European integration, capitalist diversity and crises trajectories on Europe’s Eastern periphery

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Abstract

European policy responses to the Global Financial Crisis and its European manifestation have set off a scholarly debate whether different national varieties of capitalism are equally able to cope with deepened European integration. To date, this debate has mostly focused on the contrasting fates of the thriving northern export-oriented capitalisms and the ailing southern European ones. The paper seeks to broaden the debate by focusing on Europe’s Eastern periphery. It argues that a combination of domestic transformation strategies and the EU’s accession policies resulted in two different growth regimes on Europe’s Eastern periphery: a dependent export-driven in the Visegrád countries, and a dependent debt-driven in the Baltic States. On the basis of the pre- and post-crisis trajectories of these two growth models, the paper finds that because East Central European capitalisms were profoundly shaped by EU integration, they are on balance also more compatible with deepened integration than Southern European capitalisms.

1. Introduction

European policy responses to the Global Financial Crisis and its European manifestation have set off a scholarly debate whether different national varieties of capitalism are equally able to cope with deepened European integration. While some EU member states seem to be adjusting well to the post-crisis environment, others are trapped in economic and political crises. To date, this
debate has mostly focused on the contrasting fates of the thriving northern export-oriented
capitalisms and the ailing southern European ones (e.g. Hall 2014, Hassel 2014, Iversen et al.
2016, Johnston and Regan 2015, Johnston et al. 2014). My contribution seeks to broaden the
debate by focusing on Europe’s Eastern periphery. This is for several reasons: First, in contrast to
most other EU member states, East Central European capitalisms have been profoundly shaped
by the EU from the outset. As the East Central European countries sought EU membership, the
EU has exported the core of its economic and institutional program to the region. Therefore, we
should expect valuable insights about the kind of national models of capitalism which the EU
supports.

Second, most East Central European economies shared the experience of a short boom and a
hard landing. Exploring this particular pattern – reminiscent of the Southern European periphery
and Ireland in the Eurozone – allows to shed some light on the question whether European
integration has contributed to the vulnerability of specific models of capitalism. Third,
Europeanists have to date paid scant attention to the capitalist diversity on the EU’s Eastern rim.
A thriving literature however has identified several East European varieties of capitalism (e.g. ,
Becker et al. 2010, Bohle and Greskovits 2012, Myant and Drahokoupil 2011). By building on and
developing further the insights of this literature, this paper seeks to complement the crisis
accounts that typically focus on the Southern periphery.

Specifically, this contribution will explore the compatibility of two different growth regimes that
have been thoroughly shaped by foreign direct investment (FDI), thus complementing the
analysis of Regan and Brazys in this volume. Building on insights of the “third wave” of
comparative capitalism scholarship (Nölke 2016), this paper argues that a combination of
domestic transformation strategies and the EU’s accession policies resulted in two different
growth regimes on Europe’s Eastern periphery. The Visegrád countries have become highly
dependent on foreign direct investment (FDI) in their manufacturing sectors and, under this influence developed an export-driven growth model. In contrast, the Baltic States have become integrated via dependent financialization (Bohle and Greskovits 2012, Becker et. al. 2010). In these countries, growth was based on fast rising household debt and construction booms. While dependency increased the East Central European capitalism’s vulnerability before the crisis, during the crisis it turned into an asset. The export-oriented Visegrád countries profited from the German recovery, while the Baltic States – with the exception of Latvia - could externalize the costs of saving their banks to the headquarters of their foreign-owned banks. Crucially, post-crisis recovery in East Central Europe was also heavily dependent on the EU’s external support which stands in stark contrast to the much harsher role the EU played in Europe’s southern periphery (Bohle and Jacoby 2017). The recovery notwithstanding, however, the future of the East Central European varieties of capitalism looks uncertain. FDI has not fully recovered, credit growth was curtailed, and dependency has become politicized.

The paper is structured as follows. The next section will briefly introduce the comparative capitalism framework I build on in my analysis. Section three summarizes major principles and tools the EU devised to integrate Eastern Europe. The fourth section maps the two growth models that have emerged as a result of the interaction of domestic transformation strategies and accession to the EU. The fifth section takes a closer look at the crisis and post-crisis trajectories. The final section concludes.
2. Theoretical framework

In a recent critical evaluation of the analytical contribution of comparative capitalism (CC) to understanding the Eurozone crisis, Nölke (2015) distinguishes between three waves of CC research. The “Varieties of Capitalism” (VoC), as formulated by Peter Hall and David Soskice (2001) is the focal point of the first generation. While many of its core concepts keep being influential, its binary division of capitalism, limited ability to explain institutional change, and focus on very few advanced capitalist economies have resulted in a second wave of post-VoC research (Bruff et al. 2015: 34). The second wave has mostly been concerned with extending the geographic focus, broadening the possible varieties of capitalism, and conceptualizing institutional change (e.g. Beramendi et al. 2015, Hancké et al. 2007, Nölke and Vliegenthart 2007, Streeck and Thelen 2005). While the second wave of CC scholarship “usually remains wedded to supply-side institutions and to the comparison of country models” (ibid. 6), many authors of the third wave build more explicitly on heterodox approaches in political economy to promote a more critical understanding of conflicts and power differentials that characterize capitalist social relations. Closely related, the third wave has put the issue of where demand comes from back on the agenda of analyzing capitalism, this way overcoming the supply side bias of VoC. In addition, VoC’s quest for analyzing microfoundations of capitalism have been replaced by a renewed focus on macroeconomic regularities and contradictions. Consequently, the third wave turns to older scholarship for inspiration, most prominently the French Regulation School, Dependency Theory, post-Kaleckian and post-Keynesian macro-economics (e.g. Stockhammer et. al. 2016, Baccaro and Pontusson 2016, Becker and Jäger 2012). The third wave of CC scholarship is also more
concerned with the political coalitions underpinning specific growth models, either in the form of electoral coalitions (Beramendi et al 2015), or social blocs (e.g. Amable and Palombarini 2009)\(^{ii}\).

This paper builds on concepts and insights of the third wave of CC scholarship.

This scholarship has identified at least three national growth models in Western Europe – a northern export-led, a southern debt-led, and an Anglo-Saxon debt-led regime (Stockhammer et al. 2016, Becker and Jäger 2012).\(^{iii}\) In light of the Euro crisis, the former two have received most attention. At the core of the **Northern export-led regime** is a restructuring of the manufacturing sector, partly triggered by increasing shareholder value orientation and quest for high stock prices. This endangers the profit-investment nexus. A decreasing wage share of labor leads to insufficient domestic demand, which is compensated for by exports. The archetypical example for this model is Germany, and other Nordic countries share some, although not all of its features (e.g. van Treeck 2009).

In the **Southern debt-led regime**, the deregulation and integration of financial markets and low interest rates have facilitated high credit growth. Importantly, it is not corporate but household and/or public debt that fuels growth. Easy access to credit has led to a domestic consumption boom based on the construction sector, house price increases and the rapid rise of mortgage debt. Colin Hay et al. (2008, see also Crouch 2009) coined the term “house-price Keynesianism” for this growth model. In the southern debt-led regime, increase of debt has not come at the expense of wages or welfare states. Rather, in several countries where house-price Keynesianism was at work, wages increased, and the welfare states expanded. Consequently, these countries lost their competitiveness (Stockhammer et al. 2016).
There are three characteristics that set the Southern debt-led regime apart from the *Anglo-Saxon debt-led*. First, in the Anglo-Saxon model, financialization has deeply penetrated all spheres of social reproduction: corporations, welfare states, and households. Second, rising household debt *compensates* for stagnating real wages, and is as much driven by as a driver of inequality. Third, an important growth impulse has also resulted from what is called “financial inclusion”, that is the extension of private credit to large parts of the population outside or at the fringe of labor markets – students, unemployed, or the working poor (Soederberg 2014).

Third wave CC scholarship has paid particular attention to the complementarities of first two regimes, as forged by the European Monetary Union (EMU). Indeed, the institutional set-up of EMU increased the divergence between the Southern and Northern growth models. One size-fit-all-interest rates triggered expansion in the South and contraction in the North and the integration of capital and financial markets eased access to credit. Under these conditions, the South serves both as a market for Northern exports and as a credit taker which allows the North to recycle its export surplus (e.g. Stockhammer et. al 2016; Scharpf 2011).

With few exceptions, this literature has paid little attention to the East Central European growth models. Furthermore, the focus on the effects of EMU has led to an unduly narrow understanding of the role of European integration in shaping various models of capitalism across its member states, old and new. The following section thus will broaden the analysis of the European dimension of different national growth models and examine the impact on East Central European capitalisms.
Creating Capitalism after Communism: the role of the EU

Any analysis of the growth regimes in East-Central Europe must acknowledge their embeddedness in the broader European integration process. This is for three reasons: First, the East European transformation to capitalism has coincided with the EU’s neoliberal turn in the second half of the 1980s. This turn has profoundly altered the delicate balance between positive and negative integration (Scharpf 1999). While previously, European integration had not affected the coexistence between distinct national models of capitalism, ever since the 1990s, national capitalisms are being profoundly restructured and transnationally integrated, resulting, as this special issue shows, in the incompatibility between some models of capitalism and European integration. Second, through its membership conditionality the EU has exerted considerable influence on the core institutions of East Central European capitalisms. Third, much of the capital and financial sources that have shaped East European capitalisms stem from EU member states. The remainder of this section will take a closer look at how the two latter factors have shaped East Central European capitalisms.

The literature on East-Central Europe’s accession to the EU has focussed on the mechanisms of “Europeanization”- the transfer of EU rules, regulations, and norms to its new members - in a broad variety of fields, such as democratization, minority and human rights, regulatory convergence or administrative capacity building. There is broad consensus that the new member states have been “externally governed” (Schimmelfenning and Sedelmeier 2004: 661), and that compliance with EU norms, rules and regulations was ensured by accession conditionality, the effectiveness of which was reinforced by the new members’ quest for effective solutions to major transformation problems as well as processes of persuasion and learning (ibid., Bruszt 2002,
Vachudova 2005, Schimmelfenning and Sedelmeier 2005, Jacoby 2006, Meyer-Sahling et al. 2016). The literature has also pointed out that due to the challenging tasks of admitting a large number of members who had neither much democratic nor capitalist experience, the EU created a number of new instruments and dense monitoring and surveillance mechanisms.

While this literature is mostly concerned with the mechanisms of rule transfer, it has less to say about the socio-economic content of these rules. More recent literature has however started to fill this gap. Thus, Jacoby (2010, 2014) has recently argued that the EU has “exercised remarkable control over the economic transformation in [E]CE” (Jacoby 2010: 418). He argues that this was done to manage the economic threats that might result from admitting a number of relatively poor new countries, and turn them into advantages for the EU’s and its old member states’ global competitiveness. In this respect, two issues stand out. On the one hand, the EU has actively promoted what Bruszt and Vukov (2017: 672) call a ‘liberal developmental state’. This ‘new type of economic state’ combines ‘capacities for increasing the role of transnational markets in shaping developmental outcomes with the capacities to maintain and increase the market power of various categories of domestic actors.’ (ibid.) Specifically, the authors show that during the accession process the EU sought to strengthen the applicant states’ capacity to maintain the rule of law, uphold economic freedom, prevent discriminatory practices, foster domestic competitiveness and implement European rules and policies. In seeking to strengthen these capacities, EU actors have left much less room for domestic actors than during the Southern enlargement.
A second important aspect is the way how the EU shaped East-Central Europe’s policies towards FDI, as well as the FDI inflow. FDI started to come to the region early on, when Western firms sought to explore opportunities stemming from the new low wage locations. However, initially most host countries were rather cautious. This changed successively, and EU accession played an important part in this. Thus, by the mid 1990s, all applicant countries except for Slovakia had set up national investment promotion agencies. These agencies played a key role in persuading reluctant policy makers of the benefits of FDI, and in representing the interests of foreign investors (Drahokoupil 2008: 116-117, Bandelj 2008: 71-72). Drahokoupil (2008: 115-116) describes with the example of one of the first agencies, Czechinvest, how crucial EU support was. The idea for this institution was brought up by an Irish adviser who was financed by one of the early European assistance programs to Eastern Europe. He suggested the Czech government to follow the Irish FDI-led growth model. EU finance was crucial for operation of the agency, and the EU also trained its staff (see also Medve-Balint 2014: 41).

While the EU had no specific legal instruments to foster FDI, it relied on membership conditionality and the instruments developed for the accession process to promote foreign capital inflows. Thus, international financial institutions and the EU required liberalization of the East European economies in relation to capital movements (Bandelj 2010: 478). In its Accession Partnerships and Annual Reports, the EU moreover specifically suggested privatization via foreign ownership in a number of strategic sectors, and openness to FDI crystallized as one important condition for membership (Jacoby 2010, Medve-Balint 2014). EU accession also had an indirect effect on FDI inflows. Eastern Europe’s compliance with the European rules and regulations
opened these economies for capital flows and provided legal security for investors. All this resulted in a massive inflow of FDI from the early 2000s onwards.

4. Varieties of dependent capitalisms in the East

In light of the strong dependency on foreign capital, East-Central European capitalisms have been conceptualized as dependent capitalisms (Nölke and Vliegenthart 2009). Borrowing from dependency theory and the work by Ben Schneider (2009) on Latin American varieties of capitalisms, these authors argue that East Central European economies are largely coordinated by hierarchical intrafirm relationships within transnational corporations (TNCs). They dispose of comparative advantages as export platforms of semi-standardized industrial goods produced by abundant skilled labour. These authors however provide little understanding of how dependent capitalisms came about, and it overlooks their diversity. It also overstates the capacity of external actors to govern East-Central European economies. As the contribution by Regan and Brazys in this volume shows, domestic agency is needed in order to attract FDI. In a similar vein, I will argue below that while the EU’s entry requirements served as powerful tools to shape East Central European capitalisms, and provided the framework under which transnational capital could expand eastwards, it is the combination of enlargement with East European transformation pathways and core countries’ investment strategies that resulted in different dependent growth regimes.
4.1. Dependent export-led growth: the Visegrád countries

In terms of transformation strategies, East European countries have differed in respect to the radicalism of their initial reforms, and whether reformers wanted to build capitalism with the ruins of the socialist legacies, or completely replace the old order with the new one (Bohle and Greskovits 2012). In the four Visegrád countries, reformers pursued neoliberal transformation strategies in a rather pragmatic way. They tried to make use of the existing industrial legacies as they attempted to restructure their economies (Greskovits 2014). Reformers in three out of the four countries initially tried to build national capitalisms on the ruins of communism (Bohle and Greskovits 2012, Greskovits and Bohle 2001, Drahokoupil 2008, Stark and Bruszt 1998). By the late 1990s, the resources of national capitalisms were however exhausted. Major crises and the EU accession made them turn towards FDI as a new source of investment and growth. For instance, in the Czech Republic, voucher privatization led to a delay in enterprise restructuring, and the banking sector became embroiled in an increasingly inefficient corporate sector. This resulted in a deep crisis, after which the country turned towards FDI-led growth (Myant 2003, Drahokoupil 2008). Drahokoupil (2008: 115-116) shows how the Czech Investment Agency has played a key role in preparing the ground for this turnaround. In Slovakia, a similar shift towards FDI-led growth occurred after the autocratic ruler Vladimír Mečiar, who sought to build an insider capitalism, was ousted by a center-right coalition. This coalition’s major aim was to prepare the ground for the country’s EU accession. In economic terms, this involved radical tax and welfare reforms, as well as investment incentives, all of which was to signal to foreign investors that the period of insider capitalism was over (Bohle and Greskovits 2006, O’Dwyer and Kovalcsik 2007).
The Visegrád countries’ simultaneous turn towards FDI initiated a fierce competition among them. The four countries sought to outbid their rivals by offering tax holidays, simplified tax codes, loosening their labor laws, specific investment packages, and sometimes even social expenditure cuts in order to lure investment into their countries (Bohle 2008, Drahokoupil 2008, O’Dwyer and Kovac 2007, Scepanovic 2013). This politics of outbidding was of course fuelled by investors. Especially North European TNCs have been seeking to relocate parts of their production to Eastern Europe, taking advantage of the comparatively cheap but skilled workforce, flexible labor codes and generous investment incentives, and each new major greenfield investment was preceded by a “beauty contest” of which country would offer the best conditions (Scepanovic 2013).

The German, Dutch and Austrian capital that poured into the region’s manufacturing sector, turned the Visegrád countries into veritable manufacturing miracles (Bohle and Greskovits 2012). Under the influence of northern TNCs, substantial production upgrading has taken place. Indeed, far from being a source of cheap and unskilled labour for traditional production segments, the Visegrád countries have developed comparative advantages in skilled segments of complex manufacturing such as car, electronics, or pharmaceutical industries (Bohle and Greskovits 2012, e.g. Marin 2010, Scepanovic 2013). A detailed survey of German and Austrian investment projects in Eastern Europe in 2010 finds that these are often a response to the human capital scarcity in the home countries, which became increasingly severe during the 1990s (Marin 2010). Wage restraint and disinvestment in skill formation in Germany and other North European countries has thus been complemented by relocation of skilled jobs to the cheaper East European
locations, this way increasing the overall competitiveness of the Northern export-led growth regime.

The Visegrád countries’ growth models has clear winners and losers. On the winning side are skilled industrial and service workers, a new group of business and finance professionals and managers, whereas lower skill manufacturing workers and social groups associated with domestically oriented industries are losing out. For the newly emerging entrepreneurs, petty bourgeoisie and lower skill service workers, the transformation to capitalism itself offered new opportunities, while public sector workers and socio-cultural professionals fell on hard times especially during the 1990s when states were forced to curtail their expenditures radically. While these social groups’ fate was not directly tied to the growth model, existing research suggests that state policies, such as for instance comparatively generous social programs, helped to generate broader support for the new growth regime (e.g. Bohle and Greskovits 2012).

4.2 Dependent credit-led growth: the Baltic States

In contrast to the Visegrád countries, the Baltic States have de-industrialized much more radically. This can be traced back partly to their more problematic industrial legacies, and crucially to the early priorities of the Baltic reformers. Baltic reformers implemented hyper-neoliberal transformation strategies. They experimented with currency boards, flat taxes, and zero trade tariffs long before these became part of a more mainstream neoliberal repertoire (Bohle and Greskovits 2012, Feldmann and Sally 2002). The Baltic States’ radical neoliberalism is closely tied to the agenda of nation-state building. Baltic reform elites saw national independence as their highest priority. They were united in considering Russia’s economic and
political influence as the biggest threat to their national sovereignty and security. Their transformation strategies aimed at a radical departure from the past, responded to perceived needs of independent statehood, and served the purpose of forging national identities. As they considered the inherited industries as part of the despised Soviet legacies, rapid de-industrialization seemed even desirable (e.g. Hudson 2014). As a consequence, when foreign investment started to pour into the region, it was mostly in banking and real estate (Table 1).

The ground for the massive investment in banking and finance was laid by the EU accession. Convergence on the institutional and regulative standards of the European financial area, the privatization of the banking sector, and the liberalization of capital movements were all part of the EU’s entry requirements. Perhaps most notable is the high share of foreign ownership of the banking sector, a development fostered by the EU which saw in foreign banks a guarantee for a sound banking system (Pistor 2009). The investment in banking in the Baltic States was of Scandinavian, particularly Swedish origin. Somewhat at odds with the usual understanding of the Northern growth regime in the literature, Swedish banks had been heavily exposed to the bust of a housing bubble in the early 1990s, and recovered only sluggishly thereafter (Honkapohja 2009). In this situation, Swedish banks increasingly relied on the Baltic States to regain profitability. Rather than lending to corporations, Swedish banks played a significant role in developing the hitherto non-existing mortgage markets. They unleashed a credit and housing boom which, if measured in change rather than level, even outpaced those of the Southern European debt-led regimes (Égert and Mihaljek 2007, Bohle 2016). Mortgage lending occurred mostly in euros rather than local currencies. Euro loans had lower interest rates than local currencies, and were considered riskless because all Baltic States had pegged exchange rates and
were strongly committed to entering EMU (Becker and Jäger 2012). In some ways, then, the Baltic growth regime resembled that of the Southern debt-led model. Rapidly increasing household debt was accompanied by wage increases, fueling inflation, which, under the fixed exchange rate regime, put increasing strain on export competitiveness. Before the outbreak of the GFC, all three Baltic States registered double digit current account deficits, making them even more vulnerable than the Southern European states (Table 1).

Table 1 about here

What can be said about the winners and losers of the Baltic growth model? In these countries, both skilled and unskilled industrial workers were clear losers, while business and finance professionals, as well as private service workers can count as winners. As the Baltic States have only very meager (welfare) states and states, public service workers were also put in a difficult spot. A specificity of the Baltic States, especially Latvia and Estonia, however is its ethnic cleavage which overlaps with and partly replaces the social cleavage. Thus, ethnic Russians were overrepresented among the industrial workers, whereas ethnic Balts could profit from state policies that sought to strengthen their position in the public sectors of the newly independent states (Bohle and Greskovits 2012). As ethnic Russians were also initially denied citizenship rights, in electoral politics their voices barely mattered.

5. Crisis and Recovery

Given the different growth regimes, it is not surprising the crisis has affected these states in different ways. The Baltic states fared badly. Their GDP dropped between 15 and 19 percent in
2009. By comparison, GDP dropped between four to seven percent in the Czech Republic, Slovakia and Hungary, while Poland could escape a recession altogether. Unemployment also rose more sharply in the Baltic states, reaching above 10 percent in all three countries. In contrast, among the Visegrád countries only Slovakia registered an unemployment rate above nine percent in 2010 (Eurostat). Despite these differences recovery in both groups of countries started fairly fast. This sets them apart from Europe’s South.

5.1. Austerity and Recovery in the Baltic States

While in the previous section I stressed some similarities of the Baltic States with the Southern European States, it is interesting to note that in contrast to the latter, the Baltic States voluntarily and seemingly successfully engaged in internal devaluation. The most striking example is Latvia. Similar to some of its Southern European counterparts, Latvia experienced a burst of a major housing bubble and a banking crisis. In response to the run on its biggest domestic bank, PAREX, the government took over the majority control for a symbolic price. The costs of recapitalizing and the need for restructuring PAREX ushered in a sovereign debt crisis, and the Latvian government had to turn to the EU and IMF in 2008 (Aslund and Dombrovskis 2011).

A crucial policy decision of the Latvian government was to avoid devaluation of the lats and instead prepare for euro entry. This was a controversial decision: while a number of internationally renowned economists and also the IMF team suggested that Latvia not stick to its currency peg but rather devaluate to regain competitiveness, the European Commission took a different stance, a position that ultimately prevailed (Lütz and Kranke 2014). Consequently, Latvia’s adjustment program was tough even by IMF standards. Even so, the Latvian government
often outstripped the austerity requirements set by the international organizations (Eihmanis 2017). It achieved an early repayment of the bailout loan and adopted the euro in 2014. While the Latvian challenges and answer was extreme, in all three Baltic countries adjustment happened through hefty austerity packages involving huge public sector wage cuts and lay-offs, welfare cuts, and limited tax increases. (Aslund and Dombrovskis 2011, Blanchard et al. 2013, Kattel and Raudla 2013, Masso and Krillo 2010). It comes therefore as no big surprise then that the Baltic States were publicly hailed as role models for Southern Europe to follow (e.g. Aslund and Dombrovskis 2011).

How far has austerity and internal devaluation however really contributed to the Baltic States’ recovery? As Kattel and Raudla (2013) point out, recovery was more uneven and incomplete, and much less grounded in internal devaluation as often assumed. For instance, despite significant wage cuts, the Baltic States have been unable to restore a competitive real exchange rate. In all three countries, unit labor costs are still far above the pre-crisis level, and have started growing again massively since 2012. This is in stark contrast to the Southern European states (Figure 1).

*Figure 1 about here*

Investment has not notably increased, suggesting that most export recovery occurred with existing investment. As in all new EU member states, there is little is little evidence of substantial new long-term FDI (Hunya and Schwarzhappel 2016, Figure 2). Construction is stagnant, credit demand down across private households, corporations, and for home mortgages. While Scandinavian banks have restructured non-performing mortgage loans, they also have become much more reluctant in their lending practices (Bohle 2016).
In addition to internal devaluation, what explains much of the recovery is that the Baltic States could “outsource” much of it, and “insource” additional resources (Kattel and Raudla 2013). First, the Baltic States did not need to bail out their foreign-owned banks. The Swedish Central Bank provided its exposed subsidiaries with liquidity, relieving especially Estonia, where foreign banks control more than 90 percent of all bank assets, from the burden of saving its banks (Epstein 2014). Second, all Baltic States saw massive outmigration and enjoyed large remittance inflows. Thus in 2015, the share of remittance inflow in GDP were two percent in Estonia, five percent in Latvia and three percent in Lithuania. Since the outbreak of the crisis, remittance inflows have been on par, or – sometimes significantly – higher than the net inflow of FDI (World Bank 2016). Third, and most importantly, all East Central European states received massive EU funding. For instance, 20 percent of Estonia’s 2012 budget was made up of EU transfers, and total EU spending in Estonia jumped from two percent of GDP in 2008 to five percent in 2009 (OECD 2011, Bohle and Jacoby 2017). Figure 2 shows for all Baltic States that FDI inflows have been very volatile since the crisis, whereas Structural Fund inflows have been rising steadily, and except for one single year, replaced the FDI as the most important source of foreign finance. Relying on structural funds inflows however is tricky, as these have their own cyclical behavior linked to the EU’s budgeting cycle. Thus, Adarov et. al (2016) forecast that the Structural Funds inflow in East Central Europe will drop significantly in the coming years.

*Figures 2 about here*
5.2 Crisis and Recovery in the Visegrád countries

Crisis and recovery in the Visegrád countries was more diverse than in the Baltic States. Poland could escape a recession altogether. For Slovakia and the Czech Republic, the challenges were also not that severe. Their economies have picked up together with the strong recovery in 2010-2011 of the German economy. German car producers have also refrained from relocating production back home (Scepanovic 2013). So far, regional industrial dependence on Germany has therefore been more of an asset for the two Visegrád countries. However, as in the Baltic States, FDI inflows have become more volatile and declining after the crisis, whereas Structural Funds have increased steadily and replaced FDI as the most important external source of finance (figure 3).

Figure 3 about here

In addition to more limited FDI inflow, all four Visegrád countries have faced some pressure towards bringing their public finances back in order. Although budgets and public debt in these countries with the exception of Hungary look incomparably better than in most of continental and Southern Europe, crisis-hit tax receipts as well as limited financial stimulus packages have led to an increase in debt and deficits. As argued above, state-financed compensation for the losers of transition have played a significant role in legitimating the new growth models. It is therefore not surprising that the (perceived) need to cut public expenditure has led to heightened political tensions (Myant et al. 2013).

In this respect, the Hungarian crisis and post-crisis trajectory is revealing. Hungary’s troubles ran deeper than those of the other Visegrád countries. Although its growth regime had been reliant
on foreign-led exports, credit growth fueled by mortgage lending has been more important than in the neighboring countries (table 1). In addition, its welfare state has been a substantial burden for public finances. Almost immediately after enlargement, the EU started an excessive deficit procedure against Hungary, leading to a first austerity package and heightened political tensions as early as 2006. The shock of the package was not yet digested when Hungary became one of the hot-spots of the global financial crisis in 2008, forcing the country to turn to the IMF. The 20 billion euro loan came with heavy strings attached. At the same time, Hungary’s indebted population felt the negative consequences of external devaluation. As more than 80% of mortgages were taken in Swiss Franc rather than Hungarian forint, private indebtedness soared (Bohle 2014).

It is against this background that the parliamentary election in spring 2010 gave the rightwing-nationalist FIDESZ party an unprecedented two third majority in the Parliament. Although Fidesz campaigned with the promise to end austerity, it engaged in further welfare state retrenchment, mostly hitting the poor and unskilled. At the same time, upper middle classes received ample support in relieving their debt burdens and currency risks (Szikra 2014, Bohle 2014). The government also used this stellar victor to radically alter Hungarian political and economic institutions. Most of the existing discussion of the new Hungarian economic strategy has focused on its financial nationalism (Johnson and Barnes 2015), and the corrupt nature of the empowerment of domestic entrepreneurs (Magyar and Vasarhely 2017). While both aspects are pertinent, and in their combination have the potential of undermining the dependent export-led growth model, it is often overlooked that FDI fueled exports play further on a crucial role in the Hungarian economy. What is more, at least until to date, the Hungarian government, its radical
nationalist rhetoric notwithstanding, does not seek to fundamentally alter the dependent export-led growth model. While it seeks to actively repress finance, and strengthen small and medium-sized domestic companies, and targets foreign investors that serve the domestic market with special taxes and other restrictive regulations, it also supports the competition for new industrial FDI. Current plans envisage lowering the corporate tax rate from 19% to 10% to stay competitive in the race for FDI (Visegrád Post 29/11/2016). The government has also developed a new policy tool in its interaction with industrial investors, the strategic partnerships. The Hungarian investment promotion agency summarizes the goals of the strategic partnerships as follows:

“The purpose of the strategic partnership programme is the promotion of the investment of companies established in Hungary, an increase in employment, implementation of production of higher added value, integration of companies in vocational training and the development of stronger ties with domestic suppliers. The strategic partners of the Hungarian government provide work to over 200,000 people and are currently employing 15,000 more people than at the time of the conclusion of the strategic agreements. The ratio of the Hungarian suppliers of strategic partners has increased by an average of 4% since the signing of the agreements.” (Petis 2016)

Rather than a complete overhaul of the growth model, what seems to happen is an attempt at strengthening the industrial core of the economy at the expense of finance, and to offer domestic entrepreneurs better options within that model. This way, the government seeks to forge an alternative social support coalition. While this coalition continues to build on skilled industrial
workers, business professionals and managers, it also prominently reaches out to the petty bourgeoisie and large domestic entrepreneurs, who are being offered new chances for economic activities targeting the domestic market (Magyar and Vasarhely 2017). At the same time, compensation for unskilled workers has been drastically curtailed, while finance professionals and skilled service workers are offered fewer chances than previously. Ideologically, this new social base is being forged through a nationalist revolt against dependency. However, nationalists in the region walk a thin line, as dependency is also the resource on which their economy survives. It is perhaps not entirely by chance that Hungarian nationalist forces mostly politicize financial dependency (Johnson and Barnes 2015).

While Hungary’s political answer to the crisis is certainly extreme, it is by far not the only country in the region that has experienced a nationalist resurgence. In Poland, the 2015 parliamentary elections have ushered in a right-wing nationalist government that closely follows the Hungarian example, and in the Czech Republic, an electorate keen to punish an austerity oriented government voted for a President who ever since appeals to nationalism and xenophobia to mobilize his electoral support (Culik 2016).

6. Conclusions and Outlook

The aim of this contribution was to broaden the debate on national growth regimes and their interaction with European integration by focusing on East Central Europe. Drawing on concepts borrowed from the third wave of CC scholarship, I have argued that East Central European growth models were profoundly shaped by the EU accession process. Of particular importance was how
the EU shaped East-Central Europe’s policies towards FDI, as well as the FDI inflows. While the EU had no specific legal instruments to foster FDI, it relied on membership conditionality and the instruments developed for the accession process to promote foreign capital inflows. As a consequence, all East Central European growth models are heavily dependent on FDI.

As a result of the interaction of domestic transformation strategies and EU accession, the concrete forms of dependent growth models however differed. I have distinguished two growth models: a dependent export-led in the Visegrád countries, and a dependent debt-led in the Baltics States. While dependent development has led to impressive growth rates in the early years of membership, it has also made these countries vulnerable to the crisis. In contrast to the EU’s southern periphery, however, Central Eastern Europe by and large staged a recovery.

What can we then conclude about East Central Europe’s capacity to cope with deepened European integration, and about the mixed fortunes of national capitalisms at Europe’s periphery? Overall, it seems that precisely because East Central European capitalisms were profoundly shaped by EU integration, they are on balance more compatible with deepened integration than the Southern European capitalisms. Three issues stand out. First, the Baltic States, while having experienced similar debt-led growth patterns as some Southern European countries, championed in internal devaluation afterwards. They could do so because of their specific institutional model which promoted a much more neoliberal and flexible capitalism than in the South. However, I have also shown that internal devaluation and austerity have not been not the root cause of the Baltic States’ recovery. Like in Ireland, other factors account for it. On the one hand, recovery has been eased, ironically, by dependency on foreign capital. In contrast
to Southern Europe and Ireland, where banking crises morphed into sovereign debt crises, most Baltic states could externalize the costs of bank bailouts on the mother companies. On the other hand, EU financial sources played a major role in fostering growth, an issue I will come back to below.

Second, the Visegrád countries’ foreign-led export oriented model seems a workable alternative to debt-led growth. However, this is an option that the South does not have, as FDI induced growth required socialist industrial legacies, and geographic proximity to Germany. As the contribution by Regan and Brazys in this volume shows, Ireland’s recovery has relied on a different but equally important special relation to US American capital. As late and incomplete industrializers and geographically remote from the manufacturing powerhouse of the EU, and little cultural proximity to the US, the South stands a much worse chance to ever attract the necessary investment.

Third, post-crisis data reveal that FDI has lost its central position for promoting growth in the region. Instead, since the crisis it were European structural funds (and in the Baltic States remittances) that have replaced FDI as the major source of external finance. This points to an important buffering function that the EU has taken in the case of the East Central European countries (Bohle and Jacoby 2017), which stands in contrast to the role it has played in Europe’s Southern periphery and Ireland. Further research is needed to determine whether buffering the East while straightjacketing the South was a conscious strategy, or simply the result of pre-crisis decisions on the distribution of Structural Funds. Moreover, as Structural Funds have their own cycles and are likely to dry out early in the next budgeting period, and FDI has not recovered, it
is at this point unclear what can replace these two important sources of external finance for Eastern Europe in future.

This brings me to my final point. As elsewhere in the EU, integration into the European political economy has encountered increasing political contestation, especially among the Visegrád countries. This contestation is mostly articulated along nationalist lines against foreign dependency and control. Given that the hallmark of all variants of East Central European growth regimes is their dependency on foreign capital, it would be tempting to see a direct link between the specific growth models and the resurgence of nationalism. However, as I have also shown, the political forces in the country that has travelled furthest along the nationalist path, Hungary, have also altered a number of economic institutions, without however fundamentally challenging the underlying growth model. On the other hand, dependency on the EU has been much less contested in the Baltic States, where geopolitical factors and the legacies of occupation keep shaping social coalitions and electoral responses. In addition, Brexit, Trump and the rise of right wing populism and economic nationalism across Western Europe shed some doubt about a direct link between specific growth models and the re-alignment of electoral coalitions. Taken together, this show that comparative capitalism literature needs to probe further the political coalitions that may or may not support specific growth regimes and investigate more thoroughly the possibility that issues other than socio-economic questions shape electoral coalitions which may or may not have important ramifications for growth models.
References


World Bank 2016: Migration and Remittances Data.

Appendix

Table 1: East European growth models

<table>
<thead>
<tr>
<th></th>
<th>FDI</th>
<th>Current Account Balance</th>
<th>Residential mortgage debt</th>
<th>House prices</th>
<th>Social Spending</th>
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<tbody>
<tr>
<td>Estonia</td>
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<td>14</td>
<td>-18</td>
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<td>36</td>
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<td>2</td>
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<tr>
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<td>2</td>
<td>12</td>
</tr>
<tr>
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<td>25</td>
<td>48</td>
<td>-5</td>
<td>2</td>
<td>12</td>
</tr>
</tbody>
</table>

Sources: Column 1 & 2, WIIW database, Column 3 EBRD Transition Report 2009, Column 4, 5&6 European Mortgage Foundation Hypostat 2009, Column 7 Eurostat, Column 7 EU-SILC
Figure 1: Unit Labor Costs in Southern Europe, Ireland and the Baltic States

Nominal unit labor costs, 2010 = 100. Source: Eurostat
http://ec.europa.eu/eurostat/tgm/refreshTableAction.do?tab=table&plugin=1&pcode=tipslm20&language=en

Figure 2: FDI and Structural Funds Inflow in the Baltic States
Sources: Structural Funds data: European Commission (http://ec.europa.eu/budget/figures/interactive/index_en.cfm), FDI data WIIW. The inflows are measured in millions of Euro.

Figure 3: FDI and Structural Funds, Visegrád Countries

Sources: Structural Funds data: European Commission (http://ec.europa.eu/budget/figures/interactive/index_en.cfm), FDI data WIIW. The inflows are measured in millions of Euro.

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i For reasons of space I will restrict my analysis to the Visegrád country group – Czech Republic, Hungary, Poland, and Slovakia – and the three Baltic States Estonia, Latvia and Lithuania.

ii It should be noted that for Nölke (2015), Beramendi et al. is part of the second wave of CC, as it lacks a critical stance towards power relations within models of capitalism.

iii Other authors distinguish between consumption-led and export-led growth (e.g. Baccaro and Pontusson 2016, Hall 2014, Johnston and Regan, this volume). It seems to me, however, that debt-led is more accurate, as it denotes the crucial factor that enabled consumption in the first place, and also constitutes the major vulnerability of the southern and Anglo-Saxon growth models. Importantly, it also draws attention to the crucial but differentiated role of finance in contemporary growth models.

iv Only Hungary pursued a FDI-led strategy already from the early 1990s on. This was because of its massive foreign indebtedness, which left little room for maneuver for domestic privatization. In contrast to Poland, which received a debt relief, Hungary’s policy makers decided to pay back their debt (Greskovits and Bohle 2001).