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メタデータ	言語: eng
	出版者:
	公開日: 2017-10-02
	キーワード (Ja):
	キーワード (En):
	作成者:
	メールアドレス:
	所属:
URL	http://hdl.handle.net/2297/29517

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The Journal of Comparative Economic Studies, Vol.6, 2011, pp. 35–57.

Characteristics of Systemic Change and Emerged Capitalism in Central and Eastern European Countries

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Abstract: This paper examines the process of systemic change from communism to capitalism and the characteristics of the emerged capitalism in the eight Central and Eastern European (CEE) countries: the Visegrád Four (Poland, Hungary, the Czech Republic, Slovakia), the three Baltic states (Lithuania, Latvia and Estonia), and Slovenia. The history from 1989 to 2009 in the eight CEE countries can be roughly divided into three periods: 1. the period of state-led transformation (1989-1996); 2. the period of FDI-led transformation (1997-2007); and 3. the period of economic crisis (2008-2009). After analyzing factors related to systemic change, the paper argues that 'dependent capitalism' on foreign capital emerged in the eight CEE countries in the period of FDI-led transformation. In addition, the financial and economic crises since late 2008 in the CEE countries were an outcome of 'dependent capitalism'. While the dependency on foreign capital was a common feature in the eight CEE economies, Slovenia and the Czech Republic have established a more 'embedded' capitalism in society compared to the other CEE countries. The paper explains the diversity of post-communist capitalism in the eight CEE countries mainly from the differences of their state strategies and historical legacies.

Keywords: systemic change, Central and Eastern European countries, emerged capitalism

JEL Classification Numbers: P20, P51

1. Introduction

Streek (2009), a prominent scholar of comparative political economy, argues that Germany, considered a typical example of a coordinated market economy (CME) by Hall and Soskice (2001), is no longer a CME; further, he states that the last two decades have witnessed the process of re-introduction of basic capitalist mechanism. In my view, this process occurred, at least to some extent, in almost all developed capitalist countries, which led to a global economic crisis since September 2008. Some signs of policy change in developed countries from liberalization to institutionalization (or regulation) then became apparent.

At the end of September 2010, Robert Zoellick, President of the World Bank, referred to the

end of the Washington Consensus, which had strongly influenced the economic policies of the developing and formerly communist countries. Clearly, the Washington Consensus implied a number of policies aimed at adopting a liberal form of capitalism through liberalization, macroeconomic stabilization,and privatization. Thus, the end of the Washington Consensus can be linked with the policy changes in developed countries as described above.

The systemic change from communism to capitalism in the post-communist countries was implemented when the liberalization trend was prevalent in developed countries and under the dominant influence of the Washington Consensus. It is apparent that such external conditions affected the features of systemic change from communism to capitalism and of emerged capitalism in the Central and Eastern European (CEE) countries. However, other factors should also be examined in order to characterize the systemic change and emerged capitalism in the region.

How should the systemic change in the post-communist countries be understood? How can the commonality and diversity of post-communist capitalism be defined? What determined the commonality and diversity? This paper deals with these issues. It examines eight CEE countries: the 'Visegrád Four' (Poland, Hungary, the Czech Republic, and Slovakia), the three Baltic states (Lithuania, Latvia, and Estonia), and Slovenia. First, it examines the definition of the systemic change from communism to capitalism. Second, it points out a number of factors, which were determinants of the systemic change in the CEE countries. Third, it attempts to trace the process of the change from communism to capitalism and to examine the economic crisis from late 2008 to 2009 in the region. Finally, this paper tries to characterize emerged capitalism in the eight CEE countries mentioned above.

2. From communism to capitalism: Approach from 'economics of transition' by Kornai and Lane

'Economics of transition' has provided the methodology for analyzing systemic change in the former communist countries. Kornai (2008) shows one example of 'economics of transition'. He defines communism and capitalism. Then, he estimates how far the post-communist economies retreated from communism and how much they moved toward capitalism. He defines communism as the political economy accompanying the following three necessary and sufficient conditions.

(1) Communism

1. A dominant role in ownership relations for public ownership, with private ownership present in at most a subordinate, auxiliary role.

2. A dominant role in the coordination of socioeconomic activities for centrally directed bureaucratic coordination, with market coordination present in at most in a subordinate, auxiliary

role.

3. A monopoly or political power for a Marxist-Leninist Communist party, that is, a party whose program is to abolish capitalism based on private ownership and market.

On the other hand, Kornai defines capitalism as the political economy accompanying the following three necessary and sufficient conditions.

(2) Capitalism

1. A dominant role in ownership relations for private ownership, with public ownership present in at most a subordinate, auxiliary role.
2. A dominant role in the coordination of socioeconomic activities for the market, with centrally directed bureaucratic coordination present in at most subordinate, auxiliary role.
3. No political power standing against capitalism, private ownership and the market. These institutions are either supported actively or, at least, treated in a benevolent, 'friendly', neutral manner.

According to Kornai, the change from communism to capitalism implies transition from a political economy defined in (1) to another political economy defined in (2). Although this is simplified definition of change from communism to capitalism, I accept his view in principle. Quoting two tables with regard to the share of the private sector in GDP and index of transition to the market economy from EBRD, Kornai concludes that ten new post-communist member states of the EU (ten CEE countries: the Visegrád Four, three Baltic states, Slovenia, Bulgaria and Romania) have completed this systemic change.

Lane (2007) examines systemic change, covering more post-communist countries including those once belonged to the Soviet Union. He argues that the theoretical frameworks of 'varieties of capitalism' addressed established and advanced capitalism by Hall and Soskice (2001) do not capture post-communist political economies that have developed or are developing towards capitalism. According to him, one should first ask how far post-communist countries have changed into capitalism in order to characterize their political economies. In this respect, Lane's view is the same as Kornai's one. Lane argues that the concept of 'modern capitalism' as described by Marx, Weber and Schumpeter is useful for measuring the extent of change to capitalism in post-communist countries. Thereby, economic components of 'modern capitalism' are: 1. private ownership; 2. market monetary exchange of commodities for profit leading to accumulation of capital; 3. competition between firms; and 4. wage labor. These components of capitalism generally correspond with ones Marx defined.

In addition to economic components, Lane points out psychological, political and societal components necessary to identify 'modern capitalism'. For instance, he emphasizes 'the ethos of capitalism' which Weber stressed and 'entrepreneur's spirits' which Schumpeter referred to as psychological components. Further, Lane considers that 'modern capitalism' should be defined within a global context. He describes that 'really existing capitalism' is a system of production

taking place for global market exchange. Lane defines 'contemporary capitalism' well comprehensively. After analyzing empirical data related to the above components of 'modern capitalism', Lane argues that ten EU new members and a candidate country, Croatia, have already met the preconditions of 'modern capitalism'. He introduces a typology in the economics of transition, by describing that the 'Visegrád Four', Slovenia and Estonia are closest to the 'continental European type' of capitalism. Nevertheless, his approach should be classified as 'economics of transition'.

Kornai and Lane correctly point out that one should first ask how far post-communist countries have changed into capitalism in order to define their political economies. However, in my view, the time has come to examine the commonality and diversity of the emerged capitalism in post-communist countries and such attempts have already begun and produced interesting results. Later, I examine this issue, that is, commonality and diversity of post-communist capitalism in the eight CEE countries.

3. Important factors in systemic change to capitalism in Central and Eastern European countries

In order to understand the dynamics of the systemic change and the commonality and diversity of the emerged capitalism in the Central and Eastern European countries, one should examine a number of important factors, which were determinant for systemic change in the region: 1. characteristics of 'Eastern European Revolution'; 2. quadruple challenges in systemic change; 3. historical legacies; 4. the role of the FDI inflow (multinationals).

(1) Characteristics of 'Eastern European Revolution'

The 'Eastern European Revolution' is often called the 'Velvet Revolution' or 'Negotiated Revolution' (e.g., Tökes 1999). Indeed, it was revolution without violence in many countries in the region apart from the exception of former Yugoslavia and Romania. However, a more important feature of the revolution was that it was a 'bourgeois revolution without bourgeoisie' (Bohle 2006). That is to say, it was the dissident intellectuals and reform-minded technocrats that played a large role in the abolishment of the one-party political system and systemic change to capitalism in the region (Eyal, Szelény and Townsley 1997). One exceptional case was Poland where the organized working class (autonomous trade union, *Solidarity*) also played a large role in pushing for the political change. However, the Polish first non-communist government established in 1989 also had to begin systemic change to capitalism without the powerful bourgeois.

One of outcomes of 'bourgeois revolution without bourgeoisie' is that the state itself had to create capitalism. Moreover, the states in the region, which didn't have strong domestic collaborators in creating capitalism, had to make concession to those suffering from social cost of

systemic change to capitalism such as higher unemployment and impoverishment.

Another outcome of 'bourgeois revolution without (domestic) bourgeoisie' is that the outsiders strongly influenced state strategies towards creating capitalism in the region. In the first phase of the systemic change, the most influential outsiders were the IMF and the World Bank. The core ideology of these organizations was neoliberalism. In contrast, the ILO helped the countries in the region to introduce modern capitalist industrial relations and social policies. Since the middle or late 1990s, the EU influenced the state strategies of many CEE countries, which were candidates to be the members of the EU at that time. The recommendations by the EU didn't differ from those of the IMF and the World Bank. It was not surprising because the EU integration policy in the 1990s was not incompatible with neoliberalism, even though the EU policy stance was somewhat 'embedded neoliberalism' (van Apeldoorn 2002). The multinationals as the outsiders played a decisive role for establishing capitalism in the region. Since they influenced more directly systemic change and characteristics of the emerged capitalism in the CEE countries, they should be considered as a distinct factor from the above institutions.

(2) Quadruple challenges in systemic change

The systemic change to capitalism in the post-communist countries mainly implied economic transformation. As Kornai (2008) describes, political democracy is not a necessary condition of capitalism. Capitalism coexists with both leftist and rightist authoritarian states, if these states accept private ownership and market system. However, almost all post-communist CEE countries have attempted to establish a democratic regime together with capitalism. Indeed, developing democracy was more important purpose than capitalism for intellectuals in the region.

Moreover, a systemic change to capitalism in the region implies that their economies are deeply integrated into the world economy. The post-communist governments have tried to integrate their economy with the former Western economies, especially those of the member states of the EU. In the period of systemic change, the building of nation states (or states based on ethnic majority) became also an additional challenge for countries such as the newly independent Baltic countries and some countries established after the disintegration of the former Federation of Yugoslavia. This fourth challenge was often considered as more important than the change to capitalism. All of these countries tried to implement quadruple challenges (Orenstein, Bloom and Lindstrom refer to quadruple transition. Orenstein et al.2008). The states have attempted to cope with these triple or quadruple challenges in their own way, which was one of the causes for convergence or divergence in the way to capitalism and commonality and diversity of the emerged capitalism in the region (Bohle 2010).

(3) Historical legacies

Systemic change was implemented on the basis of the historical legacies, which traced back not only to communist but also to the pre-communist era. That is to say, the change to capitalism

can be looked as an historical path dependent process. For instance, the change to capitalism was easier in the countries, which had experienced the reformed communism. Moreover, the countries in which capitalism had developed in the pre-communist era had an advantage in the change to capitalism after the breakdown of communism.

The cultural legacies were also important. The 'ethos of capitalism' or 'entrepreneur's spirits', which Lane takes as important for creation of capitalism, was not easily introduced into the countries, which had not experienced a long history of capitalism in the pre-communist era, while 'communist paternalism' was not easy to throw off. Historical legacies influenced the divergence and convergence of the path to capitalism and also 'emerged capitalist' diversity in the region.

(4) Role of the FDI inflow

According to Marx (*Das Kapital*), 'the process of original accumulation of capital' preceded capitalism. On the one hand, the 'free labor' with a dual meaning (labor with personal freedom and without any means of production) emerged; on the other hand, the material means of production (factory, machinery and land) and monetary resources were accumulated and concentrated into the hands of capitalists in that process. Indeed, it was 'original accumulation of capital' that occurred in the process of systemic change to capitalism in the post-communist CEE countries. 'Free labor' emerged together with democratization and privatization of state owned firms. It can be said that free labor (labor without any means of production) emerged typically in the forms of the unemployed and the economically inactive after the collapse of communism. Although the accumulation into the hands of domestic capitalists also occurred, the pace was very slow. Multinationals, especially those of the member states of the EU, were located mainly in the Central European countries such as Hungary, the Czech Republic and Poland from the late years in 1980s or early years in the 1990s. From the middle or late 1990s, many states in the region began to accelerate capital accumulation through the FDI inflows.

There were three purposes for multinationals to settle their factories and branches in the region. First, market seeking was most important in such sectors as hotel, telecommunication, and finance. Second, cheap labor seeking was the main motive to settle in the region for labor-intensive light industries, i.e. clothing, textile and leather industries. Third, the purpose of complementary specialization within the industrial production network was important for complex capital-intensive industries, i.e., the automobile industry and high-tech industry producing computer, communication equipments and optical instruments (Berend 2009).

While the FDI inflows contributed to economic growth in the region, they influenced the types of political economies, in other words, capitalist commonality and diversity in the region. Below, I examine the process of systemic change in the eight CEE countries, taking account the above important factors.

4. Process of systemic change and economic crisis in Central and Eastern European countries: From 1989 to 2009

We can roughly divide the history from 1989 to 2009 of the eight CEE countries into three periods: first period of systemic change from 1989 to 1996; second period of systemic change from 1997 to 2007; and the period of economic crisis from (late) 2008 to 2009.

In the first period of systemic change in the countries, the state played a great role in creating capitalism through the measures of liberalization (of price, foreign trade and so on), macro-stabilization and privatization of the state-owned firms. The IMF and the World Bank strongly influenced the policy making of the governments in the countries. In the second period of systemic change, covering the years of pre- and post-accession into the EU in the eight CEE countries, the FDI inflows increased at a faster pace and the countries were strongly integrated into the European economy in which many countries enjoyed a higher economic growth rate than that of the old EU member states. In my view, the systemic change to capitalism was completed in these countries in this period. The emerged political economies can be characterized by 'varieties of capitalism', if we compare the Visegrád Four, the Baltic states and Slovenia, which became EU members in 2004. In the third period, almost all of the eight CEE countries fell into severe recessions due to the global economic crisis, although in 2010 signs of economic recovery can be found in all eight CEE countries.

Below, I examine the respective periods in order to characterize systemic change and emerged capitalism in the eight CEE countries, which this paper addresses.

4.1. First period of systemic change (1989-1996); State-led transformation

(1)Visegrád Four

I begin with examining the cases of Hungary, Poland and the Czech Republic, which had experiences of market-oriented economic reform in the communist era and became the front-runners in the systemic change to capitalism in the CEE countries. The description below owes much to the work of Chavance and Magnin (2006).

In the beginning of the systemic change, the aforementioned three countries still had a comparatively high share of the state-owned sector. The state-owned sector was composed of large firms, interwoven ownership with large numbers of institutional owners and cross ownership. Under this ownership structure, state-paternalism wasn't abolished in the three countries.

In Hungary, 'spontaneous privatization' which had begun from the end of the communist era led to the transformation of large state-owned firms into the holdings that retained the majority of shares in many 'corporate satellites' (Stark 1996). The shareholders of holdings were generally public entities such as state-owned organization in charge of privatization, state banks and public

firms. Foreign investors and private citizens also retained shares to a lesser extent. These 'hybrid ownerships' enabled firms to maintain unprofitable units running at the cost of internal redistributions. While the first Hungarian post-communist conservative government started a number of liberalization and macro-stabilization policies, it tried to pacify people who suffered 'social costs of transformation' such as an increase of the unemployed and the poor with relatively tolerant social policies including the provision of pension for the early retired and provision for families with many children (Vanhuysse 2006).

For Hungary, the primary years of change were 1995-98. When a new Socialist-led government was established in 1994, Hungary was in a bad economic situation: it had a twin-deficit, a heavy debt, a high level of inflation, high unemployment, and stagnation. In 1995, the government decided to implement a neo-liberal economic policy, that is to say, an austerity program which included the following: a cut in public spending, the implementation of a significant devaluation of the Hungarian currency (forint), an additional import tax and a fall in real wages. Welfare expenditures decreased from 29.5 per cent of GDP in 1994 to 24.3 per cent in 1996 (Szikra and Tomka 2009 : 29). The privatization process was accelerated, and the majority of large industrial firms and the main banks were sold to strategic foreign investors between 1994 and 1997. Hungary entered in the second period of systemic change, namely FDI-led transformation earlier than the other Visegrád countries.

While the non-communist Polish government, which was established in 1989, carried out restrictive macroeconomic policies, a number of successive governments implemented a wide range of privatization methods at various rates of speed since 1990 that led to an emergence of a diversity of owners: quasi-private conglomerates stemming from the former state foreign trade organizations, public holdings in heavy industry (mining, iron and steel, and shipbuilding) and SMEs bought out by employee and managers, and individual firms. However, it should be emphasized that almost 60 per cent of large and medium sized firms were still in the hands of the state in 1995 (Chavance and Magnin 2006 : 230). The production structure was dualistic. On the one hand, it was characterized by large state owned firms with a relatively soft financial discipline; on the other hand, it was also characterized by private SMEs contributing to economic growth.

Since the Czech Republic, in contrast to Hungary and Poland, remained very close to traditional central planning until 1989, the government tried to establish a reputation that it was making a definite transformation to a market system, which led to the choice of a mass privatization strategy. However, the voucher privatization resulted in the control of state-owned major banks that set up investment privatization funds (IPFs). The latter succeeded in controlling a great part of firm shares at the end of the privatization process. Thus, the interwoven ownership relations between state, bank and IPFs gave firms easier access to gain credit that enabled them to overstaff (Chavance and Magnin 2006). In addition, the paternalistic manager's behavior inherited from

the communist period led to a social pact between employees and employers that essentially implied a 'low wage, low-unemployment' regime (Orenstein 1996). Thus, in the Czech Republic, the economic transformation was gradual and path-dependent, despite the neo-liberal discourse of the prime minister, Klaus, and his government.

Slovakia, an independent state created from the disintegration of Czechoslovakia, also adopted a gradual economic transformation policy under the populist government in the first period of systemic change. It was the second period of transformation when the 'neo-liberal turn' began in Slovakia.

(2) Baltic states

Although the three Baltic states adopted their own policies of systemic change, they had a commonality in the sense that they considered independence from Russia as a top priority among the 'quadruple challenges' in systemic change. Due to this priority, their countries adopted the most radical liberalization and macro-stabilization policies among the CEE countries. That is, the countries wished to create a form of capitalism most distant from the past communism symbolized by former Soviet Union. The strict macro-stabilization policy was important from the perspective of maintaining values of their own newly introduced currencies. Thus, neo-liberal policies recommended by the IMF and the World Bank were most suited to the Baltic states.

The 'social cost of transformation' was very high in the Baltic states. In Latvia and Estonia, where the Russian-speaking minority lives, the governments attempted to pacify the frustrated ethnic majority by adopting identity policy, i.e., discrimination policies against the Russian-speaking minority in place of social policies mitigating the 'social cost of transformation' (Bohle and Greskovits 2007). As a result, all Baltic states belonged to the group, which the poverty rate was highest among EU-25 in 2004(TÁRKI 2008). The experiences of Baltic states are prime examples of neoliberalism combined with nationalism (of the ethnic majority).

Three countries implemented voucher privatization to insiders (management and employee) in the first period of the systemic change. According to Buchen(2007), the Estonian privatization is characterized by two stages. While in first stage, privatization favored insiders, the second stage from 1992 was dominated by direct sales with equal treatment to foreigners. Estonia entered in the FDI-led systemic change earliest among Baltic states.

(3) Slovenia

Slovenia clearly shows an example of path-dependent systemic change. Buchen (2007) argues that the Slovenian post-communist capitalism resembles coordinated market Economies (CMEs) like that of Germany and Austria. Slovenia tried to create corporatist-like industrial relations with a large degree of wage-bargaining coverage and co-determinant system from the first period of system change on the basis of the past legacy, that is to say, self-management socialism. Indeed, in Slovenia, the self-management in the Yugoslavia period was transformed

to a German type of worker participation system in 1993 (co-determinant system). Although membership figures of trade unions in Slovenia dropped from 69 per cent in 1989 to 40 per cent in 2001, the Slovenian figure was the largest in Central and Eastern Europe (Gebel 2008). On the other hand, the most influential employer's association is the Slovenian Chamber of Commerce to where membership was compulsory for firm managers. Under these conditions, wage bargaining in Slovenia has been conducted industry-wide.

Slovenia carried out privatization through a mixed scheme of vouchers (both for insiders and outsiders including state-controlled funds). In 2000, 25 per cent of firms were held by private investment funds or their successor, 16 per cent by insiders and the same amount by state-controlled funds in Slovenia (Buchen 2007). Slovenia was not enthusiastic about the direct sale of public owned firms to multinationals despite the strong recommendation of the EU in the pre-accession process. In the first period of system change, Slovenia adopted the policy relying on the domestic forces (Bohle 2009).

4.2. The second period of systemic change (1997-2007); FDI-led transformation

In the period of 1997-2003, the EU pre-accession process enforced the candidate countries, i.e., Visegrád Four, three Baltic states and Slovenia to accept a number of legislative and regulative aspects of the EU. Moreover, the high volume of FDI, especially in the old member states of the EU poured into the above CEE countries in the period before and after EU accession of these countries. Thus, the eight CEE counties were integrated into the pan-European economic network.

(1) Visegrád Four

Due to the austerity policy introduced in 1995, the Hungarian economy stagnated in 1995 and 1996, i.e., the growth rates of GDP were 1.5 and 1.6 per cent during the respective years. The neo-liberal tendency of the socialist-led government was also found in pension reform. The ministry of finance led the reform process with assistance from the World Bank. The World Bank's main concern was to limit the public Pay As You Go (PAYG) scheme to a minimum scale (first pillar), introduce a mandatory and individually funded, privately managed second pillar, and establish an additional voluntary third pillar. Hungary introduced this type of new pension system in 1998, even if the proportion of the second pillar to total contributions was smaller than initially proposed by its finance ministry due to resistance by trade unions and experts of social policy in Hungary.

Although Hungary enjoyed a comparatively higher economic growth rate in 1997 (4.6 per cent), the governmental parties—Socialist and Liberal-Democrat—lost their majority in the 1998 general election. It implied that most Hungarian were against neo-liberal social policies. Accordingly, since the socialist party returned to office in 2002, it adopted more socially sensitive policies such as extra-provision for pensioners and an increase in wages for public employees.

Bohle and Greskovits classify the Hungarian political economy as 'embedded neoliberalism'. One can say that the Hungarian political economy was the most 'embedded' in the period from 2002 to 2006. While the Hungarian economy enjoyed a sustained higher growth rate from 1997(annually 3 to 5 per cent), the budget deficit reached almost 10 per cent of GDP in 2006. The deficit was due to over-spending including relatively tolerant social expenditures. Therefore, the Hungarian socialist-led government shifted again to a more restrictive fiscal policy in accordance to the EU recommendation of 2006. As a result, GDP declined from 4.1 per cent in 2006 to 1.1 per cent in 2007. The Hungarian economy had already stagnated before the global economic crisis hit the country in late 2008.

As described above, Hungary accelerated the privatization to foreign investors from the mid-1990s. The private sector share reached 80 per cent in 1998. Hungary established capitalism earlier than other countries, and the established capitalism was strongly integrated in the global economy, especially European economy. In Hungary, cumulative FDI inflows from 1989 to 2004 amounted to 37 billion US dollars and on a per capita basis, 3,719 US dollars (Berend 2009: 116). These figures reveal that Hungary was only second to the Czech Republic in attracting FDI. In Hungary, 47 percent of the employed, 82 per cent of investment, 89 per cent of industrial exports were due to foreign firms in the mid-2000s (Berend 2009: 115). The Hungarian economic growth from 1997 to 2006 was mainly brought about by multinational-led export. The leading export products were in light-complex sectors such as electrical and electronics. The primary origins of FDI inflow and foreign trade partners for Hungary were the old member states of the EU. However, the links between the foreign firms and domestic firm was weak in Hungary. Fink characterizes the Hungarian economy as 'a dualistic industrial structure' and describes: '...... whereby the modern foreign-dominated export sectors vastly outperform the indigenous dominated sector' (Fink 2009: 177).

On the other hand, the share of majority foreign-owned bank in total bank assets in Hungary had amounted to 84.5 per cent by 2005 (Sugiura 2008: 109). As described below, it was one of the causes of the economic crisis that occurred in Hungary after late 2008.

It was a new *Solidarity*-led government established in 1997 that decided to break with state-oriented policy in Poland. Balcerowicz, who returned as Finance Minister, implemented a new version of neo-liberal policies. Macroeconomic austerity came back to the top of the agenda. The result was very close to a textbook prediction: inflation decreased, but unemployment rose from 10 per cent in 1998 to 20 per cent in 2002. The growth rate in GDP decreased from 6.5 per cent in 1997 to 1.4 per cent in 2002 in Poland.

In addition to this austerity policy, the neo-liberal type of structural reforms that aimed to liberalize the Polish economy and curve state intervention was implemented, while the privatization also accelerated in both the financial and industrial sectors with priority given to direct sales to strategic foreign investors. Although the social democratic party came back in

office in 2001, it could not change the policy orientation of the previous government. Since the governmental policies had to conform to EU accession requirements with a liberal orientation, ordinary Polish people became increasing dissatisfied with politics, while support for the populist party increased, bringing about the rise of the nationalist-populist party (Law and Justice Party) in the general election in 2005 and 2007. However the leading Polish governmental party has been a conservative party, i.e., the Civic Platform. According to Chavance and Magnin, the trajectory of systemic change in Poland since 1989 has thus been marked by a rough change of direction from a state-led model of capitalism in the first period towards neo-liberal model in the second period from 1997, which sharply exemplified the general tension between state protection and economic liberalization. Chavance and Magnin describe: '[d]espite this decisive shift in the Polish trajectory, state intervention has somehow shown a path-dependent resilience'(Chavance and Magnin 2006: 236).

Bohle and Greskovits argue that 'embedded neoliberalism' emerged in the Visegrad countries including Poland. Certainly, the ratio of social expenditure to the GDP was higher in Poland (around 20 per cent. World Bank 2007) than those in the Baltic states (around 14 per cent) in 2003. However, the ratio in Poland is much lower than the average of the EU-15 (old member states, around 28 per cent in 2003). Moreover, in 2006, Poland belonged to the group, which the poverty rate was highest in EU-25. That is, the poverty rate in Poland reached almost 20 percent in 2006 (TÁRKI 2009). Therefore, the Polish capitalism is not 'embedded' enough to protect the society.

After 2003 the Polish economy recovered from the recession in the beginning of 2000 and the increase in GDP amounted to 6.2 and 6.7 per cent in 2006 and 2007 respectively. This high economic growth was mainly due to an increase in foreign capital-led export. The increased loans to households by foreign bank affiliates also contributed to the economic growth through the expansion of household consumption. In Poland, the cumulative FDI inflows from 1989 to 2004 amounted to 56 billion US dollars, which was the largest in the CEEs, although the figure on a per capita basis, 1,212 US dollars, was the comparatively lower compared to other countries in the region (Berend 2009: 116). While in Poland the outdated domestic heavy-basic sector remains more dominant compared to other Visegrad countries, the FDI-led heavy-complex sector typically represented by automobile sector had developed and the export share of heavy-complex products to total exports had increased to 31 percent by 2003(Greskovits 2003). In addition, the share of majority foreign banks to total banking assets had increased to 74 per cent by 2005 in Poland (Sugiura 2008: 109). The main origins of FDI into Poland both in manufacturing and in financial sectors were the old member states of the EU. Poland had also been integrated into the pan-European production and financial network prior to the global economic crisis in 2008.

It was a financial and broader economic crisis in 1997 that brought about institutional change in the Czech Republic. Since the main cause of the crisis was poor corporate governance caused

by interwoven ownership, the new social democratic party-led government established in 1998 passed new regulations on PIFs and bank activities. It also changed the privatization methods towards more direct sales to foreign strategic investors, which increased FDI inflow from primarily the old member states of the EU over a short period. Myant expresses this change from 'Czech Capitalism' to 'European capitalism' (Myant 2007). The social consensus remained in Czech because the social democratic party-led government tried to maintain a certain level of welfare state, while developing a strong pro-EU accession policy. Nevertheless, the desire of the social democrats and society for maintaining social spending has been constrained by the conditions of joining the European Monetary Union in the country. Myant describes: 'the European element relates as much to the areas of conflict, which match the conflicts labor and social policies throughout the EU' (Myant 2007 : 122). It could be said that governmental alternation to center-right force after general election in 2002 was partly attributed to such conflicts.

Bohle and Greskovits (2007) take the emerged capitalism in the Czech Republic as an 'embedded neoliberalism'. Certainly, the Czech Republic kept a distance from neo-liberal policies. For instance, the country has not implemented a partial privatization of the public pension system, which was recommended by the World Bank, in contrast to the other three Visegrad countries. In terms of poverty, the Czech Republic was in the lowest group among the member states of the EU in 2006 when the poverty rate of the country was around 10 per cent (TÁRKI 2009). One can conclude that the emerged capitalism in the Czech Republic is more 'embedding' neoliberalism in the society compared to the Baltic States, Poland and Slovakia (and compared to Hungary since austerity program was introduced in 2006).

On the other hand, the FDI-dominant capitalism has also been established in the Czech Republic. The cumulative FDI inflow from 1989 to 2004 amounted to 41 billion US dollars, which is the second largest after Poland. The cumulative FDI inflow on a per capita basis in the above period amounted to 4,405 US dollars in the Czech Republic, which is the largest in the region. The growth in GDP was 6.8 and 6 per cent in 2006 and 2007 respectively. Similar to the cases of Hungary and Poland, such economic growth was mainly attributed to an increase in multinationals-led exports. The leading export products were those of the complex-heavy sector such as automobiles. The share of majority foreign-owned bank among total banking assets in the Czech Republic had climbed as high as 94.5 per cent by 2005 (Barisitz 2008: 157). The main origins of FDI flow into the country in manufacturing and in financial sectors were the old member states of the EU.

It was after the general election in 1998 that Slovakian economic policy began to turn towards a neo-liberal direction. In 1998, the Slovakian prime minister changed from Mečiar, a leader of a nationalist-populist party, to Dzurinda, a leader of a center-right party. During the period from 1998 to 2006 when Dzurinda engaged with the prime minister, Slovakia adopted a number of

neo-liberal economic measures and the FDI inflow from old member states of the EU to the country accelerated.

The most striking neo-liberal measure was tax reform towards a flat rate tax regime, which was implemented in 2004. As a result, the rate of income tax, corporate tax and value added tax changed to 19 per cent, respectively. A flat income tax rate without progressiveness weakened the role for the tax system to redistribute wealth from the rich to the poor. A flat rate of corporate tax system aimed to attract foreign capital to the country. Drahokoupil calls the emerged capitalism in Visegrád Four as 'Porterian workfare state' and describes: 'it follows Porterian logic of competitiveness that puts emphasis on attracting skill intensive and technology rich investment and embedding it in the local community' (Drahokoupi 2007: 189). The concept of Drahokoupi explains well the strategy of the Visegrád Four in the second period of systemic change, especially in the case of Slovakia. Although Bohle and Greskovits (2007) classify Slovakia as 'embedded neoliberalism', this doesn't fit in this case. The Slovakian capitalism is less embedded to protect society.

Slovakia attracted foreign capital, especially in the automobile industry. Many multinationals such as Volkswagen, KIA and Peugeot built their plants in the country. Thus, on a per capita basis, Slovakia became the world's number one car producer with 800,000 cars per year by 2006 (Berend 2009: 125). The share of majority foreign-owned banks in total banking assets in Slovakia had reached 97.3 per cent by 2005 (Sugiura 2008: 109). Slovakia, which was deeply integrated in the European network of production and finance, became a member of the euro area (EMU) in 2009.

Systemic change in the Visegrád countries was completed by the time of EU accession and the emerged capitalism in the countries can be characterized by foreign capital dominancy.

(2) Baltic states

The Baltic states achieved high economic growth rate in the second period of systemic change (1997-2007). Estonia achieved 6.8 and 6 per cent of the growth rate in 2006 and 2007 respectively. The corresponding figures in Latvia were 12.2 and 10 per cent and in Lithuania 7.8 and 8.9 per cent. Therefore, it was not surprising that some economists called these countries 'Baltic tigers'.

During the years before accession of the EU, FDI inflow increased in the Baltic states, too. On a per capita basis, the cumulative FDI inflow from 1989 to 2004 in Estonia amounted to 2,847 US dollars, which was the third highest following the Czech Republic and Hungary. The corresponding amounts in Latvia and Lithuania were 1,612 and 1,212 US dollars respectively, which exceeded those of Bulgaria (1050 US dollars) and Romania (746 US dollars). However, the Baltic states lagged behind the Visegrád Four in FDI inflow for upgrading the manufacturing sector. In Baltic states, the leading export goods are still composed of products in the light-basic sector such as wood, simple wood products, textiles and clothes, although the share of products of

the light-complex sector such as telecommunication to total export has increased in Estonia. Greskovits characterizes the export structure of Baltic states as that of 'semi-periphery' countries (Greskovits 2008).

The economic growth in the 2000s in the Baltic countries was attributed to the increased FDI in the financial sector more than that in manufacturing sectors. The share of majority foreign-owned banks in total banking assets had amounted to more 58 per cent in Latvia and 99 per cent in Estonia and 92 per cent in Lithuania by 2005 (Sugiura 2008: 109). Whereas the economies of these countries grew at a quick pace in 2000s, it was growth in which the housing boom and an increase of household consumption promoted by foreign currency denominated loans played a major role. Bohle describes: '[B]etween 2001 and 2006 the price of a square meter in a standard type block house in Riga increased by 42 per cent annually, while by 2006 more than 70 per cent of the construction loans were issued in foreign currency, primarily euro' (Bohle 2010: 8-9). This housing boom with an increase of household consumption led to an increase of the current account deficit in the Baltic states, especially in Latvia.

In the second period of systemic change, the ratio of social expenditure to GDP remained low in the Baltic states. It could be said that the governments of these countries tried to compensate a small welfare state with housing and consumption boom by foreign currency denominated loans to the households (Bohle 2010).

(3) Slovenia

Slovenia achieved constant economic growth from 1993 and its growth rate reached around 6 per cent in 2006 and around 7 per cent in 2007. As described above, Slovenia was not enthusiastic about the direct sale of public owned firms to foreign investors and attracting of multinationals despite strong pressure from the EU in the pre-accession process. In Slovenia, the ratio of the amount of majority foreign-owned banks' assets to the total amount of assets of banking sector was 23 per cent in 2005 (Sugiura 2008), which was much lower compared to those of Visegrád Four and Baltic states. On the other hand, Slovenia gradually attracted FDI from former Western countries, especially from the old member states of the EU. Although cumulative FDI inflows into Slovenia from 1989 to 2004 was 3 billion US dollars, which was much a smaller amount compared to the Visegrád Four and the Baltic states, cumulative FDI on a per capita basis during the above period in the country was 1,507 US dollars, which was a greater amount than that of Poland. The leading export products in Slovenia are those in heavy-complex and heavy-light sectors such as automotive and pharmaceutical products; therefore, the export structure of Slovenia is classified as that of 'semi-core' countries (Greskovits 2008).

Three years after the EU accession, Slovenia joined the euro-area (EMU) in 2007. Slovenia was also integrated into the European financial and production network, while maintaining neo-corporatist capitalism, in other words, a most 'embedded' capitalism among CEE countries.

In terms of poverty, Slovenia was the lowest group along with the Czech Republic among the CEE countries in mid-2000s.

4.3. Period of economic crisis (2008-2009): Financial turmoil, the decline of domestic consumption and exports

While the economic growth in the CEE countries in the second period of systemic change originated from an increase of exports to the old EU member states, it also originated from the housing and household consumption boom in many countries, which was promoted by foreign currency denominated loans mostly from affiliates of the old EU member states' banks. From a few years before 2008, international organizations and economists had expressed fear of 'housing bubble' bursting in the CEE region (Enoch and Ökter-Robe 2007; Barisitz 2008). This fear turned into reality in Latvia already before the bankruptcy of Lehman Brothers on 15 September 2009. After Latvia enjoyed a high average annual growth rate of 7.6 per cent from 2001 to 2005, housing prices fell 24 per cent from mid-2007 to mid-2008.

The financial crises in the US and the old EU member states quickly led to a currency crisis in several CEE countries whose currencies were less pegged with the euro. Due to the rapid credit squeeze in the old EU member states, foreign investors, including the old EU members' financial institutions, sold shares and governmental bonds of the CEE countries and decreased lending to them. As a result, currency crises occurred in the new EU member states such as Hungary, Poland and the Czech Republic. In addition to a weakened currency, their stock market also fell sharply. After the currency crisis hit and financial market turmoil occurred in October 2008, the Hungarian government requested standby loans to the IMF for financing, above all, the governmental debt service. Hungary received loans amounting to 20 billion euros from the IMF, World Bank and EU. However, its cost was great because the Hungarian government was forced to take restrictive measures such as an increase of the VAT and wage cuts of public servants during the recession.

Although the Baltic states countries whose currencies had been pegged strongly with the euro did not face a currency crises, their stock markets also fell sharply and foreign banks decreased lending to the countries. Faced with a credit crunch, Latvia had to request and received standby loans from the IMF in order to make up a shortage of foreign currency reserves. As a result, Latvia was forced to adopt a restrictive fiscal policy, which deteriorated further the economic situation and living conditions. The affiliates of the banks of EU members such as Austria, Italy, Belgium, Germany and Sweden had played a dominant role in the banking sector in almost all CEE countries, except Slovenia. As described above, the affiliates had provided households with foreign currency denominated loans. Since capital from their parent banks to affiliates decreased due to credit shrinkage in the old EU members markets, the CEE countries faced financial difficulties. The Slovenian domestic banks also did not escape the consequences of the

international finance crisis. The financial difficulties led to a broad real economic crisis in the CEE countries. In Latvia in which the housing boom led to high economic growth and then housing prices subsequently decreased sharply, household consumption rapidly declined as well as overall GDP. This drop in GDP was the largest among the new EU member states of the CEE countries in the first quarter of 2009 (—18.6 per cent compared to the first quarter of 2008). In the three CEE countries, namely Poland, the Czech Republic and Hungary, whose currencies weakened sharply against all major currencies, the rise of household indebtedness calculated in the domestic currency became one of the factors discouraging household consumption, as housing loans were denominated by foreign currencies such as the Swiss franc and the euro in these countries.

Although the impact of the financial crises in the US and the old EU members on Slovenia was small since domestic banks dominated the financial system relative to the other CEE countries, the shrinkage of its export market hit the real economy from autumn 2008. In this respect, all eight CEE countries (Visegrád Four, three Baltic states and Slovenia) faced a similar situation. However, the scale of damage from the shrinking export market differed across the countries. That difference originated from the export dependency to GDP ratio, the economic situation of main trade partner, and the potential domestic demand of respective countries in the region.

The indicator of export dependency, measured by the ratio of exports to GDP, is very high in Slovakia (86 per cent in 2007, OECD 2009), Hungary (78 per cent in 2006, OECD 2007) and the Czech Republic (76 per cent in 2006, OECD 2008a). In Poland, it was smaller (41 per cent in 2007, OECD 2008b) than the above three countries due to its larger size of potential domestic demand size, namely a large population (38 million). In addition to a relatively lower export dependency, the improvement of the agriculture sector after accession to the EU was another reason why the impact of the global economic recession on Poland has been modest compared to the other three Visegrád countries. While the GDP of the first quarter (Q1) of 2009 compared to Q1 of 2008 was lower by 5.4 per cent in Slovakia, 4.7 per cent lower in Hungary, and 3.4 per cent lower in the Czech Republic, the Polish GDP in Q1 of 2009 was higher by 1.9 per cent over Q1 of 2008.

The export dependency of the Baltic states was lower than those of the Czech Republic, Slovakia and Hungary and higher than that of Poland. The export dependency was highest in Estonia (70 per cent) among Baltic states. Both decline of exports and domestic consumption resulted in the drastic economic drop in the Baltic states. The GDP in Q1 of 2009 compared to that of Q1 of 2008 was lower by 18.6 per cent in Latvia, lower by 15.6 per cent in Estonia, and lower by 11.8 per cent in Lithuania respectively. Although the export dependency of Slovenia (60 percent in 2004) was lower than that of the Czech Republic, Slovakia and Hungary, the country was also damaged from the severe recession of the old EU members.

The share of exports to the old EU member states (EU-15) had reached around 70 per cent of

the total export of the new EU members (EU-10 including Bulgaria and Romania) by 2004. The largest trade partner for the Visegrád Four was Germany in 2008. Austria was an important trade partner for Hungary, Slovakia and Slovenia. The Baltic states still keep trade relations with Russia and Russia is the largest trade partner for Lithuania. However, Germany is second largest importer for Lithuania and Latvia. Finland, Sweden and Germany are the three largest trade partners for Estonia. For almost all countries in the CEE, Germany is a significant trade partner. Accordingly, it could be said that the steep recession in Germany deteriorated the CEE economies from the third quarter of 2008. Subsequently, with the recovery of the German economy, many CEE economies began to recover at different rates. Relative to previous quarter in Slovakia and the Czech Republic, the growth rate turned to positive since Q2 of 2009 and Q3 of 2009 respectively. In Hungary, the GDP growth rate turned positive in Q4 of 2009. Although the economies of Baltic states and Slovenia still remained unstable and stagnated in 2009, their countries achieved the positive growth rate in Q2 in 2010 relative to previous quarter. As above described, Poland is unique case where the GDP growth continues since Q1 in 2009.

In addition to the GDP, one should note that in June 2010 the unemployment rate was highest in the Baltic states and Slovakia among the eight CEE countries (19.4 per cent in Latvia and 18.6 in Estonia, 18.2 per cent in Lithuania, 14.4 per cent in Slovakia). The unemployment rate in Hungary (11.2 percent) is higher than that of Poland (9.5 per cent) and the average of the EU-27 (9.6 percent). The rate is comparatively lower in the Czech Republic (7.1 per cent) and Slovenia (7.3 per cent). Apart from a exception of Poland whose economy was hit by the global crisis only in Q4 of 2008, these figures reflect to what extent each state has made efforts to mitigate the 'social costs' of economic difficulties.

5. Concluding remarks: Commonality and diversity of capitalism in the Central and East European countries

How can the emerged capitalism in the above eight CEE countries be characterized? How is the emerged capitalism in these countries similar, and how does it differ? I will answer these questions below.

First, I will point out the commonality of capitalism in these countries. King classifies post-communist capitalism into two types: 1. liberal dependent capitalism (with both proto-CME and LME. LME implies a liberal market economy typically represented by the US. Hall and Soskice 2001) and 2. patrimonial capitalism (King 2007: 314). Although patrimonial factors can be found in all post-communist countries, what characterizes the above eight CEE countries is their dependency on foreign capital. These countries have, more or less, been integrated into the pan-European production and financial network. While the economic development in the Visegrád Four in the 2000s is mostly attributed to the EDI-led expansion of exports to the EU

area, it was excessive lending to households by the majority of foreign-owned banks that brought about a housing and household consumption boom in the Baltic states in the 2000s. Even in Slovenia, which gradually attracted FDI, the economy is already integrated within the European economy. Therefore, the capitalism in the eight CEE countries should be characterized as dependent capitalism, that is, 'dependent capitalism on foreign capital'. It is not wrong to establish capitalism on the basis of FDI inflows, since this was how countries with insufficient original capital were able to establish capitalism.

One problem related to dependent capitalism in the CEE countries is that the spillover effect from FDI has been limited, and economic growth has not been linked to domestic R&D and technology effects (Dyker 2004). Berend points out that the role of domestic firms as suppliers to multinationals has been limited in the CEE countries. For instance, domestic suppliers in Poland produce only 40 per cent of the total supplies to multinationals. This share is 45 per cent in Hungary (Berend 2009). Another problem with dependent capitalism is that SMEs have not developed in the CEE countries. While, in the EU as a whole, SMEs employing up to 100 workers employ about 50 percent of the total workers, in countries such as Poland, Hungary, and Slovenia, at best, only 20 per cent of employed people work in SMEs (Berend 2009). Advanced technology has often been produced by SMEs, which have also provided places for employment in the US, the core European countries, and Japan. The development of SMEs is necessary for CEE countries to move towards a more balanced growth pattern between exports and domestic demand.

Second, I will refer to the diversity of emerged capitalism in the eight CEE countries. The concept of 'embedded (ness)', coined by Polanyi (2001), is useful when one characterizes the type of capitalism. In my view, the diversity of capitalism in the CEE countries can be explained by the extent and form of 'embedding' the market economy in their own societies. As mentioned above, Bohle and Greskovits classify capitalism in these countries into three types: 1. pure neoliberalism in the Baltic states, 2. 'embedded neoliberalism' in the Visegrád Four, and 3. neo-corporatism in Slovenia. Certainly, the CEE countries, except Slovenia, were influenced by the liberalization trend in the developed countries and the Washington Consensus in the systemic change to capitalism in different degrees.

The Baltic states placed the most emphasis on establishing capitalism furthest from the old regime, which originated from a strong desire for both discontinuity from the Soviet Union era and maintaining state sovereignty. In other words, the Baltic states gave the highest priority to building and maintaining nation states (nation states for the ethnic majority) among the quadruple challenges. Neo-liberal policies recommended by the IMF and the World Bank matched these aims of the Baltic states. The Baltic states, especially Latvia and Estonia, dealt with social costs such as the increase in unemployment and poverty not by direct social policies but by identity politics until the late 1990s. In the 2000s, the Baltic states tried to pacify frustrated people by the

housing and consumption boom by foreign currency denominated loans, while maintaining low social expenditures (Bohle 2010). Accordingly, capitalism in the Baltic states can be classified as pure neoliberalism, where the market economies were embedded only weakly. It will be difficult for the Baltic states to sustain economic development with 'semi periphery' industrial and export structures and to improve the standard of living with low social expenditures. The Baltic states should modernize their industry and make efforts to decrease the poverty rate.

Although the essential policy stance was also neo-liberal in the Visegrád Four, the share of social expenditure to the GDP in these countries was much higher than that of the Baltic states (World Bank 2007). In this respect, the capitalism in the Visegrád Four can be classified as embedded neoliberalism. In my view, however, the capitalism in Poland and Slovakia is less embedded in their societies. As previously mentioned, among the EU-27, Poland belongs to the group along with the Baltic states in which the poverty rate is highest. Slovakia shifted to a more neo-liberal policy line from the late 1990s, and the present unemployment rate in Slovakia is high, close behind that of the Baltic states. Capitalism is less embedded in the societies of these two countries.

It is not correct to characterize the present Hungarian capitalism as embedded neoliberalism. The first post-communist Hungarian government made efforts to mitigate the social costs of economic transformation by maintaining a comparatively higher social expenditure. Although the Hungarian economic and social policies took a more neo-liberal direction from the mid-1990s, the policies shifted again towards embedded capitalism from the beginning of the 2000s. As Bohle (2010) describes, Hungarian capitalism is partly inherited from paternalism of the Kadar era. However, such a state concession to the people, that is, embedding capitalism in society, became difficult in Hungary because of the economic crisis and budgetary conditionality accompanying loans from the IMF. The result of the general election in 2010 partly reflected this difficulty. That is, the socialist party was defeated and the nationalist center-right obtained over two-thirds of the parliamentary seats in this election. Importantly, the ultra-right-wing party became the third-largest party in the parliament. The possibility of a revival of the pre-World War II right wing authoritarian regime in Hungary cannot be dismissed.

The systemic change of the Czech Republic was unique in the sense that the Klaus-led government implemented large-scale mass privatization, aiming to create domestic and national capitalism. Ironically, this experiment led to hybrid capitalism consisting of state-private mixed ownership, which allowed communist paternalism to survive in the country. The Czech Republic government changed its strategy, moving in the direction of the capitalist creation based on FDI inflow, that is, multinationals. On the other hand, governments in the country have usually sought social consensus. Thus, Czech capitalism can be considered to be more embedded in society than that of the other Visegrád countries.

Bohle and Greskovits (2007) are correct in defining Slovenian capitalism as neo-corporatism.

It was a path-dependent architecture from past self-management socialism. This neo-corporatism has embedded capitalism well in the society. Slovenia also faced quadruple challenges, including building the nation state. Since Slovenia had a homogenous ethnic structure different from Latvia and Estonia, it did not need to mobilize people by identity politics. However, Slovenian nationalism can be viewed as a way of establishing capitalism based on domestic forces, including the working class.

Finally, I will point out that, along with state strategy, historical legacies have influenced the type of emerged capitalism, that is, the extent and form of embedding market economy in the CEE societies. The Czech Republic and Slovenia are good examples in this regard. The region corresponding to the present territories of both countries was the most economically developed one in the pre-communist and communist eras. Moreover, in the CEE countries, Czechoslovakia was the most democratic country with relatively influential social democrats in the pre-communist age. As mentioned above, Slovenia experienced self-management socialism. In terms of GDP per capita measured by purchasing power parity, Slovenia and the Czech Republic were the highest among the CEE countries in 2005 (22,140 and 19,500 US dollars respectively. Cohen 2009: 175). Not only in terms of the poverty rate but also in terms of income disparity, both countries were the lowest among the CEE countries in the mid-2000s (The Gini index was 26 percent in Slovenia and 22 percent in the Czech Republic in 2005. Cohen 2009: 175). Both countries created more developed and embedded capitalism on the basis of past advantageous legacies. In this sense, capitalism creation after the breakdown of communism in the CEE countries was the process of 'historical reproduction'. However, it may not be the last word.

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