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Varieties of Capitalism and Economic Growth in East-Central Europe

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1. Introduction

The four east-central European countries (Czechia, Hungary, Poland and Slovakia) have been slowly, in some cases painfully slowly, catching up in terms of GDP levels with their richer western European neighbours since 1989. However, they still remain clearly at a lower level in terms of innovative capacity and technology. They are not, and not likely soon to become, world leaders in any significant area.

The aim of this paper is to explore the obstacles to a higher level of economic performance using a comparative political economy approach. The focus is on the performance of an economic system, but that cannot be narrowly understood as a subject for a purely economic analysis. It needs a multi-disciplinary approach for two reasons. The first is that an economic system is created and changes under pressures from outside the economic sphere, most obviously from the political sphere. The second is that its behaviour and performance depend on policy frameworks and institutional features.

This is recognised in existing notions of varieties of capitalism, such as that of Hall and Soskice (2001) which aims to show clear links between forms of innovation and institutional features. A critical assessment of the application of that and other versions is given elsewhere (Myant 2016b, Drahokoupil and Myant 2016, Myant 2016a). A major weakness when applied to CEECs is that these approaches emphasise stability and permanence of institutional influences. Rather than concentrating on static classification, it appears more productive to concentrate on tendencies and forces that drive development and change. CEECs then appear to have passed through more than one variety of capitalism in the period since 1989, with different implications for economic performance. They are still undergoing institutional development and change which may lead to a variety of outcomes in terms of economic performance.

2. A new/old starting point

The first task is to develop a framework that is simple enough to be intelligible and manageable, that can be applied to show similarities and differences between countries and that can incorporate forces for both stability and change.

The starting point suggesting here is actually rather old, going back to an abstract and simple model of a clearly non-viable variety of capitalism, taken from Marx (Capital, Vol.1, Chapter 32). In fact, he hardly used the term 'capitalism', preferring 'capitalist mode of production', which is consistent with a focus on a narrower economic system rather than social organisation as a whole. That narrow focus is consistent with his assumption of only one variety of capitalism. A positive feature is that his model is all about change and forces for change. A negative side to this is that there is nothing about stability and forces for stability, a point that will be referred to below as one of many reasons for developing his framework into something substantially different.

The story can be put in schematic form;
- a capitalist economy brings growth and also social transformation. Those are logical consequences of how the economic system operates, with competition between units driving innovation and expansion.
- growth and competition lead to change in the economic structure, with greater concentration as rival capitalists destroy each other: the basis is thereby created for a new economic system without dispersed ownership,

- economic change in turn transforms the social structure through the polarisation of society and creation of a homogenous, propertyless working class,
- social change creates the basis for political change as the working class, united in its social position, revolts against capitalism, in turn transforming the economic system.

The denouement is described in colourful language;
'The monopoly of capital becomes a fetter upon the mode of production, which has sprung up and flourished along with, and under it. Centralisation of the means of production and socialisation of labour at last reach a point where they become incompatible with their capitalist integument. This integument is burst asunder. The knell of capitalist private property sounds. The expropriators are expropriated.' (Marx, 1971, pp.762-3).

To take this forward, we need to identify the 'right' and 'wrong' elements. What he describes is not a viable variety of capitalism, as indicated by his unfulfilled prediction that it must come to an end thanks to a fairly straightforward development process. Reality has been much more complex with capitalisms changing, adapting and ending only temporarily and in some parts of the world. So he must have got something wrong. Viable forms must somehow differ from this.

Nevertheless, combining economics, sociology and politics offers a lot. Unfortunately, nobody seems to have done it better since. The problem is that there are weaknesses in his analyses of economics, sociology and politics. Putting the mistakes right provides the makings of an applicable framework. It is relatively clear how to do this because his mistakes are largely a result of oversimplification. This is set out below under four key points;

1. Following Marx, the central subject matter is the economic system, capitalism as narrowly defined. This is less clear in some varieties of capitalism approaches. Hall and Soskice, for example, have five institutional forms with no obvious hierarchy or

indication of where drivers for change should be sought. In Marx's version, the economic system itself has an internal logic (leading to growth and development), that also impacts on the social structure and on politics. These then react back on the economic system (dramatically, they end it). So although the key question remains the nature of that economic system, it is set within the context of a wider social development.
We should keep with that central focus, but it is inadequate alone for understanding in full economic performance which depends on more than just an economic system as narrowly understood.

2. There are oversimplifications in the schematisation of the system's development. There is a tendency towards concentration of capital, but there are also tendencies in the opposite direction. There is continuous creation both of new firms set for rapid expansion and of small, independent businesses. The nature and extent of these processes varies quite a lot, depending on features of the kind of capitalism, including the levels and kinds of expertise, the ease of access to different kinds of credit, various elements of government policies and entrenched attitudes in society.

Once concentration is no longer assumed to be a fact – it should appear just as one tendency – then the assumptions both of centralisation providing an organisational basis for a new system and of polarisation in society, with all its political implications, no longer hold. We are in a more complex and varied world of diverse and conflicting tendencies.

3. The transformations of social structures are partly consequences of economic development, but are greater complexity of the latter is one of the factors leading to more varied forms for the former than suggested in Marx's version. Even in so far as there is destruction of ‘old’ small producers, and even if much of the working population becomes employees, they are not one homogeneous mass. Technological development has not led to universal deskilling and simplification of work tasks. Instead,

development has seen society become highly differentiated economically and socially. Thus here too, the vision of a simple process of polarisation is wrong.

4. The big systemic change, the end of capitalism, is brought about by politics, not by economic failure. The wording is somewhat ambiguous, both here and elsewhere. However, we do not see an economic system collapsing for purely economic reasons. The process of its transformation requires interventions from the political sphere.

However, the implications of political development for the economic system are much less clear-cut than Marx postulated. Political life is more complex and open, thanks to universal suffrage and the development of mass political parties, interest representation, ‘civil society’ and all that we are familiar with today. Political thinking is not driven by economic interests alone, although they are extremely important, as it has been shaped over long historical periods.

Taking these points together, the question then becomes one not just of 'ending', but rather one of ‘reforming’ capitalism, finding ways for it to adapt, evolve and function more effectively and more socially. It can adapt, developing new organisational forms (joint-stock companies, financial systems), with recognition of different social interests (recognising collective bargaining) and, not least, with a greater role for the state in organising and regulating the economic system, in encouraging particular directions of development and in attenuating the negative economic and social effects of the free market.

This makes a narrow view of an economic system confined only to private ownership and market relations inadequate. We need to incorporate the political sphere both in mediating changes to the economic system (narrowly defined) and in contributing through state activity to its behaviour and performance.

So, to sum up the links between economic, social and political development and how they impact on the economic system;

1. We are interested in economics to answer specific questions;
- how does the system ‘work’ economically, leading to growth and development?
- what changes does economic development bring to the economic, and then the social, structures?

2. We are interested in social change for how it affects policy making and politics;
- what social groups are increasing or declining and how are their interests expressed? In a world of universal suffrage and diverse means and forms of interest representation, this is more complex than just 'class struggle' between two sides.
- how do interests link to political programmes and political thinking?

3. We are interested in politics for how it affects the economic system;
- where do ideas on economic and social policy come from? How have they developed and taken different forms, reflecting general and specific features of countries' histories?
- what measures are adopted to attenuate the effects of the market, to improve its functioning and to overcome the economic system’s barriers and weaknesses, or even to transform that system into something radically different? What practical effect do such measures have?

There are differences in all of these that mark out differences between capitalisms. CEECs have a lot in common with each other that distinguishes them from other countries. There are also differences between CEECs that a satisfactory framework should be capable of incorporating and explaining in terms of their recent, and more distant, pasts.

The framework developed here is intended to be simple enough to be manageable but also more complete than others available. We can contrast it with three others;

Hall and Soskice (1971) see stability coming through institutions. Their classifications are much more detailed, but they do not include the implications of economic development, the reality of conflict and the forces for change which seem essential for looking at CEECs.

The regulation theorists (Aglietta, Boyer) and others in the broad field of international political economy emphasise diversity in kinds of capitalisms and recognise that market systems function within frameworks of regulation that depend on more than the economic system as narrowly understood. However, their focus has been more on broader sweeps of history and changes in capitalism at the international level. That is less relevant here. The international environment has changed compared with that of 1989 and there were constraints and pressures from outside, but the most relevant forms of economic internationalisation in this period – trade and FDI – were well-developed in earlier decades. The development of types of capitalism in this period were most dependent on internal political developments and the viability of specific elements of economic systems.

Bohle and Greskovits (2012) build from Polanyi to focus on different ways of attenuating the effects of the free market. Stability (which is not guaranteed) comes through politics, depending on past histories, strengths of social forces and the like. That appears in the present context as one part of the story. The missing element is the economic dimension. There is nothing on a logic of economic development and what it leads to.

3. Applying to CEECs

The interaction between economic, social and political changes can be followed starting with the big changes of 1989-1990. What follows is a process of development and change, continually creating and transforming. It would be attractive to express this in definable stages, each one somehow reaching its limits and creating the basis for a following stage. Such neatness is disrupted by the lack of coincidence between the courses of change in the three spheres. Each to a certain extent leads its own independent life at its own speed. There is not a single motor of change, such as the 'capital accumulation' favoured in derivatives of regulation theory. There are common tendencies and pressures that are similar across the countries under review, but they need not run in parallel. Privatisation, emergence of new businesses, inflow of FDI, transformation of welfare provision, reductions in personal income tax, among other phenomena, appear in all countries but at slightly different times and reflecting different combinations of economic and political forces.

4. Politics in command

The starting point is not a capitalist economic system in any meaningful sense. A rather different economic system is ending and being replaced thanks to intervention from the political sphere. Thus in this first phase it appears that 'politics is in command'. However, it was politics with only the key elements of democracy and still without informed input from the public and from representatives of social interests. That was the legacy of 40 years of communist rule and marks a crucial and lasting difference from western Europe. There were differences in economic level and economic structures, but the difference in societies' ability to input into policy making were enormous.

That 40 year period without in the widest sense, has proved a serious weakness. Its lasting results can be seen in the instability of politics and reliance on simplistic and ill-informed ideas for major decisions of lasting importance. There were differences between CEECs, with more continuity from the pre-communist period in intellectual life and more diversity in political thinking in the communist period in Poland and Hungary than in Czechoslovakia. There was also more scope for independent input from interest representation in Poland. This made a tangible difference to post-1989 development, but the general picture is similar in all the four countries.

Returning to the early period, this weakness of input from outside a political elite was not seen as a weakness from all sides. The term 'extraordinary politics' was used by Balcerowicz in a positive sense to indicate a period before 'normal' politics could take over. He saw it as a chance to make changes that would otherwise be prevented by opposition from social interests. It fits with the view derivable from neo-classical economics of social interests disrupting the otherwise beneficial functioning of markets.

Our interest here is in what happens during that period and how it contributed to creating permanent (or as it turned out sometimes less permanent) features of the emerging varieties of capitalism. This differs from a more common political science view of following development towards a 'normal politics' of 'consolidated' democracy with functioning competing parties and mechanisms of democratic control over power. That process does take place gradually, but not completely autonomously. It is itself influenced by the effects of economic and social development that follow the creation of the basics of the new economic systems in this early period.

There are reservations to the notion of an uncontrolled elite. It was not homogeneous or united, there were differences in its origins between countries and those who came to power needed to command public confidence. Nevertheless, a great deal was decided without input from outside the structures of power by people who were trusted not for the details of their policy proposals but because they represented in very general terms what was seen as a positive change from the past.

The thinking of this new elite was therefore crucial for setting the first policy directions and for this we can identify two important inputs (cf Myant and Drahokoupil 2014). One, shared widely across society, was an implicit critique of the old system without clear policy implications. The economic system was seen as having failed to provide high living standards and fair and adequate social provision. The second was a (roughly) matching economic theory, leading to exaggerated faith in the power of the market, free enterprise and private ownership. That was the simple solution that could claim expert backing – in abstract economic theories – and that could win public confidence for its advocates as marking a decisive break from the past.

It is important to recognise that speedy liberalisation measures, characterised by some as 'shock therapy', confronted opposition voices either before implementation or shortly after implementation and Hungary pursued a more cautious initial policy than either Poland or Czechoslovakia. ‘Extraordinary politics’ could only bring results because the policies had a degree of resonance with popular thinking. Even if the details of policies were neither widely discussed nor widely understood, their authors needed to have public trust.

Poland provides a striking example (Myant 1993: 82-6). The first major public control over the new economic direction in 1989 was a parliamentary debate (8 September 1989) where Balcerowicz won support for his idea 'to shut our eyes and jump into the hole, without checking either the state of the water or the depth of the drop'. This followed a visit from Jeffrey Sachs who outlined the policies, albeit in very crude outline. While the latter was speaking Jacek Kuroń, a figure associated with the left of the Solidarity spectrum, defended his proposals; 'I don't know much about what he is arguing for, but listening to it I know it has political value'. Here was a way forward that could claim credentials and win public confidence.

A further reservation is that disunity of elites, under conditions of limited public involvement and discussion, led to rather different kinds of outcomes in different policy fields. In some consultation with social interests and social pressures were present. This was very clear in the case of employment relations in Czechoslovakia where trade unions (admittedly the only significant organisations in existence at the start) and international agencies were involved in creating the new system (Myant 2016a). The free-market economists kept to directly economic issues leaving others, more social-democratic in outlook, to set the pace elsewhere. That was also a prudent tactical approach in view of general fears of social unrest which might disrupt creation of the foundations of a market economy. At least the need for some kind of social safety net was recognised: Kuroń, as Minister for Labour, firmly promised that and other measures were taken too to facilitate more early retirements for those facing redundancy in traditional industries.

However, as the next sections demonstrate, a striking feature of many of the changes in the early period was their lack of permanence. This was not a coherent transition from one system to another. 'Extraordinary politics' created features that were weakly imbedded in society and soon subject to revision, sometimes with arguments that they had failed and sometimes without.

'Failure' can be argued most clearly for economic policy measures. Privatisation was the supreme example, but the same point applies more widely. Weakly imbedded features include institutional forms such as tripartite structures (soon transformed and weakened or forgotten altogether while similar structures were decidedly more permanent in a number of western European countries) and much of public sector activity. Repeatedly, especially where there was no continuity from the communist past, the dominant tendency was to move towards the simple non-interventionist and free-market solutions. Without clarity on what the state's role should be, the preference was for as small a state as possible. That also matched a definite political choice to ignore the experiences of an active state role in many western European countries.

These arguments are followed in relation to the emerging economic system and the development of public services and public spending.

5. Creation of an economic system

The most important initial changes for the economic system were liberalisation to allow freeing of prices, economic independence for enterprises, creation of private businesses and rapid opening to the outside world. The starting points were not identical – Poland both had more free prices and more private enterprise than the other CEECs before 1990 – but the broad picture by the early 1990s was similar across all countries. This created an economic system with a new logic and new constraint, international competition. The need for enterprises to survive in an open economy led to a shift in economic structure towards raw materials, simpler products and outward-processing trade. The technological level appeared to be downgraded relative to the state socialist period.

Enterprises hoping to continue producing more sophisticated products could not compete internationally due to low levels of technology, poor access to finance (exacerbated by macroeconomic policies), weak integration into international networks and a poor institutional environment. Thus the new economic system pointed to the failure of significant parts of the economy inherited from the past, threatening serious social dislocation with no obvious basis for long-term prosperity.

There are several possible examples of countries that have developed rapidly with various degrees of interventionist policies. Whether or not such options existed for CEECs, any sort of systematic industrial policy was rejected (Poland's Minister for

Industry in the early period, Tadeusz Syryjczyk, famously believed that the only good industrial policy was no policy at all) and all faith placed in privatisation. Thus there was much less formal state support to industrial upgrading than in western Europe. The result was a rapid growth in private ownership as a share of economic activity, as shown in Table 1, with no further conception of how economic success could be promoted. The differences between countries reflect the high share of private agriculture in pre-1989 Poland and the slower pace of privatisation in that country.

Table 1 Approximate shares of the private sector in GDP in CEECs

	1989	1996	2008
Cz	5	75	80
Hu	5	70	80
Pl	30	60	75
sk	5	70	80

Source: EBRD

There were differences between countries in the speed and content of privatisation policies, but they did not fundamentally alter the final outcome, only finding more or less tortuous routes to get there. Czechia went furthest in finding speedy means of transferring assets into domestic private ownership – by a voucher method and by sales to private individuals who often covered the costs out of the enterprises' own resources. This was done without public involvement in decisions. Instead of creating stable ownership, still less investment in and modernisation of enterprises, the distribution of shares to the population created an environment for rapid share dealing and high levels of enterprise debt as they struggled to survive.

Myths have grown up about this Czech capitalism of the 1990s with a widely accepted view that it amounted to no change from previous state ownership. Banks remained under partial, or majority, state ownership. Banks became the main owners of investment funds that in turn owned privatised enterprises. Thus the state, we are told, remained in control and enterprises remained unreformed.

This bares little relationship to the history of the big Czech enterprises inherited from the past and privatised in the 1990s (Myant 2003). They failed because of their low initial starting levels, lack of finance for new investment, lack of contact with international networks and amateurish managements which proved incapable of formulating serious enterprise strategies. Banks did not prop up failing private enterprises in any systematic way, some indulging in speculative share dealing and helping the government's determination to privatise as much as was possible by giving credits to favoured individuals who could thereby buy shares. The myth mentioned above matched with a simplistic belief that private ownership must solve an enterprise’s problems so that when it does not it is assumed that privatisation has somehow been incomplete.

Czech development was somewhat different from that in the other CEECs, including Slovakia, in the strength of its ‘national’ capitalism phase. Poland and Hungary avoided voucher privatisation, partly because a better informed community of economists contained many more sceptics. Their big enterprises were also worse placed, with even less chance of standing up in international markets and competition. However, the political opposition to speedy privatisation in Poland was not linked to a systematic alternative and attempts to formulate one were seriously hampered by the pressures from international agencies and conditions attached to debt relief. Similarly in Hungary, solving the international debt problem pushed policy towards privatisation by direct sales to foreign companies.

6. Through the 1990s

In line with the framework set out earlier, we now follow the development logic of the economic system emerging after 1989. That means asking whether it would be characterised by growth and structural change and what implications that would have for the social structure. In fact, rather than one economic system, the economies of the four CEECs in this period can best be seen as a combination of four segments, each with different logics of development and each with different implications for the social structure.

These were a state-owned sector, lacking long-term prospects because the assumed necessity of privatisation, despite often quite good economic performance, and not discussed further here; national capitalism, derived from the privatisation of large enterprises inherited from the past and set to fail; multinational companies, resulting from privatisation into foreign ownership and, increasingly, new greenfield investments; new, smaller domestic enterprises. These last two were to prove viable while the first two were not. The fates of these economic segments carried potential political implications, with disappearance of large enterprises signalling a weakened potential for a collective working class voice while the rise of smaller domestic enterprises brought a strengthened neo-liberal agenda. The rise of multinational companies had more ambiguous political implications.

The first viable part was the foreign-owned enterprises which could overcome the problems encountered by domestically-owned enterprises. Their significance is taken up later, as they became more important in the next decade. The second viable part was smaller, domestically-oriented businesses. These appeared very rapidly, following political decisions to free private enterprise. Table 2 presents comparative figures across CEECs, including some western European countries where similar data are available. They show similarities in levels.

Evidently, a significant domestic business class emerged quite quickly, represented especially by the individual employers. Not all of the self-employed need have high incomes. Even the employers were not big capitalists in world terms and few were involved in international competition, but they could become a source for economic policy thinking, going beyond general faith in a free market, that had not been articulated in detail in 1990.

This rise in domestic businesses, and also widening differentials in established enterprises, led to an increase in income inequalities, shown by Gini coefficients in Table 3. Western European levels were around 30, with for example Sweden recording 27 in 2012. This again suggests an expanding base for a political agenda favourable to those with high incomes at a time when declining large-scale industry was weakening the most natural social base for an opposing policy agenda. It is the opposite of the progressive proletarianisation foreseen by Marx.

Table 2 Employers and self-employed as percentage of economically active population, excluding agriculture

	employers	Employers plus self employed
Cz, 1999	3.7	12.9
Hu, 2004	3.4	12.0
Pl, 2000	3.4	10.5
Sk, 2003	2.6	8.7
Fr, 2005	3.6	7.2
Be, 2003	4.0	11.5

Source: ILO Laborsta
Note: only some years and countries are available for comparison

Table 3 Income inequality, measured by Gini coefficients

	1987-9	1993-6	2012-4
Cz	19.4	26.6	26.1
Hu	21.0	27.9	30.6
Pl	26.9	32.7	32.1

sk	19.5	25.8	26.1

Source: World Bank, World Development Indicators, http://data.worldbank.org/indicator/SI.POV.GINI

Notes: Income inequality appears to be derived from per capita household incomes.

Data are not available for every year. Numbers relate to one year within the indicated period.

The post-privatisation segment that proved nonviable was the larger enterprises and banks, linked together because enterprises in trouble built up bad debt. In all countries steps were taken at various times to bail out banks and to help big enterprises survive, whether in private or state ownership. In Czechia there were more important enterprises in domestic private ownership, reflecting that country's stronger inherited base in more modern industries and the absence of pressure to sell off enterprises to foreign owners to pay off past debts. Czechia therefore had the most clearly defined national capitalism phase. It ended most clearly in a terminal crisis that brought intervention, and a major change in direction, from the political sphere in 1999.

There is little to be gained from trying to set this emerging, and nonviable, form of capitalism in the 1990s in CEECs against notions of a coordinated, or a liberal, market economy. Ownership moved quickly, leading not to a big role for shareholders but rather to concentration of power to individual entrepreneurs. Stock markets then became of very limited importance. Bank credits were important, but in financing speculative activities rather than productive investment of which there was very little. Legal controls were weak, partly because they need time and acceptance to become effective but also because laxity was accepted by political leaders as a means to enable favoured entrepreneurs to take power over enterprises. National capitalism in this case was more like a form of capitalism from the distant past than the varieties described for advanced countries today.

The end of Czech national capitalism followed a change in government and a political decision to change direction, placing faith from then on in inward FDI. It was not the only option available. Political decisions could keep national capitalism going, with subsidies of one type of another. Instead, the switch was made to putting faith for the economy's future in foreign ownership and inward investment with no more than rhetorical support for measures that might help promote a dynamic domestic-owned economy.

The shift towards dependence on inward FDI was more gradual in Hungary and Poland, but the end result was very similar. Economic systems were transformed with their international activities dominated by foreign multinationals, the 'FDI-led' stage. With that came the end of a voice from large domestic enterprises, possible advocates of active state policies to develop and/or protect domestic industry, and a weakened voice for domestic labour as employment in traditional industries fell.

7. Public spending and public services

The nature of the public sector is an important part of a variety of capitalism. It is important to peoples' standard of living and many aspects of state activity are directly important to economic activity and international competitiveness, creating and providing infrastructure, skills, research outputs and thereby setting strategic directions.

The development of public services in CEECs shows common features. The first is the extent of continual change. One reform did not seem to be enough and was followed by more that transformed the outcomes after the first round of reforms. The results of 'extraordinary politics' were either very little change or something broadly modelled on western European practice. A next wave, starting often in the late 1990s, then took this in a more clearly neo-liberal direction which has been halted, and sometimes partially undone in later years. Taken as a whole, developments look like the result of failures to find (or even seek) consensus around stable models. In the few cases when there is fuller and more open discussion, involving diverse interests, changes have tended to be more cautious (eg Czech pension reforms both in the 1990s and the early 2000s).

The first phase reflected political pressures to comply with a widespread public belief that socialism had actually been weak on its social dimension. Health and education systems were not considered unnecessary luxuries and pensions were not considered over generous. Thus there was political popularity in improving on what existed. The pension issue also had instrumental value at a time when large-scale employment reductions were expected and this could help provide a safety valve. Thus reforms were either small or based on established western European examples.

The change in the late 1990s reflected a consolidation of political life. As ‘normality’ developed, so a 'right' took shape, not around a capital.v.labour cleavage, but around an agenda of low taxes, minimal tax progressivity, low public spending and private involvement in areas of past public provision, notably pensions and health. Alongside this came support for employment deregulation and active promotion of precarious forms of employment. Voices are clear here from smaller employers, from those with higher incomes and from those without experience of social insecurity. These voices were particularly strong in CEECs thanks to past history leaving no imbedded understanding or support for policies alleviating the negative effects of markets and leaving ideas associated with the 'left' liable to rapid dismissal.

The neo-liberal trend therefore appeared significantly stronger than was generally the case in western European practice. It was held in check, or partially reversed, by further changes in government and by quite widespread doubts over the benefits of relying on the private sector for pensions, health and other traditionally public services. We exemplify these points and the different timing of changes with two areas of state activity, unemployment benefits and personal taxation.

Unemployment benefits

Unemployment benefit was a new service and the idea behind it remained only weakly embedded in public thinking. Nobody from the new elites had experienced economically-caused unemployment and there was therefore little automatic sympathy for those out of work. So, although it was accepted on all sides that something was necessary and that existing western examples provided the best model, there was a widespread assumption among policy makers that this would not be a long-lasting problem. A market system would, it was assumed, soon provide all the employment opportunities needed. Higher unemployment in western Europe could even be blamed on failure to allow full operation of free markets. Unemployment benefits systems were therefore limited from the start. Once fears of unrest faded – which meant pretty soon if not almost immediately - so levels of benefits and the scope of eligibility were cut back to well below western European levels.

The outcome can be seen in figures. In Poland in 2011 16.4% of registered unemployed were entitled to benefits, the level of which was set at 21% of the average wage for an initial three months, then declining. In Czechia in 2010 32% of those registered received benefits while in Hungary in 2007 the figure was 45%
http://www.neujobs.eu/sites/default/files/publication/2011/11/NEUJOBS%20SoA%20Report%20No%203%20Deliverable%20D6.1.pdf
The obvious costs of this are social, in terms of hardship endured by those unemployed for long periods. It may also help to depress the lowest wage levels and support precarious forms of employment as the alternative of unemployment is so much less attractive. Limiting levels of employment protection were indeed an issue for domestic employers. It should be added that low levels of unemployment support are not accompanied by good

records on active labour market policies or by visible benefits in levels of labour-force participation.

Personal taxation

The transformation of the tax system followed a pattern more typical of public services with changes in the early 1990s and again at the end of that decade. The first changes broadly followed the small group of insiders model. Major change was necessary to fit with the logic of a market economy. It was worked out by experts with outside advice, but very little publicity or comment from outside the circles of power. The model was western Europe and that meant establishing clear rules that could be judged fair and equitable, reducing taxation on organisations, increasing taxation on individuals with progressive personal income tax and developing a VAT system to replace the old turnover tax.

The results proved fragile. Tax became a much higher profile issue in the late 1990s (as people with reasonable and high incomes became conscious of how much they were paying), undermining acceptance of the progressive personal income tax before it had had a chance to take root. The timing and extent of changes varied a little, depending on governments in power, but the change comes around 2000, often with subsequent acceleration. This points clearly to a result of internal political developments rather than, for example, any link to EU accession. The extent of fluctuations along the way and, above all, the low final levels and the strength of the downward trend, mark out post-socialist countries from other EU member states. The arithmetical average of top rates of personal income tax for CEECs fell from 42.8% in 1996 to 23.8% in 2015 while that in EU member states with no socialist past fell from 51.9% to 48.5% over the same period.

Table 4 Changing maximum personal tax rates

	1996	Date of change and level reached

Cz	40	2000; 32	2008; 15	2013; 22
Hu	44	2001; 40	2011; 20.3	2013; 16
Pl	45	1998; 40	2009; 32	
sk	42	2002; 38	2004; 19	2013; 25

Source; http://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/taxation/gen_info/economic_analysis/tax_structures/2015/report.pdf, p.142.

The top rate on personal incomes is not particularly important for the total tax revenue raised, but it may be very important for establishing the general acceptability of personal taxation. This aggregate figure showed analogous fluctuations. Taxes on the population for Czechoslovakia rose from 0.3% of GDP in 1989 to 8.6% in 1992, falling to 2.3% in 2010. For CEECs as a whole, taxes on income, wealth, etc relative to GDP in 2014 averaged 6.9%, down from 9.25% in 1996. The average for EU member states with no communist past increased from 13.2% to 14.4% over the same period. Thus, as with the comparison of top rates of personal income tax, CEECs were raising considerably less by this means than other EU member states. The gap of around 7 percentage points is also similar to the gap in public spending levels, albeit with Hungary something of an exception there (cz 42.6%; hu 49.9%; pl 42.1%; sk 41.6%, EU without communist past 49.1%, Eurostat gov_10a_exp).

Thus the economic implication of reducing personal tax levels is to accentuate the constraint on state budgets, leaving less for spending than the EU average. Forces for reversing this trend across CEECs are present, as indicated by increases in Czechia and Slovakia, albeit not enough to restore previous levels. This has evidently not been a barrier to the kinds of economic growth experienced in CEECs, but it sets limits on anything that requires more state activity. Indeed, EU funds have been crucial for development of the pre-requisites of more advanced economic activities, such as R&D facilities. The implications are taken up further in the conclusions.

8. FDI-led growth

Table5 First years of high inward investment flows

	Over 5% of GDP	Over 10% of GDP
cz	1998	2002
Hu	1993	1995
Pl	2000	-
sk	2000	2002

Source: UNCTAD

The timing of an acceleration in FDI inflows is shown in Table 5. It reflected willingness of foreign companies to come. That was present to some degree even in 1990 in Hungary before a full market environment was established. The other prerequisite was appropriate government policies. The clearest and most abrupt breaks were in Czechia and Slovakia where the ruins of enterprises privatised into domestic ownership were taken back and sold off to foreign owners alongside a determined policy of attracting incoming FDI. It roughly coincides with changes in governments and with preparations for EU accession.

However, a difference between Czechia and Slovakia is that there is no link to a neo-liberal turn in the former case – it happens under a left rather than a right government – while there is some proximity in timing in the latter case, albeit no close enough to suggest a causal link. The key attractions for foreign multinationals were the substantially lower wage levels in CEECs (about one third of western European levels by current exchange rates) while the packages of tax and welfare reductions and labour market deregulations – billed elsewhere as a means to maintain competitiveness by attracting FDI - were of little importance when set against that first factor.

FDI brought economic growth, exports and rising wages. It brought an up-grading of economies' technological levels relative to those of the 1990s, albeit not to the levels of the world's most advanced countries. However, it also left economies dependent on the decisions of foreign companies. The technological level, and the potential for its further development, depended on their strategies rather than on indigenous innovations. These have therefore been characterised as dependent market economies, as distinct from the two Hall and Soskice varieties. Their competitiveness depends on imported technology, relatively cheap labour and raw material endowments.

The defining characteristic was the high level of foreign ownership over key productive assets. OECD figures for FDI stocks relative to GDP in 2014 show levels of 42% for Poland (2013 figure), 53% for Slovakia, 54% for Czechia and 72% for Hungary.[1] These are not exceptional by Western European standards, but MNCs dominated key economic sectors in CEECs with very little balancing outward FDI.

In line with the framework set out at the start, we need to ask what economic development this system produced and its impact on the economic and social structures and whether it encountered limits that point to the emergence of a subsequent phase.

A first question is whether there are economic limits to FDI-led growth. The impact of FDI can be conceived as a cycle. An initial investment comes, with a positive effect on the balance of payments: the operation matures and, if the activity leads to exports, brings benefits for the external balance. There is no doubting these positive effects. The financial inflows alone contributed to substantial financial account surpluses in all CEECs from 1991 (hu, exception in 1996), 1993 (cz), 1994 (sk) and 1995 (pl), which countered persistent current account deficits. This was an addition to prosperity that was resilient to the

[1] OECD FDI in Figures, http://www.oecd.org/corporate/mne/statistics.htm.

financial crisis of 2009 as FDI, unlike credits, does not need to be repaid.

However, all else being equal, inflows are increasingly balanced by repatriated profits, reducing the positive and leading ultimately to a net negative impact on the external balance. An operation may also run down as activities are shifted to a location with even lower wage levels. Figures indicated the extent of the threat from repatriation. For Czechia in 2014, new FDI was equivalent to 6.2% GDP; repatriated profits to 8.6%; reinvestment, which comes out of repatriated profits in balance of payments figures, was equivalent to 4.5% of GDP so that MNCs were taking 4.1% of GDP out of the country.

Continued FDI-led growth, therefore depends on continual further FDI and continual upgrading of activities. That ultimately requires developing domestic capabilities for education, higher skills, research and innovation and capacity for financing new projects and developing necessary management expertise. These in turn depend more on an adequate level of public spending than on an agenda of reducing activities of the public sphere as much as possible. Thus barriers are arguably created from a neo-liberal policy direction. We therefore turn to the impact of FDI on social and political structures and hence to their likely impact on a future economic policy agenda. Three points are significant here;

The first is the role of FDI in maintaining a level of large-scale industry and hence an industrial working class. Table 6 shows the share of GDP accounted for by value added produced in industry and construction. Although falling, it remained significantly above the EU average level. The size of units was on average smaller than under state socialism, but something significant was retained.

Table 6 Percentage share of industry and construction in GDP

	1990	2013
Cz	48.8	37.8

Hu	39.1	30.1
Pl	50.1	31.2
sk	59.1	34.3
EU 28		24.8

Source; World Bank World Development Indicators and Eurostat.

The second is the wage levels (generally higher than in domestic-owned firms leading to higher wage levels overall, with Poland something of a laggard), and employment relations systems, more likely to accept trade unions and collective bargaining, in these foreign-owned units. However, foreign ownership has frequently been associated with fragmentation into company-level bargaining. Thus, as in areas of state provision referred to above, where structures modelled on some western European experience were established after 1990 – and that was the case for collective bargaining in Czechoslovakia - they were often dismantled in later years. The effect was to weaken bargaining and employee representation and not include employees in domestic-owned firms in its benefits. This was consistent with a tendency towards separation of employment between a higher-wage sector (but still well below western European levels even for the same work) and a low-wage sector under domestic ownership.

The third is the impact on economic policies. MNCs generally preferred to limit their political involvement to the issues that concerned them the most directly. Manufacturing MNCs had quite specific concerns, for example over flexibility of working hours, but they were not the driving force for promotion of casual employment contracts, important to the low-wage parts of economies. They were essentially unconcerned about employment relations in the economy as a whole. The significance of this for long-term economic prospects is that they exert no pressure for policy changes that would provide a base for a higher technological level in a possible future wave of FDI.

9. Conclusion

CEECs have not caught up with the economic levels of the more advanced countries of western Europe. On current performance, they will not do so for some time. They have developed forms of capitalism that make their success dependent on the strategies of foreign multinational companies. This brought growth in GDP and income levels in the 2000s, but the danger is that CEECs will be left permanently competing in lower-wage activities within an integrated European economy.

This potential trap is reinforced by policies for small states and low wage levels when competing internationally by costs alone is relevant only for lower-tech activities. This limits both the incentive and the scope for MNCs to transfer higher-tech activities into CEECs as it encourages the best qualified and most skilled to take advantage of the free movement of people allowed within the EU.

It is impossible to judge what the results might have been from pursuing policy alternatives that were available in the past. State socialism left an economic level below that of western Europe and catching up was never going to be straightforward. However, state socialism also left a heritage in thinking that has damaged the ability to formulate consistent, coherent and complex policy directions. Policy formulation has rather been characterised by rapid changes and simplistic assumptions, reflecting limited experience, weak theoretical foundations and continuing low levels of informed public involvement. That has left the CEECs' variety of capitalism seriously handicapped in terms of its ability to support an economic level comparable to that of the countries of western Europe.

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