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The State, Internationalization, and Capitalist Diversity in Eastern Europe

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Contributions to the debate on varieties of capitalism in Eastern Europe are made in three ways. First, the four types of capitalist regimes that differ in particular institutional configurations and performances are empirically identified: the state-crafted neoliberalism of the Baltic States, the more directly world-market driven neoliberalism of the CIS countries, the embedded neoliberalism of the Visegrad countries, and neo-corporatism in Slovenia. Second, the diversity of capitalist regimes are explained as a result of the complex interplay of external factors – specifically world commodity and financial markets, international institutions and foreign direct investment – and different state capacities to implement reform choices. Third, a caution is given against an uncritical application of the dominant approach of comparative political economy, varieties of capitalism, since it is ill suited to study the emergence of institutions, their international embeddedness, and the semi-peripheral character of East European capitalisms.

1 KEY WORDS

1 Introduction

A surprising diversity of capitalisms has emerged from the transformation of East European societies. Researchers identified a deep dividing line between the socio-economic regimes of many countries of the Commonwealth of Independent States (CIS) and their counterparts in Central-Eastern Europe (CEE). Whereas the former are characterized by the persistence of non-market relations, and political domination of the economy, the latter seem to be closer to the Western type of liberal market economies. Within these two groups, further major distinctions have emerged. Some states in the first group seem to have abandoned the transformation towards a democratic market economy altogether, while countries within the second group exhibit more success in their effort to achieve full-scale Westernization.

In order to characterize and explain this diversity, recent scholarship has increasingly built on the insights of the currently most influential approach in comparative political economy, the 'Varieties of Capitalism' (VoC) framework as developed by Hall and Soskice (2001). This framework has generated powerful insights in the diversity of advanced capitalist economies. In our view, however, it is much less well suited to understand capitalism's varieties in Eastern Europe. First, the VoC was designed to analyse a very limited number of cases, namely the world of the Organization for European Cooperation and Development

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(OECD). Assuming that the models of capitalism characterizing the rich and powerful of this world can be transplanted wholesale to a region where capitalism is much less developed is the contemporary equivalent of assuming that by studying the life at the king's court we can gain meaningful insight into the life of the peasant, or the vagabond. Staying with the two models of capitalism discovered by the VoC approach is to underestimate the true diversity of capitalism, especially once outside the OECD world. Second, whereas the VoC approach takes institutional configurations for granted, and analyses their impact on firm behaviour and on different national strategies to meet the challenges of the global economy, capitalist institutions in CEE have emerged only recently, and their consolidation cannot yet be taken for granted. Third, the emergence of capitalist institutions in CEE have been much more thoroughly shaped by international and transnational influences than is the case in the advanced economies.

Our study therefore seeks to contribute to the development of a more suitable framework for analyzing the diversity of capitalisms in CEE, to empirically substantiate major differences between these new capitalisms, and to offer some reflections as to how this variation materialized. In section 2, we critically review the growing literature on post-communist varieties of capitalism. We also outline the elements of our own framework, particularly emphasizing the inter- and transnational context of the region's transformation, as well as the state, the key agent of change. Sections 3 to 6, demonstrate the divergences based on a number indicators of institutional configuration and performance: state capacity, market reforms, political stability, social inclusion, democratization, industrial transformation, and macroeconomic stability. Our sample is based on the most internationalized cases: the eight new CEE EU members, and three highly internationalized CIS countries. Based on the empirical evidence, section 7 identifies four major types of capitalism in Eastern Europe, and offers an interpretation of their logic of emergence. In section 8 we conclude.

2 East European Varieties of Capitalism: State of the Art and Criticism

The diversity of post-socialist political economies became a major issue for East Europeanists in the late 1990s. Before that discussions had been dominated by the essential problem of the road towards capitalism 'without adjectives'. As Sachs asserted,

> [t]he main debate in economic reform should therefore be about the means of transition not the ends. Eastern Europe will still argue over the ends: for example, whether to aim for Swedish-style social democracy or Thatcherite liberalism. But that can wait. Sweden and Britain alike have nearly complete private ownership, private financial markets and active labour markets. Eastern Europe today has none of these institutions; for it, the alternative models of Western Europe are almost identical (1990: 19).

As if to corroborate the above sequence, 15 years after the breakdown of state-socialism and after sustained attempts at market reform, the East European societies indeed seem to have settled on divergent models of capitalism, and 'transitology' has moved on to comparison.

2.1 Capitalist Diversity in Eastern Europe

As to the diversity, the first major finding of the literature is a *dividing line between two types of post-socialist capitalism*. As King summarizes, there exists 'a patrimonial variety dependent on raw material exports which produces "involution" and a liberal variety that is dependent on capital imports and manufactured exports, and that leads to some development' (2002: 28). While King derives his conclusion from the analysis of only two cases, the existence of these distinct types is confirmed by wider research. Based on a number of indicators capturing the extent of liberalization, privatization, type of integration in the global economy, redistribution and inequality, Lane (2005) finds that one group of East European countries has developed features that resemble the attributes of the continental European type of market societies. This group encompasses all East European newcomers and applicants to the EU. Recognizing these countries' overall successful rapprochement to continental European economic standards, Lane identifies deviations too: stronger state involvement in the economy, lower level of capital accumulation, and much higher degree of exposure to the global economy. Nevertheless, Lane claims that these countries 'tutored by the conditionality requirements of the EU and the IMF . . . have developed not only the economic preconditions of capitalism but also the political and societal: an appropriate type of government, a civil society and an emerging bourgeois class structure' (Lane 2005:245). In contrast, in many of the CIS countries a different type of capitalism has emerged, which is much less successful, significantly more unequal, with questionable democratic credentials even in the best cases.[1] Focusing on the tensions between capitalism and democracy, Bruszt (2002) comes to a similar result: in the new member states of the EU, the 'co-evolution' of capitalism and democracy can be observed, whereas the development of a second group of countries is better described as 'co-decomposition' of capitalism and democracy.[2]

A second major contribution of the literature on capitalist diversity in Eastern Europe lies in its growing interest in *international and transnational influences*. Whereas earlier comparative research on the region mainly focused on the transformative role of national political institutions and choices, more recent studies have started to investigate the consequences of Eastern Europe's thorough exposure to the global and the European political economy (Bohle *et al.* this volume). Their key assumption is that the EU locked the CEE countries in more promising development paths, while transnational corporations (TNC) contributed to their dependent modernization. In contrast, the predominantly raw material exporting CIS countries achieved far less favourable positions in the international division of labour, with EU membership far out of reach, left to the less benign influence of volatile resource markets and the IMF.

Even if we consider these ideas as useful starting points to explore capitalist diversity in Eastern Europe, we see two major weaknesses. First, for most authors there remains the unanswered question: *why* different countries embarked upon divergent trajectories leading to diverse market societies. The failure to explore systematically the factors and dynamics of East European capitalisms is particularly characteristic of those studies which try to describe similarities and differences across a large number of cases. Second, while there is an increasing recognition that the internationalization and transnationalization of East European capitalisms matter, little attention is paid to their *varied impact*. For instance, King sees a single liberal variety dependent on capital import (2002). Similarly, Vliegenthart and Noelke (2006) only append a third type of 'dependent' East European capitalism to the earlier types identified: Western liberal-market and coordinated-market economies.

In challenging generalizations of this kind, our earlier work has uncovered significant differences in the East European impact of foreign direct investment (FDI) and TNC, which are mediated by the sectoral composition of the national economy (Greskovits 2004, Bohle and Greskovits 2006; 2007). Likewise, we view the influence of the EU as much less

uniformly top-down than suggested by some students of East European VoC and many authors in the 'Europeanization' literature (Schimmelfennig & Sedelmeier 2005). Even if the pressure the EU exerts on newcomers is stronger and more encompassing than its influence in old member states, for us 'Europeanization' ultimately depends on what East European actors and institutions make of the requirements posed to them (Bohle *et al.*, and Lindstrom
2 & Piroska, this issue). Indeed, comparative analyses of the Estonian and Slovene models of capitalism point to the fact that EU membership is compatible with significant divergence in institutional settings (Buchen 2006, Feldmann 2006).

2.2 'Varieties of Capitalism' Travels East?

The interest in institutional configurations is also a cornerstone of the VoC approach. Hall, Soskice and their collaborators have developed a powerful account of how different institutional configurations have shaped firm behaviour and national strategies to meet the challenges of the global economy. They distinguish two models of capitalism. The liberal market economy (LME) characterized by the prevalence of market relations in the spheres of corporate governance, industrial relations, and inter-firm contacts. The market-generated flexibility is particularly suited to promote strategies of radical innovation. LMEs thus compete successfully in high-tech, high-risk sectors. In contrast, coordinated market economies (CME) rely much more on consensual and cooperative relations among enterprises, between enterprises and their respective banks, as well as between social partners. Although CMEs are less well prepared to promote radical innovation, they compete successfully in sectors where incremental innovation is crucial. Without doubt, the VoC approach has influenced many recent studies on capitalist diversity in Eastern Europe due to its straightforward logic and parsimony. However, we find the direct adoption of this framework problematic for three reasons.

First, as often pointed out, the VoC approach does not account for the emergence of institutions, a crucial issue in Eastern Europe. Rather, VoC authors usually assume the prior existence and hence explanatory power of established and consolidated institutions for firm behaviour and adaptation to the challenges of the global economy. In our view, this assumption fails to hold in post-socialist regimes. Their current institutions have emerged only recently, have been built on and with the ruins of communism, and their consolidation cannot yet be taken for granted. Arguably, their impact on firm behaviour should thus be weaker than assumed in the VoC literature. Indeed, state actors and firms have been influential in shaping institutions. An analysis of East European varieties of capitalism, therefore, has to devote *much more attention to the agency of political and economic actors*. This also implies that any meaningful conceptualization of institutional configurations must include propositions about the dynamic impact of the state as well as the political system.

Second, most of the post-socialist institutions have not yet been in place before these economies became exposed to global pressures. Rather, their emergence and consolidation have been much more thoroughly shaped by international and transnational influences than in the Western cases. Therefore, transnational and international agents and factors of institution building have to be taken more seriously than in the VoC literature. An adequate approach to the varieties of capitalism has to be able to map and carefully assess *the concrete form of international and transnational embeddedness of national institutions*, and the contradictory pressures stemming from this condition.

Third, the VoC approach has been designed to analyse advanced capitalist economies. However, as Lane argues:

> In post-communist economies, as well as other developing countries, many components of capitalism are compromised by alien features – non-market economic relationships, the absence of a complementary ideology, and classes of entrepreneurs and capitalists. They are 'transiting', as it were, to capitalism. Analysis then must grasp not only the *type* of capitalism, but the *extent* to which capitalism has been constructed' (2005: 231).

The limits of simply applying the VoC framework to the post-socialist realm is most clearly demonstrated by Knell and Srholec (2006). Their finding that the most liberal economies of the East are Estonia, Russia, and Armenia, makes us wonder how this can be reconciled with the fact that the two latter countries, as we shall demonstrate below, barely have a fully institutionalized market economy to begin with. Of the three countries, it is only Estonia which would on some substantive grounds qualify as a LME (Buchen 2006, Feldmann 2006). However, even in the Estonian case, liberal-market institutions are hardly able to shape firm behaviour in a way predicted by the VoC approach. Whereas the advanced LMEs have developed comparative advantages in radically innovative industries, the most liberal East European countries, as we will show, appear to have specialized in low-tech/low-skill sectors. Thus, *the less-advanced or semi-peripheral character of many post-socialist societies has to be taken seriously* when conceptualizing their differences.

3 Internationalization, Transnationalization and Market-building States

In line with the above criticism of existing literature, we begin the presentation of our own concept of capitalist diversity in Eastern Europe with some evidence on its essential context, internationalization and transnationalization, and on its initiator and change agent, the state. We focus on state capacities and uses of state power because in the absence of powerful social actors, it fell largely to state reformers to set the direction of change, and state capacities decided upon success or failure of the new rules and regulations and essential institutions.

3.1 Internationalization and Transnationalization

The pattern of internationalization of the different country groups confirms the picture of a divide between the CEE and the CIS countries.[3] The former were quickly integrated into the global and European economy. They trade mainly with countries of the EU. The value of their foreign trade approximates or exceeds their GDP. Via substantial FDI inflows, their assets have been incorporated into global and European systems of production, commerce, and finance. In the early 2000s, foreign control is the norm in all major export industries, and many services and utilities. The banking sector is one strategic area where foreign penetration has reached record levels, almost unprecedented in other parts of Europe and the world. This exposure to external influences has been further exacerbated by entry to the IMF, the World Bank, OECD, WTO, and, after lengthy preparation, the EU. In sum, CEE's internationalization and transnationalization has occurred via *multiple heavily institutionalized channels*, and can thus be termed 'thorough'.

In contrast, none of the CIS-3, i.e. Azerbaijan, Kazakhstan and Russia, has yet achieved WTO membership, with EU and OECD membership currently beyond their reach.[4] While they are more open to global trade and investment than many other CIS countries, their global integration significantly differs from the CEE pattern. All three countries have been more cautious in liberalizing trade and FDI inflows. They maintained to a large extent national ownership of their banking system, though this did not help Russia to avoid the consequences of the devastating financial meltdown of 1998 that also affected many neighbours and trading partners. In their exports, all three countries have been heavily dependent on the global markets of energy and other natural resources.[5] The same industries attracted the bulk of FDI both in Azerbaijan and Kazakhstan. Thus, in contrast to the multi-channel global integration of CEE, the CIS pattern seems under-institutionalized and 'shallow' as it essentially occurs through a handful of *world markets*.

3.2 Transformative State Capacity

The question then, is whether the post-socialist states are little more than the playthings of powerful international and transnational forces? Could they retain or develop a capability to assist 'the economy to transform itself and to respond to changes in the global economic environment' considered to be the key to economic development and power (Gilpin 1987: 77)? The literature on less advanced countries in other parts of the world proposed important ideas on the impact of varied channels of global integration on domestic state capacity (Shafer 1994). First, that the type of capital inflows is an important factor of domestic state capacity. The impact of capital inflows

> regulated exclusively by international market forces . . . such as oil revenues, labor remit-
> 3 tances, and portfolio investments' radically differs from the impact of foreign investment,
> and international borrowing . . . that favor a large state role in negotiating, administering
> and allocating resources' (Chaudry 1997: 25).

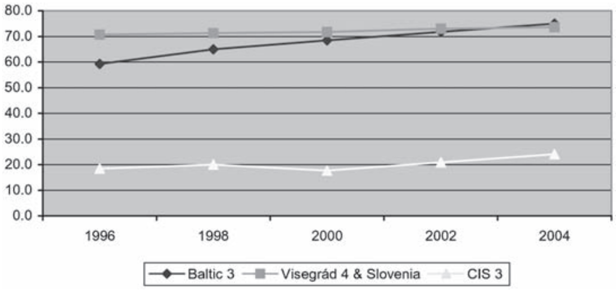
Second, according to Chaudry initial institutional endowment matters too:

> [C]ountries still forging central institutions can potentially evolve almost solely in response
> to capital inflows, generating bureaucracies that are the direct products of the international
> economy . . . In contrast, where strong institutions are in place, as in the East Asian cases . . .
> 4 international capital is more likely to be used to promote economic goals' (27–28).

It follows that the thoroughly institutionalized CEE path of international integration should be more conducive to building state capacity than the shallow CIS trajectory that was exposed to the volatility of global commodities and financial markets. Similarly, post-socialist states, faced with the less demanding task of (re)building national institutions should be more capable than where essential institutions had to be built 'from scratch'.

Stylized facts of state capacity confirm these expectations, since they highlight a radical divergence between CEE and CIS states. According to World Bank quality of governance indicators, the former are among the more capable states of the world (Kaufman *et al.* 2006, see Figure 1). Fair degrees of government effectiveness and regulatory quality set them apart from the CIS countries, which perform much worse on these dimensions. As far as the trends of state capacity are concerned, from 1996 to 2004 the Baltic countries, which started the transformation at lower initial levels of state capacity, managed to catch up with the rest of CEE. In contrast, state capacity in the CIS has not converged towards CEE standards at all. Rather, by 2004 the CIS states are as weak and incapable as in 1996.

One particular aspect of state (in)capacity, the rule of law and control of corruption, can be captured by the World Bank quality of governance data. These indicators tell the



Source: Authors' own calculation based on Kaufman *et al*. (2006). Indicators considered for state capacity are government effectiveness, regulatory quality, rule of law, and control of corruption.

Fig. 1. State capacity.

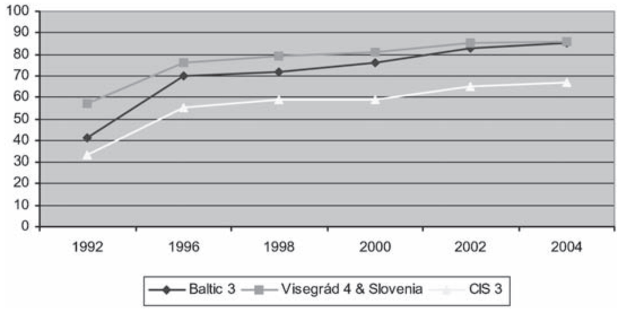
same story of a deep divide between CEE and the CIS in terms of state–society relationships. This forces analysts to ask questions about the actual significance of formal institutions in the latter group of countries, characterized by a high incidence of informal or even illegal activity, markets that are often substituted by barter or violence, and states, which are often unable to enforce existing rules and regulations. While we are aware of the salience and power of informal and illegal agents in shaping capitalism in the CIS and even in CEE, in this paper, we cannot analyze this aspect in greater detail, and shall only compare international and transnational influences and their interplay with domestic state agents.

The striking divergence in state capacity is crucial for our understanding of post-socialist capitalism's diversity in all other important respects. Most importantly, while the above data allows us to trace the variation *within CEE* at least partly to the *varied uses* of state power to pursue different transformation agendas, we cannot explain the divergence *between the CEE and CIS capitalisms* in the same terms, since the latter's state capacity has been barely sufficient to make a comparable impact. Consequently, in the latter cases, the influence of other types of factors and agents must be our primary focus.

The next question we then need to ask is: *state capacity to do what*? As often argued, the agenda of post-socialist transformative states has been overloaded by all of the major economic, political, and social challenges that development can pose. They had to build markets, preserve political stability, maintain social cohesion, democratize the political system, transform industry, and secure a stable macro-economic environment. Furthermore, advances on these conflicting dimensions often had to be made simultaneously, and within short time scales. How successfully could state actors pursue and coordinate multiple transformations?

3.3 Building Markets

By the early 2000s, all of the CEE regimes achieved high *levels* of liberalization, privatization, and market-oriented institution building (Figure 2). However, there is systematic variation in the *radicalism* of the reform paths that led to this outcome. Assessing



Source: Authors' own calculation based on the transition indexes of EBRD Transition Reports, various volumes.

Fig. 2. EBRD transition indexes (%).

radicalism by the rate at which market reforms have been introduced and new institutions built, and using the annual advance on the transition index of the European Bank for Reconstruction and Development (EBRD) as a proxy to measure it, leads us to conclude that, within CEE, the Baltic States have been more market-radical than the Visegrád states and Slovenia. First, due to their long experimentation with reform-socialism, Hungary, Poland, and Slovenia already had relatively marketized economies in 1989, while the Baltic States had to start 'from scratch'. Second, since state-socialism persisted until 1991 in the Baltic countries, their reforms began later than those of other CEE states.

Finally, the CIS, which started late and had the weakest legacy of marketization, continue to lag behind CEE. Nonetheless, even the CIS members adopted a degree of economic freedom and openness, and, in 2004, they are significantly closer to a market economy than back in the early 1990s.

However, this observation poses a puzzling supplementary question: how to explain the CIS' advance in market liberalism *without a capable state*? Our contention is that the CIS' relative success is restricted to administratively rather simple measures, while they advanced much more slowly in the more sophisticated and politically difficult institutional reform areas.[6] Nelson offers a convincing explanation of why and exactly how lacking state capacity can hamper advances with complex reforms:

> 'Despite the intense political controversies regarding first-phase stabilization and liberalization measures, many are administratively simple, in the sense that they can be decided and put into effect by a small circle of senior economic officials. Measures that usually come later – such as financial sector reforms, privatization or rationalization of large state enterprises, liberalization of labor markets, and restructuring of social services and social security – are much more complex. They require sweeping institutional and legal changes and involve the legislature, the courts, and multiple central and local government agencies . . . Moreover, while many of the initial costs of stabilization are temporary and spread over much of the population, sectoral and institutional reforms usually impose permanent losses focused on specific interests. They, therefore, prompt tenacious resistance' (1994: 14).

Thus, to the extent that the CIS countries have established a market economy at all, their relative statelessness has left it heavily *under-institutionalized* compared with the standards of CEE market societies. Simultaneously, the political resistance provoked by complex reforms points to another kind of public good states have to provide to keep development on track, and this is political stability.

4 Political Stability Through Social Inclusion Versus Political Exclusion

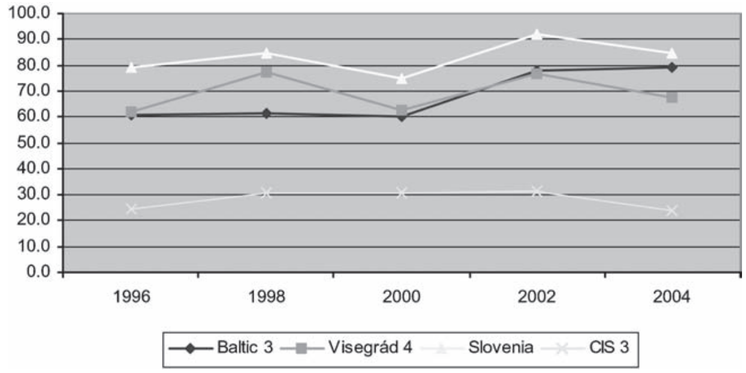
According to the World Bank quality of governance data, the ranking of East European capitalisms in terms of political stability is straightforward: Slovenia has been by far the most stable over the whole period 1996–2004, usually followed by the Visegrád states Interestingly, in the 1990s, the Baltic States still ranked third but by the early 2000s they appear to be more politically stable than the Visegrád countries. In striking contrast, CIS polities have remained unstable over the whole period (Figure 3).

To grasp this pattern, it is helpful to explore the *distinct ways* the East European capitalist regimes tried to secure political stability. One issue that received ample attention in the academic and policy discussion of the politics of post-socialist transformation was the need for social safety nets to help losers to survive hard times, and for institutions of labour inclusion to make workers feel to be active participants in the dramatic changes affecting their livelihood. East European reformers used state power with different vigour and capacity to offer greater or lesser degrees of social inclusion.

4.1 A Map of Social Inclusion

Rather than displaying a fundamental divide between the CIS on the one hand and the eight CEE states on the other, evidence on social inclusion performance attests to the essential similarity of the CIS and the Baltic States setting them apart from the Visegrád states and Slovenia. Thus, in terms of inequality there is no significant difference between the former two country groups, while Estonia seems to stand out as the most inequitable country (Table 1)

Both in light of their meagre economic performance over the 1990s, and in comparison with other countries at similar levels of development and resource-export dependency, the



Source: Authors' own calculation based on Kaufman *et al.* (2006).

Fig. 3. Political stability.

TABLE 1

Social inclusion

	Income Gini (2002, %)[1]	Income Distribution Richest 10% to poorest 10%[2]	Spending on health (% of GDP, 2000–2003 average)[3]	Total government expenditure (% of GDP, 2000–2003 average)[4]
Estonia	35	14.9 (2000)	4.0	35.6
Latvia	34	9.2 (2000)	3.3	35.7
Lithuania	30	7.9 (2000)	4.1	31.7
Baltic States average	33	10.6	3.8	34.3
Czech Republic	25	5.2 (1996)	6.4	42.1
Hungary	24	5.5 (2002)	5.4	50.0
Poland	31	8.6 (2002)	4.3	42.9
Slovak Republic	31	6.7 (1996)	5.1	50.4
Visegrad countries average	28	6.3/7.0[5]	5.3	46.4
Slovenia	22	5.9 (1998)	7.0	48.1
Azerbaijan	38	9.7 (2001)	0.8	23.9
Kazachstan	32	7.5 (2003)	1.8	22.4
Russia	31	7.1 (2002)	3.5	35.1
CIS average	34	8.1	2.0	27.1

[1] Eurostat for EU countries, UNDP Human Development Report 2006 for CIS. [2] UNPD Human Development Report 2006. [3] Transmonee Database, UNICEF 2006. [4] EBRD Transition Report 2005. [5] The higher average is for Poland and Hungary only, thus taking into account that the data for Czech Republic and Slovakia stem from a much earlier period in their transition.

distribution of income in the CIS can even be considered as surprisingly ‘equal’.[7] Indeed, Lane (2005), with reference to Gini coefficients around 50 rather than 30, still finds the CIS countries to be far the most unequal in Eastern Europe. Even taking Lane’s data into account, our observation that both the Baltic States and the CIS are significantly more unequal than the Visegrád states and Slovenia still holds true.

How about the pattern of state capacity to protect society? Since we could not find comparable data on social spending for the CIS, we chose two proxies: public expenditure on health, and general government expenditure’s share in GDP. Overall, Slovenia and the Visegrád states seem to command much larger welfare states then the Baltic group. The CIS states have the weakest welfare-capacity in both respects, while Russia’s figures come close to those of the Baltic States. It is important to note, however, that in both Russia and the Baltic States it was only in *the aftermath of the Russian financial crisis* that general government expenditure began to drastically lose its share within GDP (EBRD Transition Reports various). Thus, especially in Russia, the currently meagre welfare state might more accurately be a reflection of the devastating impact of *global financial market shock* than any conscious and ideologically grounded choice of socially exclusive policies.

All in all, the CIS’ meagre performance in political stability then, might be closely linked with these states’ incapacity for social inclusion. Conversely, the political stability of the more inclusive Slovene and Visegrád polities is unsurprising. However, if the lack of social solidarity indeed has the potential to destabilize democracy, then the remarkable stability of Baltic polities is truly puzzling, and points to a mismatch between protective state efforts and political balance. We find the solution in the fact that the Baltic States could rely on a powerful substitute for social solidarity, namely national and ethnic identity politics, and thus mobilize permanent political support for a socially exclusive transformation path – albeit at the heavy expense of democratic quality.

4.2 Identity Politics and Democratization

As Anderson wrote, '*regardless of the actual inequality and exploitation that may prevail in each* the nation is always conceived as a deep horizontal comradeship. Ultimately it is this fraternity that makes it possible, over the past two centuries, for so many millions of people not so much to kill, as willingly to die for such limited imaginings' (1991: 7, emphasis added). Since communism in its quest for ideological monopoly oppressed people as nationals and believers, many East Europeans might have felt true satisfaction over their regained freedom to 'imagine' and actually craft such communities. This, however, means that related emotionally powerful attachments could have a profound and varied impact on how the East European polities cope with other polarizing issues, such as economic discontent and conflict. For example, in Slovenia, belonging to the newly independent nation enhanced and consolidated the sense of socially inclusive politics. In most of the Visegrád countries, identity politics did not have much influence until relatively recently. However, in Estonia and Latvia (but not in Lithuania) exclusionary identity politics has had a profound impact, and undermined social solidarity from the very beginning. Because of the primary importance attributed to national sovereignty and security, the Russian speaking populations had been disenfranchised before neoliberal restructuring pushed many of their members to the margins of society. While democratic opposition of the radical transformation has thus been muffled, the rest of society has lent permanent support to a drastic break with the past that buttressed a mutually reinforcing relationship between economic neoliberalism, identity politics, and limited democracy.

Estonia's and Latvia's political stability thus was achieved at the expense of the quality of their democracy. While this fact has largely escaped mainstream measurement of democratic consolidation in Eastern Europe, which has focused on the competitiveness of elections and limitations on executive power, a recent study that reconceptualizes the measurement of democracy by including participation as a key component ranks the quality of Estonian and Latvian democracy below or close to the Russian score in 2003 (Moon *et al*. 2006).

Put simply then, over the first decade and a half of transformation there have been two main kinds of political economy configurations in which East European states could pursue marketization and restructuring in relatively stable political contexts. This has been made possible either by *illiberal identity politics and limits on democratic opposition, as in the Baltic States*, or by *mitigating the deleterious social impact of neoliberal reforms by welfare protection, as in the Visegrád states and Slovenia*. However, in the CIS, where neither social welfare policies nor exclusionary imagined communities have been consistently used to stabilize politics, authoritarian practices and features continued (as in Azerbaijan and Kazakhstan) or revived (as in Russia), to buttress claims for authority with grave implications for political stability. In a more dynamic view, the above trade-off also implies that once 'embedding' neoliberalism into protective arrangements becomes untenable, democratic politics is likely to lose balance – witness the most recent destabilization in *all* Visegrád polities. We cannot exclude the potential for restoration of these countries' political balance via larger doses of illiberal identity politics, and sacrifices in democratic quality.

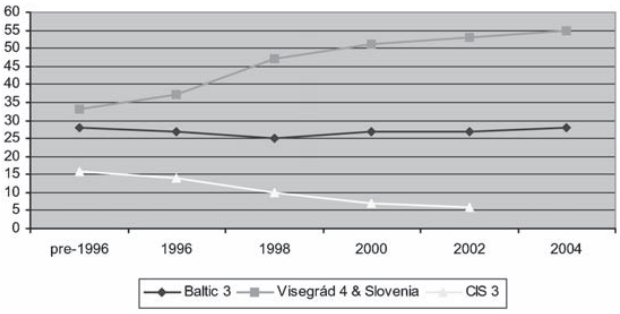
5 Industrial Transformation

So far, we have mainly focused on the domestic factors of regime variation, and paid little attention to international and transnational aspects. We now turn to these. The impact of a crucially important international factor, namely the EU, which certainly had a formative role in the divergence of the CEE regimes from the CIS capitalisms, is discussed more in detail by Bohle *et al.* and Lindstrom & Piroska elsewhere in this issue. Here, we focus on key transnational actors, TNC, which, similar to the EU, have not been enmeshed in domestic politics, but have had other means to intervene in, and leave their mark on, the emergence of regime diversity.

Our argument is that the type of FDI a country attracts has a strong impact on the capacity of the respective states to restructure the economy and transform industry. Taking a look at the performance in respect to industrial transformation, it is obvious that the Baltic States have been much less successful in upgrading their industrial profile than the rest of CEE. The bulk of their exports originate from resource- or unskilled labour-intensive industries, and thus exhibit a profile reminiscent of many less-advanced countries. The three CIS countries perform even worse. They underwent a dramatic process of deindustrialization and either never developed or almost entirely lost their skill-base of industrial upgrading and a more complex pattern of development. Consequently, their share of manufactured exports in total merchandise exports has become so low that currently they barely qualify as industrialized nations. The overwhelming majority of their export earnings originates from resources, thus from products characteristic for the least advanced countries in the world. In contrast, the Visegrád states and Slovenia mainly export the same products as many advanced countries, which rely heavily on complex capital, technology, and human skills (Figure 4).

Finally, the divergence in industrial transformation appears to be consistent with varied patterns of state institutions aimed at fostering the transformation of inherited socialist industries into new foreign controlled and invested operations. The Visegrád states mitigated the impact of market shock on their industrial legacy and at the same time attracted foreign capital through protective regulation and tariffs, export zones, foreign trade and investment agencies, investment support funds, tax exemption regimes, and public development banks. In contrast, industrial policies have not been pursued with similar vigour in the Baltic States, whereas in the CIS their aim was to conserve rather than restructure a selected few state-socialist industries.

The pattern in Figure 4 raises the question of how this variation came about. We see an important element of the answer in the type of FDI the respective countries attracted. Specifically, the variation in industrial export performance is closely linked to FDI inflow in complex manufacturing sectors. In the early 2000s, on a per capita basis, FDI stock in the complex industries of the Visegrád countries exceeded the relevant Baltic data by a multiplier of 10 (Bohle & Greskovits 2007). With the partial exception of Slovenia, no



Source: Authors' own calculations based on UN Tradecom Database. Complex exports are exports coded 5 (chemicals) and 7 (machinery and equipment) in STIC.

Fig. 4. Complex exports (% of total).

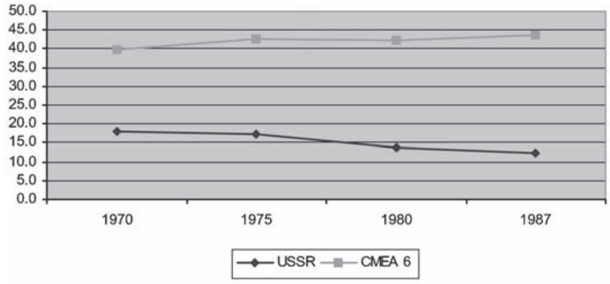
country managed to upgrade its industrial base without relying heavily on external investments. How can we then explain why the Visegrád countries were so much more successful in attracting FDI in their complex manufacturing sector than the rest of Eastern Europe?

The mainstream claims that FDI is endogenous to the advance of market reforms, therefore the meagre achievements of the Baltic States in attracting complex-industry FDI, and the resulting low-skill exports should present a conundrum. Why have these states proved so ineffective in importing the main drivers of industrial upgrading if they have been so capable of creating many of its alleged formative conditions: radically reformed stable economies, low taxes, political stability, and national security? Why have complex-industry TNC consistently preferred Visegrád locations to the Baltic as well as the CIS area? Our answer is that TNC location choices responded to the incentives stemming from a dynamic interplay between inherited and restructured industry profiles, inherited and newly-built market institutions, and special subsidy packages.

To account for TNC motivation to invest, we adapt Vernoni:'s product–cycle theory (1971). We contend that export-oriented, complex FDI would most likely flow first to those former socialist economies whose initial supply structures (that we proxy by the export structures of the late-1980s–early 90s) had been relatively complex, i.e. intensive in technologically sophisticated physical capital and human skills. As a consequence, the Visegrád countries, which already specialized in the automobile, machinery or electronics industries in late-socialism could rightly expect larger inflows of industry-specific FDI than the CIS states, where this sector was virtually absent (as in Azerbaijan and Kazakhstan) or by the end of state socialism was significantly weakened (as in Russia), as shown in Figure 5.

In this respect, the Baltic States, which by the last decade of state socialism increasingly exchanged technology and skill-intensive goods for natural resources from other parts of the Soviet empire, had not been particularly disadvantaged. Given that on the basis of their supply structures initially all CEE countries seem to have had similar attractions as new locations for transnational complex–export production, product-cycle theory alone cannot account for the diverging path taken by the Baltic and Visegrád states. How then did investors choose among them?

For an answer, we have to consider that even similar supply structures might fail to raise investors' interest if institutional and policy barriers hamper access to the local factors



Source: Authors' own calculations based on Lavigne (1991: Tables 3–5, 388–391). CMEA 6 are Bulgaria, Czechoslovakia, the GDR, Hungary, Poland, and Romania.

Fig. 5. Complex exports before the collapse (% of total).

of production. It follows then that countries which by the time investors were ready and able to cross the former Cold War borders, advanced furthest in removing entry barriers and rebuilding their institutions and policy regimes were better able to attract FDI. We argued above that, in the first half of the 1990s, the Visegrád states had an advantage over the Baltic States, which could start their quest for institutional convergence with the West only with a delay and from scratch. In the first phase of the transformation then, in the context of rather similar supply structures, institutional advantages tilted the balance of investors' preferences in favour of the Visegrád countries. Complex FDI inflows had been endogenous to the initial levels of marketization. In turn, initially the CIS lacked *both* industrial structural and institutional similarities with the home countries of TNCs, which thus had double reasons to avoid them entirely, and invested, if it was possible, only in their natural resource-based activities.

However, the interplay of structural and institutional factors seems to have fully reversed, and the endogeneity of complex FDI to marketization levels failed to materialize after the mid-1990s (Table 2). The Baltic States gradually worked off their institutional disadvantage and, by 2003, arrived at a relatively high degree of institutional similarity with their regional rivals and the West. However, their institutional catching-up does not seem to have been appreciated by transnational complex-industry investors. What seems to explain the Baltic States' inability to attract FDI in complex industries after the mid-1990s is that their radical institutional convergence has been achieved at the expense of increasing divergence in supply structure terms. Rapid liberalization without support and time for restructuring has led to deindustrialization, wiping out the most complex industries (Tiits 2006: 23). From the late 1990s on, in the context of increasing institutional similarity, TNCs continued to prefer the same Visegrád area locations mainly because of their enhanced structural similarity with the West, whereas the Baltic countries might have lost out for the increasing divergence of their supply profile. In the CIS economies, the combination of an under-institutionalized precarious market economy with increasingly dissimilar structures of supply continued to deter complex manufacturing investors.

Initial investor preferences, motivated by a combination of structural and institutional factors, seem to have launched both *virtuous and vicious circles of foreign-led capital accumulation*. Driving forces included the contrasting trends of industry upgrading versus

TABLE 2

Interplay of structures and institutions in attracting complex FDI

	Phase 1: 1990–1995			Phase 2: since 1995		
	Visegrad-4	Baltic- 3	CIS-3	Visegrad-4	Baltic-3	CIS-3
Supply structures	+	+	–	+	–	–
Institutions	+	–	–	+	+	–
Patterns of FDI inflow in the manufacturing sector	First investments in complex industries	No FDI in manufacturing	No FDI in manufacturing	Fast accummulation of FDI in complex sectors	FDI in traditional labour intensive sectors	No FDI in manufacturing

deindustrialization; the tendency that many more TNCs ‘followed the leaders’, their rivals and buyers, to the initially preferred Visegrád locations; the concomitant clustering of the complex industries in the same area; and lastly the generous subsidy packages offered by the Visegrád states to TNCs.[8]

6 Macroeconomic Stability and Growth

Finally, macroeconomic stability, manifested in low inflation rates, small budget deficits, and controlled state household debt, has become increasingly important to protect national economies against harmful fluctuations in short-term capital flows and exchange rates. To what degree are East European states capable of providing a stable macroeconomic environment? Interestingly, on this dimension, their clustering displays a similar pattern to the one that we recognized earlier when assessing social inclusion (Table 3). In the early 2000s, in several respects, macroeconomic stability in the CIS states seems more closely matching the performance of the Baltic States and Slovenia, whereas the Visegrád countries find it much harder to keep their budgets balanced and their government debt controlled.

How to come to terms with this peculiar clustering? After all, during the 1990s the CEE and the CIS states still populated the opposite clusters of success and failure, notwithstanding their shared interest in stability that had been driven by their wish to restore macroeconomic balance against the background of deep recession, galloping inflation, and threatening financial crises. Furthermore, roughly since the year 2000, new ‘sticks and carrots’ began to impact upon the CEE countries: pressures to adopt the EU’s ‘stability culture’ (Dyson 2006) as a condition for membership in the Eurozone Once more, we find an answer

TABLE 3
Macroeconomic stability

	General government balances (2000–2003 average % of GDP)	General government debt (2003, % of GDP)	Consumer price index, (2000–2003, annual change)
Estonia	+2.3	5.3	4.5
Latvia	–2.1	13.4	2.3
Lithuania	–2.1	21.9	0.9
Baltic average	–0.6	13.5	2.6
Czech Republic	–7.2	38.8	3.5
Hungary	–5.4	57.4	7.9
Poland	–3.4	45.3	5.8
Slovak Republic	–6.9	42.6	7.4
Visegrád average	–5.7	45.9	6.2
Slovenia	–2.6	29.3	8.3
Azerbaijan	–0.68	18.6	2.0
Kazachstan	+1.3	12.1	9.1
Russia	+2.0	32.4	19.3
Average	+0.9	21.0	10.1

Source: EBRD Transition Report

in the combined effect of different forms of international integration and pressures, and the different capacities of state actors to pursue their own economic policy agendas. The CIS, and especially Russia's path towards macroeconomic stability was essentially shaped by two international factors: the financial crisis of 1998 and its consequences, and the reversal of the oil prices. While the financial crisis had immediate devastating effects on the Russian economy, and on its neighbours who depended on Russian markets, it was after the crisis that Russia experienced substantial economic growth for the first time since the collapse of the Soviet Union (Montes and Popov 1999). Several factors can explain this, including depreciation of the rouble in the aftermath of the financial crisis, and the fact that the banking sector started to lend to the real economy for the first time.

However, a major factor in the rapid recovery of the Russian economy was the hike in oil prices. The combined effects of growth in the aftermath of the financial crisis and oil price hike helped Russia and other CIS countries to achieve impressive results in macroeconomic stability (EBRD Transition Report 2005). This suggests that the stability of the CIS countries has more to do with the current phase of the energy cycle than with their state capacity and institutional settings. Windfall gains spare such weak states the administrative and political challenge of creating a sustainable financial base for development by taxing their own citizens.

The financial crisis also hit the Baltic States, and even reinforced their quest for macroeconomic stability. In contrast to the CIS, however, macroeconomic stability had been a priority of the Baltic governments from early in the transformation process, and they developed a unique institutional setting that helped pursue this goal. Establishing their own currencies was one of the most important means and symbols of the newly acquired sovereign statehood. In order to acquire credibility in global and European markets, the Baltic States chose to operate by far the smallest fiscal states of the region, relying on the most restrictive monetary institutions, currency boards, and most consciously utilizing their ERM-2 entry as an international pillar of their policies to lock in macroeconomic stability (Feldmann 2006).

Prioritizing macroeconomic stability over any other economic and social policy consideration distinguished the Baltic States from the rest of the new EU members. So far most Visegrád states (except the Slovak Republic recently) have been less successful in controlling their fiscal deficits or other macroeconomic fundamentals. Confronted with demands for social protection, and active industrial policies favouring TNCs, governments in the Visegrád countries were neither willing nor able to pursue tight macroeconomic policies at the expense of these demands (Greskovits 2006, Zubek 2006). Only Slovenia managed to meet all three demands simultaneously where neocorporatist institutions such as legally enforced negotiated management–labour relations, and extended collective agreements have so far delivered the social compromises required for a balanced and inclusive agenda.

7 Paths Towards East European Capitalist Diversity: State-crafted Versus Directly Market-driven, and Embedded Versus Pure Neoliberal Regimes

The evidence presented so far allows us to distinguish between four types of capitalist regimes that emerged in Eastern Europe as a result of their transformation and integration into the world economy. The Baltic States are distinguished by radically liberalized markets, a thoroughly reformed market-supporting institutional framework, and the least generous welfare states among the new EU members. They integrated into the global economy mainly through labour-intensive traditional industries controlled by highly mobile TNCs, and through resource-based exports and the related services. Similar to their meagre welfare states, their industrial policies are minimalist, with low flat taxes rather than targeted protectionist measures at their core. In Estonia and Latvia, exclusionary democratic institutions conspire with restrictive monetary and fiscal institutions to keep their regimes stable in political and macroeconomic terms.

From a more advantageous starting position, the Visegrád countries have equally successfully transformed into capitalist economies. Their socio-economic regimes differ from the Baltic States in three major respects: first, they have offered more protection to society to compensate for some of the social costs of transformation; second, this enabled them to preserve to date a far more inclusive democracy and third, whereas the Baltic States' economic priority has been macroeconomic stability, the Visegrád countries are primarily driven by the cause of industry upgrading. With institutions and policies geared towards attracting FDI having high priority, TNCs have become the driving forces of restructuring. The relative success of the Visegrád countries' foreign-led development path is reflected in their export structure, which closely resembles that of the advanced Western countries.

Among the new EU members, Slovenia stands out for its simultaneous successful pursuit of social cohesion, industrial upgrading, macroeconomic stability, and democratic inclusion. Slovenia is exceptional among all East European countries in that it could pursue its transformation largely based on national institutions and actors, and indeed transformed into a Western type of capitalism: Its neo-corporatist regime is typical of many small West European states.

5 Finally, by the early 2000s, the CIS countries appear to have introduced rather liberal market economies too. Their regime performances and institutions seem to fall closest to the Baltic States as both groups of countries have very limited welfare states, failed to upgrade their industries, but performed well in terms of macroeconomic stability. In addition, countries in both regions have democratic regimes with serious quality problems. There are though significant differences as well. Recent developments in the quality of democracy seem to diverge, with the Baltic States improving and the CIS deteriorating. Deindustrialization has been much more severe in the CIS, and their integration into world trade is overwhelmingly based on raw material exports and industrial goods imports. The major difference, finally, setting the CIS apart from all other eight EU new members, is their comparatively weak states, which make these countries much more exposed to the direct influence of international forces and factors.

How did such variation come about? Our framework stresses the interplay between transformative state power with specific agendas – or its absence – on the one hand, and the concrete form of the inter- and transnational embeddedness of the respective political economies on the other. Thus the following regime paths can be identified.

The CIS countries experienced the collapse of their major state institutions and capacities together with the fall of state socialism. As is well documented in the Russian case, the first phase of transformation was characterized by the dissolution of central state authority (Bunce 1999). Newly independent states, increasingly independent regions, and powerful societal actors picked up the pieces left behind by the collapse of the empire, and used them to accumulate fragmented, special-interest, or personal, rather than common wealth (Hellman 1998). In this context, there was no state capacity to speak of to transform the economy in any comprehensive and coherent way. The disastrous reform performance of the first period of transformation was as much reflecting the non-existence of central state authority, as the influence of the International Financial Institutions (IFIs). While the Russian reformers radically liberalized their economy in line with the policy prescriptions of the IMF, and the ideological beliefs of the Washington Consensus, they largely failed in building up market-supporting institutions. The social and economic consequences have been devastating. Industrial production and GDP plummeted, social inequality ballooned, the economy informalized at high speed, the new owners of the Russian economy have extracted billions of dollars from the country, and the country is increasingly indebted externally. The untenable path towards 'involution' (Burawoy 1996) exploded with the financial crisis 1998.

International developments, rather than state capacity, also seem at the origin of the socio-economic recovery of the CIS states after the crisis, with unprecedented increases in oil prices allowing them to restore growth, macroeconomic stability, and repayment of international debt. It is an open question, how far the sustained period of high oil prices has indeed given them the resources to build more stable institutions and a stronger state. Evidence from the literature on petrol states suggests that when state (re)building coincides with massive inflows of petrol revenue, the new institutions are likely to be direct products of the international economy and, therefore, highly vulnerable to future bust periods (Chaudry 1997, Karl 1997). Therefore, we see that the paths, institutional outcomes, and performances of the CIS regimes as largely driven by the *forces of international markets* and IFIs. At the same time, powerful domestic social groups dependent on these same markets have pressed CIS state actors to pursue adjustment in line with their own particularistic interests.

In contrast to the CIS, all the CEE regimes can be viewed as essentially '*state crafted*'. All eight CEE either inherited functioning states and institutions from the socialist system, or were able to build these up within a short time. Therefore, whatever similarities between the Baltic and CIS regimes might exist, they also differ in three key aspects. First, the neoliberal Baltic regime was largely the result of conscious reform choices. Their fast reforms stemmed from the wish to implement a most radical break with their past, and to dismantle the former strongholds of power of old of state and party bureaucrats (Bunce 1999). Radical reforms also had an anti-imperial aspect to them. Getting rid of the *nomenklatura*, their institutions, and their inherited industries essentially meant forcing ethnic Russian to the side-lines. Second and closely linked, the Baltic countries chose to marginalise inherited social forces and invited new groups to buttress their new states. Initial reforms were to a large extent designed and led by *émigrés*. The Latvian and Estonian approaches to privatisation were much less conducive to insider wealth accumulation than the methods chosen by the CIS. Mostly ethnic Russian employees were marginalized by deindustrialization and their voices muffled by disenfranchisement. In strategic sectors, the Baltic States welcomed foreign investors. Third, the Baltic regime is supported by adequate institutions, which are likely to be more resistant to international market forces than those in the CIS. Macroeconomic stability, which had the highest priority in the economic institutional setting is more a result of restrictive monetary institutions, than purely of windfall gains from resource exports.

The inter- and transnational influences the Baltic States are exposed to partly reinforce, and partly mildly correct their initial choices. Both the breakdown of the Soviet economy and later the financial crisis of 1998 hit the Baltic States harder than other CEE countries. Yet, these international crises reinforced the initial choices of elites to weaken ties with the former Soviet Union, and justified the stress on macroeconomic stability. To be sure, economic ties with Russia have never been entirely severed. Ironically, in recent years, the Baltic States have gained from the same windfall profits as the CIS, both as transit routes for Russian oil, gas, and other resources, and as exporters of manufacturing goods to the growing Russian market. The spectacular growth rates the Baltic States have experienced over the last years probably results – at least partly – from their increased trade with Russia. Once again, international factors – in this case powerful neoliberal political and policy networks – confirm the domestic choices made by the Baltic States, since they interpret their high growth rates as signs of the victory of radical neoliberalism.

International developments have reinforced domestic choices in yet another way. The Baltic integration into the low end of the international division of labour makes transnational capital investing in the region primarily interested in flexible labour markets, low wages, and minimal public intervention into employment practices and work conditions. TNC preferences dovetail with the Baltic priorities of a neoliberal regime and minimal (welfare) state. The EU, on the other hand, has served throughout the accession process as a mild corrector of the Baltic States' overzealous economic liberalism. Trade barriers had to be raised again, and improving the standards of social and democratic inclusion has become an issue in the accession negotiations. Overall, however, EU priorities in the region are in line with the Baltic reform priorities, and EU accession therefore could mostly serve as a factor locking in earlier institutional choices.

Similar to the Baltic States, the Slovene path towards capitalism was based on conscious choices of reformers, and a state capable of implementing them. Nonetheless, the choices have been very different. The transformation of Slovenia was built on a consensus among all major forces of society – employers, employees, experts, major political parties – that had been institutionalized in neo-corporatist bodies. While Slovenia accepted the general framework of macroeconomic stability, it was also clear for the reformers that this 'alone would not facilitate a successful transition to a capitalist economy' (Lindstrom 2005: 23). Trade liberalisation and privatisation was carried out gradually, and the Slovene reform elites relied heavily on domestic forces, including labour, in the privatisation process. Slovenia opened its economy only very reluctantly and gradually to foreign ownership and control, especially in strategic sectors, e.g. banking.

This gradual and home grown transformation strategy could be built on the best legacies of CEE. Not only has Slovenia been the richest CEE country, it also inherited the most liberal, politically and socially most differentiated socio-economic system as a result of Yugoslavia's reform communism. Firms had been relatively independent from the state, able to develop dense commercial and production links to Western markets well before the transition. Trade unions, rather than being transmission belts – as had been the case in most other countries of the region – also gained a measure of independence in the 1980s (Stanojevic 2003). All these factors made a transition strategy based on broad incorporation of all domestic social forces more feasible.

As in the Baltic States, Slovenia's international embeddedness by and large reinforced its choices. Slovenia only accepted – and could afford to do so – limited FDI in its strategic export sectors, thus controlling its dependence on TNC. The markets it mainly operates in – medium to high skill manufacturing goods – are not as prone to short term fluctuations as the markets for labour-intensive goods and raw materials. Overall, the reform path chosen by Slovenian actors was also compatible with EU requirements. In some instances, where the EU pushed towards a different direction, Slovenia refused to comply without ever putting at risk the perspective of EU membership (Lindstrom and Piroska this volume).

Finally, the Visegrád countries' regime path – even if it reflected a measure of conscious choice – proved to be less straightforward, more contested, and contradictory than either the Baltic or the Slovene trajectories. Two elements set the Visegrád transformation strategy apart from the Slovene. First, their welfare states originated in political elite-driven 'reforms from above' rather than in institutionalized neocorporatist negotiations between social partners. Second, instead of domestic capitalists, foreign owners have come to dominate these economies. Rather than being purely strategic choices, both differences also reflect the concessions reformers had to make in light of the unexpected difficult challenges of transformation. The legacies of the Visegrád area had been less favourable than those of Slovenia. Accordingly, reformers were well aware of the social hardship coming with the collapse and market reforms. They could however not fall back upon identity politics and disenfranchise large parts of the affected population to stifle protest as the Baltic States did. At the same time, they shied away from offering institutionalized voice to unions and the losers of reforms, as they feared that these groups would block the road towards reforms (Balcerowicz 1995). Instead, they decided to offer *ad hoc* compensation in the form of relatively generous targeted social protection packages in order to overcome opposition (Vanhuysse 2006).

International constraints acted more strongly and in a different way upon the Visegrád countries than in the Slovene or Baltic cases. Initially, Hungary took the lead in supporting foreign take-overs across the whole economy. The origin of this privatization strategy was the huge external debt Hungary had accumulated by the late 1980s. Because of this debt service Hungary was highly dependent on hard currency cash receipts available only from export and privatisation. Poland, the other ex-socialist country with huge foreign debts at the onset of transformation, was somewhat less constrained in reform choices (Greskovits & Bohle 2001).[9] Poland's creditors were national governments rather than – as in the Hungarian case – private banks. Moreover, at the beginning of the transition, Poland successfully managed to negotiate a partial debt relief. Thus, Poland's initial transition choices to some extent resembled those of Czechoslovakia (and later the Czech and Slovak Republics). As its two southern neighbours, Poland initially hoped for maintaining significant domestic ownership in the economy. However, these attempts at 'national capitalism' failed, and since the second half of the 1990s, all four Visegrád countries increasingly have built their institutions and economic strategies around the priority of attracting FDI (Bohle 2002; Drahokoupil 2007; Shields this volume).

The concessions reformers had to make to the (perceived) threats of the losers of transformation on the one hand, and to foreign investors on the other, partly explain the more instable nature of the Visegrád regimes compared with the rest of CEE. On the one hand, as we argued above, under the conditions of inclusive democracy, political stability can only be achieved by 'embedding' neoliberalism in protective welfare regimes. Similarly, industrial upgrading in Eastern Europe – with the sole exception of Slovenia – could only be achieved by luring foreign investors with generous incentives. On the other hand, embedding members of society and key actors of economy resulted in a whole set of new problems. First, it put pressures on public budgets, which sooner or later destabilized the economy. Second, embedding society and industry can lead to mutually contradictory and overly costly fiscal spending goals. Faced with budget constraints, the Visegrád states seem increasingly compelled to reduce welfare expenditure within their budgets. More fundamentally, the resources Visegrád countries spend for welfare might just not be enough to offer sufficient protection for society (Shields in this volume). Finally, in this context, the EU functions as an additional constraint on the Visegrád countries, pushing them towards compliance with the Maastricht criteria that might ultimately result in disembedded societies. Currently, Visegrád country domestic politics and policies seem to conspire with EU pressures to produce potentially less stable and less democratic regimes.

8 Conclusion

By the early years of the new Millennium, varied types of market societies replaced the former state socialist political economies all over Eastern Europe. In our study, we set out to map and explain their diversity. Our first contribution to the existing literature on East European capitalisms is an empirically grounded distinction among four types of capitalist regimes that differ in particular institutional configurations and performances. Specifically, we identifed two subtypes of a regime that seem to share, at first glance, many characteristics of a *neoliberal* regime in accordance with the dominant ideology of the Washington Consensus. Both the CIS and the Baltic States approximate that ideal of small fiscal and welfare states, and perform well in terms of macroeconomic stability.

In contrast, though in different ways, both Slovenia and the Visegrád countries have *embedded their neoliberalisms* (for this term see Ruggie 1982, and van Apeldoorn 2002). Slovenia achieved this through neo-corporatist institutions and a generous welfare state, whereas the Visegrád countries did so through *ad hoc* compensation, that is, relatively generous targeted social protection packages to losers and opponents of neoliberal reforms. More than any other East European country, the Visegrád states also developed measures and institutions to attract and 'settle' a multitude of complex-industry TNC.

These regimes do not only differ in their current institutional configurations and performances, but also in the pathways that led to these differences. Our second contribution is our proposed framework of the logic of emerging regime diversity. Since most institutions that currently characterize Eastern European capitalisms evolved in the course of transformation, our key task was to identify the agents and factors shaping that process. We argued that the crucial explanatory variables of regime paths have been twofold. On the one hand, transformative state power, and its uses to pursue market reforms, political stability, social inclusion, democratization, industrial transformation, and macroeconomic stability – or the absence of state capacity to accomplish these tasks – mattered. On the other hand, the concrete form of the inter- and transnational embeddedness of the respective political economies has been important too.

Hence our distinction between the essentially *state-crafted* CEE neoliberalisms and the more *directly world market-driven* CIS variants, indicates the dramatically different extent to which these states have exercised control over their own institutions and performances. In this interpretation, the Baltic and CIS neoliberal regimes, which at a first glance look as two variants of a similar species, turn out to be *qualitatively* different. CIS neoliberalism is largely due to repeated state weakening, and as such highly vulnerable to periods of bust and boom in international resource markets. In contrast, the institutionally consolidated Baltic neoliberalism largely stems from conscious choices made by reformers. International factors reinforced – rather than directly produced – these choices. In the same way, Slovene neocorporatism was mostly the product of a conscious social and political choice, which got reinforced through inter- and transnational influences. Finally, the embedded neoliberal regimes of the Visegrád countries, rather than merely resulting from a conscious strategy, strongly reflect concessions and compromises by which elites responded to the unexpected challenges of transformation. Rather than pure altruism and solidarity, it had been the fear of massive protest against neoliberal reforms that led reformers towards welfare measures. Similarly, except in Hungary, they only became generous towards foreign investors after their initial strategy of creating a dominantly national type of capitalism failed.

We see our third contribution in that our analysis also offers some propositions concerning the potential for stability and the particular vulnerabilities of each regime type. If we are correct, and the CIS regime is linked to state weakness and reflects rather unmitigated world market influence, then we should indeed be cautious about its future. Today, it is an open question how far the recent sustained period of high oil prices has given these countries the necessary resources to build more stable institutions and stronger states.

The state-crafted neoliberal regimes of the Baltic States seem to be much more stable. They have been able to build coherent and adequate institutions consolidating the early choices. At the same time, society is not likely to be able to question neoliberalism, provided that democratic rights are only gradually extended to those who do not share in the 'horizontal comradeship' of nationhood (Anderson 1991). The Slovene regime seems to be equally stable, but for the opposite reasons. While no less coherent and adequate institutions were built here to support initial choices, these included the whole society in the broadest sense. In stark contrast to the Baltic States, where political stability comes at the expense of exclusion from democracy, in Slovenia it results from negotiated social compromises.

Finally, the Visegrád states share uncertain futures. Their regimes combine mutually contradictory aims and features – embedding society, luring investors, and restoring macroeconomic stability, which require fine-tuned and complex balancing acts. Balancing has become more difficult especially in light of Eurozone accession. Recent developments indicate that the Visegrád countries might have to sacrifice their welfare schemes in order to comply with the Maastricht criteria. The price could be increasing political instability and illiberal politics.

Finally, we hope that our contribution has raised doubts concerning the uncritical and mechanical adaptation of the models, methods, and predictions of the VoC approach to the East European countries. Indeed, we believe such transfer might produce more problems than valuable knowledge. Where institutions are in the making rather than consolidated, the direct application of an approach conceptualizing the impact of consolidated institutions on firm behaviour seems ill-suited. Where transnational and international influences shape the emergence of institutions, it is the varied impact of these factors that has to be systematically studied. Where capitalisms are semi-peripheral rather than advanced, similar institutions might produce very different outcomes. It is only in advanced capitalist countries that liberal institutions seem to be conducive to patterns of radical innovation. In the less developed part of the world, neoliberalism is likelier to spell the fast decline of the most innovative industries, as these will be the first victims of the global competition with their advanced country rivals.

9 Acknowledgements

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10 Notes

1 Lane distinguishes a third group of countries, which failed to make the breakthrough towards democratic capitalism altogether, such as Uzbekistan, Belarus, and Turkmenistan.
2 Bruszt also defines a third group (including Bulgaria and Romania), where institutional change in the economy and democracy permanently exhibit tensions, although neither democracy nor market reforms have been completely abandoned.
3 CEE in our sample includes Slovenia, the Baltic states Estonia, Latvia, and Lithuania, and the Visegrád states, the Czech and Slovak Republics, Hungary, and Poland. The CIS in our sample is represented by Azerbaijan, Kazakhstan, and Russia.
4 At the time of writing however, the obstacles to Russia's entry to the WTO are close to being lifted.
5 In 2003, oil, gas, and other natural resources accounted for about 94, 74, and 60% of the Azerbaijani, Kazakh, and Russian exports, respectively (authors' calculation based on UN Tradecom Database).
6 Observers have been well aware of the phenomenon of the radical expansion of private and market forces in the context of relative 'statelessness' in the CIS, as well as of the initially mainly domestic actors, who deprived these states of the capability to engage in full-scale reforms:

> 'Bearing in mind the later starting date for economic reforms in the CIS, it appears that many former Soviet Republics initially made rapid progress . . . After this initial spurt, however, the majority of CIS countries did not make further progress and have fallen behind as a result. This evidence suggests that constraints on the reform process resulting, for instance, from difficult initial conditions may become more binding as reforms become more complex. It is also consistent with the view that in many CIS countries the winners of partial liberalization and privatization efforts have often been able to block further progress in reform and to preserve for themselves the advantages created by a partially liberalized economy' (EBRD Transition Report 2000: 30, also Hellman 1998).

7 Inequality in the CIS dwarfs in comparison with Venezuela or Mexico, where the Gini-coefficients are around 50%, and the ratios of income received by the richest versus poorest 10% of population 60 and 45, respectively. Indeed, in terms of income distribution, the three CIS countries perform better than the USA (Human Development Report 2005).
8 We cover these arguments and processes in greater detail in Bohle and Greskovits 2007.
9 The third major Eastern debtor state was the former Yugoslavia. As Slovenia did not take over responsibility for these debts, she was not constrained in her reform choices.

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