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Evolving Patterns of Democratic Capitalism in Central-Eastern Europe

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Habilitation Theses
Budapest, February 2010

Introduction

After the publication of *The Political Economy of Protest and Patience. East European and Latin American Transformations Compared* [1], which - building on and significantly extending my PhD dissertation - contrasted the varied political responses to market reforms and social dislocation in Eastern Europe in the 1990s and Latin America in the 1980s, I have started a new research project. Motivated by my interest in capitalist diversity, the comparative study of Central-Eastern Europe's (CEE) new democratic market societies remained the focus of my academic activity ever since. The collection of published papers and edited volume chapters handed in as my habilitation dissertation, is representative of the phases, approaches, and findings of this ongoing work.

In the opening essay, *The Path-Dependence of Transitology*, I have tried to take stock with four important but contradictory theoretical perspectives on the dynamics of postcommunist transformation. By clarifying my reasons for dissatisfaction with existing concepts, this critical review also helped outline the guidelines for my own work on how the legacies of communism, the impact of recurrent crises, and international and transnational actors, risks, and opportunities together have shaped CEE's paths to varied types of capitalism.

In the second paper, *Leading Sectors and the Varieties of Capitalism in Eastern Europe*, I adapted the insights of sectoral political economy to come to terms with the diversity of the postcommunist economies' new specializations in the international division of labor. Based on statistical evidence on export patterns and the types of foreign direct investment (FDI) attracted, I classified the newcomer economies according to the specific roles taken up by them, asked how these specializations have come about, and made propositions concerning their impact on state capacities to assist development in the global economy.

Capitalism without Compromise: Strong Business and Weak Labor in Eastern Europe's New Transnational Industries[2] has taken the inquiry one step further. Here, I tried to understand how varied leading transnational export-industries (e.g. cars, clothing, or electronics) have influenced capital-labor relations, work conditions, unionization, and more generally workers' social standing in the region.

Neoliberalism, Embedded Neoliberalism and Neocorporatism: Towards Transnational Capitalism in Central-Eastern Europe[3] presents the so far most ambitious (albeit still incomplete) formulation of my thoughts concerning the features and driving forces of capitalist diversity in CEE. The article substantiated that in some key areas of economic

[1] Published in Budapest and New York, Central European University Press, 1998.

[2] The conceptual framework and the larger part of this article are Dorothee Bohle's and my shared intellectual property. This said, I prepared the brief case-study of Hungarian electronics, while Dorothee Bohle wrote the case-study of the Slovak automotive industry.

[3] While the conceptual framework and the larger part of this article are results of my work with Dorothee Bohle, I contributed more by developing the economic institutional aspects of diversity. In turn, the identification of political factors and mechanisms that shaped the varied regime trajectories is mainly Dorothee Bohle's contribution. I have her permission to include both co-authored papers in my habilitation proposal.

and social development the new EU-member states' institutions and performances cluster in a patterned rather than random way, and thus point to the existence of three different kinds of political economic regimes. Further, the article highlighted complex interactions across the above political economy arenas, and affinities among the developments of the former fields and these countries' particular forms of democratic government.

Subsequently, I have tried to utilize the above concept of diversity in several more detailed cross-country comparisons, which all focused on CEE's divergent routes to the Eurozone. In the chapter *Hungary and Slovakia: Compliance and its Discontents*, I have demonstrated how varied historical legacies and new – more materialist versus more idealist - structures of political opportunity and risk may help explain surprising outcomes.

In the closing article, *Gazdasági nehézségek és politikai egyensúlyvesztés Közép-Kelet-Európában*, I tried to identify the factors and processes behind the recent worrying instability of CEE's political life.

Let me present some of my findings in greater detail, followed by their summary in ten brief theses.

Rival Views of Postcommunist Market Society and Implications for Comparative and International Political Economy

At the end of the 1990s, the scholarly dispute on Eastern Europe's democratic capitalist transformations seemed to have reached a crossroads, since it was replete with hard to reconcile divisions. By and large, the debates of the time could be structured according to the participants' answers to the following key questions: (1) Is economic liberalism a prerequisite of, or rather a threat to, political freedom and democracy? (2) Is the legacy of communism a liability, or an asset, from the viewpoint of the emerging market society? Four mutually contradicting answers have been proposed, which can be termed (a) the *free market road to freedom thesis*; (b) the *impossibility theorem*; (c) the *Leninist legacy thesis*; and (d) the *communist assets thesis*, respectively.

The free market road to freedom thesis says that economic liberalism breeds political liberalism. The reason is that free markets, more than alternative economic systems, are able to bring about fast growth that helps to improve living standards and keep inequality at bay. This way, economic freedom does a good service to political freedom, and the consolidation of the rule by popular mandate. However, the impossibility theorem challenges this view arguing that simultaneous rapid advances on capitalism and democracy either are incompatible with one another, or can at best result in a fragile political economic balance. In other versions it is proposed that radical economic liberalism will ultimately lead to the rise of political illiberalism.

Next, the Leninist legacy thesis points out how democratization and marketization in postcommunist Eastern Europe are likely to be both undermined *not* by their mutual tensions and contradictions, but by the inheritance of Leninist rule manifesting itself in the resilience of many negative features of communist society. Finally, the communist assets thesis accepts that the legacy is important, but contrary to the Leninist legacy thesis it asserts that some of its effects on postcommunist political and economic development can be positive.

That none of these views is entirely new, but each can be traced to the classics' (e.g. Montesquieu, Smith, Marx, Weber, Schumpeter, and Polanyi) debates on earlier periods of capitalist expansion or contraction, is not the point I want to stress here. More significant for my further research proved to be that the contradictions among these theoretical perspectives could be transcended by adopting Hirschman's notion that,

> „however incompatible the various theories may be, each might still have its 'hour of truth' and/or its 'country of truth' as it applies in a given country or group of countries during a stretch of time." [4]

The main lesson I learned speaks against the frequently observed practice of over-generalization implying conceptual over-stretch. Indeed, at a closer look it is clear that the postcommunist capitalism has configured differently across cases and over time on both of the above key dimensions. First, in any given period, the CEE market societies have been set apart by the extent to and forms in which the (in)stability of their capitalist sytems supported or posed a challenge to the quality or stability of their democracies – and vice versa.

Second, the failure of universal negative prognoses stemming from the Leninist legacy thesis indicates that the past (even a communist one) cannot predetermine the future. The task, then, is to specify the conditions under which the inheritance prevails and indeed impairs successful transformation, or alternatively to define the circumstances in which the legacies can be transcended or even become assets for capitalism after communism.
Finally, the failure of some predictions rooted in evolutionary, path-dependentist approaches underlying the communist assets thesis suggests that the risks and opportunities stemming from international integration deserve more attention, since they have had no less deep impact on the postcommunist paths than the obstacles or assets inherited from the past system.

I took home the idea that a research program that wishes to maintain interest in intra-regional differences, has to try and find the ways for a creative *combination* of the different insights offered by the above traditions of thought. No less important is to enrich these intellectual road-maps with other approaches that are able to come to terms with the impact of international and transnational factors and actors on the postcommunist new entrants to the world economy.

[4] Hirschman, A. O. *Rival Views of Market Society and Other Essays* (Cambridge MA: Harvard University Press, 1992): p. 137.

New Transnational Export Sectors Shaping the Profiles of the Semi-Core and Semi-Periphery

After the collapse of communism, the CEE economies have shifted towards a new developmental model based on FDI and exports. While capital inflows often brought sophisticated technology and access to world markets, the new transnational export sectors usually fell short of offering jobs in the needed quantity and quality. With some variation, the region's path has proven to be that of jobless growth.

Overall depressed wages led to large numbers of working poor, even among those who found employment in the private sector. Although in the new Millennium accelerating growth and enhanced migration opportunities led to rising wages and employment, these improvements have recently been undermined by the impact of the global financial crisis and the ensuing recession.

Nevertheless, within this general pattern intra-regional differences prevailed, which partly reflected different profiles of international economic integration. Foreign investment poured into the complex – i.e. physical and human-capital intensive - industries of the Visegrád states (and to a lesser extent Slovenia), and turned them into major exporters of cars, machinery, electronics, and chemicals.

In contrast, the eastward migration of traditional light industries transformed the Baltic states as well as Bulgaria and Romania into hosts of many of the low-skill/low wage footwear, apparel, wood product and electronics assembly „sweatshops" of the EU. These countries combine the above specialization with exports in low-tech and medium low-tech heavy industries, such as iron, steel, and non-ferrous metals.

What actual degree of development do the Visegrád area's complex manufacturing export sectors exhibit when their performance is assessed in micro- rather than merely macro- or meso-structural terms? Clearly, more empirical research is needed before this question can be convincingly answered. On the one hand, the Visegrád group shares membership with many advanced economies in the elite club of complex manufacturing exporters. From this viewpoint, the sub-region's industrial transformation seems to be quite successful. On the other hand, exporting cars or electronics equipment might involve very different degrees of sophistication and skills in various economies.

To express this ambivalence, I argue that the Visegrád and Slovene economies have adopted features of a *semi-core* profile of international economic integration. The term that paraphrases Wallerstein's "world systems" terminology (without sharing all of his assumptions and predictions) seems to be suitable to characterizing the Visegrád area's developmental status for two reasons.

First, while these economies have been relatively rich in experienced and skilled labor, and even displayed a degree of local managerial and entrepreneurial talent, they have had to rely on the advanced economies in their needs for capital, technology, and global entrepreneurial skills, such as design, world-wide input sourcing, and marketing access and knowledge. Consequently, their newly achieved competitivity in complex sectors has been inextricably linked to large doses of foreign input in all the above areas.

Second, notwithstanding recent progress in technological upgrading, the actual productive roles of many of the complex manufacturing industries of the Visegrád area still seem to exhibit lower levels of autonomy, sophistication, and skills than those pursued within the western segments of the *same* transnational industry.

In contrast - as indicated by the much less robust share of complex manufacturing industries -, the Bulgarian, Romanian and Baltic economies fall short of a semi-core status and are more properly viewed as *semi-peripheral*. Last but not least (unlike many Latin American countries), none of the CEE states appear to be trapped in pure *peripheral* roles. Rather, such term seems to be more adequate to the situation of the majority of former Soviet republics, as complex industries account for but a tiny fragment, while oil, gas, metals, cotton or food for the bulk, of their production, exports, and FDI-inflows.

The Logic and Social Consequences of Varied Integration Profiles

Since divergent performances in industrial transformation coincide with the large discrepancy of FDI-inflows into complex industries, it is important to better understand why and how this variation has come about. According to received wisdom, FDI should be endogenous to the advance of market reforms, the size and geographical proximity of accessible markets, and political and economic stability. However, if that is the case, it is puzzling that the Baltic states proved relatively ineffective in attracting complex industry transnational corporations (TNC) - despite their radically liberalized and stabilized economies, low taxes, restored political stability, and promised and completed EU accession.

Why have complex manufacturing TNC consistently preferred Visegrád locations to the Baltic area? My proposed answer is that the foreign firms' location choices responded to the incentives stemming from a dynamic interplay between inherited and restructured production profiles, inherited and newly-built market institutions, and special subsidy packages.

According to the predictions of Vernon's "product-cycle theory", export-oriented, complex FDI was likely to flow first into those postcommunist economies whose initial production profiles had been relatively complex. In consequence, the Visegrád countries, which from the 1970-80s acquired a measure of experience in manufacturing and exporting complex industrial goods, could rightly expect much larger inflows of industry-specific FDI than other (e.g. the Central Asian) states where this sector was virtually absent.

Yet, in respect of inherited experience, the Baltic states (or for that matter Bulgaria or Romania), which by the 1980s traded a fair amount of physical and human capital-intensive goods for natural resources from other parts of the Soviet Empire, do not seem to have been particularly handicapped. Since for the similarity of their inherited production profile initially all CEE countries might have had comparable attractions as new locations for complex FDI, product-cycle theory alone cannot account for their diverging paths. On what grounds then have investors chosen among them?

For an answer it is useful to bear in mind, that similar profiles might fail to raise investors' interest if existing institutional and policy barriers hamper access to the demanded local factors of production. It follows that the countries which, by the time TNC were able and willing to cross the East-West borders, advanced furthest in reforming their institutions and policy regimes, were in a better initial position to attract complex manufacturing FDI.

In the first period of transformation, in the context of rather *similar inherited production profiles*, *institutional advantages tilted the balance* of investors' preferences in favor of the Visegrád countries. Complex FDI-inflows had been endogenous to the levels of marketization inherited and/or reached by means of radical reforms by the early-to-mid-1990s.

Yet the interplay of structural and institutional factors seems to have fully *reversed*, and the endogeneity of complex FDI to marketization levels failed to materialize after the mid-1990s. The Baltic states and later Bulgaria and Romania gradually worked off their institutional disadvantage, and by the mid-2000s arrived at a high degree of institutional similarity with their regional rivals and the West. Nevertheless, their institutional catching up does not seem to have been appreciated by transnational complex-industry investors. What appears to have permanently limited these locations' attraction is that their rapid *institutional convergence* has been accomplished at the expense of increasing *divergence in their production profiles*.

Initial investor preferences, motivated by a combination of structural and institutional factors, seem to have launched both virtuous and vicious cycles of foreign-led capital accumulation. Through FDI, the complex industries of the Visegrád states gained access to much needed tangible and intangible factors of production, upgraded their activities, and developed competitive strengths in the demanding Single Market.

In contrast, deprived of the above means as well as domestic industrial policies helping their survival in hard times, these same sectors in the Baltic and southeastern European countries all but lost their markets, factors of production, and policy influence. To make things worse, the Baltic states' radical course of liberalization, rather than breaking the vicious cycle, in fact accelerated the atrophy and collapse of their inherited complex industries. In short time an entirely different production profile emerged with traditional light, resource-based, or service sectors at its core.

Meanwhile, the clustering of complex industries brought about the tight cross-border integration of the Czech Republic, southwestern Poland, and the northwestern Slovak and Hungarian economic spaces, which enhanced the relative attraction of each of these locations. Last but not least, the interstate bidding-war of generous incentive packages, which in the 2000s was most prevalent within the Visegrád group, further raised the costs for new entrants in the competition for complex investment.

While Slovenia has been no less an outsider to this rivalry than the Baltic or southeastern European states, its complex industries have been more successful in international markets. Arguably, this was mainly due to Slovenia's exceptional legacy: it could improve competitiveness essentially on the basis of its inherited domestic industries, and remained less dependent on FDI than the Visegrád group – at least for some time.

As to the social consequences of divergent pathways of foreign-led industrial restructuring, some of the varied social outcomes can be detected in the relatively superior performance of the Visegrád economies and Slovenia in terms of wages and work conditions. One explanation might be that foreign businesses there relied more on high-skilled workers whose demands were easier accommodated.

Yet, complex industry specialization tended to exacerbate inequalities between the privileged core workers of the major TNC plants, and those employed under inferior conditions in their transnational and domestic supplier networks, or the still substantial low-skill/low wage parts of the economy. The clustering of TNC in already developed areas could also conserve or even increase regional disparities. Finally, the generous incentives offered to complex manufacturing investors has put heavy burden on the budget forcing the society, and ultimately its marginalized groups, to pay in one way or another the costs of foreign-led economic upgrading.

In contrast, the foreign light industry or service firms that have massively migrated into the Baltic and southeastern European states - while less demanding in terms of generous incentive packages or infrastructure development – above all expected their hosts to keep labor markets flexible, wages, taxes and social security contributions low, and workers docile. In essence, then, the businesses prominent in this kind of leading sectors made their own employees pay the costs of precarious integration.

These propositions allow for some reflections on larger debates. Concerning the social impact of global neoliberal restructuring in advanced and less-advanced countries, four competing hypotheses have been proposed in the literature, which consider the global division of labor in terms of *positive, negative,* and *zero-sum games*, respectively.

Backers of globalization are *optimistic across the board*. They assert that outsourcing production helps labor by creating more employment and faster growth in the less advanced parts of the world, while it frees resources for innovative new activities and improves the standards of work and living in the advanced economies too. Their staunchest opponents are *pessimistic on both accounts*. In their wiev, global competition and capital mobility brings about a „race to the bottom" of wages, work conditions, and labor relations both in the West and the rest.

Next, advocates of dependency theory, albeit currently less vocal than a few decades ago, still would insist that globalization *widens the gap* between the core and the periphery by improving workers' situation in the former at the expense of those in the latter. Finally, in recent literature the *reverse kind of zero-sum game* has been proposed, namely that while FDI and transnational production relocation weakens labor in the advanced economies, it creates powerful working classes capable of improving living standards in the less-advanced countries.

Regarding the debate, my above summary highlights the potential importance of an intervening variable, the leading *sectoral pattern* of neoliberal restructuring, which mediates its social impact. The derived proposition is that the losses or gains of western European and CEE workers also depended on the type of major industries, which in particular periods and various countries transmitted the impulses of liberalization, privatization, and transnational capital flows. This is so because these industries differed in their propensity to host a *compromise between capital and labor*, which seems indispensable for labor-inclusive politics in a capitalist society.

Of course, the outcome was also influenced by how far, in what form, and at what cost the CEE welfare states were willing and able to mitigate the social costs of transnational economic integration and restructuring. This is one among the key issues discussed below.

A Triad of Capitalist Regimes

Mediated by important policy legacies and choices, both the communist structural/ institutional inheritance and the locational decisions of TNCs mattered for the economic and social foundations of new regimes. Evidently, the increasing influence of the EU over the transformation of its would-be members was salient too. But were these the only important factors? This is unlikely, since the CEE countries' varied paths challenge the assumption of uniform dependence on their own communist past and/or global and European economic and political factors and actors.

To be sure, it is often claimed that the strict standards of international financial institutions and markets coupled with the demands and pressures of TNC, and of EU organizations monitoring and enforcing conditionality before and after accession, all *narrowed the room* available for local differences in various economic and social policies. This suggestion has a great deal of convincing power. But if local agency has been so constrained, how can we explain the continuing diversity that we see among the institutions and performances of many key policy areas in the region?

I contend that many of these differences are results of the efforts of the small CEE states to maneuvre among the dynamically changing risks and opportunities of the global and European political economy, and are traced to *crucial early decisions, which can best be captured at the level where democratic national politics rules*. This proposition rests on empirical evidence on three capitalist models emerging from the transformation of CEE societies: a *neoliberal* type in the Baltic states, an *embedded neoliberal* type in the Visegrád states, and a *neocorporatist* type in Slovenia.[5]

To better understand the domestic political logic of their emergence, it is helpful to adapt Polányi's theory of the "Great Transformation", and analyze these regimes above all as products of a double dynamics in the uses of state power to build market economies and simultaneously preserve their social cohesion. Ultimately, then, it is the different vigor with which the above conflicting social objectives were pursued that shaped the particular institutional configurations and performances characteristic to the new capitalist regimes.

The distinctiveness of the neoliberal Baltic regimes lies in the *combination of market radicalism with meager compensation for transformation costs, and limited democracy* within which political rights are only selectively granted,[6] and political participation remains at low levels even relative to the meager regional standards. Challenging the optimistic views, which were prevalent before the Baltic area's current calamities, I have been skeptical about the merits of the pure neoliberal model that rapidly instituted the market economy without mitigating businesses' risks and losses or helping new firms to capture promising market niches.

Similarly, the Baltic welfare states fell short of providing sufficient protection against inequality and social exclusion. Finally, for their fragmented and atomized industrial relations systems, the "volunteer Nordic" Baltic states appear to be the least "Nordic" in the whole region. Yet, until the mid-2000s, the Baltic regimes stood out for their internationally celebrated results in macroeconomic stabilization.

In turn, initially the Visegrád states opted for a socially and politically more inclusive strategy. They mobilized substantial resources to compensate for the transformation costs of inherited domestic firms and pamper in their infancy and later assist the expansion of new transnational industries. Relatively generous welfare schemes helped large social groups to avoid or at least slow down decline to underclass status. It is precisely the *search for compromises between market transformation and social cohesion* that makes the Visegrád states' neoliberalism embedded and distinctive. The Visegrád regime differs from the Baltic pattern in political terms too, as it has granted political rights to all citizens.

The above differences are less accentuated when the institutions of negotiated industrial relations are considered. While originally relatively established, the Visegrád countries' neocorporatist institutions have largely atrophied over time. To make things worse, after the mid-2000s, their democratic institutions also fell short of effectively coordinating the transformation agenda. In consequence, to different extents though, they all have had to face, to paraphrase Katzenstein's term, "*high-voltage politics*" fueled by macroeconomic instability and manifesting itself in varied political imbalances.

[5] Arguably, via different paths and with a delay, Bulgaria and Romania adopted many features of the neoliberal regime.
[6] In this respect Lithuania is an exception.

Slovenia adopted the least radical variant of economic neoliberalism, and the region's most protective and specifically targeted compensation efforts. Unlike the Visegrád states' industrial policies, which increasingly favored foreign capital, the Slovene policy has been geared towards inherited industries, and nurtured domestic entrepreneurial and managerial talent. Furthermore, the Slovene welfare state has been far the most generous in East-Central Europe.

Uniquely in the region, the Slovene regime exhibits many features of what Katzenstein termed a "democratic corporatist" polity, in which *dense multi-level networks of neocorporatist institutions* have tended to orient interest groups and political rivals towards compromise solutions. Legally enforced negotiated management-labor relationships, extended collective agreements, and social pacts that invite business, labor and the state to act as social partners, have so far enabled the balanced pursuit of an inclusive and macroeconomically stable strategy of transformation and European integration.

Why have reformist elites institutionalized marketization and social protection with so different vigor and in such varied forms? How have they managed to generate political support for sharply divergent transformation agendas? A plausible answer is that while after the fall of communism each country embraced the idea of a "return to Europe," reform elites proposed very different routes toward this goal. The options can be aptly characterized in terms of the different "contracts" proposed to society, which reflected both their *past histories* and varied *perceptions* of the communist (and earlier) legacies as either threats or assets from the viewpoint of national sovereignty, economic progress, or social cohesion.

Let me hint at some of the differences. In the Baltic regime the rejection of the Soviet legacy and the agenda of nation-building under threat conspired for a *nationalist social contract* that initially backed popular acceptance of radical economic restructuring and a meager welfare regime that identified some beneficiaries on grounds of citizenship and language, and operated through selective deprivation of political rights. At the same time, the social losses resulting from radical marketization burdened disproportionately Estonia's and Latvia's mostly Russian-speaking manufacturing workers.

Yet, from the dominant perspective in which Soviet industrialization appeared as colonization, and the immigrant workers as colonists, the deindustrialization of the 1990s and the implied dislocation of ethnic Russian labor forces seemed to be an escape route from post-colonial subordination. In addition, these countries' restrictive citizenship laws deprived most Russian-speakers of a democratic voice on the direction of transformation, and buttressed their social exclusion with political exclusion.

The meager protection offered by the welfare state fell short of compensating for the ethnic bias in social losses, especially given that some of its priorities were in line with the nationalist social contract. On the one hand, spending on benefits that are accessible for citizens and non-citizens alike – i.e. healthcare, pensions, or labor market policies – has become subject to strict control over time.

On the other hand, the few areas where Estonian and Latvian welfare generosity exceeds or approximates other CEE countries' standards – i.e. public sector employment and spending on higher education – happen to be those which have a larger potential to distribute benefits above all to the "titular nation" majority as access can be limited through requirement of citizenship or/and official language proficiency.

The *welfarist social contract* buttressing the Visegrád states' transformation to democratic market society had a different logic. It envisaged protection - through liberalized access to disability and early retirement, benefits for the unemployed and families, and expansive public healthcare and education - against decline in social position due to material deprivation and status loss.

Reflecting a measure of continuity with the past, protection has been granted above all to those who had already acquired a fair degree of social status under communism. Such groups' losses were mitigated in proportion to their demonstrated or anticipated ability to resist - whether by social protest or massive anti-incumbent vote at elections - the changes making them vulnerable. Importantly, however, especially Hungary's and Slovakia's sizable Roma populations were deprived of sufficient protection against the threat of a decline to underclass status. As observed by Szalai, the (not exclusively Roma) poor did not have the political means to combat exclusion, as they had few allies among the better off, and were passive in democratic politics.[7]

Finally, drawing on communist Yugoslavia's indigenous legacy of self-management, the contract offered to Slovenes was that of an encompassing *democratic social partnership*. Reminiscent of neighboring Austria's democratic corporatist regime, this settlement seems to have successfully instituted piecemeal coordination of the conflicting social objectives of marketization, social cohesion, and macroeconomic sustainability by inviting not merely the electorate or political parties, but also organizations of business and labor, to participate in major policy decisions. Even if the strong reliance on communism's inherited assets was not always acknowledged, some experts confirmed that this particular institutional setup lent robust social legitimacy to Slovene capitalism.

Social Pacts, Welfarism, Nationalism, and Macroeconomic Convergence

The main conclusion so far seems to be that pressures of international and transnational factors and actors in interplay with communist legacies and initial policy choices, have locked the new regimes into trajectories able to reproduce many of their features. Put differently, by the early-mid 2000s the development of CEE societies appears to be path-dependent on the key choices made a decade ago by external and domestic actors.

Yet, recent facts have challenged the general validity of the idea of path-dependent regime consolidation. Indeed, peculiar new developments suggest the need for a more dynamic interpretation, which allows for the possibility that over time and under specific

[7] Szalai, J. *Nincs két ország … ? Társadalmi küzdelmek az állami túlelosztásért a rendszerváltás utáni Magyarországon* (Budapest, Osiris Kiadó, 2007).

conditions the CEE countries may *gradually drift or even radically shift* back and forth between more or less marketized and/or socially and politically inclusive institutional setups. The likelihood of such changes has much to do with the macroeconomic sustainability of the initial patterns, and with reform elites' will and skill to mobilize political support for a partial reorientation of policy strategies.

Hungary's so far failed and the Slovak Republic's eventually successful efforts to enter the Eurozone among the first of the EU's new member states are cases in point. In 2001 Hungary was among the region's leaders in complying with the Maastricht criteria of macroeconomic convergence. By 2007 it was a laggard. Conversely, Slovakia whose fast euro-entry seemed initially unlikely, fulfilled all the entry conditions by 2008, and was allowed by the EU to introduce the euro in 2009. To gain the EU's approval by credible commitment to macroeconomic stability, Slovakia radically restructured its public sector, including its welfare state. In contrast, Hungary delayed such reforms until 2007 and beyond.

An interplay of external and domestic factors can go far in explaining the different outcomes. Approaching EU membership, both countries were exposed to intensifying pressures for compliance. Yet, their varied records indicate that the Europeanization of fiscal and monetary policies did not ultimately depend on the EU's demands, but on what domestic politicians made of the requirements posed to them. Why were Hungarian elites reluctant to follow their Slovak counterparts in this endevour?

Without doubt, policies aiming at disinflation, balancing the budget, and cutting and restructuring public welfare service provisions are politically very difficult, as they imply that domestic elites terminate the welfarist social contracts, which hitherto contributed to the political stability (as well as recurrent macroeconomic instability) of all the Visegrád states. Yet, many other EU member states have had to face similar obstacles on the road to euro entry. A key to their success was their reliance on special institutions to distribute adjustment costs: established neocorporatist practices and routines, and:

> „new arrangements involving broad encompassing social pacts between employers, trade unions, and governments striking deals across policy areas from wages to social and employment policies."[8]

Similarly, when preparing for euro entry Slovenia (alone in CEE) embarked on the western European path. Its neocorporatist institutions allowed for national social pacts, which *accommodated* compliance into fiscal, monetary, labor market, and welfare institutions, shared its burden with business, labor, and the population at large, and contributed to building the region's highest state capacity for sustainable euro entry.

This was in striking contrast with the situation of Hungary, Slovakia (and other CEE states), where labor was weak to press for negotiated settlements and business less willing to accommodate labor demands. In these countries, then, sharing out the burdens

[8] Hancké, B. and Rhodes, M. "EMU and Labor Market Institutions in Europe. The Rise and Fall of National Social Pacts", *Work and Occupations*, 32(2) 2005, pp. 196-228: p. 196.

of adjustment was entirely left to democratic governments, and broadly the process of democratic competition with troubling consequences for the latter's balance. This is the comparative context in which the Hungarian failure and Slovak success ought to be assessed.

Ultimately, I argued, failure and success could be traced to the varied – welfarist/materialist versus more idealist - structures of opportunity and risk characterizing the political life of these small democracies. Though indentity politics has certainly not been absent in Hungary, nationalist politicians could usually not reach their constituencies without first addressing their demands for social welfare protection. In consequence, all parties that hoped for mass popular support promised welfare „for all", and once in power, tried to implement a mix of policies to that end.

Conversely, although welfare has not lacked salience in Slovakia, the fact that popular sentiments tended to weigh the need for social protection against appeals of national pride (or shame) allowed more room for political maneuvering. Many Slovaks tended to view the social question through the lenses of necessary sacrifices required for the re-birth and consolidation of a Europeanized form of Slovak nationhood that deeply affected citizens' self-respect.

This way, policies of macroeconomic convergence with the rest of Europe eventually resulting in different timing of euro entry could count on broader support in Slovakia than in Hungary notwithstanding the social costs, which were substantial in both cases. Ironically, however, both the rather deadlocked Hungarian and the more flexibly adapting Slovak regimes share a similarity with each other, and indeed, with many other CEE countries: the loss of political balance. This raises a broad and more painful issue, which I shall address in the concluding section below: are the varied success stories of postcommunist transformation politically sustainable, and if so, under what conditions?

Why Have So Many Roads to Democratic Capitalism Led to Political Instability?

Many of the new market societies have been facing hard times for democratic government well before the current global financial and economic downturn struck. Indeed, politics has been unstable across CEE since the accession to the EU. Since enlargement, there have been riots, strikes, and mass demonstrations, centrist parties have moved back and forth between their originally moderate and more radical programs, illiberal extremist forces have ascended and in several countries have come to power.

The rise of radical voices has coincided with a mass exit of citizens from formal politics, as evidenced by, among other things, dramatic drops in voter turnout. Although such symptoms have also been observed in older EU member states, these symptoms' strength and their simultaneous occurrence in the new member states signal deeper troubles for the democracies of the CEE region.

To some extent, these turbulences can be traced to the changing international environment. Before and for some years after the EU enlargement, international financial actors continued to feel relatively sure that the CEE countries were still on the path to qualify for full memebership in the EU's Economic and Monetary Union, and so rarely made moves to punish them for their fiscal instability or accumulating current accounts deficits.

However, since the mid-2000s, this permissive external environment has given way to stricter conditions and/or higher risks associated with access to external finance. All the CEE states were forced to gradually or radically re-balance their macroeconomic fundamentals, which led to the eruption of fierce distributional struggles region-wide. From 2008, the global financial crisis still raised the stakes involved for winners and losers alike. As we learn from Gourevitch:

> „In difficult economic times ... patterns unravel, economic models come into conflict, and policy prescriptions diverge. Prosperity blurs a truth that hard times make clearer: the choice made among conflicting policy proposals emerges out of politics. The victorious interpretation will be the one whose adherents have the power to translate their opinion into the force of law." [9]

In CEE recently two kinds of forces have been particularly resolved to translate their opinion into the force of law. Both camps capitalized on middle-class frustrations with the economic or political aspects of the „unfinished transformation", and proposed radical corrections for the shortcomings of the prevailing compromised settlements.

EU-accession has strengthened the voice of adherents to radical neoliberal solutions: low taxes and social security contributions, and welfare retrenchment coupled with radical public sector reform. Radicalization of better-off groups - including many of the educated, the urban, and the young - might have to do with their tendency to identify the obstacles to their own upward mobility in the high costs of the welfare state.

The rationale behind their frustration is that "finishing" economic transformation through radical structural reforms would liberate the over-taxed middle-class from responsibilities for the masses of (potential) losers left behind by communism. Irony of ironies, particular middle-class groups at the same time vehemently resist curtailment of their *own* benefits from the public welfare system.

Competing with the neoliberal economic solution, a radical illiberal political alternative is being advocated across the region. While nationalist, ethnic, xenophobic, and anti-communist fundamentalisms have been around and swelled the ranks of supporters of radical parties over the whole transformation period, their current popularity can partly be viewed as a response to the challenge of resurgent neoliberal radicalism, which enhanced the gains from social demagoguery.

[9] Gourevitch, P. *Politics in Hard Times. Comparative Responses to International Economic Crises* (Ithaca and London, Cornell University Press, 1986): p. 17.

The political illiberal camp targets enemies at the top and bottom alike. Communists, foreign capitalists, and ethnically "alien" underclasses are all held responsible for blocking the social advance of non-communists and the national bourgeoisie, and for devouring the resources that could protect the "national" elements of society against social decline. The proposed solution is heavy coercion of "unfair" competitors at the top, and of "alien" welfare parasites at the bottom.

However, two facts have to be taken seriously for a fair account of the growing social and political ambivalence of CEE's middle-classes. First, in these relatively poor countries there is no clear dividing line between the living standards of the lower-middle and the poor income groups. Rather, a decline to underclass status has been a serious threat for many citizens. Second, much more than in the older member states of the EU, in CEE the security of middle class status either depends on the state, a major provider of employment and welfare, or on the informal private economy, a safe heaven from taxation or, most typically, a combination of both.

What seems to further exacerbate democracy's troubles is that the ascendance of radical voices has gone hand in hand with the striking extent of electoral passivity in CEE. Many earstwhile voters might have repeatedly tried and failed to find genuine political representation before they ended up boycotting elections. Disappointment with once trusted and supported parties manifested itself in dramatic drops of turnout whenever a drastic stabilization package has been implemented in CEE. An even larger group might have been shied away from political participation by more recent failures of neoliberal economic and illiberal political programs to address its pressing needs.

Summary

Generally, I see two ways in which my work could contribute to Hungarian social science. First, similar empirically driven and conceptually ambitious comparative analyses of CEE's new systems are still in short supply. Second, I believe that my work can contribute to a fuller account of the interplay between politics and the economy during the two decades of postcommunist development.[10] Let me summarize the contribution in ten theses below.

Thesis 1: *To capitalize on the existing important but contradictory scholarly perspectives on postcommunist market society, a research program that maintains interest in intra-regional differences, has to find the ways for a creative combination of the insights of what I termed the free market road to freedom thesis, the impossibility theorem, the Leninist legacy thesis, and the communist assets thesis. No less important is to enrich these intellectual road-maps with other approaches, which help to come to terms with the impact of international and transnational factors and actors.*

[10] So far in Hungary e.g. Kornai, J. *From Socialism to Capitalism. Eight Essays*. (Budapest and New York: Central European University Press, 2008), and Csaba, L. *A fölemelkedő Európa*. (Budapest: Akadémiai Kiadó, 2006) have advanced the field of comparative political economy of postcommunist transformation.

Thesis 2: *During and after the 90s, the East European economies have shifted towards a new developmental model based on FDI and exports. Yet, within this general pattern diversity prevailed. The terms semi-core, semi-periphery, and periphery appear as apt characterizations of their international integration profiles, since they are consistent with empirical observations of the large differences in the export specialization and sectoral orientation of FDI inflows of the Visegrád states, the Baltic and southeastern European states, and many of the post-Soviet republics, respectively.*

Thesis 3: *In the first period of transformation, institutional advantages tilted the balance of investors' preferences in favor of the Visegrád countries and Slovenia. In the context of rather similar inherited production profiles, complex FDI-inflows had been endogenous to the levels of marketization partly inherited and partly reached by market reforms by the early-to-mid-1990s. Yet the interplay of structural and institutional factors seems to have fully reversed, and the endogeneity of complex FDI to marketization levels failed to materialize after the mid-1990s. The earstwhile laggard countries could not catch up with the frontrunners in complex-industry FDI, because their institutional convergence was accomplished against the background of atrophy of their inherited industries leading to increasing divergence of their new production profiles.*

Thesis 4: *Some of the social outcomes of varied international integrational profiles can be detected in the relatively superior performance of the Visegrád economies and Slovenia in terms of wages and work conditions. However, the generous incentives offered to complex manufacturing investors have put heavy burden on the budget forcing the society, and ultimately its marginalized groups, to pay the costs of foreign-led economic upgrading. In contrast, the foreign light industry or service firms - while less demanding in terms of generous incentive packages or infrastructure development – above all expected their hosts to keep labor markets flexible, wages, taxes and social security contributions low, and workers docile. In essence, then, the businesses prominent in this kind of leading sectors made their own employees pay the costs of precarious integration.*

Thesis 5: *Shaped by the actors of evolving transnational production regimes, the influence of the EU, as well as national democratic politics, three capitalist models have emerged from the transformation of CEE societies. The neoliberal Baltic type, the embedded neoliberal Visegrád type, and the Slovene neocorporatist type tend to configure differently in the institutions and performances of the key areas of marketization, industrial transformation, social welfare, and macroeconomic coordination.*

Thesis 6: *At the level where national democratic politic rules, these regimes are to be traced to early decisions on the varied degree to which and forms in which state power was used to pursue market reforms while also maintain social cohesion and democratic legitimacy. In particular, reform elites proposed society different "contracts" on the routes of the return to Europe, which reflected both their past histories and varied* *perceptions of the communist (and earlier) legacies as either threats or assets from the viewpoint of national sovereignty, economic progress, or social cohesion.*

Thesis 7: *In the Baltic regime the rejection of the Soviet legacy and the agenda of nation-building under threat conspired for a nationalist social contract that initially backed popular acceptance of radical economic restructuring and a meager welfare regime that identified some beneficiaries on grounds of citizenship and language, and operated through selective deprivation of political rights.*

Thesis 8: *The welfarist social contract of the Visegrád states envisaged protection against decline in social position granted above all to those who had acquired a fair degree of social status under communism. While their losses were mitigated in proportion to these groups' ability to resist the changes making them vulnerable, the politically less resourceful became neglected and marginalized even if they were more needy.*

Thesis 9: *Drawing on communist Yugoslavia's indigenous legacy of self-management, the contract offered to Slovenes was that of an encompassing democratic social partnership. This settlement has been most successful in the region in instituting piecemeal coordination of conflicting social objectives by inviting not merely the electorate or political parties, but also organizations of business and labor, to participate in major policy decisions.*

Thesis 10: *Whether the initial contract was more of the nationalist, welfarist, or democratic corporatist kind, has also had a bearing on how far the new capitalist regimes could weather the hard times of the second half of the 2000s, which - especially after the global crisis struck - brought about increasing macroeconomic and political instability in many of the CEE societies. Having in mind the general uncertainty concerning global capitalism's future development in all its local variants, it is difficult to predict whether its sub-types outside the core of wealthy and powerful countries will be robust enough to answer the challenges of massive distrust in democracy, mass-exit of citizenry from electoral politics and, at the same time, the growing appeal of radical solutions in policy and politics alike.*

List of Publications Submitted as Part of the Habilitation Dissertation

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“Europeanization and the Variety of Competition States in Central-Eastern Europe” (with Dorothee Bohle) presented at the conference Deepening and Widening in an Enlarged Europe: The Impact of Eastern Enlargement organized by the EU-CONSENT Constructing Europe Network, Budapest, February 2-4 2006.

“Neoliberalism, Embedded Neoliberalism, and Neocorporatism: Paths towards Transnational Capitalism in Central-Eastern Europe” (with Dorothee Bohle) Presented at the Comparative Politics Workshop “Post-Communist Political Economy and Democratic Politics”, organized by Duke University, Department of Political Science, Durham N.C. USA, April 7-8, 2006.

“Mass-Exit, Extreme Voice, and the Fiasco of Reform-Mongering: Political Obstacles to Resurgent Neoliberalism in Central and Eastern Europe” presented at the conference Overcoming the EU Crisis: EU Perspectives After the Eastern Enlargement organized by the EU CONSENT Wider Europe, Deeper Integration Constructing Europe Network, Budapest, October 26-28 2006.

"Terminating Social Contracts: Mass Exit, Extreme Voice, and Regime Destabilization in Central-Eastern Europe" presented at the Mellon Sawyer seminar organized by Cornell University, Ithaca, February 18–22, 2007.

“Compliance and Its Discontents. The Domestic Politics of EMU Accession in Hungary and Slovakia” presented at the conference European States and the Euro: The First Decade organized by The British Academy May 23-25 2007, London

“Central Banking in Estonia and Hungary” presented at the research workshop Central Banks in the Age of the Euro organized by The British Academy and EU-CONSENT, Cardiff, May 2007.

“Estonia, Hungary, and Slovenia: Banking on Identity” presented at the workshop Central Banks in the Age of the Euro organized by The British Academy and EU-CONSENT, London, November 2007.

„Ideas, Policies and Institutions: Small-State Capitalisms Compared” presented at Potsdam University, Potsdam, December 2007.

„Ideas, Policies and Institutions: Varieties of Capitalism in New EU-member States” presented at the International Seminar on Varieties of Capitalism and Transformation: The 21st Century COE Programme, Kyoto Institute of Economic Research (KIER), Kyoto University. Kyoto, February 7-9 2008.

“Slovakia and Hungary: Successful and Failed Euro Entry Without Social Pacts” (with Dorothee Bohle) presented at the workshop Social Pacts in the European Union organized by the European Trade Union Institute (ETUI) Brussels, March 13-14 2008.

„Transnationalization, Social Integration, and Capitalist Diversity in the East and South" (with László Bruszt) Presented at the workshop "International Inequality, Then and Now: Revisiting Cardoso and Faletto's Dependency and Development in Latin America" held at the Watson Institute for International Studies at Brown University on April 4-5, 2008.

"Protest in Hungary: 1989-2004" (with assistance of Zoltán Várhalmi) presented at the workshop: The Logic of Civil Society in New Democracies (Hungary, Poland, South Korea and Taiwan) organized by the Mindade Gunzburg Center for European Studies, Harvard University, Cambridge, May 2-4, 2008.

„Labor, Welfare, and Democracy in Central Eastern Europe" (with Dorothee Bohle) presented at the DISC Launching Conference The Qualities of Old and New Democracies, organized at the Central European University, Budapest, June 18-19, 2008.

"Central Europe: A Region of Rivals" presented at the research workshop Whose Europe? The Politics of Differentiated Integration organized by the British Academy and EU-CONSENT, Cardiff, September 10-12, 2008.

"Slovakia and Hungary: Successful and Failed Euro Entry Without Social Pacts" (with Dorothee Bohle) presented at the conference Social Pacts in the European Union organized by the European Trade Union Institute (ETUI) Bologna/Forli, October 2008.

"Who liked and disliked America in new Europe in 2007?" panel presentation at the Luigi Einaudi Anniversary Conference organized by the Institute of European Studies Cornell University, November 26-28 Ithaca, 2008.

"Manufacturing Miracle, Welfare State Pathology, and Political Disaffection in Central Eastern Europe" presented at the conference Europa 1989/2009. Geschichte Einer Hoffnung, Ende Einer Illusion organized by Deutsche Gesellschaft für Osteuropakunde, Redaktion Osteuropa, und Polnischer Institut Berlin. Berlin, March 2009.

"Combating Poverty and Inequality in East-Central Europe" (with Dorothee Bohle) presented at the conference "Poverty, Inequality, and Democracy," organized by the International Forum for Democracy Studies at the National Endowment for Democracy, the Institute for Public Affairs (IVO) of Bratislava, Slovakia, and the Center for Democracy, Development and the Rule of Law (CDDRL) at Stanford University, Bratislava, April 26-28, 2009.

"Social Protection, Identity, and Contentious Politics in Hungary in 1995-2004" (with assistance of Zoltán Várhalmi) presented at the international conference and planning workshop on The Logic of Civil Society in New Democracies: East Asia and East Europe organized by the Institute of Political Science Academica Sinica (IPSAS), Taipei June 5-7 2009.

“Varieties of Capitalism and Capitalism *Tout Court*?” Launching Lecture of the Political Economy Research Group (PERG) Central European University, Budapest, October 2009.

“Personal Reflections on Hungary’s Gradualist Transformation” presented at the Workshop 1989 in Europe and the World, organized by the Institute for European Studies Cornell University, Ithaca November 19-20, 2009.