively high wages and offer some interest in collaborative labour relations. In this regard, the Czech Republic and Slovakia, in particular, managed to stop the process of deindustrialisation after the breakdown of *Comecon* and maintain a high degree of industrial employment (Figure 1).

Figure 1:



Source: World Bank (2014).

However, western multinationals display only limited interest in skill development and the countries' innovative capacities, and they have little use for indigenous banks or capital markets. The banks which multinationals do business with in the host countries are usually branches of their home banks. Even more decisive is the fact that the foreign-owned companies rarely look for independent financial sources outside of the transnational company network, as they often rely on internal financial transfers. Nölke and Vliegenthart may overstress these limitations, as the empirical studies on multinationals in Central Europe (CE) show at least some interest in skill formation (especially with the increasing shortage of skilled labour after EU integration), and have also developed CE production sites into 'competence centres' that include R&D (cf. Bluhm 2007; Hancké/Kurekova. 2008 Jürgens/Krzywdzinski 2010).

In short, a typical feature of a DME is the fact that CE subsidiaries are not at the bottom end of the value-adding chain, but rather in the middle. This reflects the typical manufacturing structure of continental Europe, with automotive and engineering industries at its core. These countries rely on the supply of human capital (cf. Bohle/Greskovits 2012: 12) and are successful in terms of upgrading, which is due in part to the efforts of skilled labour forces and managers in those countries. So far their activities are dependent on strategic decisions made at company headquarters, typically located abroad. Therefore, we observe in Central Europe a *specific constellation of the subsidiarisation* of economies.

This is precisely where the limits of DME are to be found: the ‘third variety’, added by Nölke and Vliegenthart, is not open to other possibilities of dependency. For example, the Baltic states do not fit into the category of DME, although they too embraced a ‘Western-led’ modernisation strategy and belong to the most advanced market economies in CEE. They share with CE a high degree of subsidiarisation of the banking sector, in which foreign-bank assets represent between 60 and 90 per cent of the countries’ assets. By comparison, UK foreign-bank assets, in one of the world’s financial centres, is approx. 44 per cent of all assets in the country, a level that, according to the Economist recently, helps ‘to boost the British economy, but also poses risks that were revealed in the financial crisis of 2007-09’ (*The Economist* March 1, 2014: 70). What the Baltic states lack, when compared to Central Europe, is the high influx of FDI to medium-skilled, capital-intensive manufacturing of complex durable goods.

Neo-Polanyian regime types

One of the most fascinating conceptualisations of different capitalist regimes in the post-socialist EU has been proposed by Bohle and Greskovits (2007, 2012). I will only sketch the main idea briefly, which is much more sophisticated than can be illustrated here.

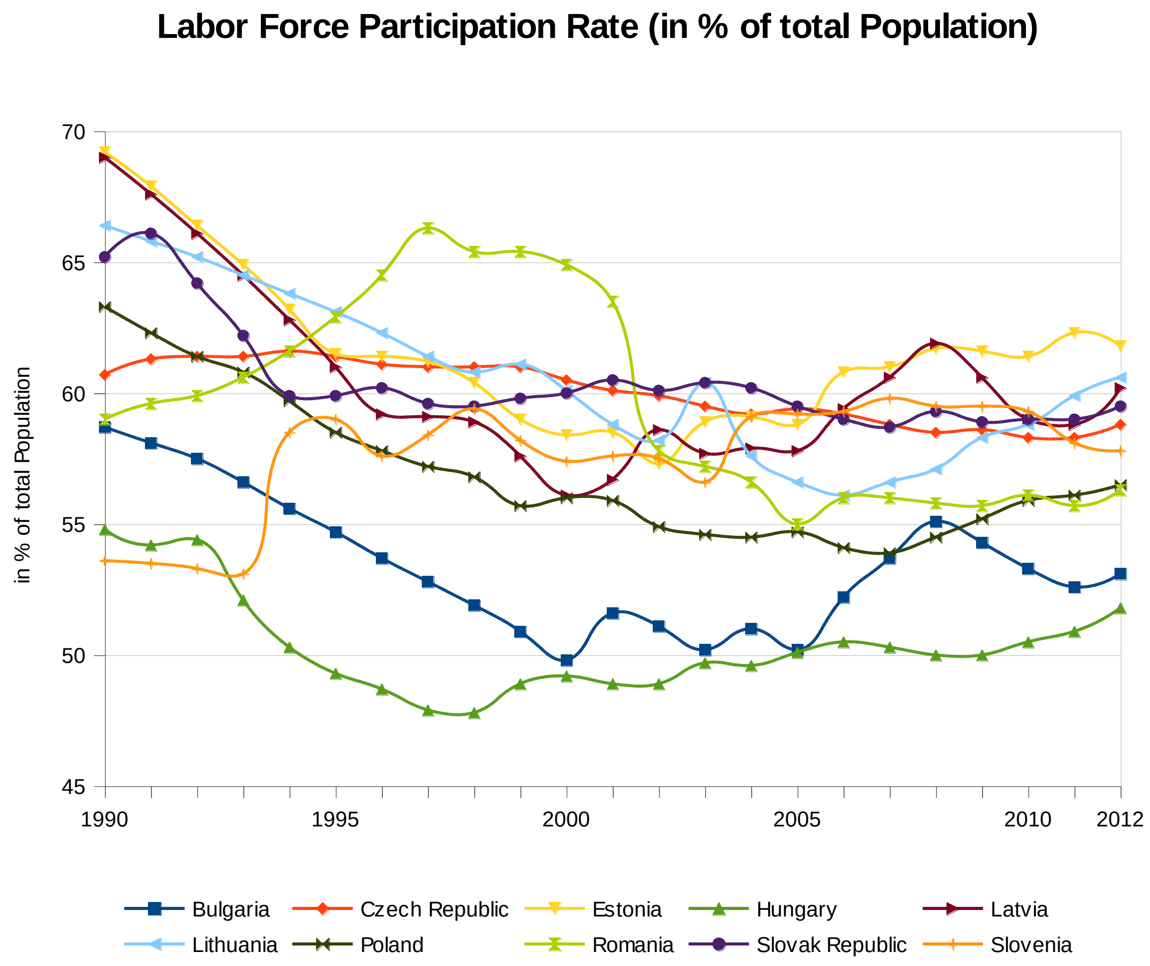
Bohle and Greskovits placed *politics* center stage in their typification. They adopt from Polanyi’s *The Great Transformation* ([1944] 1957) the idea of a so-called ‘double movement’ in the transition from a planned to a market economy. The transition is differentiated according to the reform paths, which means the extent to which the reformers followed the idea of self-regulating markets (movement) and the extent of state policy intervention via industry, labour or social policy (countermovement). Sufficient state capacities to implement and conduct reforms are a decisive precondition.

On this basis, Bohle and Greskovits state that there are three types of post-socialist regimes:

- The *neoliberal regime type* of the Baltic states, which adopted a strong neoliberal approach of freeing markets from the state, and did little to counter its effects: labour codes are very flexible, welfare-state provisions are scant and industry policy is perceived as illegitimate state intervention. The Baltic states could afford this kind of market radicalism, due to the fact that it formed a cornerstone of national identity policy, repudiating the countries’ Soviet past and their Russian minorities. Nation-building represented a more important source of political legitimacy than social compensation and inclusion.

- In Central Europe, Bohle and Greskovits distinguish the *embedded neoliberal regime type* in the Baltic states, which from the outset of transition also embraced the neoliberal approach of fast liberalisation, state withdrawal and privatisation, but did much more to counterbalance the social costs of this approach by promoting passive labour policy, more generous welfare-state provisions, and political and social inclusion. At an early transition stage, passive labour-market policy played an important role in ‘shock absorption’ and contributed to relatively low employment rates by EU standards, especially in Hungary, where employment rates have, until recently, remained the lowest in the EU (Figure 2).

Figure 2:



Source: World Bank (2014)

- Slovenia represents for Bohle and Greskovits a separate type, called the *neocorporatist regime*, since the country adopted the 'least radical strategy of marketization coupled with the region's most generous and specifically targeted transformation cost compensation efforts' (Bohle & Greskovits 2012: 24). They classify Romania and Bulgaria as a 'non-regime type', due to their statuses of being states with weak capacities, which were unable to undertake any of the above reform directions during the 1990s. This situation has slowly changed under the umbrella of the EU.

A Polanyi-inspired approach is not a better framework for analysing capitalism than the VoC approach(cf. also Streeck 2009, 2012), because it is even more centred on the regulation of markets. Not accidentally, Polanyi speaks of the 'capitalist market economy' instead of capitalism. The mode of accumulation of capital based on a developed credit system and an ongoing rationalisation process of production is not at the heart of his theory. The shift towards a *policy-centred approach* based on Polanyi's insight into markets as politically constructed, has some advantages over the *firm- and coordination-centred* VoC approach, but they lie in different fields:

- It puts the actions of the state and politics at the center of regime formation. State capacity and the welfare state are, therefore, important issues here.
- It clearly raises the question of social protection and welfare-state development.

- As an analysis of the conflicting processes of disembedding and re-embedding of markets, it points to institutional fragilities and dynamics resulting from multi-level influences (including convergence effects of the EU).

On the other hand, there are significant downsides in comparison to the VoC approach. Polanyians tend to view institutions mainly as *externally imposed* constraints on self-regulating markets, which is precisely why the approach is suitable for conceptualising counter-movements of market re-regulation in the interest of the wider society. Institution-building as a solution to coordination problems *within* the economic sector, and as a result of interaction between economic players, remains outside of this view – at least without additional assumptions, which significantly complicate the argument (cf. Bohle/Greskovits 2012). A Polanyian approach, therefore, seriously limits the understanding of institution-building and its dynamics.

Growth strategies and financial crisis

The financial crisis hit the individual countries in CEE in quite different ways. Interestingly, this holds true even among those countries which have pursued a comparably fast-track policy towards western and European integration. The Baltic states were more affected than the Czech Republic or Poland. Even among those four countries which Nölke and Vliegenthart perceive as 'dependent market economies' and Bohle and Greskovits as 'embedded liberal regimes', the effects of the crisis varied. Poland, the Czech Republic and Slovakia recovered relatively quickly, while Hungary had to seek a new rescue package from the IMF. Although growth modes and varieties of capitalism are related, the crisis made clear that even similar versions of capitalism in CEE do not simply translate into similar scenarios in the crisis.

Consequently, the debate has begun to focus more on the countries' growth modes. Jan Drahokoupil and Martin Myant (2010, 2011) differentiate between five modes of growth and international integration:

1. International integration through the export of relatively high-value products manufactured in branches of large MNCs (DME – Central Europe).
2. Integration through export in complex sectors without reliance on FDI (which fits only Slovenia).
3. Integration through exports in simple manufacturing (Southern and Eastern Europe, Baltic states).
4. Integration in the world economy through exporting raw materials and semi-manufactures that requires a less sophisticated business environment (Russia, Ukraine).
5. Integration through 'financialised' growth in which foreign borrowing supports public and private sector activities (Baltic states, Hungary).

The Czech Republic, Slovakia and Poland were mainly hit by the crunch of the real economy and profited from German anti-crisis measures which kept production of durable goods up. They then recovered on the back of the German export industries which have significant markets outside the EU. The Baltic states, in contrast, were not only much less protected by their growth mode, in this regard, but they also adopted a strategy that Collin Crouch has called 'private Keynesianism', i.e., a switch from public to private spending as the motor of the economy, a term originally coined for the US. The Baltic economic miracle before the crisis relied strongly on a housing and construction boom financed by private credit, mainly in Euros. This was lucrative because of the stable currency ratios guaranteed by their respective currency boards. As Bohle and Greskovits (2012) put it: the 'nationalist social pact' was replaced by privatised Keynesianism to ease the growing social tensions in those countries.

Interestingly, during the crisis, the Baltic states did not divert from their path. Instead of devaluing their currency vis-à-vis the Euro, they kept the fixed exchange rate and pursued a drastic internal devaluation through cuts in wages, pensions and social provisions. Estonia and Latvia even became Euro-area member-states, which completed their Western integration.

Hungary also combined two modes of growth (modes 1 and 5), because of the increasing dissatisfaction of the populace with the results of the transition and European integration. In contrast to the Baltic states, where private consumer credit was the driver of the increasing foreign debt, the Hungarian government continued to finance state expenditures via foreign loans. The Hungarian political elite 'slipped into a spiral of promises about outsized government spending' (Lengyel/Ilonszki 2010), while the FDI-driven growth mode fell behind its CEE competitors (Lengyel/Bank 2014). The mismatch between the limits of a foreign-driven growth strategy, on the one hand, and the high expectations for rising living standards among the populace, based on previous relatively high levels of consumption during 'goulash communism', could present the explanation why Hungary alone slipped into this spiral, and not the Czech Republic or Poland. The reasons for the variations remain underexplored.

The Hungarian government, however, responded quite differently to the crisis than did the Baltic states. The Òrban government reacted with a currency devaluation that entailed less hardship for the people, the re-nationalisation of the newly established second-pension pillar, and the introduction of a special tax for foreign multinationals, all the while reducing the tax burden for small and medium-sized companies. The special tax for foreign multinationals was halted only after the intervention of the Court of Justice of the European Union. As in the West, there have been links between the varieties of capitalism which have emerged, the modes of growth and the methods of coping with the financial crisis.

What lessons can be drawn?

The debate on the emerging varieties of capitalism in CEE has given us some significant lessons:

First, we should abandon the idea of a catch-all typology of real world capitalism, because capitalism can be combined with 'limited access orders' or 'open access orders' (North *et al*. 2009) which can hardly be bridged within one typology.

Second, CEE has never had a period of 'relatively undisturbed' national institution-building since World War II, in contrast to the North and West of Europe. The US influence on Germany after that war and Bretton Woods are not comparable to the influence of globalisation and europeanisation in the 1990s. The convergent effects of the European Union in the more recent accession processes have been particularly strong, even when compared to the south-European countries' entries in the 1980s. These effects need to be studied further. Whether Slovenian exceptionalism will survive deepening European integration, for example, remains an open question.

Third, the outlined typologies for CEE encompass a narrowly defined time span between the mid-1990s and the financial crisis, and are thus still heavily inspired by the transition paths, i.e. the period of institution-building. Their strength is in explaining the consolidation of certain paths towards a market economy and capitalism (which are not the same), and providing a basic understanding of newly established path dependencies. There is no need to assume that every single (even small) country fits a particular type of capitalism, even if we narrow down the possibilities. Hall and Soskice have made this clear. Yet, more detailed comparative analyses of particular spheres are needed in order to get a deeper understanding of particular institutional fields of the political economy in those countries. In spite of the limitations I have outlined, I would argue that the heuristic potential of the VoC approach for analysing institutional spheres in the advanced post-socialist economies has yet to be exhausted.

Fourth and finally, in his review of the VoC approach, Robert E. Goodin (2003: 211) concluded that 'the relationships of trust that are so central to the CME way of organizing an economy are hard to build and easy to destroy.' With 'trust' he has the social capital of Robert Putnam in mind. The capitalisms that have emerged in CEE seem to prove this notion. Yet, establishing a fully-fledged liberal political economy seems almost equally difficult.

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