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In-depth comment on the varieties of capitalism in the new Member States, as well as on the key issues regarding competition and innovation

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The varieties of capitalism in the old member countries of the EU can be correctly described based on Amable's typology including the Anglo-Saxon type ("Market-based economies"), the Central European type (the German-speaking part of Europe, in the first place), the South European type and the Nordic type. It is rightly assumed by Maria Joao Rodrigues, the author of the Key Issues Paper that East European transition countries are likely to represent a fifth kind of capitalist development in spite of the fact that their recent experience in this respect goes back to one and a half decade only.

It is also true, however, that some of these countries, especially the Visegrad ones (Poland, the Czech and Slovak Republics and Hungary) and also Slovenia had some experience with the Central European kind of capitalist development prior to WWII. Due to the more than forty years of Socialism in these countries however, the reconstruction of the institutions of market economy had to be carried out from scratch in most of them. Only the modestly liberal and internationally more or less open Hungarian and the not centrally planned, also favorably located Slovenian economy were partial exceptions to this rule. In contrast to them, most former Soviet republics (except for the three Baltic countries) did not have any real capitalist experience which is also reflected in the condition of their current economic and social models. In the following, we focus on Central European experience regarding Eastern European capitalism.

The matrix kind of scheme of the types of capitalism makes it possible to define the social/economic models of the former transition, now new member countries (NMCs) as compared to the other members of European integration. We feel, in the same time, that the three Baltic republics (BRs) represent a sub-type of this model for several reasons. Without trying to be exhaustive, these reasons include the following:

The BRs were, with the very limited exception of Estonia, extremely isolated from the West. This made it possible for their post-1990 governments to launch the transition process without any major concern regarding social tensions or political reluctance to change based on references to welfare state practices in Western Europe, and also supported by an unusually wide political consensus on leaving behind the Soviet model as fast as possible.
The macroeconomic constraints on these economies were modest for at least one reason: the BRs did not inherit any foreign or internal debt.
The BRs were completely free to elaborate their systems of economic and social regulation in the early nineties. As opposed to them, the Visegrad countries had a number of former legislations in place (as, for example, relatively inflexible regarding labor market regulations) which were difficult to be discarded. Furthermore, the less than unanimous political support for in-depth transition made it that most Visegrad countries had to adopt such transition-related elements of legislation which did not really help accelerate the transition process. Such elements include rules of privatization, tax rules, labor market regulation and subsidy schemes for agriculture, among other things and depending on countries.

For the reasons listed above, the BRs cannot be considered as countries entirely compatible with the model of Eastern European capitalism. And again, other former Soviet republics including Russia, Ukraine or Belarus are still even more different from the Central European submodel of Eastern European capitalism.

Coming back to the main features of Eastern European capitalism, they are listed below following the structure of the Key Issues Paper.

Science: the R+D system is notoriously underfinanced (less than 1 per cent of the GDP with the slight exceptions of Slovenia and the Czech Republic) but delivers better than the comparable systems of some old member countries, especially in Southern Europe. This is true mainly for publications and, to a lesser extent, patents as well. Public money covers about two thirds of GERD in these countries. BERD is low due to poor industrial interest in domestic R+D, the dominance of foreign owned firms in high-tech output and exports, and also to the fact that only a minor part of the corporate sphere is effectively interested in R+D. The institutional system of R+D is fragmented in some countries with government financed basic research going on in universities and in research centers of the national academies of science as well. In the same time, research centers focusing on applied R+D are rare and, in many cases, not directly linked to the business world.

Technology: a sharp contrast can be observed between the considerable average high-tech content of exports and poor domestic innovation activities. This is true especially for Hungary, the Czech Republic and Slovenia. The as yet more or less unclear regulation of intellectual property rights (partly due to problems of application of the law) and the poor legal background of venture capital based financing of innovation make it that incentives for domestic innovation are also insufficient. In general, basic research performs much better than the entire domestic innovation system in these countries. Innovation is sporadic and, in general, not too competitive in the SME sector.

Competence and skills: labor markets are, in general, overregulated and formal job protection quite strong. Mobility within these countries is hampered by very rigid housing markets and other insufficient infrastructural conditions of mobility (education, social and health services etc.). Skill structures are becoming increasingly counterproductive: the high percentage share of labor supply with higher education is not supported by an adequate supply of skilled workers. While these societies are ageing rapidly, the new age cohorts entering the labor market possess less skills needed by business and industry whilst too many of their members are skilled for jobs offered by the public sector. The outcome of these biases is the shrinking of supply of skilled workers. Some countries such as Hungary have a number of FDI-based high-tech manufacturing capacities with significant immigrant employment as a result of the domestic shortage of skilled labor.

Education: pre-1990 governments put, as a rule, much weight on this sector with its quite generous financing. The priority treatment of education served both equal social opportunity purposes and ideological indoctrination. Financial inputs did not really dwindle in absolute terms after 1990, but shrinking human capital and soaring enrolment (first of all in higher education) brought some national education systems in the region close to crisis. The Austro-Hungarian tradition of intensive and demanding high school education is still in place, but the quality of high school graduates is deteriorating as shown by PISA figures. Vocational training has also lost much ground. In general, the education sector of the Visegrad countries is suffering from increasing problems of international competitiveness. On the policy level, no really appropriate solutions have been found yet to the dilemmas of theory versus business, and general knowledge versus techniques/methodologies oriented middle and higher education. A further burden on these systems consists in the poor overall command of widely spoken foreign languages and IT techniques by the populations of these countries. To conclude this section, systems of lifelong learning are also narrow in focus and underdeveloped in these countries.

Wage-labor nexus: formerly strong systems of employment protection have been significantly streamlined since 1990. Trade unions have lost much of their political influence, membership and social base. Labor legislations are still quite employee-friendly, but many cases of harm to employee interests are not even brought to court. Some multinational firms, hypermarket chains for example, have a reputation of poor industrial relations. As a result of weak employee protection however, strikes are rare in the countries of the region with partial exceptions of Poland and Slovakia. Recent countrywide Slovak strikes can be linked to aggressive reform measures by the government in parts of the public sector as, for example, the healthcare system. Wage bargaining is carried out in a centralized way, but many employers including SMEs and certain foreign-owned firms do not necessarily follow recommendations produced by such bargaining.

Labor markets: regulation is strong, at least in a nominal sense, but both employers and employees are inventive in bypassing rules on minimal wages, job protection and social security. This is the case especially in Hungary, but not only there. One such technique of bypassing regulations is replacing employment with subcontracting in which case people technically working for a larger company are, in fact, employees of their own small firms subcontracted by their real employer. Such solutions decrease the level of social protection to a significant extent, since part of wage costs are transformed into payments to subcontracting firms. Labor markets are quite segmented both in the sectoral and the regional sense. In general, underdeveloped Eastern regions of these countries suffer from high structural unemployment.

Social protection: healthcare and pension systems are inefficient. Although they are financed from social security contributions high in a European comparison and adding much to wage costs, quality healthcare is exceptional and pensions are low as compared to costs of living. Reform proposals suggesting increasing self-financing of such services have been partly put in practice (e. g. by the Hungarian pensions system reform of 1997), but major changes in the healthcare system have led to considerable social unrest (e. g. in Slovakia). As a rule, mortality rates and indicators of social health do not reflect relatively high current levels of public expenditure on healthcare in the Visegrad countries. Health related social security spending is often not well structured. For example, hospital capacity is too large while outpatient clinics are underdeveloped, and governments are often unable to resist supplier pressures towards increasing prices of drugs and medical equipment.

Competition: a strong presence of major multinational players makes a number of sectors highly concentrated. This reflects the fact that privatization has been carried out often without any attention to concerns on competition. Concentration is usually very strong in network industries. Competition policies and legislations closely follow established EU models, but the implementation of competition law is sometimes slow and inefficient. Major competition policy problems include bid-rigging at government tenders and mergers in highly concentrated industries dominated by private successors of former state monopolies.

Product-market competition: price competition is still dominant owing to low average purchasing power levels and also to problems related to the state of competition and consumption cultures of the populations of East European countries. Governments are quite weakly involved in market and price regulation which is reflected by dominant positions of a number of hypermarket chains vis-à-vis their suppliers, subcontractors and also employees. The protection of domestic markets from too aggressive import competition is usually weaker than in the EU-15. Non-price coordination exists in a number of sectors. The degree of this kind of coordination depends on the sectoral and regional structures of FDI since most major market players are domestic owned. As a rule, many of their informal networks existing abroad are also present in the NMCs.

Finance: financial insitutions are technically well developed and organized entirely according to West European patterns. Banking and insurance markets are highly oligopolistic and the suppliers of such services usually operate with considerable profit margins. This makes credits to firms usually expensive and business reluctant to too high credit exposure. Banks are therefore increasingly oriented towards retail markets which are still considerably unexplored. A potential Achilles heel of banking systems is soaring consumer debt partly denominated in foreign currencies (EUR, USD, CHF) and therefore strongly exposed to exchange rate fluctuations.

Financial sector: rules of corporate governance follow German patterns with some Anglo-Saxon influence (e.g. Supervisory Boards are less powerful than in Germany). The protection of minority shareholders is well developed in a formal sense, but practice shows a number of cases where such protection was ineffective. Institutional investors have a major role in a few firms only, but these firms include the most important players of the energy, telecom and banking sectors and are quoted on the national stock exchanges. In some countries however, the ownership structure of many firms, including major exporters and employers still lacks transparency. The degree of sophistication of financial markets is rapidly increasing, new instruments of investment are fast gaining ground. Conscious and strategic investor behavior is, however, still quite a rarity among households.

Summary

Eastern European capitalism has been described here as it exists in the NMCs of East Central Europe (the Visegrad countries). It can be presented briefly as a mixture of the Central and the Southern European model with its formal (regulatory) elements borrowed more from German speaking countries and its economic and social systems functioning more along Southern European lines. While a few elements of the market-based model can be still identified, elements of the Nordic model are completely missing from this picture.