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Capitalist Diversity in Eastern Europe

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East European varieties of capitalism: State of the art and criticism[1]

By the early 2000s, following a decade of political and economic transformation and global and European integration, the post-socialist political economies seem to have settled on divergent models of capitalism. Scholars have contributed in three ways to understanding this diversity. First, they identified a dividing line between Central-Eastern Europe (CEE) and the Commonwealth of Independent States (CIS). While the former achieved closer resemblance with the Western democratic market societies, it is underdeveloped markets, informality, and tensions between capitalism and democracy that characterize the latter (Bruszt 2002). Second, the same divide has been confirmed by comparative work focusing on these regions' different positions within the global political economy (King 2002). This research proposed that the European Union (EU) locked the CEE countries in promising paths of development, while transnational corporations (TNC) contributed to their dependent modernization. In contrast, the CIS states, which neither could rely on the EU nor occupy favorable positions within the international division of labor, were left to the less benign influences of the IMF and volatile natural resource markets (Lane 2005). Third and most recent, East Europeanists – directly adopting the influential "Varieties of Capitalism" (VoC) approach that has generated powerful insights into advanced capitalism's diversity (Hall/Soskice 2001), - have discovered the Western polar types of "liberal-market" and "coordinated-market" economies in the Central and Eastern Europe as well (Buchen 2006; Feldmann 2006).

We believe that although the VoC framework seemingly equipped East Europeanists with a straightforward and parsimonious logic, its uncritical import has impaired their sensitivity to the specificity of the emerging regimes. This is so because none of the key VoC assumptions fits the East European cases. First, authors in the VoC literature usually assume the prior existence and hence explanatory power of established and consolidated institutions for firm behavior and adaptation to global challenges. However, the institutions of East European capitalisms have emerged only recently, and their consolidation cannot yet be taken for granted. Arguably, their impact on firm behavior would thus be weaker than assumed in the VoC literature. Indeed, state actors and firms have actively "crafted" the new institutions. Second, institutions in the East evolved as part and parcel of the region's international integration, and have been affected much more thoroughly by the pressures of the EU, TNCs, and global markets, than the institutions of Western capitalisms. Finally, the idea that the knowledge about the worlds of rich and powerful OECD capitalisms[2] can be imported without further ado to the study of less developed regions, equals to assuming that learning about the life at the king's court yields meaningful insights into the life of the peasant, or the vagabond.

In our own ongoing research on the eight new CEE member states of the EU, and the three most internationalized CIS countries, Azerbaijan, Kazakhstan, and Russia, we try to devote more attention to their specificity in the above respects. When accounting for the countries' capitalist diversity, we attribute key importance to the impact of the state and other political and economic actors; try to assess the concrete form of international and transnational embeddedness of national institutions and the contradictory pressures stemming from this condition; and take seriously the less-advanced character of many of these new market societies.

Mapping capitalist diversity in Eastern Europe

As often argued, the agenda of post-socialist transformation has been overloaded with all the major economic, political, and social challenges development can pose: building markets, preserving political stability, maintaining social cohesion, democratizing the political system, transforming industry, and securing a stable macro-economic environment. How successfully could these countries pursue and coordinate multiple transformations? Based on empirical evidence we established the following regime variation.[3]

Radically liberalized markets and a thoroughly reformed market-supporting institutional framework distinguish the Baltic States of Estonia, Latvia and Lithuania. They could maintain superior political stability that is puzzling especially since they have barely relied on social welfare provisions to achieve political balance. Among the new EU members, the Baltic states have the least generous welfare states and the most atomized industrial relations. However, in some qualitative aspects of their democracies, such as enfranchisement, Estonia and Latvia lag behind other CEE countries. Likewise, the Baltic States so far seem to have been much less successful in industrial restructuring than the Visegrád countries (Czech Republic, Hungary, Poland and Slovakia) or Slovenia. They integrate in the international economy mainly through labor-intensive traditional industries controlled by highly mobile TNCs, and through resource-based exports and related services. Similar to their meager welfare states, their industrial policies are minimalist, with low flat taxes rather than targeted protectionist measures at their core. Finally, in macroeconomic stability, the Baltic performance is superior to that of the Visegrád states. Restrictive monetary institutions (currency boards and/or independent central banks) as well as small and balanced fiscal states are the key institutional underpinnings of Baltic macroeconomic stability (Feldmann 2006).

Interestingly, in the early 2000s, the institutional configurations and performance of the three CIS countries that we include in our analysis: Azerbaijan, Kazakhstan and Russia, seem to closest to the Baltic pattern. The CIS appear to have fairly liberal market economies too, even if they continue lagging behind in the development of a market-supporting institutional infrastructure (e.g. reformed banking or improved enterprise governance). There are differences in the political aspects: their polities lack stability, and their systems are closer to authoritarianism than democracy. Just like the Baltic group, however, the CIS have very limited welfare states, and lack inclusive industrial relations. They seem to have failed even more than the Baltic States in industrial transformation. De-industrialization was more severe in the CIS, and currently their global economic integration occurs almost exclusively through raw material exports, and manufactured imports. Interestingly, over the early 2000s their macroeconomic indicators are no less satisfactory than those of the Baltic States.

From a more advantageous starting position, the Visegrád countries have successfully transformed into liberalized and thoroughly institutionalized market economies. Their regimes differ from the Baltic and CIS patterns in three key respects. First, they have offered more protection against the consequences of economic hardship and social dislocation stemming from neoliberal restructuring. Special welfare schemes, e.g. extensive disability and early old-age retirement schemes, family and child-care allowances, and active and passive labor market policies, helped large social groups to avoid, or at least slow down, their decline to underclass statuses. Second, at least to date, the Visegrád countries preserved more inclusive democracies. Third, whereas the Baltic States' priority has been macroeconomic stability, the Visegrád countries mainly pursued re-industrialization and industry upgrading. With adequate institutions and policies – including protective regulation and tariffs, export zones, foreign trade & investment agencies, investment support funds, tax exemption regimes, and public development banks, - the Visegrád states managed to attract adequate FDI in their technologically complex capital- and skill-intensive industries. Their export profile resembles that of the advanced countries. Finally, the complex and expensive agenda of industry upgrading and relatively generous social protection have come at a cost: the institutions safeguarding macroeconomic stability have not established dominance in most Visegrád states so far. Moreover, in political terms, especially after 2004, they are the least stable within CEE.

Among the new EU members, Slovenia stands out for its simultaneous success in all above tasks. Dominant neocorporatist institutions, such as legally enforced negotiated management-labor relationships, and extended collective agreements have so far been able to deliver the compromises required for a balanced and inclusive agenda.

Internationalization, transnationalization, and transformative state capacity

The significance of the varied configurations cannot be fully understood without capturing *how* these configurations came about. In line with our critical stance towards existing literature, our own explanation focuses on the international context in which these institutions evolved, and the capacity of the state to transform institutions.

The pattern of internationalization confirms the existence of a divide between the CEE and CIS countries. The former became thoroughly integrated into European systems of production, commerce, and finance, and acquired membership in the most important international organizations, including the EU. CEE's "thorough" internationalization and transnationalization has thus occurred via *multiple institutionalized channels*.

In contrast, EU membership has been out of reach for the CIS-3. While they are more open to foreign trade and investment than the rest of CIS, their global integration significantly differs from the CEE pattern. In their exports, all three countries have been heavily dependent on the global markets of energy and other natural resources. The same industries attracted the bulk of FDI both in Azerbaijan and Kazakhstan. Thus in contrast to the multi-channel global integration of CEE, the CIS pattern seems under-institutionalized and "shallow" as it essentially occurs through a handful of *world markets*.

The question then is: are the post-socialist states anything else than playthings of powerful international and transnational forces? Could they at all retain or develop a capability to assist 'the economy to transform itself and to respond to changes in the global economic environment' that is considered to be the key to economic development and power (Gilpin 1987: 77)? Proxies of state capacity highlight radical differences in "stateness" in CEE versus the CIS, and this is crucial for our understanding of post-socialist capitalism's diversity in all other important respects (Kaufman et al. 2006). Therefore, while stylized evidence allows us to trace the variation within CEE at least partly to the *varied uses* of state power to pursue different transformation agendas, we cannot explain the divergence *between the CEE and CIS capitalisms* in the same terms, since in the latter cases state capacity has barely been sufficient to make a relatively strong impact. Thus in the CIS cases, the influence of other types of factors and agents must be our primary focus.

The literature on less advanced countries in other parts of the world has suggested that varied channels of global integration as well as initial institutional endowments matter for domestic state capacity (Shafer 1994). More specifically, it is proposed that while, for instance, windfall oil revenues undermine state capacity, FDI tends to enhance it. Likewise, while "[c]ountries still forging central institutions can potentially evolve almost solely in response to capital inflows, generating bureaucracies that are the direct products of the international economy … where strong institutions are in place … international capital is more likely to be used to promote economic goals" (Chaudry 1997: 27-28). It follows that the thoroughly institutionalized CEE path of international integration should be more conducive for state capacity than the shallow CIS trajectory that was exposed to the volatility of global commodities and financial markets. Similarly, post-socialist states, which faced less demanding tasks of (re)building national institutions, should be more capable than the ones where essential institutions had to be built "from scratch".

Embedded vs. pure neoliberal, and state-crafted vs. directly market-driven regimes

Combining our map of capitalism's diversity with the above insights on its main driving forces allows us to differentiate among four types of capitalist regimes in post-socialist Eastern Europe. In the Baltic and the CIS countries we identify two subtypes of a political economy that seem to share, at a first glance, many characteristics of a neoliberal regime as perceived by the Washington Consensus. Countries in both sub-regions are characterized by small fiscal and welfare states, atomized industrial relations, low taxation, and macroeconomic stability. In contrast, albeit in different ways, both Slovenia and the Visegrád countries have *embedded their neoliberalisms* (for the genealogy of this term see Polányi 1957; Ruggie 1982; and Van Apeldoorn 2002). Slovenia achieved this through neo-corporatist institutions and a generous welfare state, whereas the Visegrád countries did so *by ad hoc* social protection packages targeting losers and opponents of neoliberal transformation.

How did this variation come about? Our framework stresses the interplay between transformative state power with specific agendas – or its absence – on the one hand, and the concrete form of the inter- and transnational embeddedness of these political economies on the other hand. On these grounds, we suggest the following regime paths.

The CIS countries experienced the collapse of their major state institutions and capacities together with the fall of state socialism. As it is well documented for the Russian case, the first phase of transformation was characterized by the dissolution of central state authority (Bunce 1999). Newly independent states, increasingly independent regions, and powerful societal actors picked up the pieces left behind by the collapse of the empire, and used them to accumulate fragmented, special-interest, or personal, rather than common, wealth (Hellman 1998). In this context, there was no state capacity to speak of to transform the economy in any comprehensive and coherent way. The disastrous reform performance of the first period of transformation was as much reflecting the non-existence of central state authority, as the influence of international actors such as the IMF. While Russian reformers radically liberalized the economy in line with the policy prescriptions of the IMF, they largely failed in building up market-supporting institutions. The social and economic consequences were devastating. Industrial production and GDP plummeted, social inequality ballooned, and the country became increasingly indebted externally. The untenable path towards "involution" (Burawoy 1996) exploded with the financial crisis of 1998.

International developments, rather than state capacity, also seem to be at the origin of the recovery, with dramatic increases in oil prices allowing the CIS to restore growth, macroeconomic stability, and pay back international debt. It is an open question to what extent the sustained period of high oil prices has indeed given them the resources to build more stable institutions and a stronger state. The literature on petro-states suggests the opposite: when state (re)building coincides with massive oil-revenue inflows, the new institutions are likely to be highly vulnerable to future bust periods (Karl 1997). Therefore, we see the paths, institutional outcomes, and performances of the CIS regimes as largely *driven by the forces of international resource and financial markets*, as well as the international financial institutions. At the same time, powerful domestic social groups dependent on these same markets have pressed CIS state actors to pursue adjustment in line with their own particularistic interests.

In contrast to the CIS, we view the CEE-regimes as essentially *"state-crafted"*. All CEE countries, Baltic states included, either inherited functioning states and institutions from the socialist system, or were able to build them up rapidly. Whatever similarities between the Baltic and CIS regimes might exist, they also differ in three key aspects. First, the neoliberal Baltic regime was largely the result of conscious reform choices. Their fast reforms stemmed from the wish to implement a most radical break with the past, and to dismantle the former strongholds of power of old state and party bureaucrats (Bunce 1999). Radical reforms also had an anti-Empire aspect to them. Getting rid of the nomenclature, their institutions, and inherited industries essentially meant forcing ethnic Russians to the sidelines. Second, and closely linked, the Baltic countries chose to marginalise inherited social forces and invite new groups to buttress their new states. The initial reforms were to a large extent designed and led by *émigrés*. The Latvian and Estonian approaches to privatisation were less conducive to insider wealth-accumulation than the methods chosen by the CIS. Mostly ethnically Russian employees were marginalized by deindustrialization and their voices muffled by disenfranchisement (Lagerspetz/Vogt 2004). In strategic sectors, the Baltic States welcomed foreign investors. Third, the Baltic regime is supported by adequate institutions, which are likely to be more resistant to international market forces than those in the CIS. Macroeconomic stability, which got the highest priority in the economic institutional setting is more a result of restrictive monetary institutions than windfall gains from resource exports.

The inter- and transnational influences to which the Baltic states are exposed partly reinforce and partly mildly correct their initial choices. Both the breakdown of the Soviet economy and later the financial crisis of 1998 hit the Baltic States harder than any other CEE country. Yet, these international crises reinforced the initial choices of elites as they weakened ties with the former Soviet Union, and justified the stress on macroeconomic stability. To be sure, economic ties with Russia have never been entirely severed. Ironically, in recent years the Baltic States seem to gain from the same windfall profits as the CIS, both as transit routes for Russian oil, gas, and other resources, and as exporters of manufacturing goods to the growing Russian market. These developments might partly explain for the spectacular growth rates over the last years. Other international factors – in this case neoliberal political and policy networks – ideologically confirm the domestic choices made by the Baltic states, since they interpret their high growth rates as merely signs of the victory of radical neoliberalism.

International developments have reinforced domestic choices in yet another way. The Baltic integration at the low ends of the world economy makes TNCs primarily interested in flexible labour markets, low wages, and minimal public intervention into employment practices and work conditions. TNC preferences dovetail the Baltic priorities of a neoliberal regime and minimal (welfare) state. Throughout the accession process, the EU served as a mild corrector of the Baltic States' overzealous economic liberalism and exclusionary political practice. Trade barriers had to be raised again, and improving the standards of social and democratic inclusion has become an issue in the accession negotiations. Overall, however, the EU agenda for the region is in line with the Baltic reform priorities, and EU accession therefore could mostly serve as a factor that locks-in earlier institutional choices.

Similar to that of the Baltic States, the Slovene path towards capitalism was based on conscious choices of reformers, and a state capable of implementing them. Nonetheless, the choices have been very different. The transformation of Slovenia was built on a consensus among all major forces of society - employers, employees, experts, and major political parties - that had been institutionalized in neo-corporatist bodies. While Slovenia accepted the general framework of macroeconomic stability, it was also clear for the reformers that this "alone would not facilitate a successful transition to a capitalist economy" (Lindstrom 2005: 23). Trade liberalisation and privatisation was carried out gradually, and the Slovene reform elites relied heavily on domestic forces, including labour, during the privatisation process. Slovenia opened its economy only very reluctantly and gradually for foreign ownership and control, especially in strategic sectors like banking.

This gradual and home-grown transformation strategy could be built on the best legacies of CEE. Not only has Slovenia been the richest CEE country, it also inherited the most liberal, politically and socially most differentiated socio-economic system from Yugoslavia's reform-communism. Firms had been relatively independent from the state, and could develop dense commercial and production links to Western markets well before the transition. Trade unions, rather than being pure transmission belts – as had been the case in most other countries of the region – also gained a measure of independence in the 1980s (Stanojevic 2003). All these factors made a transition strategy based on broad incorporation of all domestic social forces feasible.

As in the Baltic States, Slovenia's international embeddedness by and large reinforced its choices. Slovenia only accepted – and could afford to do so - limited FDI in its strategic export sectors, thus controlling its dependence on TNC. The markets where Slovenia competes – medium to high skill manufacturing goods - are not as prone to short term fluctuations as the markets for labour-intensive goods and raw materials. Overall, the reform path chosen by Slovenian actors was also compatible with the EU requirements. In some instances, where the EU pushed towards a different direction, Slovenia refused to comply without ever putting at risk the perspective of EU membership (Lindstrom 2005).

Finally, the Visegrád countries' regime path – even if it reflected a measure of conscious choice – proved to be less straightforward, more contested, and more contradictory than either the Baltic or the Slovene trajectories. Two elements set the Visegrád transformation strategy apart from the Slovene one. First, their welfare states originate in political elite-driven reforms from 'above' rather than in institutionalized neocorporatist negotiations between social partners. Second, instead of domestic capitalists, foreign owners have come to dominate these economies. Rather than being purely strategic choices, both differences also reflect the concessions reformers had to make. Although Visegrád reform elites had been well aware of the social hardship associated with the collapse and market reforms, they could not fall back upon identity politics and disenfranchise large parts of the affected population to muffle protest as the Baltic States did. At the same time, they shied away from offering institutionalized voice to unions and the losers of reforms, as they feared that these groups would oppose the transformation. Instead, they decided to offer ad hoc compensation in the form of relatively generous targeted social protection packages in order to overcome opposition (Vanhuysse 2006).

Moreover, international constraints acted stronger and in a different way upon the Visegrád countries than in the Slovene or Baltic cases. Initially, Hungary took the lead in supporting foreign take-overs across her whole economy. At the origin of this privatization strategy was the huge external debt that Hungary had accumulated by the late 1980s. Because of her debt service Hungary was highly dependent on hard currency cash receipts available only from export and privatisation. Poland, the other ex-socialist country with huge foreign debts at the onset of transformation, was somewhat less constrained in her reform choices (Greskovits/Bohle 2001). Poland's creditors were national governments rather than – as in the Hungarian case – private banks. Moreover, at the beginning of the transition, Poland successfully managed to negotiate a partial debt relief. Thus, Poland's initial transition choices to some extent resembled those of Czechoslovakia (and later the Czech and Slovak Republics). As its southern neighbours, Poland initially hoped for significant domestic ownership in the economy. However these attempts at 'national capitalism' failed, and since the second half of the 1990s, all four Visegrád countries increasingly have built their institutions and economic strategies around the priority of attracting FDI (Bohle 2002).

The concessions reformers had to make to the (perceived) threats of the losers of transformation, as well as to foreign investors, partly explain the relative instability of the Visegrád regimes. At the same time, under the conditions of inclusive democracy, a measure of political stability could only be achieved by "embedding" neoliberalism in protective welfare arrangements. Similarly, industrial upgrading in Eastern Europe – with the sole exception of Slovenia – could only be achieved by luring foreign investors with generous incentives.

However, embedding members of society and key actors of economy resulted in a whole set of new problems. The pattern of contradictory and costly public spending has led to recurrent macroeconomic instability. Faced with budget constraints, the Visegrád states seem increasingly compelled to reduce welfare expenditure within their budgets. More fundamentally, the resources Visegrád countries spend for welfare might just not be sufficient to protect their societies. Finally, in this context, the EU functions as an additional constraint on the Visegrád countries, pushing them towards compliance with the Maastricht criteria that might ultimately result in disembedded societies. Currently, Visegrád countries' domestic politics and policies seem to conspire with EU pressures for potentially less stable and perhaps even less democratic regimes.

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Endnotes

1For a detailed discussion of the Central-East European cases see Dorothee Bohle/Béla Greskovits 2007a: Neoliberalism, Embedded Neoliberalism, and Neocorporatism: Paths Towards Transnational Capitalism in Central-Eastern Europe. In: *West European Politics* May, forthcoming. For the extension of our concept and typology to the CIS countries see Dorothee Bohle/Béla Greskovits 2007b.: The State, Internationalization, and Capitalist Diversity in Eastern Europe. In: *Competition and Change 2(2), June* 2007, forthcoming.

2Most of the countries studied in the VoC framework are members of the Organization of Economic Cooperation and Development (OECD).

3To empirically establish the regime variation we consulted the following sources: EBRD Transition Reports. London: European Bank For Reconstruction and Development, various volumes; EuroStat database accessed online; COMTRADE database of the United Nations Statistics Division accessed online; Visser, Jelle 2005. *Patterns and Variations in European Industrial Relations.* Report prepared for the European Commission.

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Capitalist Diversity in Europe's periphery is not the first and certainly not the last attempt to deconstruct the emergence of capitalism in post-socialist Europe. Earlier writers made use of Hall and Soskice's popular Varieties-of-Capitalism approach; some predicting a convergence to one of the approach's ideal types developed in the seminal work, others claiming the existence of a third type of "dependent market economies". Bohle and Greskovits reject the feasibility of the Varieties-of-Capitalism approach in Eastern Central Europe altogether, and ground their analys â€œEuropean Integration, Capitalist Diversity and Crises Trajectories on Europeâ€™s Eastern Periphery.â€ New. Political Economy Vol. 23, No. 2 (2018): 239â€“253.Â Sustainable Growth Model, ETUI Conference Reader (with Bela Greskovits). â€œCapitalist Diversity in Eastern Europe.â€ European Economic Sociology Newsletter, February 2007 (co-. authored with Bela Greskovits). Second, the diversity of capitalist regimes â€“ is explained as a result of the complex interplay of external factors â€“ specifically world commodity and financial markets, international institutions and foreign direct investment â€“ and different state capacities to implement reform choices. Third, caution is given against an uncritical application of the dominant approach of comparative political economy, varieties of capitalism, since it is ill suited to study the emergence of institutions, their international embeddedness, and the semiperipheral charac...Â @inproceedings{Bohle2007TheSI, title={The State, Internationalization, and Capitalist Diversity in Eastern Europe}, author={D Scott Bohle and B{\'e}la Greskovits}, year={2007} }. D Scott Bohle, BÃ©la Greskovits.