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Models of Capitalism in the Enlarged EU

4.1 Combined Clusters

I attempt to examine the clusters obtained in the individual subsystems collectively in order to see what kinds of clusters would emerge as a result of taking into account all the subsystems together, with the existing clusters as a basis. Because I form new clusters from cluster classifications as categories, a “two-step” cluster analysis has been applied using the SPSS software. The advantage of this process is that the cluster-formation process is able to handle categorical variables. The result is what is considered—according to the process—to be an optimal cluster number. Consequently, we obtain two clusters: one containing the OMS, and the other containing the NMS.

Given that the cluster number suggested by the software is only a recommendation, it is customary to investigate other possibilities outside of the resulting “optimal” cluster number. Consequently, I try out solutions involving three, four, or more clusters. I list the clusters in the order in which they separated from the cluster of OMS as the number of clusters increased and choose from among the various cluster numbers by comparing them with qualitative analyses found in the literature.
The combined clusters essentially correspond to the four models that crystallised from the old EU member states in the literature that does not follow the dual classification method (Table 2.1) and that, according to the results of this investigation, must be complemented with the CEE model (Table 4.1). In the following, we scrutinise these models, using the results obtained from analysis of the individual subsystems.

### 4.2 The Nordic Model as a Blueprint

In this analysis, Luxembourg is included alongside the Nordic countries of Finland and Sweden. No economic context can be attributed, given that Luxembourg formed a cluster of its own as a special case in three separate subsystems. For this reason, its customary classification in the literature among its continental neighbours might be more justified. Denmark, at the same time, is missing from the cluster of Nordic countries. Nevertheless, Denmark can be regarded as a borderline case because, in terms of both its labour market regime and social protection, it belongs firmly within the cluster of Nordic countries.

The fate of the Nordic countries attracts attention strongly disproportionate to their size; this does not apply only in Europe. One may recall that institutional analyses came to the fore partly precisely because of the debate over whether market economies are necessarily advancing in the direction of the free competition-based Anglo-Saxon model. For those who reason that there is no conformity to a universal rule, the main argument is the success of the Nordic countries. For this reason, a brief summary will be provided about the main attributes of these countries’ institutional arrangements, which the literature roughly agrees upon and which also emerged from this cluster analysis.

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**Table 4.1 Combined clusters of the EU-25 member states**

<table>
<thead>
<tr>
<th>Cluster</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>North-Western cluster</td>
<td>Austria, Belgium, Denmark, UK, France, Netherlands, Ireland, Germany</td>
</tr>
<tr>
<td>Mediterranean cluster</td>
<td>Greece, Italy, Portugal, Spain</td>
</tr>
<tr>
<td>Nordic cluster</td>
<td>Finland, Luxembourg, Sweden</td>
</tr>
<tr>
<td>Central and Eastern</td>
<td>Bulgaria, Czech Republic, Estonia, Poland, Latvia, Lithuania, Hungary, Romania, Slovakia, Slovenia</td>
</tr>
<tr>
<td>European cluster</td>
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The structural realignment that began in the 1970s, followed by intensifying competition in the global economy and the deepening of European integration—which also determined the economic environment in countries that were not yet EU members—made the system known as the Swedish or Scandinavian welfare state unsustainable beginning in the second half of the 1980s. These processes took place in different ways in the various countries. The performance of the Swedish economy has steadily deteriorated since the second half of the 1970s, making attempts to handle the situation not through structural reforms but via currency devaluation all in vain. The high level of employment, maintained amid a growing balance of payments deficit and public debt, inevitably gave way to an employment crisis by the beginning of the 1990s. Thanks to Soviet export opportunities, the Finnish economy was still living through prosperous times in the 1970s and 1980s, which plunged deeper at the beginning of the 1990s because of the loss of Soviet markets. Although Denmark never suffered a financial and economic crisis as serious as the aforementioned two countries did at the beginning of the 1990s, slowing growth and employment problems began to emerge in the 1980s (Kiander 2004; Andersen 2011).

In summary, at the time of economic hardship afflicting the Nordic countries at the beginning of the 1990s, it appeared that the Scandinavian welfare state failed once and for all. However, successful reforms were carried out, helping these countries embark on a path of development beginning in the mid-1990s that would once again elevate them among the world’s leading economies. Although welfare expenditures were cut, they still remained higher than in other developed countries, particularly compared to the Anglo-Saxon model. In Sweden’s case, Lindbom (2001) examines in detail how the characteristics of the social democratic model described by Esping-Andersen (universality, the high replacement rate in pensions and sickness benefits, and so on) remained not only on the level of spending but also in the institutional system, while the quantitative reduction in welfare expenditures did not result in a qualitative change. The high level of welfare provision and the accompanying high level of taxation continue to prove effective in maintaining a strong degree of social equality, even if not to the extent preceding the 1990s. Among other factors, the outstanding innovative performance of the economy
and a flexible labour market, combined with an active employment policy, has helped sustain the elements of the welfare system. While these distinctive features of the Nordic model are common knowledge, it is considerably less well known that competition has been fierce on the product market since the deregulation of the 1990s. As shown earlier, there has been a shift in the institutional framework of the financial system away from the continental bank-based system and towards a financial market regime. Opinions are split regarding how to interpret these adjustments; some hold that the current practice of Nordic countries is no longer an independent model, but rather a transitional solution on the path towards Anglo-Saxon liberal capitalism, which they term consolidated neo-liberalism (Ryner 2002). Apparently more convincing is the argument stating that it is typical of the overall modernisation of Sweden (from the second half of the nineteenth century onwards)—as the defining, trend-setting country in the Scandinavian region—that the stable market institutions of a capitalist economy have continuously developed in parallel with institutions supporting equality and solidarity (Bergh 2011). The combination of competition-based market solutions and those guaranteeing equality of opportunity is therefore not alien to Swedish development. It is also a fact that strict monetary and fiscal policy was an essential element of the original model of the Swedish welfare state from the 1950s onwards. The monetary and fiscal loosening that began in the mid-1970s can be regarded as an “aberration” occurring in response to the crisis of the time. For this reason, Anxo and Niklasson (2006) are justified in their interpretation of the reform of the Swedish economy in the early 1990s—and the restoration of monetary and fiscal rigour—as a return to the essential elements of the original Swedish model. The 1990s saw the signing of collective agreements at the company level, rather than centralised wage bargaining. However, recentralisation began at the end of the 1990s, and the results of wage bargains in export-oriented industries paved the way for the economy as a whole. A new labour market authority was established in 2000 (the Medlingsinstitutet—National Mediation Office), which ensured that the manufacturing sector retained a decisive role in the evolution of wages. This also restored another characteristic feature of the Swedish welfare state whereby wage agreements promote the international competitive-
ness of Swedish exports (Anxo and Niklasson 2009; Schnyder 2012). It is true not only of Sweden but also of Finland and Denmark that the essence of the Nordic model was successfully preserved amid the transformations (Lindgren 2011; Mailand 2011). In Part III, this topic will be discussed in detail.

In the first half of the 2000s, the Nordic countries also drew attention to themselves by regularly appearing at the forefront of the Lisbon reforms, aiding the competitiveness of the EU, together with the Netherlands, Austria, and Ireland (Farkas 2008). The average pace of economic growth both between 1970 and 2006 and between 1990 and 2006 was slower than in the USA but exceeded the rate of growth in the continental countries and that of the Mediterranean countries between 1990 and 2006, similar to the English-speaking countries of Europe.

Witnessing these lasting successes, it became generally accepted by the mid-2000s that efforts towards innovation, strong competition on product markets, and flexibility on the labour market offset high public expenditures; thus, a renewed Nordic model was created (Aiginger 2008; Heipertz and Ward-Warmedinger 2008). This may mean the implementation of a model that better corresponds to the distinctive features and order of values of the European economic and social model. Not only does the oft-mentioned study by Sapir (2006) present the Nordic model as one capable of simultaneously accomplishing both economic efficiency and a high degree of social equality, but studies by other research institutes close to the EU also put forward the same interpretation (Schubert and Martens 2005). Aiginger et al. (2007) likewise draw the conclusion that while economic performance justifies both the Anglo-Saxon and Nordic models, greater social cohesion counts in favour of the Nordic model. A book about the Swedish welfare state was published under the aegis of the IMF, which acknowledges—while also recommending further reforms—that this distinctive institutional arrangement is capable of functioning (Thakur et al. 2003).Labour market reform in the Nordic countries—which differs substantially among individual countries—has become a point of reference in EU reform plans, with the experiences of the Danish flexicurity system serving as a guiding thread (European Commission 2007). In the midst of the 2008 crisis, World Bank experts looked upon the model of the Nordic countries as an exception from the
general rule of slow economic growth linked to extensive government spending. In order to avoid these two phenomena acting in tandem, there is a need for professional, transparent government, an efficiently functioning institutional system and the profound confidence of society (Gill and Raiser 2012). In the history of the Nordic countries, the beginnings of this favourable accumulation of social capital reach to the time before the capitalist modernisation (Bergh 2011).

These special circumstances severely limit the adaptability of the Nordic model. It is also incontestable that the ageing of society presents a danger to the fragile balance that the Nordic countries have shaped between economic efficiency, competitiveness, and social cohesion. In the mid-2000s, the question often arose of whether the Nordic countries proceed on an enduringly sustainable course. The storms of the 2008 crisis took their toll on these nations to varying degrees; we shall return to this topic later.

4.3 A North-Western, Not Continental, Model?

The cluster analysis has generated a group of countries that comprises both the North-Western continental and English-speaking nations. What appears at first sight to be an astonishing outcome is nevertheless understandable if we recall the picture we obtain of the individual sub-systems. These data demonstrate that the EU’s unified internal market has attained the strongest level of integration with respect to products, with only the Mediterranean countries standing out from among the OMS. Full-blown differences exist among the non-Mediterranean OMS in the areas of labour markets, the financial system, and social protection. This confirms the earlier mentioned approach of Sapir (2006), who classifies the OMS on the basis of the labour market and social protection. Here, the Anglo-Saxon model appears only in these two areas and in the financial system and in only two out of the three areas in either the UK or Ireland. The UK displays the expected Anglo-Saxon characteristics in both its labour market and financial system. Looking at its social pro-
tection regime, Ireland appears “more Anglo-Saxon” than the UK itself, while the Irish labour market also possesses typical Anglo-Saxon features. In the combined clusters, this all falls into place in a way that does not permit us to form a clearly separate Anglo-Saxon cluster, and instead, we can view the English-speaking nations as borderline cases in the North-Western group of countries. This kind of diluted presence of the Anglo-Saxon model indirectly also means that European integration as a whole can be set against the USA as a model that, despite its internal heterogeneity, can be differentiated from the American model. This coincides with the similarly aforementioned findings of Ebbinghaus (1999).

The two English-speaking countries underwent severe ordeals in the 2008 crisis, and for this reason, it is justified to devote special attention to their situation prior to the crisis as a subgroup within the North-Western cluster.

4.3.1 Anglo-Saxon Borderline Cases: The UK and Ireland

In the decade preceding the 2008 crisis, both the UK and Ireland were among the EU’s most successful countries. Even by global standards, the UK delivered outstanding performance among the developed countries, with its GDP growth rate of around 3 per cent. For its part, Ireland’s growth of around 5 per cent enabled it to close in by 30 percentage points on the EU-27 average per capita GDP between 1995 and 2008 (Eurostat). As mentioned in connection with the Scandinavian countries, both nations were also at the forefront on the basis of indicators intended to measure the progress of the Lisbon reforms.

In the UK, the processes that characterised the period following the crises of the 1970s began before those of the other European countries. The service sector provided the economy’s pulling power, while a flexible labour market and high level of employment led to the spread of low-skilled, low-wage jobs and increasing social inequality. British industry was pushed into the background, and there was no “patient capital” from banks behind companies financed from the financial market. Neither shareholders’ short-term attitude nor the supervising role of commercial
companies encouraged industrial concerns to develop a high-added-value production structure. The welfare system was curtailed, and the government did not even target poverty reduction as a goal. In the Thatcher era, the UK displayed the characteristics of the Anglo-Saxon model, pursuing a neoliberal policy similar to that of the USA and shaping its institutional framework in this spirit.\textsuperscript{6}

With the Labour Party’s ascent to power in 1997, significant changes took place in the welfare regime, and the British system began to more closely resemble the European system. The range of services expanded as state childcare support increased and the system adapted to the dual-earner model, while application of the means-testing principle typically remained in place. Nationwide collective agreements appeared in industrial relations, at least in the public sphere. The number of students in higher education dynamically increased. The structure of the economy remained on the development path that evolved in the preceding cycle. The service sector acquired such importance that the loss of industry’s status no longer occupied economic policymakers (Rubery et al. 2009).

One of the drivers of the UK’s impressive growth was the performance of the financial sector, which continued to gain strength under the Labour government. As it could be seen in the examination of this subsystem, not only financial markets—but also the banking sector—are more advanced than in the other member states. In the decade preceding the crisis, financial services expanded at a rate of around 6 per cent, double the rate of GDP growth, and the most dynamic escalation was seen in the banking sector. As a result, the banks’ combined balance sheet totals easily exceeded fivefold the amount of British GDP prior to the crisis (Davies et al. 2010: 325). At the outset of the period in question, the contribution of the financial sector to GDP was less than 6 per cent, but this grew within a decade to close to 9 per cent. (By comparison, this ratio is 4 to 5 per cent in the major continental countries.)

Comparing the study by Rubery et al. (2009) to this cluster analysis with respect to the appraisal of the UK’s institutional arrangement, it is clear that similar empirical results can be assessed in different ways, depending on where the emphasis lies. Rubery et al. (2009) also recognise that the British institutional arrangement under the Labour government moved closer to Europe and away from the Anglo-Saxon model repre-
sented by USA, also claiming that the changes took place while preserving the essence of the latter model. It was that the EU, particularly in the context of the non-Mediterranean OMS, functions as an effective “melting pot” on the unified internal market, although important institutional differences remain—mainly in the other subsystems. During the British presidency of the EU in 2005, Tony Blair offered the member states the UK model as the saviour of Europe. In evaluating this offer, I agree with Rubery et al. (2009) that the comparative advantages gained in the services sector—mainly in finance—across decades would be difficult to transfer to other countries, although since the 2008 crisis, this is not an attractive alternative.

Financial services in Ireland expanded to an even greater degree than in the UK. The contribution of financial services to GDP in Ireland between 1998 and 2008 grew from barely more than 6 per cent to over 10 per cent (Burgess 2011: 234). During the 2008 crisis, however, precisely this advanced financial sector placed a huge burden on both countries. In Ireland’s case, not only did the international financial crisis have a “ripple effect”, but also the success story of the country already tritely known as the “Celtic tiger” was called into question. For this reason, it is worth scrutinising in a little more detail the path of development in Ireland prior to the crisis.

As is widely known, Ireland’s convergence process was built on attracting FDI, which was already the focus of Irish development policy in the 1958 Economic Development Plan. The outcome was seen as unsatisfactory because the influx of capital—mainly from USA—made limited contact with local businesses, largely bringing assembly lines or simple textile industry work to Ireland. Upon the establishment of the European Economic Community in 1973, the Industrial Development Authority was established, which consciously strived to ensure that FDI flowed into high-tech sectors. The 1980s saw the initial formation of chemical, pharmaceutical, and electronics industry clusters and the successful building of contacts between multinational and local firms. However, the economic environment as a whole was unfavourable during this period because the oil crisis of the 1970s led to a recession in Ireland as well, with multinational firms cutting investments and repatriating profits amid growing unemployment. The state financed the stimulation of the economy through
the government deficit, which led to a fiscal crisis. Following this, the Irish success story unfolded in the 1990s. Macroeconomic conditions stabilised as the country adopted a strict fiscal policy, reversing a 20-year trend. The 1992 Culliton Report brought new emphases to industrial policy, pointing out the severe dichotomy and separation between foreign and domestically owned companies. A “holistic” approach in industrial policy was recommended to the government in order to resolve this. The ensuing decade saw small domestic enterprises, which were often spin-offs from multinational firms, proliferate mainly in the software industry (Andreosso-O’Callaghan and Lenihan 2011). Parallel to the soaring of the US economy, the 1990s were characterised by GDP and GNP growth of 7 through 9 per cent. Precisely because of the substantial FDI presence, GDP exceeded GNP by 20 per cent. A more realistic reflection of the situation in the Irish economy, GNP showed 216 per cent growth by 2005 compared to the 1987 base value of 100 (Kirby 2010: 33). The government contributed to this economic performance by dynamically improving the education system. When characterising labour markets in my cluster analysis, Ireland’s appeared typically Anglo-Saxon in nature. At the same time, the corporatist element is firmly present in industrial relations, and from 1987, social partners regularly entered agreements on key issues of economic and social policy. This social accord was a similarly important element of economic development. The rapid rate of growth was interrupted by the “dotcom” crisis (the bursting of the bubble on the IT market), as well as by the unfavourable global economic effects of the terrorist attack on the USA on 11 September 2001. Export-led growth was replaced by growth based on internal demand, in which the construction industry played the greatest part. Labour costs per unit of output increased as the Irish economy began to lose its international competitiveness. The 2008 global economic crisis brought slowly accumulating internal imbalances to the surface.

Opinions are divided on the assessment of the transformation in the Irish economy, even ignoring the crisis. Those still deeming this transformation an unequivocal success story to this day cite, on the one hand, the undeniable growth-generating role of FDI, and on the other hand, those instances connected largely to a specific individual sector in which spill-over effects and domestic high-tech companies also appear (for example,
Barry and Bergin (2012). Andreosso-O’Callaghan and Lenihan (2006) painted a more nuanced picture before the crisis. Although the role of domestic small businesses in high-tech fields grew during the glory years of the 1990s, within the sector of small and medium-sized enterprises (SMEs), domestic firms were typically microenterprises, while medium-sized firms were foreign. The propensity to export within the SME sector grows as the size of the company increases; moreover, the drivers of the boom were large companies. Despite the existence of undeniably positive examples, the 2006 data also show that most of the turnover in sectors using high-level technologies was handled through foreign companies, and in low-tech sectors by domestic companies. Labour productivity is higher in foreign firms in every sector without exception (Andreosso-O’Callaghan and Lenihan 2011). Given that a typical feature of not only the Irish but also the European convergence model as a whole is that it builds on the involvement of foreign capital, we will return to these observations later.

### 4.3.2 The German Locomotive Is Running Again

With the “reallocation” of Luxembourg, the combined cluster analysis also shows the usual cluster of continental countries, Austria, Belgium, France, the Netherlands, and Germany, which are joined by the UK, Ireland, and Denmark as borderline cases. For a long time in the continental countries, the reforms of the two largest states were considered the least adequate in strengthening their competitiveness. In the midst of the 2008 crisis, analysts began to rethink their assessment of the German economy. It is worth examining the German reforms in a little more depth not only because its size makes the German economy of key importance in terms of the entire European integration process but also because we are talking about a completely different type of process from the one observed in the case of the Nordic countries or Ireland.

For Germany, too, the two oil crises of the 1970s brought an end to the unprecedented economic boom that followed WWII. Economic growth, however, slowed down substantially only after the second shock from 1982 onwards; this is regarded as a turning point in German economic
development. The economic upturn at the end of the decade proved to be temporary, and the 1990s showed GDP growth of approximately 1.5 per cent. The full employment of the early 1970s had given way to unemployment of over 10 per cent by the mid-1990s, and in parallel with these developments, the social insurance system became unsustainable. Added to these interrelated and mutually reinforcing problems, from 1990 onwards, a new challenge arrived in the form of German reunification. A part of the country—the eastern states (“Länder”)—where labour productivity was one-third that of West Germany, had to be integrated with the West German economy. In the mid-1990s, transfers to the east amounted to 3 to 4 per cent of Germany's GDP. It was partly due to this that between 1989 and 1998, public debt, expressed as a percentage of GDP, grew by 22 percentage points to 63 per cent. By historical standards, it represented a huge step forward that, by the beginning of the 2000s, the per capita GDP of the eastern states had reached two-thirds of that of the western states, and labour productivity exceeded 70 per cent. However, by the middle of the 2000s, with the exception of a few urban growth centres, the convergence had ground to a halt. According to leading German economists, however, the slowing in growth and high unemployment experienced from the 1980s onwards can be traced back to structural causes that were unrelated to German reunification (Siebert 2005: 39-42), and they clearly hold the old European social model responsible for their country’s economic woes (Siebert 2006, Sinn 2007). The process of correction and adaptation began in the mid-1990s, but its specific method was nevertheless influenced by the reunification process. In the opinion of certain researchers, before the reunification, in the debate about how the reforms should be carried out, there was balance between the market radicals and those who supported reforming the traditional German model. Alarmed by the shock of German reunification and its economic and social consequences, the economic and political elite clearly turned towards neoliberal solutions. First of all, for example, they quickly introduced the system of collective bargaining agreements in the eastern states, as well, but the bureaucratically interposed, rootless institutions did not function in the same way as similar, socially embedded institutions in the western part of the country. From then on, the traditional corporatist German model increasingly eroded (Lehndorff et al.
It is certainly striking that an acclaimed German economist such as Horst Siebert, in the subtitle of his book on the post-war history of the German economy, refers to the abandonment of the German model: “Beyond the Social Market”. What makes this even odder is that the author introduces the German social market economy, and it is clear from what follows that the passing decades saw a growing departure from the original concepts and ideals, and he could have found reference points for renewal within the original social market model. Instead, however, the author refers to the British, American, and Swiss models (Siebert 2005).

The correction process began when, in agreement with the weakened social partners, wage increases were reined in. Between 1996 and 2000, unit wage costs did not grow, while productivity increased by 2 per cent a year, which brought a strengthening of international competitiveness. It followed, by necessity, that internal demand remained lacklustre and that growth could only be driven by exports. Growth in the economy as a whole jumped before the crisis, in 2006–2007, to 3.4 and 2.7 per cent, but in 2008, it was down to 1 per cent (Sabbatini and Zollino 2010: 245, 250).

The cutback on wages did not represent an institutional change, and the German labour market was also typified by the problems prevalent in the continental countries in general, that is, status preservation, generous unemployment benefits, passive labour market policy, high taxes and social insurance contributions, and the strong employment protection. Given the results for the Nordic countries, this should have been the obvious recipe for maintaining the social market economy in Germany. However, the elements of this—easier dismissals, high taxation, and a strengthening of active labour market policy—were all disputed. In Germany, it was held that due to the strong bargaining power of workers in the “core” of the labour market, the state could implement labour-market reforms only step-by-step, beginning with atypical forms of employment (Eichhorst 2007). The Germans’ reservations regarding the Nordic labour market solutions were heightened by the fact that, in the Nordic countries, the state itself attempts to provide a substantial proportion of the employment in the context of welfare services, while in Germany even today, the most important segment of the labour market is export-oriented industry; that is, well-trained workers in the private sec-
Among the most developed countries, only the Netherlands, Austria, and USA have a higher employment rate for workers in the private sector than Germany, while Germany’s rate is roughly the same as that in the UK (Heipertz and Ward-Warmedinger 2008: 283).

The “Hartz reforms” (named after the head of the reform committee) of the early 2000s, among other changes, permitted the conclusion of more flexible employment contracts, while reducing unemployment benefits and tightening the rules for their disbursement. As the fear of Americanised labour-market solutions meant that it was not possible to carry out comprehensive reforms, the end result was a dual labour market in which traditional (permanent and protected) employment is increasingly displaced by flexible, but unsecure, jobs. The “hybrid” system of labour market institutions that is created by such layering gives rise to instability (Eichhorst 2007). The introduction of solutions that provide incentives to work, for example, the payment of unemployment benefits for 18 months rather than 36, also represented a cut in welfare expenses. With pension reform and other cost reductions, state redistribution decreased from 48 to 43 per cent of GDP between 1999 and 2009 (Jackson and Sorge 2012: 1152).

The strengthening of competition in the global economy and the EU in 1990s brought changes to the system of corporate governance; process and product innovation were strengthened both at large corporations and in the “Mittelstand”, the SME sector that is regarded as the strong point of the German economy. All this had an impact on labour relations and on the co-determination system. At companies, foreign ownership emerged, and the relationship with banks, with “patient capital”, loosened. The financial system—in line with the financial-market liberalisation underway in the EU—shifted from being a bank-based system to a more market-oriented system. Trade union membership fell dramatically, and negotiations between social partners were decentralised from the sector level to the corporate level.

Behind these changes lies not only the pressure of competition in the global economy but also the transformation of the economic structure. Although some 90 per cent of German exports are industrial products, by the 2000s, almost 70 per cent of the employed worked in the service sector. Insurance-based unemployment benefits, dependent on status,
were created for specialised skilled workers in the industrial manufacturing sector. In the labour market, however, a growing percentage of workers have general training and skills, and a high number of these are women. The proportion of those on low wages has also increased (from 11.1 per cent in 1995 to 17.5 per cent in 2006), which is on a par with the British level (Fleckenstein et al. 2011: 17). In the more flexible labour market, supporting women in work has become a more important task than ensuring the status of those with special training, and accordingly, the focus of social services has shifted from unemployment benefits to family policy, and the formerly conservative welfare system, based on the man as breadwinner, is slowly changing.

The German reforms have also raised the question of whether what we are seeing is Americanisation, following the Anglo-Saxon path, and opinions in this regard are divided. Some highlight the survival of special characteristics (Boyer 2005b), while others consider convergence to be the defining feature (Lane 2003). Streeck sees the transformation of Germany as nothing less than a case study of the return of capitalism. Such a return “seemed impossible three decades ago” (Streeck 2009: 233). Others regard the duality of the industrial economy working with well-paid, skilled workers, and the low-wage service economy, as well as the attendant low domestic demand, the declining investment in human capital and the growing social inequality, as factors that endanger long-term development (Lehndorff et al. 2009).

Experience to date shows that in the wake of the reforms, by the mid-2000s, the competitiveness of the German economy had strengthened, and it had once again become the “engine” of European integration. The role it played in the years following the 2008 crisis will be discussed in detail later.

4.3.3 The Other Half of the European Tandem: France

The other large continental country, France, took the path of gradual reforms, similar to Germany. The end of the post-war growth period and the start of the new era came at the beginning of the 1980s for the French economy, too. France, however, arrived at this point with a completely
different system of institutions and in a far worse economic state than Germany did. The stagnating investment, double-digit inflation, burgeoning deficit, and currency crisis forced a change of economic policy from the Socialist president Mitterrand in 1983, and although long, this process led to the most dramatic institutional transformation among the OMS.

If we were to compare the French economic system in the four decades after the WWII with that of Germany, France and Germany would not fall into the same group of countries. With respect to this period, the ratings that label France as a state-led economy (for example, Schmidt 2002) are correct. The state not only closely regulated the economy and controlled macroeconomic processes through indicative planning but also was an owner of large corporations operating in what were regarded as key industries and providing public services, and even in commercial banks; consequently, it employed around a fifth of the labour force. At large corporations, the relatively low-skilled employees working in an inflexible Taylorist system were supervised by a high number of middle managers. Job protection was strong; the labour market displayed the features of the continental model. In labour relations, however, we do not find the corporatist solutions typical of Germany and other continental countries and of the Nordic countries. A relatively small part of the heterogeneous labour force (25 per cent in the early 1970s) formed a few high-membership, politicised trade unions. The culture of contractual relationships between the various groups of society, which primarily permeates the Scandinavian countries, was absent here; labour relations, and the conflicts between capital and labour, were controlled by the state. The welfare state, as in other continental and Mediterranean countries, provided comprehensive protection that was dependent on status; that is, on one’s employment situation, a decisive factor in this being the situation of the head of the family, in other words, the breadwinning male (Berrebi-Hoffmann et al. 2009).

When they came into power in 1981, President Mitterrand and the Socialist government began with the traditional Keynesian policy of demand stimulation and nationalisation. However, they soon had to respond to the deepening fiscal and monetary problems with a change in economic policy. In the public sector, they carried out sweeping privatisa-
tion; the strict monetary policy, the abolition of price and capital control, and the introduction of part-time employment regimes amounted to a deep restructuring of the institutional system that had been in place since the end of the war. The government made this result politically tolerable by introducing a series of social and labour-market measures. In addition to the burden that these measures placed on the budget, the early retirement option and generous social transfers kept employment at a low level, in contrast to the Scandinavian solutions that aimed to return workers to the labour market (Levy 2011).

Measures that seemed clearly liberal at first glance, such as privatisation and deregulation, did not lead to an institutional system of the Anglo-Saxon kind. To ensure the stable management of large corporations and banks, the bulk of shares in the privatised companies were sold to a “hard core” of investors—long-term investors, including banks, insurance companies, and industrial corporations—thus circumventing the financial markets. Some 15–20 per cent of the shares came to be owned by 15–20 holdings. This process was intended to guard against future takeovers of the companies. After a while, the development of the large corporations was set back by the lack of an advanced network of suppliers with which a cost-saving, “just-in-time” supply system could be established. In France, as a part of regional policy, from the 1960s onwards, incentives were given for siting industrial companies outside the Paris agglomeration. In the 1980s, these subsidiaries were used to build up the regional supplier networks of the companies that continued to have their headquarters in Paris. With the participation of local higher education, these subsidiaries assisted in the modernisation of the SME sector. This entire process, however, was coordinated no longer by the state, but rather by the large corporations. With respect to funding, the role of the financial markets increased in comparison to the almost exclusively (state-owned) bank financing of the previous period. The state contributed to the success of the changes by developing the education system and bringing it into line with the needs of the labour market. The legislation made it possible for the institutions of worker participation to emerge at corporate level, thereby neutralising the trade unions and integrating workers into the corporation. The number of strikes decreased considerably, and in capital-labour relations, the state is now only a last
resort if agreement cannot be reached. The transformation was made easily because the French elite were selected during their university studies, at the “grandes écoles”, and during their careers, they move between state, financial and business management posts every few years, building up a complex network (Hancké 1999; Schmidt 2003).

The reform of the French labour market began by following a similar logic to that of Germany in a series of small steps. However, France did not progress as far as Germany; in terms of competitiveness, the French economy fell behind that of Germany, and an even more dichotomised labour market was created. Atypical employment was partially liberalised. There was a shift away from passive labour market policies towards the activation of the labour supply, which they tried to achieve through reductions in benefits and stricter controls (Eichhorst 2007). Attempts were made to lower the unemployment rate, which had been permanently high since the mid-1980s, by introducing a 35-hour working week; however, not even this represented a long-term solution. The government tried to alleviate unemployment by creating jobs in public services, and despite the privatisations of the 1980s, the state remained the largest employer (employing 21–24 per cent of all workers in the mid-2000s). From the 1980s onwards, there were constant shifts in the insurance-based, employment-linked Bismarck model of the welfare state towards minimum incomes based on national solidarity and working as a social safety net (Berrebi-Hoffmann et al. 2009: 191).

The French transformation was also promoted by the obligations stemming from European integration (a European single-market programme, preparation for adopting the euro). The most successful years were between 1997 and 2001, when the growth of the French economy exceeded the EU average; these were followed by years of mixed results. After the dismantling of state dirigisme, the social services system compensating for the liberalisation reached such a level that the right-wing president Sarkozy, when taking power in 2007, believed that it was unsustainable and perpetuated high unemployment. For this reason, he announced further liberalisation, but in response to the 2008 crisis, he attempted to revive certain elements of the old French dirigisme. His experiment had no resounding impact, partly due to EU regulation and partly due to his defeat in the 2012 election.
When assessing the institutional transformation, scholars unanimously recognise that the changes were dramatic. Hancké (1999) and Levy (2011) place the emphasis on the changes, while Berrebi-Hoffmann et al. (2009) highlight the hybrid nature of the institutions that emerged in the wake of the reforms. Schmidt (2003) argues that the transformed French market economy remains a third variant of capitalism (contrary to the dual categories of the VoC model). In the cluster analysis, it became apparent—without casting doubt on the surviving unique features of the role undertaken by the state—that the French economy fits into the group of continental countries. Viewed from the level of the EU-25 nations, the similarities that tie France to these countries seem more important that the peculiarities carried over and retained from its past. Amable et al. (2012), based on their institutional analysis, also confirm that France belongs among the continental countries; the problems and instability of the French implementation of the continental model in connection with the financial crisis will be discussed later.

4.3.4 The Smaller Continental Countries

Among the three small continental countries, the literature usually praises the results of the reforms in the Netherlands and Austria, but the path taken by Belgium is more contradictory. In my cluster analysis, the Netherlands displayed features similar to those of the Nordic countries, such as its labour market apparatus and its efficient education system; together with the Nordic countries, and to a greater extent, it has shifted towards a market-oriented financial system. Austria has consistently moved with the “hard core” of continental countries, Germany and France, but in terms of the labour market, it is usually grouped, together with the Netherlands, among the reforming continental countries (Eichhorst 2007; Sapir 2006), and in terms of its education system, it has joined the cluster of frontrunners.

The Netherlands has traditionally been regarded as a trading nation since the sixteenth century, and even after the industrialisation of the nineteenth century, it did not have such a strong industrial base as Belgium. After WWII, until the oil crisis, the Netherlands showed dynamic economic
growth; the state, employers, and employees cooperated to reduce growth in prices and wages, thereby creating a supportive environment for investment. It was during this period, in the fields of oil refining, the chemical industry, the food industry, and the tobacco industry, that today’s well-known Dutch multinational corporate giants were born. The first oil crisis brought a greater slump in the Netherlands than in the other Western European countries. The expenses and burgeoning social services that came with high unemployment were initially covered by the income from oil and natural gas fields, which had begun production in the 1960s. The strengthening of the Dutch guilder on the basis of oil and gas exports, however, had a negative impact on the exports of other sectors, in a phenomenon that has come to be known in economics parlance as the “Dutch disease”. In the 1970s, wages spiralled out of control, inflation rose, and, after the second oil price explosion in 1980–1982, the Dutch economy went into a severe recession. After this, the reforms began, the results of which began to be seen in the mid-1980s. In 1982, the social partners established the Wassenaar Arrangement, under which they restored the practice of keeping wages down. Here, too, the measures intended to make the labour market more flexible began with those in fixed-term employment relationships. The spread of part-time employment was primarily related to the fact that women began to work en-masse in the 1980s (Visser and Hemerijck 1997).

In the early 1990s, the reforms gained new momentum due to the renewed slowdown in the economy. As a consequence of privatisation and liberalisation, institutional investors took on a more prominent role among the owners of corporations, and both the outflow and influx of FDI doubled. In the Netherlands, deindustrialisation took place on a larger scale than in the other continental countries and was accompanied by a parallel increase in the ratio of services to GDP. The role of Dutch banks strengthened in the global financial markets, and Amsterdam grew to become a financial hub. However, the Dutch industrial multinational corporations also retained their importance. Labour relations took a paradoxical course. While in legal terms, the corporatist negotiations became decentralised by the mid-1990s and the membership of trade unions declined considerably, the informal role of the Social and Economic Council and the so-called Labour Foundation strengthened.
The Dutch version of the flexicurity system was enshrined in the 1999 Act on Flexibility and Security, which was also accepted by the social partners. In the welfare system, the responsibility of the individual was emphasised; the pension system was placed on three pillars, comprising the citizens’ pension and the insurance-based pension related to employment, and voluntary pension insurance. The transformation of the welfare system and reduction of state expenditure brought spectacular results in the second half of the 1990s in the form of an improvement in the balance of public finance. By the turn of the millennium, the Maastricht criterion relating to public debt had also been met (Houwing and Vandaele 2011).

Belgium’s post-WWII upturn had already turned to recession by the end of the 1950s, a factor of which was the loss of colonial incomes from the liberated Congo; additionally, Belgium also had to take over the new state’s debts. The 1960s were a “golden decade” for Belgium, too, but the new automotive and chemical industry investments went to Flanders, while in Wallonia, with its loss-making, crisis-ridden coal mining sector, the industrial decline did not stop. The oil crisis and the accompanying steel industry decline hit Belgium hard, and during the 1970s, society showed little willingness to accept the necessary austerity measures. As a result, public debt spiralled out of control, remaining above 110 per cent of GDP throughout the 1980s, despite having only been 48.1 per cent back in 1970 (Mommen 1994: 124, 214).

In Belgium, the reforms started later than in the Netherlands, and the state’s spending beyond its means continued in the 1980s. In the 1990s, FDI picked up in Belgium, too, but no national champions akin to those of the Netherlands emerged. The rise in foreign investors had already weakened the Belgian business networks by the time the debate on how best to keep economic decision-making in Belgium began. The majority of Belgian corporations are family-owned; a law passed in 2007 stopped them from being squeezed out of decision-making processes in joint stock companies. In labour relations, corporatist cooperation has continued unabated, the proportion of trade union members is high, and collective wage negotiations are centralised. At the same time, the state’s role as an intermediary has come to the fore, and corporatism has weakened, but these results are not due to globalisation or neoliberal dominance, but
rather to the federal reorganisation of the Flemish and Walloon provinces in 1994, which was accompanied by the fragmentation of corporatist negotiations. The subdivision of the country has also left its mark on the labour market; as we have seen above, in terms of employment, there is a ten-percentage-point difference between the country’s two provinces, in favour of Flanders. Although the welfare reforms, similar to those in the Netherlands, are built on greater individual responsibility, in practice, hardly any austerity measures took place, and the changes are of lesser importance than those enacted in the Netherlands (Houwing and Vandaele 2011).

In Austria, the post-oil crisis era brought a long series of step-by-step reforms. After WWII, the country became a textbook example of social partnership, where all strata of economic and social life were permeated by the parity system that was adhered to almost pedantically. Employer and employee advocacy groups agreed on economic and social issues in close cooperation with representatives of the Austrian People’s Party and Socialist Party. Essentially, the parliament merely enshrined the decisions in law. The trade unions were strong; the Socialists were among the governing powers for 52 years between 1945 and 2008. The Austrian business sector carried less weight than in Sweden or the Netherlands. A substantial proportion of the major corporations were under state ownership; however, the presence of foreign, and especially German, investors was not negligible. “Austro-Keynesism” (a combination of the fiscal stimulation of demand and a strict monetary policy) was effective in managing the first wave of the oil crisis, but the growing losses of state corporations forced a change of direction.

Privatisation took place in several stages, beginning at the end of the 1980s and the beginning of the 1990s with the banks and industrial corporations, while the turn of public services came only after EU accession, in compliance with the common market obligations. The latter stage also affected the SME sector, while until then, the sector had been supplied with cheaper raw materials and energy by the state corporations. In the course of the privatisation, efforts were made to ensure that the headquarters of the corporations remained in Austria and to also keep the better-quality jobs there (Alfonso and Mach 2011).

In the wake of the liberalisation and deregulation carried out in the 1990s, fierce market competition emerged. Austrian companies
responded with product and process innovation, which had not previously been among their strengths. The SME sector was backed up by the economic chambers, membership to which remained compulsory. Following the eastern expansion of the EU, the expansion of Austrian companies in the NMS gave a boost to the whole economy.

Even in the 1960s and 1970s, the Austrian labour market was more segmented than in other Northern European countries. In the tourism, construction and clothing industries, many guest workers were employed in the less favourable jobs even then. The liberalisation of the labour market further reinforced this segmentation, and the proportion of those working part-time and with fixed-term contracts rose steeply from the 1990s onwards. In Austria this resulted not from the government’s active deregulation, but rather from a process of spontaneous adaptation by the companies. Despite the decline in trade union density, the collective bargaining system remained, albeit in a far more decentralised form. In policymaking, however, social partners were pushed into the background, and the parliament took on a greater role. The restructuring of the welfare system also displays a process of constant adjustment. Within the classic Bismarck system, the first minor austerity measures took place as early as the end of the 1980s, but the right-wing coalition accelerated the pace of the transformation at the beginning of the 2000s, with the slashing of unemployment benefits and the tightening of the rules governing the pension system, including the abolition of early retirement. The comprehensive pension reforms of 2003 triggered the largest strike in Austria’s history. In summary, Austria carried out significant changes to its system of market economy institutions while managing to maintain a high degree of continuity (Alfonso and Mach 2011; Hermann and Flecker 2009).

### 4.4 Mediterranean Europe

The Mediterranean countries, Greece, Italy, Portugal, and Spain, clearly make up a cluster separate from the Nordic and North-Western countries, which is a notable result because in the progression of the 2008 crisis, to date, they have also constituted a markedly separate group within the euro area. It may come as a surprise that one of the founding member
states of the union, Italy, in spite of its developed northern regions, fits seamlessly into the cluster of Mediterranean countries. There was not a single subsystem where, diverging from the other Mediterranean countries, Italy could have been placed among the continental countries.

In contrast to the success stories of previous decades, in recent years, we have heard of almost nothing but the difficulties faced by the Mediterranean countries, so it is worth taking a longer historical view to summarise just how they achieved their economic successes in the first place and what kind of structural and institutional characteristics were responsible for the failure to sustain these.

4.4.1 Convergence of the Mediterranean Countries

*Italy's* economic performance was one of the post-WWII “miracles”, alongside those of Germany and Japan. Until the 1980s, the Italian economy displayed formidable growth (the average was 5.7 per cent in the 1960s and 3.8 per cent in the 1970s). Under the division of labour within the EU, in contrast to the North-Western countries that produced investment goods, the Italian economy specialised in the production of consumer goods. In the 1970s and 1980s, the small businesses of the North-Eastern region, concentrated in industrial zones and clusters, adapted well to the “post-Fordist” era, which demanded greater flexibility; and while retaining their traditional consumer-goods-manufacturing operations, they extended their manufacturing operations to include the machines and equipment necessary for their production. Even in the 1980s, however, they were capable only of maintaining the competitiveness of the economy as a whole by means of continuous currency devaluation. The extremely modest growth of the 1990s was followed in the 2000s by expansion of less than 1 per cent. It seems that Italy has become “bogged down” in a specialisation built on low skills, and in the high-growth, highly R&D-intensive sectors, it has been steadily losing ground in the global market since the 1990s. The flexibility advantages of the small businesses are outweighed by measures such as increased spending on R&D, information technology, and human capital, and these are mainly the preserve of medium-sized and large corporations. This sum-
mary assessment can be nuanced considerably by taking the country’s seemingly hopeless North-South divide into consideration. In the northern part of the country, an internationally competitive corporate sector can be found, while the southern part is increasingly falling behind. In 2007, in the two northern regions, per-capita GDP was 124–126 per cent of the EU-27 average, while in the southern region, it was 69 per cent (European Commission 2010b). In the decades of dynamic growth, the central government pumped considerable resources into the lagging southern regions, with scant results. The high hopes attached both to the funding sources themselves and to the expected results ran out, and since the 1990s, the disparity between the two halves of the country has been growing again. This can be effectively illustrated with a single item of data: in 1997, there was a ten-percentage-point difference in the employment rate between the northern and southern regions, while in 2003, this figure was 20 percentage points (Simonazzi et al. 2009: 214).

The EU accession of Spain and Portugal ended a long period of isolation; after the dictatorships of Franco and Salazar, it was fundamentally in Europe’s best interest to strengthen democracy in the Iberian Peninsula. Although as a founding member of the European Free Trade Association, Portugal was theoretically a more open economy, the Franco regime left a more favourable economic legacy. The Portuguese economy had also been stressed by the pre-1974 colonial wars. The second wave of the oil crisis caused a severe economic slump, and the return to democracy—which entailed a strengthening of wage demands—led to an expansive fiscal policy. It was against this uncertain backdrop that the countries joined the EU in 1986, when per-capita GDP was 72.5 per cent of the EU-15 average in Spain and 52 per cent in Portugal. Concerning the Iberian countries, it is difficult to overstate the stabilising role of the institutional system adopted as a result of community membership. Economic growth was assisted not only by the joining of the internal market but also by the assistance received under EU cohesion policy. For example, between 1994 and 1999, EU assistance amounted to 1.5 per cent of Spanish GDP and 3.3 per cent of Portuguese GDP. Membership in the EU enjoyed enthusiastic public support, and by 2000, Spain’s per-capita GDP had grown to 81 per cent, and Portugal’s to 74 per cent of the EU-15 average. Until the end of the 1990s, Portugal’s growth was more dynamic, at an
average of 2.5 per cent per year, while Spain’s economy grew at a rate of 2.1 per cent. Around the turn of the millennium, the situation reversed; Spanish convergence sped up, the approximately 20 per cent unemployment rate fell to 8 per cent before the 2008 crisis, while 5 million (mainly Spanish-speaking Latin Americans) immigrants joined the labour force among an ageing population. By 2006, Spain’s per-capita GDP not only exceeded the EU-27 average but also approached the EU-15 average (at 98 per cent thereof). It was also during this period that Spanish growth came to be overshadowed by the fact that the sectors driving it were the construction industry, commerce, financial services, and catering, which do not participate in foreign trade and have a low R&D content (Royo 2008: 36, 68; 2010: 223).

In Portugal, following its entry to the euro area, fiscal discipline relaxed, and the balance of payments deficit was also high. The budgetary consolidation attempts did not yield permanent results because rather than being based on structural reforms, they were based on increasing revenue. Economic growth slowed; indeed, there was actually contraction in 2003 (−0.8 per cent), the convergence changed to divergence, and per-capita GDP in 2006 was only 70 per cent of the EU-15 average (Royo 2010: 233).

Greece at the end of the WWII was clearly an agricultural country, and it began to be industrialised from the 1960s onwards, which is also when international tourism began. In the wake of the civil war that broke out after the world war, the country remained deeply politically divided, reaching the point where, when a weakening of the right wing was expected at the next elections, it was used as a pretext for a military junta to take over the government in 1967, lasting for seven years. During this politically turbulent period, economic growth exceeded 8 per cent per year, but this was not accompanied by job creation. The economy was incapable of absorbing the labour capacities freed up from agriculture, and the surplus labour force was removed through an active emigration policy. (One-third of those in the 15–44 age group left Greece during this period.) Then, from the mid-1970s until the mid-1990s, the Greek economy went into a state of near stagnation, with growth of barely over 1 per cent. In addition to the recessive impact of the oil crisis, heightened welfare expectations related to democracy also played a role. The wage
increases were detrimental to investments, and state spending led to a double-digit budget deficit. Additionally, after the fall of the dictatorship, the government embarked on a massive nationalisation programme, and in this respect, Greece caught up with Italy and Portugal. The industrial crisis of the 1980s primarily impacted large and medium-sized corporations, and, as in Italy, the response was to reduce the size of companies. In the textile and food industries, a network of small enterprises working as subcontractors emerged. For small businesses, the employment of unpaid family members and informal working arrangements became a widespread means of cost-cutting. The labour market disparities deepened between the state employees engaged in favourable terms, which increased greatly in number due to the unemployment resulting from the crisis and the mainly informal workers in the small businesses. In the 1990s, first, as a result of the single market program of the EU and then the Maastricht Treaty, some deregulation and privatisation took place in the Greek economy, too. All these factors, however, did little to change the fact that the Greek state was captured by interest groups, showed weak governmental performance, and was exceptionally corrupt by European standards. Despite the weak system of market institutions, the economy managed to display 3 to 4 per cent growth in the decade before the crisis. This result can be explained by the fact that capital market liberalisation and product market deregulation were carried out within such a rigid system that even this small change stimulated growth. Contributing factors were the 2004 Olympic Games and the impact of support from the EU (Mitsopoulos and Pelagidis 2011b: 111–113). The price of this growth, built on the shaky foundations of the constant increase in the balance of payments deficit and public debt, was paid by the Greeks in the 2008 crisis.

4.4.2 Changes in the Institutional System

Notwithstanding the different historical paths, on the basis of our cluster analysis and the case studies of the individual countries (Banyuls et al. 2009; Bragues 2011; Della Sala 2004; Karamessini 2009; Kornelakis 2011; Royo 2008; Simonazzi et al. 2009), in terms of their institutional
arrangement and the methods of their transformation, there are striking similarities to be found between the Mediterranean countries. In Italy, the North-South divide, and in the three other countries, the legacy of the authoritarian and/or outright dictatorial systems, left their mark on the system of market economy institutions and, to this day, remain an obstacle to the adoption of solutions that have proven successful in the North-Western countries.

The ownership structure of the large corporations is concentrated, and they are mainly family-owned. The SME sector is extensive and lags far behind the large corporate sector in terms of its efficiency and innovation capacity. The size of the informal, shadow economy is also considerable, and since the 1990s, the majority of immigrants have found work in this sector. The informal sector reduces the tax base, which, in turn, limits the state’s scope for manoeuvring in regard to managing social problems.

The state sector had a substantial role in the decades following WWII. In the 1990s, privatisations were carried out (which, with the exception of Greece, took place on a very large scale), but without the appropriate competitive environment, the expected improvement in efficiency failed to materialise.

Even in countries where the post-oil-crisis stagnation was followed by economic growth in the 1990s (Spain and Greece), this effect was achieved only at the cost of external and/or internal imbalance. All of the Mediterranean countries struggle with labour efficiency problems; Portugal and Greece have remained at a low level with some improvement, while Spain, and to an even greater extent, Italy, have clearly diverged from the EU-15 average. The annual average change in productivity during the pre-crisis years of the 2000s was negative in all four of the Mediterranean countries (Eurostat). Given the low level of R&D spending and the weak innovation performance, the modest improvement or actual deterioration in labour productivity comes as no surprise. The emergence of competitors both within the EU (the NMS) and from outside the EU (China, India, and other emerging countries) led to market loss. In the period after the oil crisis, from the 1980s until the precursor of monetary union, every Mediterranean country tried to maintain competitiveness by means of currency devaluation.
In the education system, huge growth in enrolment took place in comparison to the past in these countries, but by European standards, they came at the bottom of the league table in terms of the quality of the education system, as well as in their implementation of the Lisbon reforms (Table A.7).

In the decades following WWII, the labour market, similar to the product market, operated inflexibly, with strict state regulation in every country. The liberalisation process began in the 1980s, but assertive reforms took place only from the 1990s onwards. They followed the same logic as in the continental countries; in other words, the unionised industrial workers managed to at least partially retain their position under labour law, which is why the fixed-term or part-time employment contracts, the reduced labour-law obligations, were introduced in the lower-paid, less skilled sectors, especially the service sector. This opportunity also arose from the fact that the labour market had always been segmented, as workers in small businesses had never been unionised, not even in the heyday of the trade unions. The reforms that began from the “margins” made for an even more segmented labour market than in the continental countries.

Labour relations during the times of the dictatorships were defined by the lack of free trade unions; either they could not operate legally (Spain) or could perform their activities only with statist corporatist frameworks (Greece, Portugal). Following the transition to democracy, in these three states, as well as in Italy, the trade unions displayed a class-warrior mentality even when agreements were reached in spite of the conflicts (for example, in Italy, the moderation of wage increases in second half of the 1980s, and in Spain, the 1977 Moncloa Pact). The ferocity of the conflicts abated with the decline in unionisation and in response to the EU-wide acceptance of the ideal of social partnership.

Welfare systems everywhere were typified by a strong reliance on the family; instead of universal care, they provided residual, fragmented services; the institutions of care for children and the elderly were undeveloped. The most important component of the welfare system is the pension system, which served to protect employment status, that is, the place occupied in the social hierarchy during retirement years. There were greater or lesser shifts everywhere towards adapting the social policy to
a dual-income model, as opposed to the family model based on a single (male) breadwinner. When women gained opportunities to work in the 1990s, they were in a far less favourable situation compared to female workers in the northern countries. State redistribution was reduced in the name of liberalisation; therefore, fewer funds were available for the development of child and elderly care institutions. In the ageing societies, a paring down of the pension system was unavoidable. Spain went the furthest in establishing a low-level, universal system (that is, one that was no longer tied to employment status).

The Mediterranean countries did not respond to the global economic transformation of the 1980s with as comprehensive reforms as those in the northern countries. Their path-dependent and incremental reforms are more reminiscent of those of the large continental countries but shaped their economies to a far less extent than in the continental countries and often created inefficient hybrid solutions. They failed to show a breakthrough in precisely the areas that are critical from the perspective of sustained growth, so it is hardly surprising that researchers of the Mediterranean countries talk about feeble, “mimed” reforms, although there are significant differences in the degree of these reforms between countries.

4.5 The North-South Divide Among Old Member States

In the institutional comparison, there is no way of arriving at an indisputable, exclusively valid classification or clustering. Depending on the aim of the research, it must be decided what level of clustering will yield an answer to our questions. In this case, I want to group, and create models of, the market economies of the EU member states in accordance with how I can interpret the differences in their economic performance. The above cluster analysis clearly revealed that in the OMS, there are far-reaching differences between the institutional systems of the Mediterranean and non-Mediterranean member states. The signifi-
cance of this was painfully corroborated by the 2008 crisis, in which the Mediterranean countries became a disaster area.

The boundaries between the non-Mediterranean countries are not so clearly defined, as well illustrated by the borderline situation of the Anglo-Saxon countries. Given the differences between the Anglo-Saxon and continental countries, it is debatable whether there is any justification for lumping them together with the group of “North-Western” countries. The differences between the Anglo-Saxon and continental countries are not the only ones up for debate, as it could be argued that despite various changes, France has retained more of the state’s economic role than other continental countries. In my assessment, for the purpose of this study, the similarities nevertheless justify that the North-Western countries are interpreted a group. This grouping shows two important factors that would otherwise be missed. First, that European integration, the operation of the internal market and community policies, compel these countries to employ similar institutional solutions. These solutions aim to achieve the same as the reforms of the Nordic countries; that is, to adapt to the challenges of European and global competition while retaining as many social achievements as possible. Second, this is not just a “one-way street” involving the cutting of European welfare services and a drifting towards the Anglo-Saxon institutional system and, effectively, that of the USA. We can see in the British example that when it came to welfare services and labour relations, the Labour Party government was prepared to shift towards the Nordic and North-Western solutions.

It is clear that the longest journey has been made by the countries farthest from the institutional system that came to be sustainable in the post-oil-crisis world. These include the French or Austrian economies, which operate with considerable state ownership, but Sweden, with its massive income redistribution, and Finland, which manufactured for the Soviet market, also carried out large-scale reforms. Overall, France that departed the most from its own original institutional system that had emerged after the WWII. Although there are still some peculiarities in terms of the state’s role, currently, there is certainly no justification for classifying it in the same group as the Italian or Spanish economy, which, in the 1980s, could have still have been a defendable stance.
Regarding the countries that previously served as a model in a certain sense, it is interesting to note that they have different attitudes towards the changes. In Britain, after the neoliberal shift of the 1980s, the Labour Party’s correction to the “Anglo-Saxon free market model” in the 1990s took place in a way that ensured continuity. Following the failures of the 1980s, many theoreticians of the Swedish welfare state (for example, Rudolf Meidner) wrote essays about the downfall of this model. However, after one-and-a-half to two decades of successful growth, they—often the same authors—now take the view that with their reforms of the 1990s, building on the most defining traditions of Swedish historical development, agreement between the social groups, and on contractual relationships, they have returned to their own roots, that is, to the original model (Schnyder 2012). Most predominantly in Austria, through a model of “social partnership”, the reform process was based on small steps. Retaining certain elements of social partnership, without any major change in ideological direction, Austria developed an internationally competitive, innovative economy from an economy built on state ownership and control and on natural resources. In terms of the ideology of economic policy, Germany departed the most radically from its past; as we saw earlier on, where this country’s reforms are concerned, even in the obvious cases, no references are made to a return to the original “social market economy” model. Of course, we cannot rule out the possibility that, over time, if they were to again achieve sustained successes, the reform process would come to be interpreted as a return to their own model. The first signs of such efforts are observed (see Funk 2015).

If we compare this situation with the rate at which the Nordic and North-Western countries resolved to carry out reforms and the external forces that compelled them to do so, it is difficult to find any general inevitabilities. The larger internal markets in larger states provide more opportunities for delay, which Germany—for example—seized; however, Britain was at the forefront of a sharp change of direction back in the early 1980s. France was forced by severe imbalances to make a few drastic changes, but beginning in the mid-1980s, a continuous stream of relatively small changes had already become the norm. For the small and open economies of Sweden and Finland, it took a full-on financial crisis to set the reforms in motion. Denmark, the Netherlands, and Austria
did not wait for the situation to deteriorate, but the latter spun out the reform measures over a longer period.

While the Nordic and North-Western countries witnessed an institutional convergence with the retention of numerous peculiarities, the hybrid solutions of the Mediterranean countries did not constitute a system that was capable of producing sustained, substantiated growth. The favourable global economic environment that the region experienced for a decade and a half beginning in the 1990s and the initial cheap funding opportunities that accompanied the introduction of the euro obscured the deeper institutional and structural problems that were glaringly exposed by the crisis of 2008.

4.6 The Post-Socialist Countries

The post-socialist countries in my cluster analysis were clearly distinct from the other member states, but at the same time—as we have seen—numerous studies attempted to place these countries into existing market models or to create clusters within the post-socialist countries. In my opinion, there is clear empirical evidence that the post-socialist countries do not fit into the models that were developed for the OMS. Within the region, the differences between the countries have significance depending on the purpose of our analysis. If we seek an answer to whether the institutional systems of the post-socialist countries have common unique features that differentiate them from that of the OMS and whether this is significant with regard to their development prospects and to the European integration of the region, it is sufficient to focus on their common characteristics. If we also aim to determine whether there are opportunities for differing paths of development within the group of countries, we should also examine the differences between them. The 2008 crisis demonstrated the importance of both dimensions; the FDI-based model of reform made the region as a whole particularly vulnerable, but at the same time, the differing depths of the crisis also highlighted the importance of the differences between the countries. Therefore, both approaches will be addressed.
4.6.1 The Central and Eastern European Model

The cluster analysis therefore indicates very assertively that the separation of the CEE countries from the OMS is more pronounced than their differences, and on this basis, a CEE model of the market economy can be drawn. If we compare the individual institutional areas with those of the most similar old member state model, the peculiarities of the model can be seen more clearly.

In the product markets in the post-socialist countries, the carrier of advanced technological standards is FDI. At the same time, these markets fall into one of two groups depending on whether their functioning is characterised by moderate or more formidable bureaucratic obstacles, that is, a low or moderate state presence. Their clusters are positioned between the North-Western and Mediterranean clusters, with product markets that are less flexible than the former and more flexible than the latter. In regard to R&D&I, the post-socialist countries make up a group with the Mediterranean countries. The bank-based financial system does fit in with the model of the continental countries (in this respect, the financial system of the Mediterranean countries can be described as being comparable with the continental model), but at a significantly less advanced level.

A comparison of the labour market and labour relations presents a more complex picture than we have seen so far. The labour market lacks the duality that is typical of the Mediterranean and continental countries; this makes these countries akin to the Anglo-Saxon countries, but the labour markets of the latter group are less flexible. In labour relations, also, the similarity is half-and-half because, similar to the Mediterranean model, the state intervenes in labour relations, but in collective bargaining arrangements, the employer-employee relationship is not one of conflict. Only Slovenia made it into the group of continental countries.

In terms of the degree of social protection, the countries split into two groups. Poland, Hungary, and Slovenia fit in with the continental countries, as a “more modest version” of them. In the other seven post-socialist countries, the level of welfare spending is low, and—with the exception of the Czech Republic and Slovakia—income disparities are high, showing the traits of a residual welfare state. For this reason, they display similarity
with the Anglo-Saxon model, but in terms of the structure of financing, they have remained with the continental traditions of social insurance.

The extensiveness of the education system is on a par with the EU average, but the level of employment is worse, especially with regard to the employment of those with low qualifications. In the education system, there are no clear models, such as those in the other subsystems, but the NMS show the most similarities with the education systems of the continental countries. Only Slovenia made it into the group of—mainly Nordic—countries that present the most successful education systems.

Overall, therefore, the institutional system of the market economies of the EU post-socialist countries has the most in common with the institutional system of the continental countries, but not to the extent of enabling these groups to be identifiable. In the labour and social system, we find Anglo-Saxon elements, but we found no likenesses with any of the institutions of the Nordic countries. At first glance, it may seem that the institutional solutions of the various subsystems were combined with each other in an arbitrary manner, and the use of the term “cocktail capitalism” coined by Cernat (2006) could be warranted. However, based on a closer examination of the elements of the CEE model, in my view, they can essentially be attributed to three factors: a shortage of capital and management skills, a weak civil society, and the impacts of the EU and international organisations on the NMS. The shortage of capital and management skills made foreign investment a necessity, accompanied by immediate liberalisation, without even a suggestion of the industrial protection measures customary in emerging countries at other times and in other regions. This result came from the economic paradigm prevailing in the western countries and the level of integration achieved by the OMS. The shortage of capital made it a necessity for the financial system to be bank-based because a substantial part of the FDI was realised in the financial sector, that is, in banks. The functioning of the labour market and labour relations are different from those of the OMS because civil society, specifically unionisation, is less effectual in CEE countries than in the OMS. Without the compulsion of EU legal harmonisation, the position of employees would presumably be even weaker. A low or relatively high level of social protection, the suppression of welfare redistribution, correlates well among the NMS with the relative strength or weakness of
civil society and the depth of the roots and traditions of the institutions of social protection. The system of R&D&I is also easy to understand, given the lack of a domestically based, internationally competitive corporate sector, which drives the innovation system in the Nordic, North-Western countries. Nowhere can state-induced R&D compensate for this lack. If my reasoning is correct—in other words, if the CEE model did not emerge arbitrarily as a form of “cocktail capitalism”, but as a response given to the starting conditions—it cannot be regarded as a transitional state that will automatically progress towards some other European capitalism model, and one could surmise that this institutional arrangement might be capable of reproducing itself. This possibility, however, would strongly limit the chances of convergence for the countries of the region, as it would entail the perpetuation of the asymmetric state of dependence on the economies of the OMS.

The complementarity between the elements of the institutional arrangement described in the foregoing certainly suggests the likelihood of the model’s sustainability. The capital flowing into less developed countries seeks out relatively cheap, but suitably skilled labour, and this attraction can be retained with a liberalised labour market. The survival of the liberalised labour market is assisted by weak unionisation, but the former also limits the strengthening of trade unions. The lower productivity resulting from the underdeveloped domestic economy and the lower added value of the production conducted at foreign corporations permit a relatively low level of investment in human capital both in education and in the social services. This result, however, not only makes the residual welfare state durable but also limits the development of R&D&I systems, which, in turn, maintains the asymmetric dependence on the OMS and the highly developed countries in general. This type of institutional complementarity can be dismantled if the FDI can fulfil the role that economists expected of it at the time of the change in the political system, in other words, if the spillover effect enables the domestic economy to converge with that of the highly developed countries in terms of productivity.

Further research is needed in order to judge whether the survival or the transformation of the model is more likely. Therefore, the differences within the CEE model need to be addressed, that is, the capitalist transition of the individual countries. The most similar subgroup of countries is
that of the Baltic States. We also found numerous common traits among the Visegrád nations. Although Slovenia differs from these countries in many ways, it still has more in common with them than with the other Southeast European countries, Romania and Bulgaria. Due to its unique and different path, this topic will be discussed in a separate subsection.

4.6.2 The Baltic States

The population of the Baltic states is currently less than 7 million, but owing to their radical departure from their Soviet past, their geopolitical importance and their rapid convergence in the pre-crisis period, their progress is nevertheless a focus of international attention.

Estonia is the smallest of the three, but this state, which had a population of one and a half million at the time, played the pioneering role within the region. The towns of Estonia were under German influence until the sixteenth century through the Teutonic Knights and the Hanseatic League. This Finno-Ugrian ethnic group remained culturally Germanic until the second half of the nineteenth century, in spite of a century of Swedish rule followed by two centuries of Tsarist Russian rule. The Estonian national movement that arose in the second half of the nineteenth century achieved its goal after the First World War (WWI); the Bolsheviks were unable to hold on to power and were expelled by the German army at the end of the WWI, and Estonia existed as an independent nation state between 1918 and 1939. Following the Molotov-Ribbentrop pact, however, Estonia came under Soviet rule until the collapse of the Soviet Union. Without an understanding of the country’s turbulent past, it is impossible to understand the choices made by Estonia—and the other two Baltic states—whereby they developed their new market economy institutions. At the time of the fall of communism, Estonia was the most westernised among these countries: before the Soviet occupation, many Estonians had emigrated to Sweden, Finland, and North America; they could understand the broadcasts of the Finnish television and radio due to their shared linguistic roots, and the Estonians were the most open to the market economy. Even within the Soviet Union, Estonia was regarded as an experimental laboratory for reforms.
from the 1960s onwards, but these decades brought great setbacks in terms of development. Its industrialisation took place before the Soviet occupation, and by approximately 1940, its per-capita GDP was on a par with that of Finland; in 1990, however, it amounted to only 40 per cent of Finnish GDP. At the same time, emigration to the west, deportations to Siberia and immigration from the Slavic regions of the Soviet Union dramatically upset the ethnic composition of this small nation, and by 1989, only 61 per cent of the population remained Estonian (compared to 94 per cent in 1945) (Mygind 1997: 19–21).

The goal of creating the nation state shaped not only the political system but also the economic system. The most sensitive issue of the political transformation was the restriction of citizenship for the Russian minority. There were moves to also restrict the citizenship, and thereby the right to vote, of those who had been, or whose forebears had been, Estonian citizens prior to 1938. Following international protests, the act on citizenship was relaxed, but to this day, it prescribes knowledge of the Estonian language. Currently, the number of those without citizenship and those opting for Russian citizenship is below 10 per cent.10

In the Estonian privatisation, a role was given to cash and voucher-based privatisation, as well as restitution, with the latter especially prevalent in the agricultural sector. The whole process was geared toward ensuring that ownership rights were transferred from the Soviet Union to Estonia. For this reason, cash privatisation only picked up pace when the Estonian kroon was introduced in 1992 and the fear that the use of the rouble would lead to the acquisition of assets by parties from other regions of the former Soviet Union subsided. The preferential purchase options available to employees and management also served to keep assets under domestic ownership. The rules for the distribution of the vouchers were elaborated in such a way as to put the minority at a disadvantage (Mygind 1997).

In terms of the stabilisation and liberalisation of the economy, Estonia became a model country for neoliberal economic policy. Foreign trade was rapidly liberalised, and a strict wage policy was pursued. Prices shot up after the liberalisation; once Russian raw materials were priced in line with global market levels, hyperinflation broke out, but it was reined in fairly quickly with a strict monetary policy. The Estonian central bank
functioned as a currency board, and the new currency was pegged to the German mark. Because credit creation was strictly tied to central bank reserves, the central bank was unable to influence the credit growth, could not carry out open market operations, and could not finance the government deficit. In the name of neoliberal policy, welfare benefits were cut drastically, especially pensions. Spending on education and higher education, which were important for building the nation state, however, was generous. The weak employees’ and employers’ associations did not influence state economic policy. This economic policy brought spectacular results in terms of stabilising the economy, on the one hand, and had an impact on the structure of the economy and the development of the institutional system on the other. The rapid liberalisation sealed the fate of the industrial corporations that manufactured for the Soviet market, and apart from the flat tax, there were no investment incentives for FDI such as those offered in the Visegrád countries. Consequently, the bulk of FDI—especially from nearby Sweden and Finland—flowed into the banking sector, services and real estate sector, and a process of vigorous deindustrialisation took place. The Estonian leadership presumably allowed this to happen not only because of the consistent neoliberal economic policy but also because the majority of the industrial labour force belonged to the Russian minority (Bohle and Greskovits 2012).

In summary, Estonia embarked on a period of dynamic growth, producing a growth rate of 6–11 per cent with the exception of one year between 1995 and 2007. Following the Russian crisis of 1998, until the crisis of 2008, per-capita GDP at purchasing power parity (PPP) came 20 percentage points closer to the EU-27 average. The external imbalance, that is, the balance of payments deficit, continued to grow, however, which led to a severe setback in the midst of the global economic crisis, but I shall return to an analysis of this topic later. One of the successes in terms of development was that, as a result of the 2001 research and development strategy, by 2011, Estonia had joined Slovenia in the group of innovation followers, displaying performance close to the EU-27 average (European Commission 2012). Despite the difficulties of the crisis, the Estonian economy was able to adopt the euro in 2011. The downside of the development was that all these processes were accompanied by massive growth in economic inequalities. I will examine the
longer-term social and economic impacts of these processes during the analysis of the crisis years.

Latvia’s history is largely similar to that of Estonia, with the difference that there was a brief interlude between the periods of German and Swedish influence, in the second half of the sixteenth century, when it was under Polish rule. The German occupation during WWI was followed by independent statehood between the two world wars for Latvia, which lasted until 1939. After the Soviet occupation, the country was able to return to being an independent state in 1991. The ethnic composition had changed dramatically due to emigration, deportations and the Russian influx. In 1989, some 52 per cent of the population of approximately two and a half million was Latvian (compared to 83 per cent in 1945). The unusual, Baltic-derived Latvian language was not conducive to a more active relationship with the western world, as was the case with the Estonians, and the market economy was a less familiar setup at the beginning of the change in political system. In the 1930s, incomes were on a par with those of the Estonians; alongside the industrialisation process, Riga also played an important role as a centre of commerce (Mygind 1997: 19–21).

In Latvia, too, the construction of a nation state was the main objective during the change of the political system; however, Latvia had more barriers to overcome than Estonia. Latvia, and especially Riga, was a Russian military base, and the Russians had a stronger position in Latvia’s industrial corporations than in those in Estonia. A strong Russian party was formed, so the exclusion of this ethnic group from citizenship was not sustainable after 1994, which was also partly due to vociferous international protests. Nevertheless, the tensions have remained to this day. In February 2012, a referendum was held on whether Russian should be an official language because 27 per cent of the population spoke Russian as their native tongue (and the proportion of those without citizenship remains above 10 per cent). Three-quarters of voters rejected this proposal.12

The Latvians also attempted to assert national criteria in the privatisation process, but deeper political divisions than those in Estonia led to more chaotic processes. The privatisation ran its course the most quickly in the agricultural sector, where it took the form of restitution because in
the rural areas—similar to Estonia—the majority of the population were indigenous. Voucher privatisation was intended to have a more prominent role because it could be more easily controlled in line with Latvian interests; however, in reality, this measure could be enforced only in the smaller companies. By the time that large corporations were addressed, the company managers had acquired the most valuable corporate assets through lease agreements that included a purchase option. FDI had a less prominent role in Latvia than in Estonia (Mygind 1997).

The same elements of the neoliberal economic policy are found as in the case of Estonia, only implemented with less consistency. The lowest point of the recession exceeded that of Estonia by 20.7 percentage points, and in 1992, the economic downturn was 34.9 per cent (EBRD 1999: 73). Strict wage controls, liberalisation of the labour market, and weakness of the trade unions were also observed in Estonia. Foreign trade was liberalised gradually. The political conflicts also had an impact on stabilisation policy; following the upsurge in inflation in 1992 (the increase in Russian raw materials prices), fiscal policy was strengthened under pressure from the IMF. Monetary policy played a greater role in the stabilisation process. In Latvia, first, the Latvian rublis was introduced, to be replaced in 1993 by the lat. Here, instead of a currency board, a central bank with full powers was established, but in terms of their actual functioning, there was little difference; the exchange rate of the lat was pegged first to the SDR basket and, then, later to the euro. The openness of the economy and the strict monetary policy with its attendant lending restrictions triggered a process of deindustrialisation in Latvia as well. The social system was reformed with a similar approach and social consequences as those in Estonia, and this was the first of the post-socialist countries to introduce a multi-pillared pension system (Mygind 1997).

Latvia’s transformation did not lead to the same success as that of Estonia. Latvia tried to forge an advantage by providing offshore banking and commercial services to Russia through its free ports and special economic zones (Sommers and Bērziņš 2011). The growth rate and extent of convergence was similar to that of Estonia until the crisis, but in terms of its R&D&I performance, Latvia came last among the EU states, a situation that had not changed by 2011 (European Commission 2012).
Lithuania, in contrast to the other two Baltic states, existed as an independent state as early as in the thirteenth century. In the fourteenth century, the marriage of the Grand Duke Jogaila and the Polish queen Jadwiga of the House of Anjou (the daughter of King Louis I of Hungary) gave rise not only to the Jagiellonian dynasty but also to a personal union with Poland. Except for a brief period in the fifteenth century, the Polish-Lithuanian union functioned until Poland’s partition in the eighteenth century. After this, Lithuania came under Russian rule and remained so until Russia’s defeat in WWI. Between 1918 and 1939, Lithuania also enjoyed the freedom that it would regain only in 1991 after the fall of the Soviet Union. Before WWII, Lithuania was an agrarian nation and poorer than the other two Baltic states; its industrialisation did not take place until the Soviet era. At the time of the change in the political system, Lithuania was the least open of the three Baltic states to a market-economy approach, and its unique Baltic language, which is also different from Latvian, did not promote liaison with the western world, either. In 1989, some 79 per cent of the population of 3.5 million was Lithuanian, but this represented only a one-percentage-point decrease in comparison to 1945 (Mygind 1997: 19–21). In 1990, Lithuania made the most assertive declaration of independence, to which the Soviet leadership responded with an economic blockade. In 1991, Soviet troops carried out a military intervention, during which 13 civilians were killed at the radio and television centre in Vilnius.

For Lithuania, the Russian minority, by dint of its proportion, did not represent such a great problem as the other two countries, and the citizenship act also accommodated minorities. The Lithuanian communists were pro-independence, and the 1993 elections brought victory for the left. These circumstances led to slightly different scenarios in terms of both the privatisation and the stabilisation process than in the other two Baltic states. In the absence of nationality problems, privatisation ran its course quickly, mainly taking the form of voucher-based and employee ownership schemes; in the agricultural sector, restitution was applied here, too. The members of the old nomenclature acquired corporations by taking out bank loans to buy vouchers from investment funds, which had obtained them from the general public. The collateral for these loans was the inventory stock of the companies—under their management—
that they planned to purchase (Samonis 1995). Initially, foreigners could acquire only a 99-year lease. The stabilisation process—again, in the absence of nationalist pressure—took place more slowly; here, too, the recession was its greatest in 1992, at 21.3 per cent (EBRD 1999: 73). The reduction of real wages took place later than in the other two countries, under pressure from the IMF. Fiscal and monetary policy was tightened from 1993 onwards, successfully curbing hyperinflation (Mygind 1997). The country adopted its own currency, the litas, and after lengthy disputes, the Lithuanian central bank also functioned with the powers of a currency board. The flat tax was also a feature of the Lithuanian transformation, as was pension reform, although private pension fund membership was not made compulsory. While in Lithuania, there was no determined neoliberal policy as in the other two Baltic states, the impoverishment of the old and the rapid growth in social inequalities occurred, and the trade unions also played no greater role than in the other two Baltic states (Bohle and Greskovits 2012).

Lithuania’s performance in terms of convergence falls between that of Estonia and that of Latvia, but it is closer to the latter. The extent of deindustrialisation did not match that of the other two countries, but Lithuania’s R&D&I performance was sufficient for it to overtake only the Latvians and the Bulgarians (European Commission 2012).

### 4.6.3 The Visegrád Countries

In the first half of the 1990s, besides the Baltic countries, Poland’s rapid transition attracted the greatest interest and recognition. At that time, the start of the radical transformation and rapid growth of Estonia and Poland were the focus of international attention as a vindication of the neoliberal recipe, which was followed at the beginning of the 2000s by that of Slovakia, the “Tatra Tiger”, for similar reasons. The performance of the Polish economy during the 2008 crisis garnered more interest, and there was talk of a growth miracle (Lehmann 2012).

Poland suffered major losses, even in comparison to the other socialist countries, during the change in the political system. For example, per-capita GDP in PPP matched that of Hungary in 1950, but by 1989,
Hungarian GDP was 146 per cent of Poland’s. After WWII, Poland’s GDP had exceeded that of Greece, Spain, and Portugal; by the time of the change in the political system, these countries’ GDP was twice to two and a half times Poland’s. The rate at which the Polish economy fell behind accelerated in the 1980s; between 1979 and 1982, output fell by 25 per cent due not only to the typical problems of socialist economies but also to the 1981 imposition of martial law and the isolation from the west that ensued (Rapacki 2008: 21–22).

The strengthening political opposition was not broken by martial law, and the attempts at economic reform also failed to yield results. Poland arrived at the change in the political system with a massive public debt, constantly on the verge of state bankruptcy and, in 1989, hyperinflation. This situation forced the first freely elected government to embark on a comprehensive stabilisation program; there was no real choice between “shock therapy” and a gradual transition. The stabilisation was made viable by the fact that the Maziwiecki government, dominated by the Solidarity movement, enjoyed the population’s trust and willingness to make sacrifices on the one hand and the support of the international financial organisations on the other. The latter meant support for stabilisation, credit from the World Bank, and the write-off of half of its interstate and, later, its commercial bank loans. Despite the favourable external circumstances, tough measures were needed here. After prices spiralled out of control in 1990, inflation was approximately 600 per cent (which is still lower than the approximately 900–1000 per cent inflation of the Baltic states). The zloty was made convertible, and its exchange rate was pegged to the dollar at the true market rate rather than at the previous official exchange rate; strict monetary and fiscal policies were introduced, and in this way, inflation was successfully curbed. Support for state corporations was cut dramatically. The lowest point of the recession was in 1990, when the economy shrank by 11.6 per cent (EBRD 1999: 73; Lehmann 2012).

Privatisation got off to a slow start, and by 1993, mainly the SMEs came under employees’ ownership through lease schemes. The right-wing government did not want to sell off what were considered the key sectors either to managers belonging to the nomenclature or to the workers. The voucher-based privatisation began in 1994 within a strict legal
framework, thus avoiding corruption scandals similar to those of the Czech Republic (which we will discuss later). The management costs of the national investment funds executing the process were so high, however, that these failed to become an effective means of building the capital market (Soós 2010). Interest from foreign investors was also limited. Management buyouts became typical after 1993, when the post-communist successor party took power. The influx of foreign capital got under way following the write-off and the rescheduling of debt in 1994 (Belka 2001), but foreign investment plays a smaller role to this day than it does in the other Visegrád countries.

The development of labour relations got off to an unusual start in Poland because the main opposition force was the Solidarity trade union, and civil society was far stronger than in other post-socialist countries. Nevertheless, the 6-million-strong trade union membership of the beginning of the 1990s was halved by the end of the decade, with Solidarity members numbering approximately 1 million of these. By the time of EU accession, labour relations were very reminiscent of what was being experienced in the other Visegrád countries: a low level of institutionalisation and cooperativeness that stemmed from the helplessness of workers and conflicts that rarely became open. According to Polish experts, the path led from social partnership to enlightened paternalism (Pańków and Gąciarz 2001).

At the end of the 1990s, the Polish government resolved to carry out the reform of social services. The reform of pensions, healthcare, education, and regional government are referred to as the “four reforms”. In stark contrast to the Baltic states, and similar to Hungary, the compensation for losses resulting from the structural transition to a market economy and the curbing of unemployment were resolved through the pension system. In comparison to the OECD average, the proportion of disability pensioners was higher, but early retirement reached an exceptionally high level. The reforms attempted to make the three-pillar pension system sustainable with respect to the future (Lehmann 2012). The education system was brought into line with labour market requirements, and performance incentives were incorporated into teachers’ pay (Belka 2001). The transformation of the education system in the 2000s yielded results that were measurable in the PISA tests. In terms of R&D&I, Poland is
a moderate innovator, surpassing only Latvia, Lithuania, Bulgaria, and Romania (European Commission 2012).

Poland did not achieve as high a high peak growth rate as the Baltic countries, but its performance was more consistent. Therefore, relative to the 1989 base, Poland boasts the highest rate of growth among the ten post-socialist countries: prior to the crisis, in 2007, more than one and a half times, or 169 per cent, of its GDP at the time of the change in the political system (EBRD 2008: 13). Similar to the other Visegrád countries, Poland’s industrial output was successfully restructured so that products of a high and medium technological level accounted for half of exports by the mid-2000s (Eurostat). However, the performance of the entire economy was impaired by the low productivity of agriculture. Even in 2008, the proportion of those employed in agriculture was 14 per cent, while the agricultural sector contributed only 2.2 per cent to GDP (European Commission 2010a: 47). Another reason for this result is that its income disparity indicators (risk of poverty, Gini coefficient) are better than those of the Baltic countries but worse than those of the other Visegrád countries (Table A.8).

One of the secrets of Poland’s economic success is that while the governments carrying out reforms were punished by the population at elections as a matter of course (Donald Tusk’s government was the first that managed to remain in power after the 2011 elections), successive governments did not dismantle each other’s reforms, but merely modified them (Lehmann 2012). Polish economic policy, beginning with the first reforms, was committed to liberal solutions; it became a reliable implementer of IMF-inspired adjustment programmes, but this did not make its economic policy into a doctrine (Belka 2001). During the crisis, the clear signs of this Polish pragmatism can clearly be seen.

Following the change in the political system, the “velvet revolution” of 1989, the process of transition to a market economy also began in Czechoslovakia. The formation of this young state, which was founded in 1918, began in a context that differed markedly from the other two Visegrád countries. On the one hand, the system, which stiffened after the crushing of the 1968 “Prague spring”, lacked the economic and political reform experience that the political and economic leaders of Hungary or Poland already possessed. On the other hand, the economy was more
stable, the Czech tradition of fiscal discipline had been retained by the communist leaders, there was no substantial public debt and per-capita GDP was second-highest, after Slovenia, among the ten post-socialist countries. Nevertheless, a finance minister was appointed to lead the economic reforms, in the form of Vaclav Klaus, who was a staunch proponent of neoliberal economic policy and who announced radical changes, the creation of a market economy “without adjectives” (that is, no social market economy). This process was irreconcilable with the continuation of support for the Slovak economy, which, during the socialist era, entailed the redistribution of up to 8 per cent of Czech national product to the Slovaks (Švihlíková 2011: 189). The trade liberalisation applied as a part of the shock therapy also took a greater toll on the Slovak economy. These tensions also contributed to the fact that on 1 January 1993, Czechoslovakia split into the independent Czech Republic and the Slovak Republic.

The Czech Republic was unable to avoid the recession brought about by the change in the direction of foreign trade, which reached its lowest point in 1991 at 11.5 per cent, the spiralling of prices and a more than 100 per cent depreciation of the Czech koruna brought 52 per cent inflation (EBRD 1999: 73, 76). The momentum of growth lasted until 1997, when the Czech economy sank into a mild recession, receding by approximately 1 per cent. The cause of this result was the unique brand of liberalism represented by Klaus, now in his capacity as prime minister. The Czech government opted for voucher privatisation because it expected that, in this way, joining the free market would not be limited by the situational advantage of the managers governing the companies, and it did not intend to put foreign capital in a more favourable position, either. The household vouchers, however, came to be owned by the privatisation investment funds established by the state-owned domestic banks, and the companies were not modernised and reformed either technically or in terms of their management. Thus, the competitiveness of Czech exports remained weak, while imports grew. The initially favourable position of the banks deteriorated due to the accumulation of bad loans. In 1996, the government introduced strict austerity measures; the unpopularity of these measures and the corruption scandals that accompanied the opaque process of the voucher privatisation led to early elections in
1998. The minority left-wing government was forced to sell the companies, which had been improved through the state restructuring agency, to foreign investors, as they did with the banks. The costs of bailing out the banks between 2000 and 2005 burdened the Czech budget to the tune of 1.5 per cent of GDP (Myant 2007).

All in all, the modernisation of the Czech economy was also based on FDI, and similar to the other Visegrádi countries, the automotive industry was the driving force. The rate of economic growth remained lower than in Poland or Slovakia, but to this day, it has retained second place in terms of per-capita GDP among the post-socialist member states. A major achievement of the Czech transformation was that, throughout the process, the high employment rate of over 70 per cent, which exceeds the EU average, was accompanied by 6 to 8 per cent unemployment (Eurostat).

In labour relations, the trilateral talks began promisingly, with a general pact in 1991. The combination of the Klaus government’s philosophy and economic difficulties led to a situation in which the consultation mechanisms failed to develop into true corporatist institutions. The pension system was built up in a decidedly egalitarian way, and the employment difficulties were not resolved to the detriment of the system, as in Poland or Hungary, but through the provision of support to employers and with active labour market policy measures. Thus, there was no pressing need to privatise the pension system, which was reformed gradually, and only voluntary private pension insurance was introduced (Bohle and Greskovits 2012). The employment situation and the social insurance solutions led to low social inequality indicators despite the fact that the Czech Republic spends only 18–19 per cent of its GDP on social protection. Nevertheless, one may doubt whether the Czech data could be more favourable than the Finnish, Swedish, or Danish figures in terms of the risk of poverty, the Gini coefficient, or the EU 2020 poverty indicators. These doubts are reinforced by regional disparities, as in the Scandinavian countries, there is up to a one-and-a-half-times difference in per-capita GDP between the individual regions, while within the Czech Republic, there is a threefold difference (European Commission 2010b). The Czech government did not treat either R&D or education as a priority, and it produced indicators that were similar to its regional peers. The number of
participants in higher education and education spending remained below the EU average (Myant 2007).

Slovakia, owing to the shock therapy that began when the country was still part of Czechoslovakia, suffered a greater recession (–14.6 per cent) and higher inflation (58.3 per cent) in 1991 than the Czech Republic (EBRD 1999: 73). The less developed Slovak economy was hit harder by the collapse of the Soviet markets, and its tourism was far more modest than that of the Czech Republic. In 1993, the unemployment rate was not even as high as 4 per cent in the Czech Republic, while in Slovakia, it was over 14 per cent (EBRD 1999: 213, 265). Privatisation started with a small amount of restitution, the sale of small companies and, mainly, voucher privatisation. In Slovakia, the retention of state ownership and employee buyout schemes also remained popular alternatives. Following the transition to an independent state, the Mečiar government halted the privatisation and, in 1994, sold the large industrial corporations to domestic entrepreneurs, thus building up political clientele. However, this measure proved to be a temporary solution here, too, as the companies were sold to foreign investors either voluntarily or due to bankruptcy. The government tried to stimulate economic growth by squeezing the prices of public services below production costs and through infrastructure developments, with the latter financed by the state-controlled banks. The loose fiscal policy was paired with a strict monetary policy with high interest rates, which, although curbing inflation, was unable to prevent the emergence of twin deficits. While the Czech economy was negatively impacted by the 1996 narrowing of the western markets, the Slovak economy was impacted mainly by the 1998 Russian crisis. In addition to the economic difficulties, international isolation led to the fall of the Mečiar government, which was strongly nationalist and a threat to democracy. Slovakia was barred from joining the OECD, from the NATO expansion and from the start of the EU negotiations.

From 1998 onwards, the Dzurinda government switched to the neoliberal recipe also applied in the Baltic countries. The banks and public services were privatised, and attempts were made to attract FDI in industry, costs were cut and the koruna devalued. Owing to the stability of the economy, from 2000 onwards, Slovakia set off on a path of dynamic growth, with FDI bolstering industry here, too, especially the automo-
tive industry. The sustainability of growth was provided for by the structural reforms of the second Dzurinda government from 2002 onwards. The introduction of the flat tax system had greater international reverberations than the similar Baltic or Czech measures due to its consistent implementation. The pension reform reduced the state’s commitment in the long term; the restructuring of the first pillar was accompanied by the introduction of a mandatory second pillar. By liberalising the labour market and reducing welfare transfers, the intention was to boost economic activity. In the favourable global economic environment, employment began to rise. The education reform was mainly successful only in terms of financial stabilisation and the restructuring of the institutional system in line with the declining number of children. The performance of the healthcare system triggered such general discontent that radical marketisation was seen as the solution. In this area, however, they were no longer able to consistently implement the accepted reforms (transformation of the hospitals into incorporated business entities and the insurers into profitable management organisations). The dramatic changes that were expected on the basis of the election campaign rhetoric of the left-wing Fico government elected in 2006 failed to materialise. The privatisation of public services was halted, and a few popular measures with a low budgetary impact were adopted (for example, they abolished the patient co-payment in the health sector), and joining the second pillar of the pension system was made voluntary (Beblavy 2010). With its reforms, Slovakia not only came out of international isolation and became a member of the OECD, NATO, and the EU, but in 2009, it was able to adopt the euro.

With regard to labour relations, at first, the trilateral corporatist negotiations worked in Slovakia, but this practice was unable to take root under Mečiar’s authoritarian rule. Although the Dzurinda government passed a law on social partnership in 1999, against the backdrop of the austerity measures and later reforms, this law did not work in practice (Bohle and Greskovits 2012). In Slovakia’s case, exceptionally favourable income disparity indicators are found. These indicators are slightly worse than those of the Czech Republic but remain close to those of the Scandinavian countries, which is why one can doubt their reliability even more than that of the Czech data (Table A.8). This result is difficult to
believe, given the social spending amounting to 17–18 per cent of GDP, an unemployment rate that never fell below 10 per cent (Eurostat), and a Roma minority, which was stricken by similar education and employment problems, of a similar proportion to that of Hungary. Additionally, there is a four times difference in per-capita GDP at PPP between the Slovak regions, which is even greater than in the Czech Republic (European Commission 2010b).

If we analyse Slovakia’s performance since 1989, then only Poland’s 169 per cent GDP growth was enough to surpass its previous 154 per cent. If we look at the EU-27 average, Slovakia needed the “helping hand” of the 2008 crisis to overtake Estonia, thus coming third among the post-soviet countries after Slovenia and the Czech Republic (EBRD 2008:13, Eurostat). Slovakia achieved this impressive convergence in such a way that successive governments did not devote as much attention to either R&D or education as Slovenia or Estonia.

Hungary is the last to be discussed not out of courtesy by the Hungarian author to the neighbouring Visegrád countries, but rather because the path of this country’s development has differed to a certain extent from that of the previous three, especially since the beginning of the 2000s. These differences can be attributed partly to the legacy of the past and partly to economic-policy decisions.

In 1956, Hungarian society rebelled against the dictatorship, and although the uprising was rapidly crushed, it had a profound effect on the communist party leadership. From the mid-1960s onwards, the essence of consolidation under Kádár was intended to make up for the missing political legitimacy by improving prosperity. To this end, the 1968 economic reforms brought changes that were unparalleled in the entire eastern bloc. Following a number of setbacks and renewed efforts, by the time of the change in the political system, several institutions of the market economy had already been created (for example, the partial liberalisation of prices, partial freedom of enterprise, a two-tier banking system, the introduction of personal income tax and value added tax, and so on). However, not even the partial reforms resolved the efficiency problems of the state socialist system, so the modest but constantly rising household consumption serving the political stability of the system could
be covered only by growing public debt. In 1990, the gross public debt exceeded USD 21 billion (Kornai 1996: 956).

The National Round Table Talks conducted between the Hungarian Socialist Workers’ Party and the opposition parties in 1989 ensured a peaceful transition. At the first free elections held in 1990, a right-wing coalition received a mandate to govern, led by the Hungarian Democratic Forum (MDF) with József Antall as prime minister. With its slogan of “quiet strength”, MDF attracted voters who highly valued stability, and the state of the Hungarian economy did not require the use of shock therapy as Poland did. Although the recession was severe in Hungary, too, bottoming out in 1991 at 11.9 per cent, inflation never turned into hyperinflation (inflation was 32–33 per cent in 1990–1991), nor did the liberalisation process have to begin from scratch (EBRD 1999: 73, 76).

The burdens associated with the transformation soon triggered resistance; in response to a petrol price increase planned by the government, a blockade by taxi drivers brought Budapest’s traffic to a standstill in October 1990. Although the price increase was necessary, the opposition took the side of the taxi drivers. The government arrived at a settlement with the taxi drivers through the Reconciliation Council, and the drivers received price compensation. Two decades on, with hindsight, this conflict began to reveal the traits that would prevent Hungary from maintaining its initial position as the frontrunner of the change in the political system. The vast majority of Hungarians, who, compared to their neighbours, had lived in relative freedom and affluence, expected the change in the political system not only to bring freedom but also to quickly allow them to enjoy the affluence of the western countries. The government could not rely on the same willingness to make sacrifices as in the case of the Baltic countries or Poland. With the deep political divisions, whoever was in opposition at any given time had no compunctions about exploiting longings for prosperity in order to gain power in the short term. Thus, the successive government never embarked on comprehensive reforms except when they were forced to do so by macro-economic imbalances. These measures were softened either by themselves or by their successors at the first opportunity; therefore, they returned to the path beaten by the party leadership under Kádár. The expansive fiscal policy, which exceeded the country’s load-bearing capacity, and the
“stop and go” economic policy that accompanied it could justifiably be interpreted as the manifestation of a path dependency that spanned the change in the political system (Benczes 2011).

In Hungary, not only liberalisation but also privatisation had begun before the change in the political system with the 1988 Companies Act; however, these processes took place on a large scale only in 1990 onwards. The free distribution of property was not supported either by economists or by economic policy makers, but it was out of the question anyway due to the country’s indebtedness. The restitution and employee ownership program continued to have little significance. The acquisition of ownership by Hungarian nationals was supported with preferential privatisation loans. Unlike in the other post-socialist countries, the sale of the larger corporations to foreign owners had begun in 1988, and the first substantial waves of sell-offs took place in 1992–1993 (Soós 2010). The socialist-liberal government that took power in 1994 restarted privatisation in 1995, selling energy companies and—after their restructuring—banks to foreign investors. However, an analysis from the period noted that, in many cases, cannot talk about privatisation in the strictest sense of the word for energy companies because these companies were bought up by foreign state or community-owned companies (Voszka 1996). Overall, in Hungary, after the primary privatisation and owing to the green field investments, FDI led to the emergence of a competitive export structure.

In 1995, the macroeconomic imbalances forced the implementation of the package of austerity measures named after the then-finance minister Lajos Bokros, comprising forint devaluation, surplus import duty, welfare spending cuts, and a wage freeze (Kornai 1996). Economic growth began and the public debt shrank due to the privatisation revenues. Hungary seemed to be on a sustainable growth curve, which was maintained by the right-wing government following its 1998 election victory until the spending spree in the run-up to the 2002 elections. The socialist-liberal coalition regained power with the promise of a “welfare regime change”. As a result of the budgetary spending, the public debt began to grow again, and the households also became externally indebted through foreign currency loans advertised with low interest rates. The government employed various tricks to buy time until the 2006 elections, which it
won, but afterwards, it had no choice but to impose austerity measures. Hungary’s convergence, in terms of per-capita GDP at PPP, stalled at 62–63 per cent for several years beginning in 2003 (Eurostat). Hungary entered the 2008 crisis with a weakened economy, and the government no longer had the elbowroom to pursue an anti-cyclical economic policy.

Labour relations developed similar to those of the other Visegrád countries. The Reconciliation Council’s successful handling of the taxi blockade was not followed by a strengthening of trilateral interest representation. Among the trade unions, the communist legacy organisation, the National Federation of Hungarian Trade Unions, became the largest, but none of them developed into influential employee organisations. During successive governments, there were nuanced differences, but the position of employees and social partnership remained just as weak as in the previous three countries. Among the Visegrád countries, Hungary had the highest social spending, a factor in this was that, similar to Poland, the burden of the unemployment resulting from the change of economic structure was borne by the pension system. In 1998, the financing of pensions was restructured to form a three-pillar system, of which the second pillar—compulsory private pension funds—was nationalised by the Orbán government in 2010 (Bohle and Greskovits 2012).

In terms of innovation performance, Hungary comes second among the Visegrád countries, following the Czech Republic, which holds 17th place overall, at 19th in the ranking of the 27 member states (European Commission 2012). As the PISA report mentioned above shows, in terms of education, Hungary falls in the middle of the European ranking. The financial conditions for improving educational performance, however, are less favourable than in the other Visegrád countries. Although GDP-proportionate spending on education was lower in the Czech Republic and in Slovakia than in Hungary, in Hungary, this spending has been falling steadily since 2006 (Eurostat).

4.6.4 Slovenia’s Separate Path

Of the countries discussed so far, none has such a starkly different assessment in the literature as Slovenia. Its population of two million, similar
to the Baltic states, is on the scale of a city state, but Slovenia was the only one of the post-socialist countries to have since become EU member states to choose a radically different path of transformation. This difference is also reflected in my cluster analysis, as although the country falls into the CEE group, it is on the borderline with the North-Western (continental) countries. For researchers, Slovenia is a kind of test bed, regarding which the question can be put, and possibly answered, of whether it would have been possible to transform the state socialist system into an institutional setup more akin to the old, North-Western member states, and what conditions would be necessary to do so. For this reason, more space is devoted to the study of the Slovenian transition than would otherwise be warranted by the country’s economic weight.

As an independent state, Slovenia is even younger than the Baltic states, as it has existed only since 1991. Slovenian tribes arrived in the Balkans as early at the sixth century, but they lived as a part of the German-Roman Empire and, later, the Habsburg Empire. By the collapse of the Austro-Hungarian Monarchy, the industrialisation of the Slovene-inhabited regions had begun, but agriculture still dominated. Two-thirds of the Slovenian population became a part of the Kingdom of Serbs, Croats and Slovenes that was established after WWI and later of 1929 Yugoslavia, while the remaining one-third became a part of Austria and Italy and has shrunk to a minority numbering a few tens of thousands. In this new state framework, Slovenia was the most advanced unit, as Slovenian per-capita national product exceeded the Yugoslavian average by 60 per cent (Ferfil and Philips 2010: 8). Slovenia became the engine of industrialisation and benefited from the relatively large Yugoslavian internal market. This process of development was halted by the Great Depression of 1929 and later by the occupation of Yugoslavia in 1941. After WWII, Slovenia began to build up a Soviet-type planned economy, but the Tito-led state’s split with the Soviet Union also brought new economic policy solutions. The establishment of self-management in corporations was accompanied by political decentralisation; decision making moved from the national level to the level of the member republics. The abolition of the planned economy and the strengthening of ties with western economies led initially to dynamic, 5 to 7 per cent growth in Yugoslavia as a whole and, specifically, in Slovenia. This workers’ self-management or market social-
ism, however, increasingly came to be ruled by the logic of the communist political system. Statism was revived at the level of the member republics, and the institutions of self-governance were hollowed out. After the 1973 oil crisis, Yugoslavia—like Hungary—tried to keep itself afloat by relying on foreign loans. In the 1980s, in economic terms, Slovenia was already functioning as a virtual independent state that, similar to the other member republics, was effectively stagnating while struggling with inflation of 30–40 per cent, peaking at 1385 per cent in 1989 (Ferfiša and Philips 2010: 18–20). After a referendum, Slovenia announced its separation from Yugoslavia in 1991, and the predominantly Serbian Yugoslav army responded with a military assault. Owing to the ethnic homogeneity of Slovenia and the support of the West, the war lasted only ten days and ended with few losses. Following the introduction of political democracy, the transformation of the country to a market economy began. Owing to the loss of the Yugoslav markets and to the Balkan war, the economic transition sparked a recession in Slovenia, which reached its lowest point in 1991, with an 8.9 per cent drop in GDP (EBRD 1999: 73).

The Slovenian leadership chose a method of economic transition that truly fits the description of gradualism usually described in the literature, given several factors. The last Yugoslav Prime Minister, Ante Marković, embarked on radical market reforms in 1989, which led to a dramatic economic recession. Slovenian workers reacted to the first attempts at stabilisation after independence with a wave of fierce strikes. The left-leaning orientation of the majority of society was also reflected in the election results. The Liberal Democracy of Slovenia, although not the communist successor party, but a spin-off of the former young communists organisation, became the leading force in the coalition at the first free elections in 1990, and the president’s chair was taken by a reform communist politician. The unstable Western Balkan environment also may have provided an incentive for the government to avoid further shocks, and in spite of the various economic problems, the workers’ self-management system provided the foundations for the construction of a neo-corporatist decision-making system (Rojec et al. 2004; Soós 2010; Stanojevic 2005). Yugoslavian market socialism, despite the distorted nature of the market relationships, provided extra know-how at the start of the transition in comparison to the countries that transitioned directly from a planned
economy, as in the case of the reforming Hungary. Unlike the latter, however, it did not have a public debt so large as to remove any possibility of choice.

The stabilisation of the economy began in 1991 with the introduction of the independent currency, the tolar. The market reform index used by the EBRD, as well as other indexes measuring economic freedom, unanimously show that Slovenia made progress in building a market economy, but at a slower pace than the Visegrád and Baltic countries. Slovenia put in place the conditions necessary for EU membership but maintained a higher degree of state intervention (Pezdir 2006; Šušteršič 2009). The uniqueness of the Slovenian path, besides the neo-corporate nature of the employer-employee relationship, lies mainly in the country’s attitude towards privatisation and FDI. In the first step, similar to other countries, employer and employee acquisition and voucher-based privatisation represented the means of transforming ownership relationships. However, there was no “secondary” privatisation; in other words, a substantial degree of employer ownership remained, and the corporations and banks that had been nationalised after the workers’ self-management form of “social ownership” remained under state ownership. The role of FDI continued to be far more limited than in the other post-socialist countries of the EU (Soós 2010).

Until the crisis, Slovenia showed impressive performance in terms of its convergence; in 1995, its per-capita GDP was 74 per cent of the EU-27 average, which was the most favourable figure among the 10 transitioning economies, and by 2008, this figure had risen to 91 per cent (Eurostat). In terms of its innovation performance, Slovenia is also close to the EU average, at the forefront of the “post-socialist camp” (European Commission 2012); much attention has always been devoted to education, and Slovenia’s social system places it clearly among the continental countries. Although initially, a relatively expansive monetary policy was used to stimulate the economy, Slovenia nevertheless succeeded in reducing inflation, and this was the first of the countries that joined the EU in 2004 to adopt the euro in 2006.

One striking point of view in the assessment of the Slovenian path places Slovenia, based on the features of privatisation, in the same group as Russia and Ukraine (Soós 2010), although based on the results men-
tioned above, this is very formal and unconvincing preposition. Bohle and Greskovits (2012) point out that what can be observed in the Slovenian economic policy is not a general anti-FDI or protectionist attitude but rather deliberate selection. Unlike the banking and utility sectors and those based on simple work (for example, the textile and lumber industries), in the complex sectors, FDI has an important role, on a par with that ascribed to it in the Visegrád countries, which also explains Slovenia’s export performance. At the same time, the impact of the 2008 crisis shows that not even this latter, clearly positive assessment gives the complete picture. Slovenian authors, through their detailed analysis of the export structure and competitiveness traits, have long warned that Slovenian gradualism has reached its limits and that, without further reforms, the growth achieved to date is not sustainable (Pezdir 2006; Rojec et al. 2004; Šušteršič 2009). Later, in the discussion of the management of the crisis, the question of whether the Slovenian path will remain viable after the corrections or whether a change of model is unavoidable will be discussed at length.

4.6.5 South-Eastern Europe: Romania and Bulgaria

The two South-Eastern European countries took paths that were similar to each other but different from those of the other post-socialist EU countries. Initial gradualism did not lead to a development path similar to Slovenia’s; instead, the steps of liberalisation, institutionalisation, and privatisation were taken after a protracted transition.

The change in the political system in Romania swept away the most violent dictatorship in CEE. The horrors of the Ceauşescu system, including the bankrupted economy, the destruction of villages, and the attempts to absorb and exile Hungarian and Saxon minorities, were known throughout Europe. The party leader, who was in power since 1965, had built up a personal cult and maintained political oppression that, in the 1980s, was unparalleled in the region. The revolution that began in Timişoara in December 1989 brought Ceauşescu’s rule to an end quickly, and the number of fatalities topped one thousand. The president of the National Salvation Front, Ion Iliescu, set up a tribunal that sentenced Ceauşescu
and his wife, who held various political posts, to death; the sentence was carried out immediately, on 25 December 1989\textsuperscript{15} (Bottoni 2009).

This dramatic end by no means marked the beginning of a radical transformation. The communist successor party and its leader, Iliescu, won the elections and indeed remained in power until 1996. A circumstance that favoured the transformation was that, in order to achieve independence from the West, Ceauşescu had to repay the public debt, albeit at the cost of hardship for the general population. The economic slump was not exceptionally pronounced in comparison to that of the Visegrád countries, and it reached its low point in 1991 at −12.9 per cent, while inflation between 1991 and 1993 was 200–300 per cent (EBRD 1999: 73, 76). Price liberalisation and currency devaluation were not followed by structural reforms; the loss-making state-owned corporations received assistance, which temporarily slowed the growth in unemployment. Thanks to these measures, between 1993 and 1996, the economy grew by an average of 4 per cent. Privatisation got off to an awkward start; aside from the agricultural restitution, the employer and employee buyout method was used only among SMEs. The government deficit was not high (around 3 to 4 per cent), but a substantial part of the actual budgetary burdens remained hidden among debts between state corporations and tax arrears owed to the budget. It was possible to push inflation down only by overvaluing the currency. Another sign of the unsustainability of the economic processes was the growing balance of payments deficit (Scrieciu and Winker 2002: 6, 18).

Seeing these economic difficulties, the right-wing coalition that came to power in 1996 committed itself to accelerating the reforms, that is, to “shock therapy”. Prices began to be liberalised in the agricultural and energy sectors, which together with the indexing of wages and loosening of monetary policy, scaled inflation back by more than 150 per cent by 1997, returning to single digits only in 2005. The economy shrank every year between 1997 and 1999 at an average rate of 4.4 per cent. In 1998, a stabilisation program began with the support of the IMF. The privatisation programme was extended to large state corporations, which were sold off to foreign investors on a large scale. Direct assistance for the remaining state corporations was reduced, but the low energy prices and the credit guarantees, which were usually paid out of state coffers,
continued to represent concealed subsidies. Given these economic difficulties, unemployment was not exceptionally high (at approximately 10 per cent) because the agricultural sector served as a buffer (Ahrend and Martins 2003; Scrieciu and Winker 2002: 6–8).

The recession that came with the transformation dramatically increased poverty, which, in 2000, helped the left to regain power, so the results of(112,640),(992,650) the start of economic growth came to fruition when they were in government. Once again, there was an attempt to return to gradualism, but the EU accession talks that began in 2000 marked the path of the institutional reforms. The 4 to 8 per cent growth rate remained until the 2008 crisis (Eurostat). The structure of the economy developed less favourably than in the Visegrád countries. The share of agriculture, even in 2008, was the highest in the whole of the EU both in terms of GDP (6.0 per cent) and in terms of employment (28.8 per cent) (European Commission 2010a: 47). In the industrial sector, seeing the inability of the state’s heavy industrial corporations to compete, Romanian businesses were able to secure comparative advantages in the labour-intensive branches of light industry (textile, footwear, and lumber). In light of the above, it comes as no surprise that in 2011, Romania was ranked 24th in the EU in terms of its innovation performance (European Commission 2012), and the performance of its economy is made possible only by the low level of welfare provision and modest funding for education.

The trade unions responded to the economic recession with fierce strikes. Due to the state’s weak public policy and public administration performance, however, a tripartite consultation system failed to emerge. The left-wing governments were afraid of the workers’ movements, but the treaties on social dialogue never had any impact. Therefore, even if they had wanted to, the trade unions could not have pursued a moderate strategy because the governments were incapable of credibly promising any future results with the potential to offset the short-term sacrifices (Bohle and Greskovits 2012).

Bulgaria embarked on a process of building democracy after a peaceful transition. In contrast to Ceauşescu, who strove for independence even from Moscow, Bulgaria’s government had been the Soviet Union’s most faithful satellite, which did not give rise to antipathy on the part of the population. Todor Zhivkov led the Bulgarian Communist Party
between 1956 and 1989, but he did not build as extreme a personal cult as Ceauşescu. The rigid planned economy reached the limits of its capacity by the 1980s, and the Bulgarian party leadership attempted to compensate for the declining economic growth with foreign loans. As in Romania, the “nationalism card” was played here, and the oppression of the 10 per cent Turkish minority became a source of international friction. These economic and political difficulties, as well as the encouragement provided by Gorbachev’s glasnost and perestroika, led to opposition movements and mass demonstrations. In an effort to maintain power, the reformers in the party leadership removed the ageing Zhivkov, whose place was taken by the foreign minister Peter Mladenov, who entered into negotiations with the opposition. The first free election was held in 1990. A stable government was not formed until 1996, however, because in three elections, five governments did not receive a clear mandate to carry out market reforms. The dominant force was the socialist successor party, which planned to arrive at a market economy after a 20- to 25-year transition (Frye 2010).

The economic recession reached its low point in 1991, at −11.7 per cent; then, in 1994–1995, three years of shrinkage gave way to growth of approximately 2 per cent. Inflation exceeded even that of Romania, at 339.9 per cent in 1991, and did not fall much below 100 per cent in the following years. The unemployment rate was between 11 and 16 per cent throughout the 1990s (EBRD 1999: 73, 76, 205). The paradoxical reform policy could not have yielded any other result. In an economy that was geared almost entirely to supplying the Soviet markets, trade was liberalised and price controls lifted, but in 1994, controls on a number of prices were reinstated. On the one hand, the government tried to use the unified exchange rate as a nominal anchor and narrowed the monetary supply; on the other, the government supported loss-making corporations through state-owned commercial banks. A law was passed on privatisation, but in practice, company managers who were affiliated with the party state, the supporters of the successor party, benefited from a concealed privatisation process and were able to build their own corporations from the profits sucked out of the state corporations. The voucher-based privatisation scheme and employer and employee buyouts, also provided an opportunity to build up a clientele. FDI steered clear of Bulgaria,
which was not due solely to the uncertain business environment. In 1990, Bulgaria suspended the repayment of its debts; its foreign debts exceeded USD 12 billion. The negotiations and restructuring of debts took three years, and Bulgaria made its full return to the foreign capital markets around the turn of the millennium (Mihov 1999: 7–8, 38).

By 1996, the postponed reforms had pushed the country into another recession, which again ran to double figures (−10.1 per cent), while inflation shot up to over 300 per cent, with the following year’s average exceeding 1000 per cent (EBRD 1999: 73, 76). In the wake of the failures of the transition, in 1997, a strong majority of votes was scooped up by the right wing, which was committed to liberal reforms. The employer and employee buyout programs that began with the socialists were continued, but forgetting their own criticisms, voiced in opposition, the right-wing government also used these to reward their supporters. A new development was that large state corporations were also privatised either by direct sale or through the stock exchange, this time to foreigners as well (Frye 2010). The new government managed to reach agreement with the IMF and also began to implement the stabilisation program that it supported. Trade and price liberalisation continued. A key element of monetary policy was the establishment of a currency board; the lev was pegged to the Deutschmark. A disciplined fiscal policy was introduced, and tax collection was improved. Owing to these measures, inflation decreased, falling to single digits from the turn of the millennium onwards, and the banking system was also successfully stabilised (Demopoulos and Fratzekos 1998). Until the 2008 crisis, economic growth settled at a level of 5 to 6 per cent, while the unemployment rate did not fall below 10 per cent until the last few years before the crisis. The ability to sustain these results was helped by the fact that the deep political divisions abated. Interestingly, a factor in this process was that the 2001 elections were won by a new moderate right-wing party headed by the one-time Bulgarian Tsar Simeon II, who lived as an emigrant up until 1996 (Frye 2010).

The structure of the economy in Bulgaria, similar to that of Romania, is characterised by a share of agriculture that, even in 2008, exceeded that EU average, accounting for 5.5 per cent of GDP and 7.5 per cent of employment (European Commission 2010a: 47). The country’s ability to attract foreign capital increased in the 2000s, with the ratio of FDI
to GDP exceeding that of the Visegrád countries by the middle of the decade. In terms of its structure, however, as in the Baltic countries, the FDI went mainly into the financial sector and property development and less into the tradable sectors.

With regard to labour relations, welfare provision, the innovation system and education, Bulgaria’s story is very similar to that of Romania. In Bulgaria, too, workers responded initially to the economic recession and the difficulties entailed by the market reforms with strikes. The ability of the trade unions to mobilise failed to result in tripartite consultation and a neo-corporatist system. There is good reason to assume that in Bulgaria, the weakness of the state was the key factor ensuring that the agreements on social partnership were not followed by actions (Bohle and Greskovits 2012). The EU’s poorest member state clawed its way back to achieving 66 per cent of its 1989 GDP in 1998; therefore, it was able to maintain a very reduced level of welfare services and educational expenditures. In terms of innovation performance, Bulgaria is ranked 26th among the EU member states (EBRD 1999:73, European Commission 2012).

The growth of the 2000s was accompanied in both countries by (primarily external) macroeconomic imbalances, which, even before the 2008 crisis, foretold stalling growth.

4.7 A Unique Feature of the Central and Eastern European Model: Modernisation Based on FDI

Having reviewed the transitions of the individual countries, I now summarise the conclusions that can be drawn on the basis of the capitalist transformation because, when making the comparisons, I was confronted with results that are inconsistent with generally held beliefs. Additionally, this summary allows me to verify the findings regarding the CEE model made in connection with the cluster analysis. I separately scrutinise a defining features of this process, namely, the fact that the modernisation process was founded on FDI.
4.7.1 Lessons of the Transition

The current crisis in the euro area has given broad scope for Eurosceptic thinking. Taking a longer historical view, it must be emphasised that in the post-socialist countries, the opportunity for EU membership and the preparations for this membership played an exceptionally important anchoring role in the course of building the market economies. The significance of these factors was enormous from two perspectives. On the one hand—as Csaba (2009a) analyses in detail—neither the economists of the post-socialist countries nor the advisors of the international organisations were equipped to carry out the transition from socialism to capitalism. Apart from a general framework outlining a combination of stabilisation, liberalisation, institution building, and privatisation, the specific recipe adapted to the region’s characteristics was not available. In the absence of the appropriate theoretical background, after the initial steps of macroeconomic stabilisation, the adoption of community law provided a point of reference for building up the institutional system of the market economy. On the other hand, the efforts to join the EU also helped the transition to be carried through in countries where the internal power structure might have otherwise made it highly likely to become stuck in “patrimonial” (King 2007) or, to use another term, “uncoordinated” (Lane 2007) capitalism. Without EU membership, through their historical traditions and under the influence of post-communist forces, Bulgaria and Romania would have most likely drifted onto a path similar to that of Ukraine or other CIS countries. The IMF and international experts also influenced the transition, but countries turned to the IMF only as a last resort. Bulgaria’s example is a good illustration of this limited scope of influence. The IMF attempted to reach agreement for years in vain, which yielded a result only when the internal political relationships changed in response to the protracted crisis. In places where the IMF was able to act more quickly and more effectively, such as Poland or Estonia, this process was made possible by the willingness of the government and society to reform.

In the literature, the steps necessary for the transition from a state socialist economy to a capitalist market economy are commonly referred to as the “SLIP” agenda, an acronym for Stabilisation Liberalisation,
Institution building, and Privatisation. A study of the individual countries has confirmed this to be a sound interpretive framework. The literature does not, however, support the commonly held view that what took place in the region was adherence to a consistent neo-liberal recipe suggested by international organisations. Csaba (2009a) points out that the contrasting of gradualism and shock therapy in the transition literature draws attention away from the more important issues. This assessment is emphasised by a study of the transformation of the individual countries. The general frameworks of the transition were determined by theoretical insight; however, the choice of specific solutions can be much more effectively explained by the historical legacy, that is, the political and economic circumstances, than by the impact of theory.

The transformation as a whole cannot be perceived as a comprehensive course of shock therapy; the privatisation took place at a different time than did stabilisation and liberalisation, even in the Baltic countries that chose the most radical transformation. Institution building in the economic—or, more precisely, the institutional economic—sense is by no means the same as formal organisational restructuring. The permanent alteration of the rules of play and the solidification of the new institutions are clearly possible only as outcomes of a longer historical process. In terms of the speed of stabilisation, the extent of the imbalances left genuine opportunities to choose in only a handful of cases. It can be said of Czechoslovakia that, in spite of the country’s stable economic situation, Klaus announced a radical program of reforms that was—as we have seen—unacceptable for the Slovaks. In Hungary’s case, one can talk about genuine gradualism only in the sense that the reform socialist measures involved the introduction of certain market institutions. After the change in the political system, the process of liberalisation and transformation of the ownership structure took place rapidly in comparison to the region’s other countries. Romania and Bulgaria did not transform gradually, either, but instead postponed the reforms before taking the same steps that had been implemented immediately by the Baltic countries. We can talk about a deliberate gradual transformation only in the case of Slovenia, which was in a position to do so by virtue of its special characteristics, although it, too, has now reached the limit of this capacity.
Every country except Hungary experimented with the creation of national capitalism. In Hungary, this phase was omitted due to the country’s high public debt, and even the strongly nationally oriented Antall government began to sell off corporations to foreign investors. This result indicates that the key role of FDI stemmed not from any commitment to a neoliberal doctrine, but rather from a lack of capital and management knowledge. In the Baltic countries, the governments’ adherence to neoliberal economic policy was something of a means to an end; they saw in it a guarantee of emancipation from the former Soviet empire. As described above, this commitment was not the same for each country and was also proportionate to how threatened the countries felt by the Russian minority. A neoliberal conviction without any external compulsion was found where the Klaus government was concerned, but the launch of voucher-based privatisation showed that the government did not want to give preference to foreign capital. However, every country except Slovenia sooner or later made an effort to attract FDI. In Slovenia, however, non-foreign-owned property means state property, the well-known drawbacks of which had become serious and inevitable by the time of the 2008 crisis.

The importance of the historic legacy is also underlined by the development of labour relations. Nowhere—with the exception of Slovenia—did the workers’ movements, temporarily strengthened by the change of political system, give rise to neo-corporatist employer and employee relationships similar to those of Western Europe. Thus, the region returned to the historic path that was characterised by weak representation of workers’ interests, which is modified more or less as a formality by the requirements of EU laws.

### 4.7.2 Growth Opportunities and Limits in the Central and Eastern European Model

The literature fully agrees that a defining feature of the CEE transformation was modernisation based on FDI. In a comparison of the EU-27 member states, the unique character of the post-socialist member states lies not in the high volume of FDI relative to GDP, but in the asymmetry
of the sizes of the inward and outward FDI stocks (Table A.9). Among the OMS, the ratio of inward to outward FDI stocks does not exceed two, even in the countries with the lowest per capita GDP (Greece, Portugal); among the post-socialist countries, only Slovenia has a ratio below two, accompanied by the lowest GDP-proportionate rates, while for the others, these rates are between 2.82 and 61.53 (Romania’s and Bulgaria’s are above 60).

As seen above, King (2007) places emphasis on dependency when talking about the Visegrád states as liberal dependent countries. Nölke and Vliegenhart (2009) simply view dependence on FDI as an element that defines every material aspect of their model elaborated for the Visegrád countries. Bohle and Greskovits (2012) paint a more nuanced picture, pointing to the significance of the distribution of FDI between the sectors; that is, whether it went into tradable sectors because only in this case can it support sustainable economic growth.

The Commission produced an assessment on the fifth anniversary of the EU, in which it sees the influx of FDI as a source of successful integration of the NMS (European Commission 2009b). In the midst of the crisis, the World Bank’s experts published a book on how the European model could be restored to its former glory, and in this, the successful FDI-based model of the CEE countries is compared with the unsuccessful model of the Mediterranean countries based on portfolio and other capital flows (Gill and Raiser 2012).

In order to assess the growth prospects of the CEE countries, we need to examine in more detail whether, based on experience to date, the region’s long-term convergence can be ensured by FDI-based economic development. According to economic theory, FDI supports growth in the receiving country’s productivity via two channels: directly through investments on the one hand and indirectly through the spill over effect on the other. The latter is especially important because this is how FDI can be expected to promote the modernisation of the domestic economy. A great many empirical studies have been made of these impacts on the CEE countries. From two wide-ranging literature reviews, it can be inferred that in the vertical backward linkages, the impact of FDI was clearly productivity boosting, while in the horizontal linkages, the majority of the studies could demonstrate only a weak relationship (Gorodnichenko et al. 2007;
Hanousek et al. (2010). A study by the ECB also listed extensively the often-contradictory empirical analyses found in the literature. Their own measurement found a positive linkage between FDI influx and productivity growth; however, the authors note that this is not automatic, but depends on the absorption capacity of the receiving country (Bijsterbosch and Kolasa 2009).

The aforementioned EU research (European Commission 2009b) and that of the World Bank both take into account the results of econometric studies on the role of FDI. However, they go beyond these and evaluate the development of the CEE countries along the lines of a very similar logic. According to both analyses, the chief strength of this model is that, in addition to facilitating economic growth, it facilitated the emergence of a capital-intensive export structure conforming to high technological standards. The openness of trade, the influx of FDI and the institutional development due to the EU accession were the main drivers of growth. The Commission’s report highlights that, “during the period 2000–2008 accession the NMS an extra growth boost … Model simulations suggest … the NMS enjoy a 50–100 basis point advantage relative to other emerging economies with comparable fundamentals” (European Commission 2009b: 17). The Commission’s report also examines the processes from the perspective of the OMS. On the one hand, few jobs were lost to the relocation of production because some 70 per cent of the FDI went into market acquisition and services. On the other hand, in many sectors, it was possible to maintain competitiveness only by moving production facilities, while retaining the part of production that required specialist know-how, technological development, and ownership. The report does not, however, mention what kind of limitation these features of the FDI movement could represent in the longer term from the perspective of the convergence of the CEE countries.

Gill and Raiser (2012) emphasise that Europe is the only region in the world in which capital flows in the “right” direction; that is, into the poorer countries with a higher growth rate. They attribute the success of the convergence to the fact that the companies of the Nordic and North-Western countries restructured their value chain after the fall of communism. These companies relocated their assembly operations to the NMS, and the low wages there strengthened their competitiveness. This was also
beneficial for the NMS because it allowed them to integrate the global economy with increased productivity. They regard the EU as a three-speed union, with the leading Nordic and North-Western countries, the eastern followers, and the laggard southern countries.

None of the analyses asks the question of whether this model makes it possible to achieve, in the longer term, the ultimate goal of the CEE countries, namely, to converge with the living standards of the Western European countries. These studies outline a division of labour, in terms of production, between the North-Western countries and the CEE countries. Although this does not preclude the possibility of subsidiaries in the latter countries climbing higher up the value chain, there is no reason to assume that the parent companies will surrender their key positions in innovation, technology development, and strategic decision-making. The development of domestic companies—as the empirical studies quoted above have shown—is promoted considerably only among the suppliers by the technological transfer that comes with FDI; the horizontal impact is minimal. The third opportunity could be the accumulation of capital based on domestic savings, but in CEE, the high level of FDI influx was accompanied by a low level of savings, unlike in the emerging Asian countries.

As shown earlier in relation to Ireland, how difficult it is in an emerging country, even with several decades of deliberate economic policy, to narrow the productivity gaps between domestic and foreign companies. Empirical surveys show that even in the developed countries, there is a general tendency for the economic performance of multinational corporations to be better than that of domestic companies. Possible reasons for this include the fact that multinational companies are present in the sectors with a higher R&D content than the domestic companies; however, the state incentives for FDI could also put them at an advantage. From this, Bellak (2004) draws the conclusion that the differences in performance between the companies are determined not by their foreign or domestic nature, but rather by whether they are multinational or bound to a national economy. Therefore, economic policy should concentrate not on ownership, but on eliminating the performance gap. This distinction is appropriate in the developed countries. However, in the case of emerging countries that are weak in capital, the two approaches over-
lap considerably. The comparison of Ireland and Sweden by Andreoss-O’Callaghan and Lenihan (2011) showed that, in contrast to Ireland, Sweden’s foreign companies are more evenly distributed across the industrial and services sectors, while the export-oriented and high-tech sectors are dominated by domestic companies. There are no data for a wider-ranging international comparison, but a good approach to the problem is to compare the productivity of the large corporate and SME sectors, for which EU data sources are available. The 2007 data are still unaffected by the impact of the crisis (Fig. 4.1).

Figure 4.1 clearly shows that—with the exception of Poland—the gap between the large corporate and SME sectors is the greatest in the countries that are struggling with the greatest difficulties in the present crisis. Among the post-socialist countries where FDI was on a large scale and flowed into the manufacturing industry and where the contribution of the large corporate sector to GDP matches or exceeds the EU average, it was possible in Slovakia only to reduce the productivity gap between the SME sector and the large corporations to the level of the North-Western member states. The reason why a far weaker performance is shown in Slovakia at the level of the medium-sized corporations cannot be deduced from the statistical data. Estonia and Latvia lack an FDI-based large corporate sector similar to that of the Visegrád states, which is also related to the small size of the former two countries.

Overall, the development model of the CEE countries undoubtedly led to successes. If, from the period after the transformational recession, we treat 1995 as the baseline (this, importantly, being the first available data in the Eurostat database) and compare this with the year before the crisis, then in terms both of GDP and of final consumption, which better expresses the prosperity of the population, with the exception of the two richest states, the Czech Republic and Slovenia, a growth of 10–30 percentage points could be observed. A comparison with the 1989 baseline could also be made, but due both to the quality of the statistical data from that time and to the quality of the commodities making up GDP back then, this comparison is suitable only as a very approximate guide (Table 4.2).

However, it is also clear from the foregoing that the features of the current CEE model do not support the thinking that prevails in the EU doc-


Fig. 4.1 Difference in labour productivity between large and medium-sized enterprises and between large companies and the SME sector, relative to the average for the whole economy, as percentage points, in 2007. Source: Author’s calculation based on Wymenga et al. (2011). Note: Labour productivity is measured in terms of gross added value per employed person

documents (for example, the Commission report discussed above), namely, that the new, post-socialist member states are on a growth path that only from the OMS differs in quantitative terms and that convergence is only a matter of time. We can realistically define the current position
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Source: AMECO, Eurostat, EBRD (2008: 13)

Note: Actual individual final consumption is equal to expenditures on the consumption of goods and services by households and non-profit institutions serving households and in-kind social transfers.
and future growth of the NMS by applying Porter’s (1998) competitive advantage theory presented in Part I. To use Porter’s terminology, the CEE economies are in the factor-driven stage because we have to classify them on the basis of the home-based economy.  

On the basis of Porter’s (1998) theory, for the transition to long-term convergence and the innovation-driven stage—which was the goal of the EU’s Lisbon Strategy and, later, the Europe 2020 strategy—FDI, the presence of foreign multinational corporations is necessary, but not in itself sufficient. Multinational corporations position their activities, which are present in the various phases of the value chain, in the various countries in accordance with their global strategy. In other words, the domestic base, as described above, remains in the home country in which the company has its seat. An emerging economy that bases its strategy only on multinational corporations could be destined to remain a factor-driven economy. In certain phases of development, the focus of economic policy must shift towards indigenous corporations.

In other words, the economic policy framework that the EU tends to designate (for example, in the study quoted several times above, ensuring macroeconomic stability, a sustainable balance of payments, effective use of subsidies from EU funds, and so on) is necessary, but not in itself sufficient to ensure that the NMS progress in the direction of convergence in the long term. The present institutional frameworks are adequate only for a growth path that perpetuates asymmetric mutual dependency between the OMS and NMS. The most important promise of the change in the political system was that the CEE countries, which were left out of the mainstream of development after the WWII, could converge with the more fortunate western countries within a historically foreseeable time frame.

The task of economics and political economy is to answer the question of what path can be taken by the NMS towards an innovation-driven, home-based economy. Among the countries that converged only very late, after WWII, only Finland shows convincing evidence that it has succeeded in entering this stage. Finland, however, had a means of travelling the path from the factor-driven economy to the innovation-driven economy. The global economic environment of the time made it possible, during the investment-driven stage, for the state—partly through
its ownership of large corporations—to play a key role in the modernisation process, and the source of capital accumulation was chiefly national capital. Even still, we are only talking about economic factors, and we have not gone into detail regarding the differences in terms of social capital relative to the CEE countries.\textsuperscript{17}

If one aims to maintain convergence as a defining element of the system of economic policy targets of the post-socialist member states, a way to supplement the FDI-based model in the current stage of global economic and EU integration with a set of tools that facilitate the development of an innovation-driven, home-based economy in the original Porterian sense must be found. Additionally, all this should be achieved by building on genuinely extant social institutions, norms and attitudes and genuinely extant social capital.

If the 2008 crisis had not occurred, then due to the low income levels of the post-socialist countries, these questions might have remained theoretical for a long time, and the present model could have assured growth potential for a long time to come. The Czech Republic and Slovenia might have been the experimental countries that either became stuck at the current level\textsuperscript{18} or were capable of joining the core countries. The crisis, however, is transforming the entire landscape of the global economy, and the development opportunities available to the CEE member states need to be reassessed in this light, as does the question of whether, in the wake of the crisis, the individual countries in the region have embarked on differing paths of development or whether they can still be interpreted in the framework of a single model.

Notes

1. The number of clusters, based on Akaike’s information criterion and its relative change, is almost always two.
2. The single cluster of new member states would have broken up only in the seven-cluster version, without any definitive economic explanation.
3. The Swedish reforms are discussed in detail by Freeman et al. (2010), the Danish reforms by J. G. Andersen (2011).
4. The authors’ subtitle—Can the Bumblebee Keep Flying?—indicates that we are dealing here with something of a curiosity compared to the eco-
nomic mainstream. The analogy was borrowed from the Swedish prime minister. In theory, bumblebees should not be able to fly, given their large bodies and tiny wings. The IMF’s meticulous authors restore the scientific world order at the end of their work, referring to a study in which physicists explain how such flight is indeed possible.

5. Hereinafter, the Eurostat on-line database (http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/themes) is referred to as “Eurostat”.

6. When analysing social protection, it has been indicated that the process of liberalisation was not complete even at this time; due to political resistance, the Thatcher government stepped back from privatising the National Health Service (Pierson 1996).


8. A 30 per cent threshold was determined necessary for initiating a mandatory takeover offer (Houwing and Vandaele 2011: 130).

9. It is an interesting comparison that the community support provided to Spain—not including the agricultural fund—between 1986 and 2006 accounted for three times as much as the amount of the Marshall Plan (Royo 2008: 48).


11. For a related analysis of the Estonian Research and Development Council, see Tiitset al. (2003).


13. There are significant differences in GDP data among the sources. The data in this study are based on the Report of EBRD from 1999, on the one hand, because this organisation specialises in the research of this region and, on the other hand, by that time, corrections had been made. It is especially important to note because according to Mygind (1997: 58–59), on the basis of earlier EBRD data, the decline was more than ten percentage points greater in case of Estonia and Lithuania. These years are not included in the online database of Eurostat.

14. The public debt of all of Yugoslavia was 15.99 billion USD at the end of 1991, and the part controlled by the federation (one-third) was distributed in the agreement on succession issues. The successor states began negotiations with the international organisations and the “Paris Club” creditors. Negotiations had been conducted since 1988 with the “London Club” (which included the private creditors) about debt restructuring processes,
and as a result, by mid-1993, the debt of 7.3 billion USD shrank to 4.3 billion USD. This result was greatly facilitated by the fact that the Yugoslavian government bonds were purchased for 20 per cent of their book value on the secondary market; thus, basically, the states themselves acquired their own debt (Stanič 2001: 758–761).

15. Please note that for those Romanians who belong to the Romanian Orthodox Church, the day of the execution was an ordinary day, not Christmas day.

16. The competitiveness report of the World Economic Forum places these countries higher in the classification—with the exception of Bulgaria—and these countries are in the innovation-driven stage or are on their way there, that is, in a transition phase (Schwab 2009). However, in the report, the aspects of the assessment broke away entirely from the original theory of Porter (1998); the basis of comparison was per capita GDP compared at market rate and the exports of mineral products as a share of overall exports. In this study, in assessing the prospect of the CEE model, Porter’s aspects are more relevant; therefore, these aspects will be reviewed.

17. The survey of Eurobarometer in 2004 reveals the differences in social capital among the member states rather well (Eurobarometer 2005).

18. The Czech Republic has not been able catch up as far as final consumption is concerned since 1995 (Table 4.2); the structural problems that were hiding behind Slovenia’s spectacular economic performance would have spoiled the achieved consumption level anyhow, even without the crisis.

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