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Summary
This report will analyse the massive political-economic transition in Central Europe since the fall of the Berlin Wall in 1989. In many ways, the period of the mid-2000s when this project was conducted, was a good time to assess the establishment of democratic capitalism in the region. In May 2004, most of the Central European states had introduced democratic political systems and become functioning market economies, and many of them joined the EU as full members. Thus, in formal terms, the first (and often formative) stages of the transition were over, and this report analyses the effects of those first stages on the subsequent political-economic development in the region. Moreover, by the mid-2000s, the broad shape of the new political economies had firmed up, and even if it may be too early to draw hard conclusions about the ultimate outcome, the relative positions of the three key actors in democratic capitalist political economies – the state, (foreign) capital and (organised) labour – seem to be relatively fixed. Understanding how they interact and the broad political-economic consequences of these interaction patterns is the core goal of this report.

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I. Economic Governance and the transition

With the fall of the Berlin Wall in 1989, and the wave of peaceful revolutions in its wake, the entire Central European region, from the Baltic sea to the Adriatic sea and the East Mediterranean became a part of the then west and now broader European capitalist democratic political-economic block. On the whole we know very little about what building capitalism is about, and in a way, the transition in Central and Eastern Europe (CEE) offered us a gigantic laboratory to explore the conditions under which this happened. How would the emergence of a competitive party system influence the building of competitive markets? How would governments withdraw from ownership of the productive assets in an economy without undermining their own legitimacy? How would governments balance competition in different markets with the need for economic security by a large part of the population dislocated by the introduction of competitive markets? Such crucial questions about CEE would help us understand better how capitalist economies in the West were constructed and how the different subsystems in those economies operate.

Yet studying the emergence of capitalism in Central and Eastern Europe is not just looking into a prism that shows the early history of Western capitalism. While many of the generic structures and constraints that capitalist systems face may be very similar in East and West and North and South, one crucial difference between contemporary Western and Central Europe is timing: capitalism emerged in nations in the West and the North of the globe, and as a result, these countries were not only integrated into a ‘world capitalist system’, but constructed it, defining the rules of the game as their economies developed. Countries in Central Europe had no such chance. The organization of their political economies was, to a large extent, given by explicit blueprints such as the EU Copenhagen criteria and the policies promoted by the IMF, World Bank and other international institutions, and implicit ones that followed from the particular shape and content that capitalism had taken in the West. Globalization, deregulation, competition, fiscal restrictions and monetary constraint, the rules by which modern European capitalism seems to play today, offer very different policy parameters than the principles of full employment, industrial policies producing national champions, and Keynesian aggregate demand management which guided post-war Western European capitalism. The capitalism that CEE countries entered in the 1990s was a very different and often much more vicious form of capitalism than the one that Western-Europe constructed in the 1940s and 1950s. Put differently, as Stark and Bruszt (1998) have argued, when trying to understand capitalism in CEE it is imperative to keep in mind that these countries were ‘rebuilding the ship at sea’: they were joining the capitalist world while making the transition from a planned economy to a market economy. Keeping in mind this historical context, which conditioned the nature of the transition as well as the options that governments faced, is critically important in any analysis of CEE capitalism.

One thing we do know from the West, however, is that there are different ways to organise a capitalist economy (Hall & Soskice 2001). Some capitalist economies rely more on dedicated resources such as specific skills, while others rely on general skills. Some have labour markets that produce relatively equal income distributions, while others treat income inequality as the price to pay for higher efficiency. Some have a financial system that provides patient capital to companies while others display a short-term profit orientation. And in the integrating world and European economies, some nations specialise in producing high value-added goods which gradually incorporate innovations while others concentrate on radical innovations. As a result of such differences, the political economy of capitalism is likely to vary according to how the institutions governing these subsystems differ: all other things being equal, for example, asset specificity is likely to lead to a more equitable distribution of gains in the economy.
(Iversen 2005), while a reliance on generic assets is likely to lead to more income inequality. Understanding the emergence of market economies in CEE therefore needs to start from the idea that the different starting points for labour, capital and the state, and the different transition policies that governments adopted with or without labour and business, have shaped the adjustment paths of the economies in the region.

This report will analyse this massive political-economic transition. In many ways, the period of the mid-2000s when this project was conducted, was a good time to assess the establishment of democratic capitalism in the region. In May 2004, most of the Central European states had introduced democratic political systems and become functioning market economies, and many of them joined the EU as full members. Thus, in formal terms, the first (and often formative) stages of the transition were over, and this report analyses the effects of those first stages on the subsequent political-economic development in the region. Moreover, by the mid-2000s, the broad shape of the new political economies had firmed up, and even if it may be too early to draw hard conclusions about the ultimate outcome, the relative positions of the three key actors in democratic capitalist political economies – the state, (foreign) capital and (organised) labour – seem to be relatively fixed. Understanding how they interact and the broad political-economic consequences of these interaction patterns is the core goal of this report.

Our assessment in this report of the shape that capitalism has taken (and is taking) in CEE is guardedly optimistic. Almost two decades after the transition, much of Central Europe, and especially the so-called Visegrád 4 (V4), Poland, the Czech Republic, Slovakia and Hungary, have well-functioning market economies, relatively stable and high economic growth rates that reflect them catching up with the West, and modern industries that produce sophisticated export goods – a surprise for many who were looking at the region in the early 1990s. While it might come as less of a surprise that foreign multinational companies have been the main drivers of these developments, some might raise eyebrows when they discover that FDI is not concentrated solely in low-cost operations. The fear of German trade union officials that ‘South-East Asia starts 70 km east of Berlin’ (Jacoby 2006) seems to have been exaggerated: real wages have risen steadily in CEE, especially in foreign-owned companies, unit values of produced goods are converging on West-European averages, and companies regularly announce significant investment plans in the region. Furthermore, regional authorities – the main visible arm of government in the supply-side of the economy – have often played a significant role in this process, usually to support foreign-company driven adjustment processes and provide frameworks that allowed companies to produce collective goods such as training systems and supplier upgrading operations.

Yet this FDI-led economic development model has a dark side associated with it: while the cross-border region comprised of the Czech Republic, south-eastern Germany, south-western Poland, Western Slovakia and north-western Hungary has witnessed a fast upgrading of its supply-side, and rapidly rising growth rates and living standards as a result, the remaining regions in the different countries have, on the whole (with the exception of Warsaw, which has become a regional financial services center) received considerably less foreign investment, and have grown considerably more slowly as a result (producing the ironic result that a whole generation seems to have decided that jobs in English restaurants offer more of a future than the home economy). The previously existing regional inequalities within each of the V4 have therefore become more accentuated as a result, and the more the fast-growing regions attract foreign investment, the more these inequalities grow.

This first chapter will introduce the basic analytical elements that guided the research. It starts with a short review of the key debates on the political-economic development of Central
Europe, then moves on to present the key approaches that we deployed, and which build on different levels of economic governance, and concludes with an outline of the remaining chapters of the report.

I.1 Making sense of Central Europe

How do we make sense of recent developments in post-1989 Central Europe? Most of the debate about economic governance has focused on the benefits and losses of market-led economic transition and the role of the state in that process. Somewhat schematically, liberals have favoured a rapid introduction of market mechanisms against a background of macro-economic stabilisation after an initial liberalisation of prices. The shock therapy approach holds that the rapid and simultaneous introduction of the central institutions governing a market economy is a necessary condition for a successful transition to a market economy. The information and incentives system underlying a planned economy is so different from a market economy that hybrid systems are unlikely to function well, and may actually lead to perverse outcomes since the constraints of a market economy are dulled by non-market elements – ‘you cannot jump over a chasm in two steps’, thus the key legitimating idea. Freely moving prices will quickly tell producers what to drop doing and where to concentrate their activities, will guide the allocation of resources in the economy, and will allow consumers to balance free choice with a hard budget constraint. Relying on the price mechanism, however, is only possible if prices are stable, and a transition therefore entails a macro-economic stabilization programme as well, led by tough central banks and finance ministries, who can contain spending and thus stabilise inflation as well as exchange rates.

By the end of the 1990s this orthodox interpretation was coming under fire. Stiglitz’s (1999) critique of transition, which criticised the wholesale destruction of existing pre-transition institutions and the problematic timing of different stages in the transition, was among the first systematic counterarguments to emerge. Trust, thus the argument, is a necessary ingredient of a market economy; since this trust is embedded in non-economic networks (social capital – cf. Putnam 1993), the destruction of these networks ultimately undermines the capacity to choose different paths for the economy; left to its own devices, the economy thus adopted a purely market-based form of coordination; nothing, however, made this a necessity. In his comparison of Estonia and Slovenia, Feldmann (2007) took this critique one analytical step further: the difference between the ‘coordinated market economy’ Slovenia and the ‘liberal market economy’ Estonia (the CME-LME terminology is borrowed from Hall & Soskice 2001) is related to the network-promoting versus the network-disrupting government policies adopted during the transition in the two countries.

While these insights provide a powerful corrective to naive neo-liberal views, the problem with this critique is that it assumes that we can tell ex ante which institutions that date back to the pre-1989 order would have beneficial effects in the transition, and which ones would not: imagine that half the institutions that existed before the transition embody social capital and trust, but that the other half simply reflect vested interests of party bureaucrats; picking the wrong ones may block the transition forever.

From a slightly different perspective, but compatible with this critique of market-making as ‘disembedding’ economic behaviour, Greskovits and Bohle (2007) and King (2007) have drawn attention to the politically and economically ‘dependent’ nature of Central European economies: foreign intervention – ranging from multinationals to international organisations – is critically important in understanding both the direction and pace of economic development in CEE states. The ‘transnational varieties of Central European capitalism’ perspective (Bohle & Greskovits, 2007) starts by identifying leading export sectors in the different
economies (those sectors that contribute most to exports – which we will discuss in more detail in chapter 2), and then examines the role of multinational companies and the state in the dual processes of building a leading sector and guiding social development. Neo-liberal strategies are in this regard not the natural outcome of the construction of a market economy, but the product of deliberate strategic choices by governments. Similarly, Slovenian corporatism emerged because of the attempts by the state to make sure that producers’ associations remained strong (e.g. by giving trade unions and chambers of commerce representative monopolies). And the ‘embedded neo-liberalism’ of the V4 reflects the contradictory developments of strong reliance on foreign investment and claims on the state to handle social dislocations.

All of these arguments give us important tools to understand the transition from state socialism to capitalism in CEE. Markets have incentive systems which are different from those of planned economies, and prices organize those. But markets are embedded, and destroying the institutions and social networks that preceded the introduction of capitalism, may unnecessarily limit options further down the road. And the state always plays a role in this process, both as the guiding hand behind the introduction of capitalism, and as the expression of the social non-market elements in society. But this debate also has limited our understanding of CEE to a comparison of trends and developments at the macro-level. And while some observers have introduced (multinational) companies into the picture, the strategic choices of investors receive relatively little attention (Greskovits, 2005, and Bohle & Greskovits, 2007 are among the few exceptions).

Largely as a result of their macro-bias, these models search for systemic coherence in a world in which many adjustment processes, often of a contradictory nature, are still playing out, and in which new actors are trying hard to find their place and define the rules of the game. It is probably too early, therefore, to make sweeping statements about the pace and direction of change of the region: small political changes can still have significant effects and throw a whole block of countries on to another track. But identifying and exploring the causal mechanisms underlying adjustment, however, might help us understand to what extent the different political-economic actors have been capable of mobilising institutional and political resources in the process. Handling that complexity seems to require a more micro-centred approach, which looks at how a market economy is built from the ground up, and ties strategic choices of companies to the broader macro-economic and institutional context. Since the state is important in this process, we will start the presentation of our analytical framework there, and then outline the different elements that guided us in this report.

I.2 The state in transition. Weaknesses, constraints and opportunities

The political and economic transition that Central Europe experienced between 1989 and 2004 was a novel experience in every sense of the word. Never before in modern history had a massive reorganisation on this scale of the economy and polity of so many countries happened simultaneously. In essence, the economic transition in CEE countries entailed a shift from an economy in which, with a few exceptions such as Hungary and some of the former Yugoslav republics, the totality of productive assets were collectively owned through the state, to a system in which ownership of the majority of these assets were transferred to private actors, and in which the central plan as the main coordinating mechanism was replaced by the decentralised market. The economic implications of this massive ownership transfer will be the subject of the rest of this report, and especially the next chapters. In this section we will assess the place of the state in this process, and map the different ways in which the role of the state has been conceptualised in the most important analyses of the political-economic
transition. We identify three perspectives on the state in the transition in Central Europe: state weakness, state capacity, and ‘transition-as-constraint’.

The first perspective emphasises the relative weakness of the state. Compared with the Southern European transitions in the 1970s, which witnessed a dramatic expansion of the state to compensate for the social dislocations associated with liberalisation, the state in Central Europe after party dominance is relatively weak (Innes, 2005). The key issue here is that the transition of the 1990s has exposed the extent to which state socialism in Central Europe crucially depended on the party: once the Communist parties collapsed, the state was unable to renegotiate its links with civil society and the newly emerging party system, at a time that major political-economic reconstruction was taking place. Against this background of excessive claims on the state’s capacity to regulate and organise an emerging market economy and the unwillingness of the parties in the post-communist party system to play an active role in the supply-side of the economy, and with the shock therapy frameworks offered by international economic advisors and international institutions, Central European countries have, after an initial reform wave that introduced macro-economic stabilisation, liberalisation and privatisation policies, largely been left to themselves. The state retreated from the economy, and concentrated on ad hoc welfare policies to handle the massive social dislocation.

This process was exacerbated by the fact that the key issues relating to the transition were relatively under-politicized. After the establishment of a democratic political process, which involved new constitutions and the emergence of a new party system, both left and right parties made accession to the EU and the introduction of a market economy one of the cornerstones of their programmes. The immediate effect was that traditional socio-economic cleavages that had been central to defining the relation between state and economy in the history of Western Europe never gained the salience that they did in the West. In part this followed from the particular nature of the transition itself, which required a reorganization of the role that the state played in the economy, and which almost invariably led to a dramatic reduction of the direct influence of the state in the economy. Accession to the EU reinforced this process of forced state retreat from the supply-side of the economy, as it was conditional upon the establishment of a functioning market economy, in the terminology used in the Copenhagen accession criteria.

A second set of arguments interprets these developments differently, and emphasises that building a market economy de novo requires major state capacity. The basic idea is that privatization and the introduction of market mechanisms require the construction of new regulatory frameworks, which is organized by the state. In one variant of this argument, the state is enlisted in the construction of capitalism by weakening labour and opting for neo-liberalism from above (King 2003). Thus, for example, the rapid shock therapy introduced by Poland in the early 1990s is not just – or even primarily – a reflection of the needs identified by international advisers, but also a way of structurally weakening organized labour. The dramatic rise in the unemployment rate which followed shock therapy assured that labour unions were, with very few exceptions, insignificant economic actors in the first stages of the political-economic transition. Ironically, the transition from communism to capitalism therefore entailed an emasculation of the working class, and has been at the basis of the populist unrest in Central Europe since the early 2000s (cf. Ost, 2005).

In another version of the argument, the importance of the state in some areas reflects the shift toward a market in the other (Bohle & Greskovits, 2007). Whereas in the neo-liberal state argument, the state is an active agent in setting signposts for economic policy, this Polanyian view sees the state more as an agent that attracts foreign capital and compensates sections of the population which lose out as a result of this accelerated modernisation of the economy.
Building a capitalist economy is as much about building market mechanisms as it is about building a welfare state and other protective mechanisms to shield large groups of vulnerable citizens from the vicissitudes of the market.

The final argument, the ‘constraints’ view, can be found in many positive and negative versions in the literature on Central Europe. It emphasises the importance of international political and political-economic actors in the transition process in Central Europe. Regardless of the ideological orientation of the parties in power, and of the perception of strength or weakness of domestic governments, the degrees of freedom at their disposal were limited, in large measure because of the wide-spread agreement across the political spectrum on the ‘return to Europe’ and because this process required the building of a market economy along the liberal lines laid out in the EU acquis and the Copenhagen criteria. In this view, the state was constrained by international actors such as the EU and the IMF, whose policy options translated into domestic policy. The effect was a more or less well-developed regulatory state (commensurate with the acquis) and a passive evolution of the budgetary state, primarily reflecting the growth in welfare spending.

Perhaps the most important conclusion from this short overview of interpretations of the political-economic transition in CEE is that, despite the important differences in emphasis between these different views, they agree on the limited remaining role for governments. Many diverse factors conspired to limit economic policy options of governments of both ‘left’ and ‘right’ to macro-economic stabilisation and passive support of economic restructuring through labour market policies and ad hoc welfare adjustments. Wherever the emphasis is put – on the timing and nature of the transition, the nature of the political economy debates, and the role of economic advisors in early 1990s, or EU accession – the outcome was invariably that a massive retreat of the state from the supply-side of the economy was very likely. The state thus reorganised itself around regulation and welfare, and reduced its role in the supply-side of the economy, through liberalisation and privatisation policies.

While this is an important insight to draw from this debate, these views also have their limitations. The conventional attention which has been paid to central governments and the relations between the nation-states and the EU has almost naturally imposed the national level as the level of analysis, at best in interaction with international and multinational actors such as the EU and large multinational corporations. But this emphasis on national and international developments has drawn attention away from sub-national developments. While the ownership and organisation of productive assets has received relatively more attention, dynamics at the level of regions have not been well-understood. Regional growth policies often can have, as we know from other countries, short-term beneficial effects but longer-term negative consequences through agglomeration effects (network externalities dictate that modern companies locate where other modern companies are already present), and this is likely to lead to important inter-regional inequalities. In the balance of the report, we will therefore shift the attention to these different levels of the economy, and build a picture of state-economy interactions based on micro-foundations.

I.3 Four levels of governance

Handling this complexity in the search for causalities requires a differentiated approach, which builds on the potentially relevant levels of economic governance. We have identified four as central arenas for the transition to play itself out: the (obvious) national and international levels, the industry (sectoral) level, the (multinational) firm level, and the regional level. These four levels of governance alert us to the multi-dimensional nature of the transi-
tion process, and allow us to unpack aggregate data and institutional effects by examining their interaction with lower levels of operation such as sectors and firms.

With regard to the first one, the national and international level, we will pay attention to different comparative advantage indicators and how the CEE region thus evolved into emerging varieties of capitalism. National and international governmental and quasi-governmental arrangements may also have an autonomous impact: government policies lay down institutional frameworks, and the EU acquis may have acted as an independent constraining framework on broad economic policy choices. Foreshadowing what is to come: a look at comparative aggregate data on broad product market strategies of companies in different economies suggest that two different export profiles have emerged in CEE. The first one entails the states that have embarked on a sustained market-oriented transition path. The Baltic states are the main cases here; exporting companies in the Baltics are disproportionately concentrated in activities which require competitive low-cost jurisdictions. The other broad path is given by the Visegrád 4 and Slovenia: the export profiles of these economies combine cost-sensitivity with the need for complex inputs – especially labour force skills, since foreign companies can draw on funds in headquarters for their capital needs.

The second level builds on this idea of comparative advantage and draws attention to the way sectors, both (newly) emerging and disappearing over the last two decades, have developed since the mid-1990s. The basic idea is that not all sectors require, as it were, the same broad institutional framework. As a result of their combination of (specific v. general) skills and (generic v. specific) capital assets, some industries are likely to require complex coordinating mechanisms, which often involve extensive strategic coordination, while others rely more on market-based modes of coordination (Hall & Soskice 2001). Car manufacturing, chemicals, pharmaceuticals, and machine tools rely on relatively sophisticated skills and capital goods, while food processing or mass textiles require comparatively low skills. All other things being equal, economic governance mechanisms are therefore likely to differ across different types of industries, since companies that rely heavily on workforce skills are likely to develop wage policies, working conditions and decision-making structures that reflect this dependence.

This brings us to the third level of analysis, which focuses on firms, and tries to understand how firms, especially multinational companies (MNCs), make decisions within this new political-economic framework. If indeed different CEE countries specialise in different types of products, and if those specialisations in turn find an expression in different institutions that govern wages and the labour market more broadly, then multinational companies face different institutional frameworks in different locations in CEE. A simple location model would suggest that MNCs favour low-cost jurisdictions, where wages and taxes are low, for their activities, and use their move there as a way of leveraging down wages and working conditions in their Western locations. But that is, in fact, not exactly what has happened in CEE. Many MNCs have undoubtedly located in CEE in search of cost advantages relative to the West; but they invested in areas where they combined different relative advantages: wages (not necessarily the lowest), skills, sophisticated suppliers, etc. Put differently, MNCs seem to have explored the comparative advantages of the different CEE countries, and their initial location decisions have forced them to make a series of strategic choices when the relative abundance of cheap labour in the local workforce dwindled. Understanding these choices is of crucial importance in any analysis of economic governance because of the large role that MNCs have played in the dynamic adjustment of CEE countries.

The final level of analysis is the region –the place, as it were, where firms, sectors and the state meet. If the central state is constrained in its capacities, as we think, yet if different locations attract different types of foreign capital because of their different specializations, then
looking for the state (in the economy) in the capitals may be misleading. Moreover, since borders are porous in this region – implying that foreign capital can easily move around across borders – and relative cost advantages small since all governments offer similar attractive subsidy packages, the capitals may play only a marginal role in economic governance. Regional governments, however, are both less constrained by ‘high politics’ in national parliaments, and more nimble in the solution sets they can offer to MNCs. At this level of analysis we concentrate on the interactions between large foreign firms, the company networks that they produce, and local state and non-governmental actors.

Combined, we believe, these four levels of analysis will allow us to retain the strengths of the previous generation of studies which concentrated on national state actors, and at the same time bring in elements of economic governance that will reveal more dynamic processes. Concentrating on foreign companies directs attention to the key supply-side players in the region, and understanding their location decisions as well as the solutions they explore when faced with strategic problems will help us unpack better state and foreign capital interact in the region.

I.4 The argument in brief: Foreign firm-led development, sectoral and regional inequalities

The line of reasoning that we explore in this report builds on the importance of foreign investors in CEE, their actions, and the effects that these produced. The argument in brief is that under specific conditions, foreign investors may and almost certainly will have beneficial local effects, but with very few exceptions, these effects do not lead to supply-side spill-overs for the entire economy. Network or agglomeration effects imply that foreign companies locate in regions where other foreign companies already are located, and as a result, sharp sectoral performance inequalities emerge, which often express themselves as regional inequalities. The Czech Republic appears to be the only of the V4 countries that has avoided such sharp regional inequalities – in large part, it seems, because of its location, which allows it to benefit from the emergence of a cluster of automotive and related industries between the German border and the other V4 countries.

Regional governments play a dual role in this process of reindustrialisation, but with slightly different, almost opposite effects. By supporting large foreign investments for reasons of economic development, they contribute to these agglomeration effects and the emerging regional inequalities. Their corrective action, which consists of programmes to attract foreign investors in other parts of the country, potentially produces a counter-effect. However, the west-European experience with the Cohesion and Structural Funds makes us sceptical of these attempts: while average income at the national level may rise as a result of structural policy, regional inequalities often persist or increase.

In the balance of this report, we will develop this argument in four steps. We start, in chapter 2, with an analysis of national differences, which takes a closer look at privatizations and the ownership patterns that followed from that. We use that discussion to look at different comparative advantages that have emerged in Central Europe, and explore different paths of reindustrialization in different sub-regions of Central and Eastern Europe. Chapter 3 examines why different industrial sectors have fared differently, primarily analysing the textile and automotive sectors, and extending the arguments we develop there to other sectors. Chapter 4 shifts the focus to how firms adjust, how they resolve bottlenecks through emergent forms of coordination, and how non-market actors, such as regional authorities become involved in that process. Chapter 5 then pays attention to the regional effects of this large firm-centered, FDI-led reindustrialization model, especially the growing regional inequalities within CEE coun-
II. Ownership, foreign investment and comparative advantage

A functioning market economy has one crucial institutional element, without which capitalism is simply impossible: it requires a clear system of private property rights. In its most minimal form, the transition from state socialism to capitalism thus required a massive transfer of ownership rights from an abstract, collective entity – the state – to private actors. Simple as it may be in principle, this process presented itself as a major issue. There were the basic questions of selling, and if so to whom, or simply to give away the companies – and how? Since the state in CEE very often owned the quasi-totality of productive assets, the scale of the operation was enormous; in large part because of the immense scale, there were very few blueprints that could be used, and information asymmetries made valuation methods for existing companies close to impossible. In the background, finally, strategic considerations of future performance mattered: how could the privatizing authorities make sure that the companies continued to operate, grew and thus created employment?

Central European countries were, on the whole, quite quick to privatize: in most cases, over 90% of the economy was privatized within a few years, and the remainder was often liquidated immediately afterwards. With a few exceptions, most countries also were very open with regard to ownership. Driven by the need to meet the EU acquis which imposed freedom of capital, and to find strong owners for their companies, most countries accepted that foreign investors, often with deep pockets, came in to buy up the companies. The effect was that in most cases, the inevitable transition recession, which was triggered by a decomposition of the old system of production and the construction of a new one, was very sharp but also very short, and that high growth picked up only a few years later.

This chapter will discuss the privatization methods that were used, their prospective and their actual effects. The somewhat surprising conclusion of that review is that final ownership appeared to be a considerably more important predictor of the aggregate performance of firms than the method of privatization per se. Furthermore, foreign investment has clustered in remarkable ways. Measured in terms of their contribution to exports, two profiles emerged in Central Europe: one is best captured by the Baltic states, whose export profiles are concentrated in basic industries, while the other is found in the Visegrad-4 (V4), whose dominant profiles is what we call complex industries that require relatively sophisticated capital and skills.

II.1 Privatizations and ownership: different modes, same outcomes?

By the mid-1990s, a large part of the productive sector in the former Communist countries had been privatized through some form of mass transfer of ownership. The Czech(-Slovak) voucher privatization scheme was perhaps the most important (and possibly the clearest) example of this: all citizens received a nominal share in the economy, which they could then retain or sell on. The underlying idea was that no single body – certainly not the governments, which had proven deeply incompetent in guiding a transition from extensive to intensive forms of growth in the 1970s and 1980s – was able to process the information necessary to distinguish ‘good’ from ‘bad’ companies, and that the decentralized decision-making structures that markets provide would be a more efficient and rapid way to restructure the economy. In the region, only the former GDR adopted a centralized model in which one company (the Treuhandanstalt) technically owned the economy and proceeded with privatizations from
that position; in the other countries, ownership of the bulk of the economy was transferred without central intervention.

The different privatisation models have been the subject of a heated debate among economists and political scientists studying the transition. In essence there are two positions. The dominant position is that in the end the method of privatisation does not seem to matter for aggregate outcomes: a decade after the transfer of ownership from state to private sector was more or less finished, broad economic indicators suggest that growth, exports and competitiveness in the different CEE countries have converged even if the trajectories were different – steep at first, and slowing down afterwards, and the other way around. Bennett, Estrin and Urga (2007) argue that voucher privatization has been associated with faster growth, due to the speed of the cutting of the links between state and firm.

But not everyone agrees with this assessment: Stiglitz (1999) pays special attention to the problems of the long agency chains in mass privatisations, which weaken the incentives of owners in a company to actively monitor management, with suboptimal aggregate outcomes as a result. The critique is in essence that mass privatisations fail to create a single owner with a stake in the company; the result is therefore that companies are put on hold until such an owner arrives, that companies are stripped of their assets and thus fail to gain a viable future, or even that assets were siphoned off without any productive investment associated with it. Many potentially viable firms thus disappeared as a result of this convoluted process, either because an owner with a stake in the company did not arrive early enough, or because of simple corruption in the process. King (2003), in turn, argues that shock therapy – the radical transition to a market economy via a policy of rapid and extensive price and trade liberalization, stringent monetary and fiscal stabilization, and which includes mass privatizations – produces supply-and-demand shocks for enterprises which may lead to unnecessary firm failure. The result is a fiscal crisis of the state because of the narrowing tax base, which feeds back into the underdevelopment of the private sector, since the state is unable to produce the institutional framework that are the non-market basis of capitalist economies. The effect was that those countries which kept their state apparatus intact, predominantly the Central European countries which have joined the EU in 2004, were also the ones which avoided a total collapse of their economies. They were able to attract strong foreign firms to sell the companies, started manufacturing goods to export to Western Europe, and thus found themselves on a high-growth path very early on (King, 2003: 40).

A look at the relation between individual firms and economic performance from the vantage point of the mid-2000s, seems to confirm this more complicated picture. The starting point is to distinguish between mass and strategic privatisation. Mass privatisation is the standard method through which the nominal value of a company is expressed in a large number of shares that are distributed to the population at large to specific groups within the population or the workforce, and which can then be traded, often through specialised investment banks. ‘Strategic’ privatisation refers to a mode of ownership transfer that keeps (a large part of) the company intact and transfers it more or less wholesale to a single owner, usually after an evaluation of different offers in terms of expansion plans and price, and after the negotiation of a detailed business plan and clear milestones in ownership transfers between the new owner and the government.

The most important finding that comes out of such a retrospective analysis – what type of firm is at the basis of economic performance today? – is the crucial role that foreign-owned large firms, both those that were strategically privatised and greenfield investments, play in the region. Most of the strategically privatised companies were eventually sold to a foreign owner, and FDI in general accounts for anywhere between 50% (Poland and the Czech Re-
public) and over 80% of exports (Hungary). In most countries, inward FDI stock accounts for between 25% and 60% of GDP (all data are taken from Henriot, 2003). This foreign investment, both through privatisations and through new investment, was disproportionately concentrated in a small number of sectors and regions. The region covering south-eastern Germany, south-western Poland, the Czech Republic, western Slovakia and north-western Hungary has become home to an important and fast-growing engineering sector, with a concentration in car assembly and automotive supplies. In its wake, other complex engineering emerged as well (Greskovits, 2005).

Linking the mode of privatization to the ownership structure that followed therefore sheds light on different trajectories of economic performance. Most studies agree that foreign versus domestic ownership is the single most importance factor for assessing the quality and effectiveness of restructuring and the subsequent upgrading (e.g. Hotopp et al., 2005; Lizal & Svejnar, 2002; EBRD, 2005: 82-83). However, privatisation methods seem to have been an important factor in determining ownership. On the basis of Czech data, Marcincin & Wijnbergen (1997) point out that the decisions on which mode of privatization to adopt for individual companies were made on the basis of the offers: the ‘quality of the company’ was judged according to the number of bids and offers that a particular company received. If the number of initial offers was high, the government would proceed with what we have called strategic privatisation; the ‘weaker’ companies, which received fewer or no bids, were privatized through some form of mass, usually voucher-type, privatization. In addition, Simoneti et al. (2003) argue that after mass privatization, most of the companies were further privatized (through what is called ‘secondary privatization’), and here it mattered who the seller was at this stage. If a company was owned by private owners rather than the government, secondary privatisation was more successful.

This analysis suggests therefore that the mode of privatization mattered primarily in conjunction with ultimate ownership. While mass privatizations may have had a higher chance of leading to unnecessary failures, there are also instances of companies that were privatized along that model which did well – if they found a foreign owner afterwards. Strategic privatizations, in contrast, seemed to have a higher chance of leading to success, especially – again – if a foreign company bought the privatized firm, since the deep pockets of the new owner allowed a deep restructuring of the company. In both instances, however, foreign ownership appears as the best predictor of later success. But foreign ownership was not evenly distributed across all Central European states: some regions attracted foreign companies engaged in complex manufacturing, while others did not. These processes led to different industrial and export profiles. The next section analyzes the consequences of differences in type of foreign ownership.

II.2 Comparative advantages in the V4 and the Baltic states

Foreign ownership thus has played a crucial role in the reindustrialisation of Central Europe. But the history of recent industrialisations in other parts of the world such as Latin America and Southern Europe suggests that foreign capital can have very different effects. Multinational companies can have relatively benign developmental effects, can become hard-to-control extra-governmental powers, and often locate in newly industrialising areas exploiting significant cost advantages. In that respect, Central Europe initially was no exception. While before the late 1980s some market-seeking logic may have been at the basis of multinational activity in Central Europe, there is little doubt that the post-1989 investments were primarily guided by the low wage and other cost advantages of the region relative to Western Europe. On the whole, however, since productivity levels were low and basic infrastructural networks
weak in the early and mid-1990s, many medium-sized Western firms in search of cheap labour quickly retreated back to the home base after discovering that context conditions were considerably less beneficial than initially thought.

But large companies face a slightly different calculation when locating abroad in an under-industrialised region: their weight allows them to negotiate from a position of strength with local and national governments, their financial autonomy allows them to internalise costs as well as benefits, and their long-term links with other firms allows them to build a state-of-the-art just-in-time supplier network. Multinational companies, furthermore, can cross-subsidise a few years of losses in new operations if they assume that strategic gains lie further down the road.

A careful comparison of investment in and export profiles of different CEE member-states, based on the asset-specificity typology that Greskovits (2005) has constructed, suggests quite convincingly that broadly speaking two very different production profiles have emerged there over the last 10-15 years. In essence, the typology is based on the degree to which industries are labour or capital-intensive, and, dichotomising the positions for both factors of production, leads to four types which are summarised in table 2.1: a) intensive only in physical capital, b) both physical and human capital intensive, c) only human capital, and d) neither physical nor human capital, but unskilled labor. In the following, these factor-combinations are referred to as a) heavy-basic, b) heavy-complex, c) light-complex, and d) light-basic profiles (Greskovits, 2005). Two very different production profiles thus emerged: while the former rely on relatively complex technologies and sophisticated skills, the latter do considerably less so.

<table>
<thead>
<tr>
<th>Table 2.1: Leading sectors</th>
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<tr>
<td><strong>‘Complex’ sectors</strong></td>
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<td>- Light-complex: only human capital intensive: e.g. pharmaceuticals, office and data processing machines, electrical machinery, scientific equipment, optical goods, clocks</td>
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<td>- Heavy-complex: intensive in both physical and human capital intensive: e.g. chemicals, machinery and equipment, road vehicles and transport equipment</td>
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<td><strong>‘Basic’ sectors</strong></td>
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<td>- Light-basic: intensive neither in physical nor human capital, but unskilled labour: e.g. cork and wood, textile, rubber, furniture manufacturing, clothing and accessories and footwear</td>
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<td>- Heavy-basic: intensive only in physical capital: e.g. food, live animals, beverages and tobacco, fuels, vegetable oils, iron and steel, pulp and paper, non-ferrous metals</td>
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Source: Greskovits 2005

Using this typology as a lens to look at reindustrialisation and especially investment in Central Europe shows a remarkable differentiation across the region. As figure 2.1 demonstrates, Slovenia and the Visegrad 4 (Czech Republic, Poland, Hungary and Slovakia) have increasingly specialised in heavy-complex and light-complex export industries, while in the others (the Baltics and south-eastern Europe) heavy-basic and light-basic profiles dominate. While in the V4 and Slovenia at least 40% of their exports – and usually more – over the last ten years consisted of complex goods, 40% appears to have been the ceiling for the remaining countries. In addition, the trajectories of the V4 and Slovenia contrast sharply with the Baltics and south-eastern Europe (SEE). In the first group, the share of complex products in exports rises
almost immediately after the transition recession of the early 1990s, while that share first fell in the other group and began to rise only toward the end of the decade, and then only slowly. While it may be too early to treat these different outcomes as stable, there are reasons to believe that it is very difficult for the Baltics and SEE to catch up with the V4 in terms of the importance of complex manufacturing. The initial wave of investment in CEE as a whole seems to have produced network externalities which imply that complex manufacturing in future is likely to locate where other companies with a similar profile are located.

**Figure 2.1: The evolution of leading sectors in Central Europe**

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<th>Year</th>
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<th>Czech Republic</th>
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Companies, especially multinational companies, in the V4 are therefore on the whole very different from their counterparts in the other Central European states. One of the characteristics of foreign investment in the region was not only that much of it had a high degree of asset-specificity, but more importantly that much of the investment in complex production led to high fixed costs. A plant in the automotive, chemical, or steel industries is highly capital-intensive, and often requires a relatively long (>10-15 year) period for the investment to be written off. Precisely because such investments can only be realised over the medium to long run, these companies are unlikely to rapidly relocate in new lower-cost jurisdictions, since that would mean foregoing the gains from the initial investment. In sum, the V4 and to some extent Slovenia thus seem to have attracted long-term, ‘rooted’ FDI which brings better jobs and pushes economies upwards, while the others appear to have attracted companies with a much more foot-loose capital structure and relatively short-term amortisation periods, which allow them to relocate rapidly without incurring tremendous costs as a result of non-realised investment.

These different firm profiles have important consequences for companies when they encounter strategic problems, as we will see shortly. Foot-loose capital, expressed in light investment, can move, but large investments cannot do so easily; the first can circumvent problems by exiting the jurisdiction, whilst the second is forced to stay and address the issues within the location. And that constraint alters the capacities for cooperation among firms. Before we ex-
plore these effects, however, it makes sense to make a little more sense of the history of these different production profiles. The upward move in the V4, had, as we will see in the next section, its roots in a significant shift in the strategies of firms after the initial investment, from low-value added to high-value added activities.

In sum, the current success stories in the region seem to be better explained by foreign ownership than the mode of privatisation. Yet foreign investment decisions, company strategies, timing and time-horizons have differed across the V4, Baltic states and Slovenia (Bohle & Greskovits, 2007). At the time of entry into the EU, the export, trade and production profiles of the V4 states and Slovenia were composed mainly of complex goods (automotive, electronics, chemicals), which were both capital and skill intensive. The profile of the Baltic states, in contrast, consisted of light industries (food, wood-processing) which were significantly less capital-intensive and dependent on unskilled rather than skilled labour. Given the importance of complex manufacturing for the development of complex services as well as for possible spill-over effects to the rest of the economy, these differences are likely to lead to very different political-economic profiles.

II.3 Conclusion

In this chapter we started our empirical investigation, by discussing the mode of privatization adopted in the different countries in Central Europe and the nature of ownership. While there are certainly reasons to question the mass privatization model that prevailed in many CEE countries because of the way they may have foreclosed the viability of many companies, the main differentiating factor appears to have been ownership. If a company ultimately had a strong foreign owner, it went through a deep restructuring phase, and usually came out quite strong at the end. Aggregating this up to the level of an economy as a whole, it appears that those countries that based their strategy on attracting strong foreign owners – the CEE-V4 – have managed the transition from a planned economy to a market economy in a way that is very different from others. By the mid-2000s, two very different trajectories emerged across the new Central-European capitalist states. One is typified by the Baltics, where little foreign investment has come in that can be considered ‘rooted’, and the other by the V4 and Slovenia, which have attracted foreign capital in complex manufacturing sectors – the type of capital that is likely to stay in the region because of its longer-term investment horizons.

In the next two chapters we will use this analysis as an entry into the question of economic and firm governance. The intuition is that ‘rooted’ capital faces different exit options than relatively foot-loose capital, and this results in different governance mechanisms, both at the formal level of the state and at the level of sectors and firms. Chapter 3 will discuss the broad sectoral patterns that emerge from such an analysis, while chapter 4 will discuss emerging forms of inter-firm coordination in the V4.

III. Sectoral success and failure

By the mid-2000s, the different groups of countries in Central and Eastern Europe had developed very different comparative advantages, which expressed themselves in different profiles of dominant sectors. This chapter will explore which factors lie behind the successes in the region, by comparing two sectors that had similar starting points in the late 1980s – right before the transition – but evolved differently thereafter. We will compare the automotive and
textile sectors. Both were important sectors in the pre-1989 economies in the region. The comparison between the two is particularly enlightening since, on the basis of the initial specialization, and considering that foreign investors initially moved into the region to take advantage of cost advantages (expressed in low labour costs and low taxes), one could have expected that the textile sector, which is considerably more sensitive to labour cost considerations and in relative terms requires significantly less capital, would have done well. The slightly counterintuitive outcome that we will explore in this chapter is that initial factor endowments of the region, with its abundant cheap labour, would have favoured the textile sector, but that precisely this sector declined, while the automotive industry, which requires higher capital and skill intensity and is frequently a highly unionized sector where wages grow fast, fared relatively well and continues to grow rapidly. In fact, most observers analyzing the political economy of CEE in the early 1990s would have been surprised to find, a mere ten years later, that in some of the most successful transition economies sophisticated engineering goods were being produced. Moreover, while the automotive industry in the Visegrad 4 (V4) is comparable to the quality and sophistication of the car industry on the Iberian peninsula, the CEE automotive sector achieved its status in terms of product profile and value added in half the time that it took Spain to do so. However, there have also been individual failures in the automotive sector, e.g. the Ford closure in Plonsk, Poland (European Foundation for the Improvement of Living and Working Conditions, 2004), and successes of individual companies within the textile sector. Comparing these two sectors and the individual success stories within them against the broader background of sectoral decline and success will allow us to understand and isolate the factors which lie behind the successes. We start by setting up the framework for the comparison by providing a general background to the logic of the functioning of the two sectors in the different economies. We then offer empirical evidence for each of the sectors and combine that in a more general argument on the determinants of success and failure of sectors in the economic development of CEE.

III.1 Comparing the automotive and textile industries

Both the automotive and the textile industries are highly competitive, internationalized and global industries which function in the integrated production systems consisting of highly specialized, segment-specific, horizontally and/or vertically-organized transnational firms coined as commodity chains or value chains (Gereffi, 1995; Caves, 1982). However, the two industries are structurally very different and represent prototypes of producer-driven (automotive) versus buyer-driven (textile) commodity chains. Both of these two sectors have been important vehicles in the industrialization and economic development in different parts of the world, ranging from Latin America to South-East Asia.

The automobile industry is a classic example of a producer-driven commodity chain. The automotive sector is among the largest and most internationalized industries. The industry has a high intensity in capital, technology and skills, and exhibits high barriers to entry. Consequently, lower-income countries with large labour supplies only do not have a comparative advantage in such industries (Lee and Cason, 1990: 223). The car industry can be subdivided into final assembly and components production. These different parts of automobile production are interconnected, which implies that the technological and organizational development of one part is a prerequisite for development of the other. The high barriers to entry, in turn,
imply that the sector tends to have an oligopolist structure with only a few companies playing a major role in one country and in world competition. In addition to a larger optimal size because of high economies of scale, changes to vehicle technology are becoming more and more important. As carmakers strive to extract higher margins through increased specification, this has resulted in a move ‘up-market’ in specifications and the inclusion of more on-board electronics and telecommunications systems.

A change in the organization of the industry from Fordism has eventually resulted into adopting the Japanese model of ‘lean manufacturing’ which aims at utilizing all resources in the most efficient way. In addition, the system of just-in-time parts delivery has transformed the organization of the supply industry. Logistics and material movement have become skills in themselves and have forced firms to specialize in this area. With suppliers taking over functions previously undertaken by car manufacturers, the supply industry has become very important – up to 60% of new cars come from the suppliers with prospects to increase even more (European Foundation for the Improvement of Living and Working Conditions, 2004: 7-10), a trend which imposes high demands on the quality of a host country’s infrastructure. Further, the industry is undergoing another structural evolution, with its shift toward collaborative engineering and production, resulting in even greater outsourcing (Dannenberg and Kleinhans, 2005).

The textile industry, in contrast, is a prototype of a buyer-driven commodity chain based on decentralization and a decoupling of design and retail from the actual production of goods. Production is generally carried out by tiered networks of third world contractors that make finished goods for foreign buyers. The specifications are supplied by large retailers who order the goods. Skill intensity thus varies greatly along the different segments of the chain with the production part requiring low skilled labour and relatively little capital or knowledge. Hence, profits in buyer-driven chains derive not from scale, volume, and technological advances as they do in producer-driven chains, but rather from unique combinations of high-value research, design, sales, marketing, and financial services that allow the retailers and designers – based almost exclusively in the US and Western Europe – to act as strategic brokers in linking overseas factories and traders with evolving product niches in their main consumer markets (Gereffi, 1994). The production segment is characterized by a myriad of small firms, which employ disproportionate numbers of women, handicapped and older people. Unlike the automotive industry, it can therefore be set up in regions with a weak infrastructure and a low-skilled workforce.

Both sectors played an important role in the pre-1989 Central European economies. The socialist import-substitution-based industrialization strategy concentrated heavily on developing industry, both heavy and light and, despite its autarchic features compared with the market economies in the west, supported trading and exchange within the Eastern bloc. The more western parts of the eastern bloc, today’s new EU member-states, served as industrial bases for processing primary commodities coming from the Soviet Union. This industrial tradition in these areas almost invariably dates back to before the Cold War era. While the Czechoslovak automotive tradition goes back to the 1920s, when the Skoda factory was set up, the history and experience of the textile industry in the region dates all the way to the 15th century for some of the Czech guilds, and to the late 19th and mid-20th century for several other firms that have survived until today.
Figure 3.1: Selected performance indicators in the automotive and textile sectors, 1994-2005
Global competition after 1989 has been handled very differently by both sectors. Figure 3.1 demonstrates that, after starting from relatively similar positions in terms of export shares and shares of manufacturing output in the early period of transition, the textile sector has gone through a protracted process of decline while the automotive industry has grown rapidly. On average, automotive sector exports and share of manufacturing output rose from about 10% in 1994 to nearly 25% in 2005 for exports and from nearly 15% to over 25% for output. The trend has been the opposite for the textile sector: a decline of over 7% (from 12.5% to less than 5%) in exports and of 5% (from 8% to 3%) in output between 1994 and 2005. Further, at the turn of the century, the sectors started to diverge significantly in the ability to create jobs and attract labour. Combining these evolutions with figures on labour productivity, which has risen in both industries, suggests that labour productivity in textiles has increased at the expense of employment, while the opposite is true for the automotive industry. On the basis of these indicators and others that we will discuss below, we treat the automotive sector as a success and the textile sector as a failure. The automotive industry has become a leading sector in at least three out of four Visegrad countries – Slovakia, Czech Republic and Poland. Alongside the production of cars and engines, Hungary performs exceedingly well in exporting light-complex commodities within the electronics and electrical industry.

Table 3.1 gives a stylized picture of the two sectors in the V4. Note the variation across the different countries, such as a relatively better position of the textile industry in the Czech Republic compared to the rest of the region. In the next 2 sections, we will analyze the development trajectories of the two sectors in more detail, starting with the automotive industry and continuing with an analysis of developments in the textile industry.
Table 3.1: Summary of development of the automotive and textile sectors

<table>
<thead>
<tr>
<th>Automotive sector</th>
<th>Textile sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>Increasing shares in exports and in the share of</td>
<td>Falling shares in exports and in the share on</td>
</tr>
<tr>
<td>manufacturing output</td>
<td>manufacturing output</td>
</tr>
<tr>
<td>Rise in labour productivity and in employment</td>
<td>Rise in labour productivity but fall in employ-</td>
</tr>
<tr>
<td>Upgrading of product profile</td>
<td>No upgrading of product profile</td>
</tr>
<tr>
<td>Skill upgrading</td>
<td>No skill upgrading</td>
</tr>
</tbody>
</table>

III.2 The unexpected success of the automobile industry in Central Europe

The automotive industry writ large has been the single most important sector in the high growth Visegrad 4 geographical region. By the mid-2000s, this industry and its offshoots alone comprised a significant part of GDP in all of the countries, and accounted for the bulk of exports ranging between 22% and 27% in 2006 (Figure 3.2.).

Figure 3.2: Automotive sector exports (SITC Rev. 3: 71, 74, 78) as share of total exports

The motivations of large car manufacturers to invest in the CEE states were driven by a combination of factors which took shape in two stages. Initially, the CEE played a role mainly as the target market as MNCs followed a *build-where-you-sell* strategy, motivated by cheap, productive and skilled labour. In the case of Poland, for example, restrictive trade policies of the Polish government in the 1990s and high import duties on EU–produced cars in effect until 2002, were the main reasons for establishing assemblies in Poland (Dunin-Waswicz *et al.*, 2002: 18-19). Nevertheless, a *follow-the-leader* pattern has been clearly evident and the initial VW investment in the former Czechoslovakia was soon followed by many other brands.²

² Table 1.A in the Annex provides an overview of all major car manufacturing investments in Visegrad 4 countries, giving more insights into volume of production and sequencing of the investments.
However, the small size of the Central European market and the slowly growing disposable household income in the region has led firms to expand production gradually and use CEE as a production base to serve the EU market (Radosevic and Rozeik, 2005: 5-6; Snyder, 2005). The prospects of EU accession significantly encouraged car manufacturing MNCs to enter the market or expand their activities, and instigated a second wave of automotive investment which took place from the late 1990s. Today the region produces more cars per head than any other region in the world and the growth in volume has been extremely fast since the start of stable production in the late 1990s (Figure 1.A. in the Annex).

Two additional processes seem to have characterized the evolution of the sector. First, the product market strategies have shifted from manufacturing of long combination vehicles (LCVs), trucks, agricultural tractors and motorcycles to passenger cars. Secondly, there has been a clear upward shift in terms of product and production profile. Car producing operations in Central Europe also tend to employ the most modern equipment and are usually among the most advanced within their companies (Jakubiak et al., 2008). The plants have marked a sharp upward shift in the product range from relatively small, simple cars to high-end ones - e.g. from VW Polo or Opel Corsa to the large high value-added off-road Audi Q7 or the Opel Zafira. The upward shift in product and skill sophistication is also visible in Figure 3.3, which presents export share and unit value – the average monetary value of a single car produced, a good proxy indicator for quality and skill – for motor vehicles only (rather than the broadly defined automotive sector in Figure 3.2).³ Again, the export shares show a rising trend, with Slovakia topping the other three countries from 1998 on, as does unit value. Between 1994 and 2006 the unit value has risen on average about 3.5 times, gradually in Poland and Czech Republic while increasing more sharply since the late 1990s in Slovakia and Hungary.

³ We measure motor vehicles with SITC code 781 (Rev.3).
This upward shift in product ranges has gone largely unnoticed but appears particularly striking when further compared with Portuguese and Spanish car plants (Figure 3.4). Especially in the last five years did the average unit value in the V4 rise a lot faster than in Southern Europe. In other words, about 15 years after the transition, car plants in the V4 region have transformed with great speed from low-wage extended workbenches of western operations to flexible high-end producers, able to combine the advantages of large volume with a focus on product range variability and high quality and value added.
In sum, what seems to have emerged in the automotive industry in the CEE-V4 region is an industrial structure that can no longer be characterized simply as a low-cost competitor in low value-added market segments, but a fully-fledged robust industrial system that has managed to capture higher-end product market segments. It combines high skills with growing wages, upward shifts in product market strategies with increasing production volume, and integration into a wider, strong group with growing autonomous R&D capacity. From being initially highly dependent on strategic decisions made in headquarters in the center, car producers in the region have increased their operational autonomy, have been renegotiating strategic and R&D capacities with the center, and increasingly appear insulated from distant shocks. Thus, the pessimistic assessment about a lack of the use and development of domestic engineering and design skills and even a reduction of local R&D facilities in the late 1990s and even still in the early 2000s (Gorzelak et al., 1995; Kurz & Wittke, 1998 cited in Dunin-Waswicz et al., 2002: 22), has changed rapidly. Importantly, the degree of embeddedness and the levels of autonomous R&D seem to vary among the Visegrad states, with the Czech Republic as a regional leader, and, also among different manufacturing operations, with German car makers most prone to rely on local engineering knowledge and capacity also at the highest end of the value chain. The fact that the companies might be changing their strategic intentions in the region is also manifested by the fact that firms have increasingly started to invest in training and education, setting up various forms of cooperation with local secondary schools, universities, and among themselves. This general pattern, which includes upgrading in product market strategies, cooperation, and strategic engagement of local resources, is very different from what we find in the textile sector. As we will see, almost all the elements that have made the automotive industry in Central Europe a success story are absent in the case of the textile industry.

III.3 The failure of the textile industry in central europe

The textile industry in Central Europe is a sector with a long and successful tradition dating back several centuries. Before the late 1980s, more than half of the production in the region was directed to the Soviet Union as part of the exchange for raw materials and other economic
arrangements. Due to secure demand, no sophisticated development or modernization was necessary. In the initial stages of the transition, the industry fared reasonably well but the peak of the mid-1990s was followed by a general decline of the sector in terms of employment levels and export shares (Figure 3.5). Only the textile industry in Slovakia witnessed slight growth in employment and labour productivity between 1999 and 2002, which was due to factors including a shift of low-skilled labour from the EU 15 to the accession countries, the conflicts in the former Yugoslavia which was at that time a leader in the textile industry among the transition countries, and a relatively weak Slovak currency (ATOP, 2007).

Figure 3.5: Export shares in textile industry in Visegrad

![Graph showing export shares in textile industry in Visegrad](image)

Source: UN COMTRADE. Note: Textile = SITC Rev.3: 26, 65, 84, 85. Authors’ calculations.

The general decline in the sector, caused by an increasing competition from Asia and unfavourable textile trade treaties with China on the EU level (European Commission, 2007; see also Figure 2.A in the Appendix for decline in employment in the textile industry), has hit Western Europe in the last few decades as well. Against this broad background of general decline and a limited ability to move to more sophisticated and research-informed production in Central Europe, however, some success stories of individual firms exist within the sector. A crucial element that exists in all the successful companies, i.e. those which manage to hold on to a stable share of the regional market and/or produce products with higher value added, is the presence or full ownership of foreign capital. A few examples illustrate this point: backed up by a Swiss investor, Rekos in Revuca (South-Central Slovakia) has been able to produce carpets with sophisticated technology, and Titex in Humenne (Eastern Slovakia) produces sanitary and health textile for a large part of Europe with Danish capital and know-how. PLEAS in the Czech Republic was sold directly (rather than through voucher methods) to a strong Swiss foreign investor as early as 1994: the 10 million DM investment into renewing and developing the equipment and production sites in 1995 proved a good choice and the company managed to keep its trademark as well as a stable share in several stages of clothing production, including preparation and development of knitwear/fabric (knitting, colouring, and design), cutting, and sewing of the clothing (www.pleas-servis.cz).

The shape and timing of FDI entry into the textile industry across the four countries – as is true generally for foreign investments in the V4 – differed in sequencing and scale over the

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transition. Poland, the Czech Republic and Hungary differ from the Slovak Republic in attracting larger inflows of FDI earlier. Moreover, the Czech Republic and Poland have benefited significantly from their close proximity to Germany. In contrast, as a result of Mečiar’s economic protectionism Slovakia attracted foreign investment only later, while the Hungarian government, considering the textile industry not good enough for the country’s future economic development, eliminated it through its minimum wage policy which made textile production unsustainable. Since competing with the Asian producers was impossible on cost alone, the textile industry in CEE has concentrated on seasonal production, built on smaller quantities and greater flexibility. Unlike investments into complex sectors, foreign investment in the textile industry has received little government support, with the exception of tax breaks during the 1990s which perversely resulted in the closure of these companies after the 10-year tax holidays expired.

Despite the general decline of the textile sector in Europe and in Central Europe, two new elements are worth discussing. First, in addition to a few technologically more sophisticated and computerized production sites which perform well, other firms have been able to move up the value chain through outsourcing of the simplest and most labour-intensive parts of the production processes further East, from Ukraine to China. Some companies in the eastern part of Slovakia, for example, source to Ukraine and some successful regional retail brands in Poland outsource production to the Far East. Retail brands such as KAN (Tatum), LPP (Reserved) or Redan have all been set up in the 1990s and have managed to expand into various countries in Central and Eastern Europe since then (and some made it onto the regional stock-markets), concentrating on design and distribution channels while outsourcing merchandize production (www.tatum.com; www.lpp.com.pl; www.redan.com.pl).

The textile sector has also seen a peculiar development in the area of R&D. While the industry used to have research centers running parallel to production centers in the past, these have in fact ceased to exist in Slovakia and with the extinction of the industry also in Hungary. In Slovakia, cooperation between the two existing research centres and firms is very weak. Partly this is a function of foreign ownership, as R&D in foreign firms tends to take place in the home countries, but it also reflects the inability of the remaining R&D centres to cooperate closely with those firms which would be interested in moving some R&D functions to Central Europe. In the Czech Republic, however, R&D in textile and clothing was preserved and further developed, partly a result of a greater share of textiles in the industry mix in the early 1990s, characterized by a higher technological intensity than clothing. Textile firms in the country have clustered in the Liberecko area north of Prague, and are thus able to combine existing resources and seem prone to share knowledge more than elsewhere in CEE.

On the whole, though, the clustering and in some cases tight networking that has characterized the automotive or electronics industries has not taken place in the textile and clothing sector. Such clustering and cooperation has been a key factor behind the success of the textile districts in the Third Italy, since it allows firms to pool resources and even share production capacity. In CEE, in contrast, and with the exception of some Czech cases, firms tend to act in isolation rather than cooperate, even in situations where they are unable to meet their orders. The same is true for relations across sectors: even though part of the production of a few of the companies is geared towards the domestic automotive sector, cooperation between the sectors is limited. Recently, the textile and clothing industry has even seen an outflow of labour to the booming sectors. For example, after the lay-offs in Ozeta, a traditional Slovak tailoring company in Trenčín (Western Slovakia), many of the women employed there were immediately offered positions in “Leoni Autokabel Slowakia”, a second-tier supplier for the automobile industry. When Ozeta announced the end of its production, the automobile sub-
contractor organized ‘excursions to their company’ whereby the women were handed employment questionnaires to fill out. They could easily transfer their skills from clothing production to cable production as in both jobs, manual skills and the ability to concentrate on delicate work for longer periods of time is essential. (Pravda, 7 June 2007)

III.4 Conclusion

In this chapter we analyzed a particular developmental path of the Visegrad 4 countries which host an automotive cluster that is competitive with the most advanced production facilities elsewhere in the world. The V4 countries stand out in comparison to the rest of the CEE states and even in comparison to the Iberian peninsula. Yet while the automotive industry has become a leading sector in these economies, what appears to be emerging is not primarily a regional economy highly dependent on the cyclical car industry, and therefore highly vulnerable to decisions made outside the region. The large number of suppliers who located in the region and export to the western EU make the region significantly more resilient to cyclical downturns in the car industry than it would have been if only final assemblers and in-house component suppliers had settled there. One important consequence is that this significantly decreases the possibility of relocation which has faced Spain and some Western European countries over the last decade (see for example: European Foundation for the Improvement of Living and Working Conditions, 2004). The comparison also allowed us to analyze the experience of textile sector which started from a similar position in the early 1990s but did not fare well against the world competition and declined fast.

While the textile industry has mainly faced competition from developing countries in Asia, the successful automotive sector in CEE-V4 has been able to stand its ground against Germany, France, Spain and the USA. We have identified a number of factors, summarized in Table 3.2, which contributed to the different sectoral outcomes in automotive and textile sectors, broadly defined, in the V4 countries. First, the automotive sector is characterized by a strong presence of foreign capital from the very early stages of the development to the level of quality and the type of sector as we see it today. The textile industry, on the other hand, has been able to attract considerably less foreign investment and did so later on in the transition. However, those firms in the textile sector that managed to attract foreign capital and know-how have performed well, often reaching regional leadership positions. Second, foreign investment in the automotive sector was related to a long-term strategic vision, which has helped to root the industry in the region. This has not been the case in the textile industry as the cases of relocation after the expiry of tax breaks and an almost complete lack of inter-firm cooperation suggest. Third, the existing pre-1989 situation, which concentrated on skills and infrastructure (both important for the automotive sector) as well as know-how (which is equally important for the textile industry) helps understand both the success of the automotive industry and of individual firms in the textile industry. The fourth dimension is the difference between cooperative behaviour and functional clustering in the automotive sector versus fragmented, individualistic and strongly competitive reactions in the textile sector. Finally, the degree and form of government intervention across these two sectors varied significantly greatly and the textile industry has never received the extensive support that car manufacturing received.
Table 3.2: Explaining the differences between automotive and textile sectors

<table>
<thead>
<tr>
<th>Automotive sector</th>
<th>Textile sector</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI driven success</td>
<td>Little FDI</td>
</tr>
<tr>
<td>Long-term vision and strategic thinking</td>
<td>Lack of long-term prospects</td>
</tr>
<tr>
<td>Cooperative strategies to cope with supply shocks, functional clustering</td>
<td>Competitive rather than cooperative behaviour, fragmentation, poor communication</td>
</tr>
<tr>
<td>Voluntaristic forms of private network arrangements (joint training, exchange of employees)</td>
<td>Individualistic strategies</td>
</tr>
<tr>
<td>Government support at the sectoral level and firm level</td>
<td>No government support at the sectoral level and limited support at firm level</td>
</tr>
<tr>
<td>Structural preconditions and industrial tradition were essential for the initial location of investments as well as later embedding of industries</td>
<td>Success cases: combination of the foreign participation and sector specific know-how (tradition) which have jointly allowed to upgrade products or production processes</td>
</tr>
</tbody>
</table>

One crucial further question relates to the extent to which this analysis of developments in the car and textile industries help us understand what happens in other industries. While a lot more systematic research is necessary to answer that question conclusively, there are indications that successful sectors share the same basic profile as the automotive industry. The electronics sector is a case in point: it is very similar to car manufacturing in terms of export shares, employment creation and labour productivity, and has grown fast, in some instances even outpacing the automotive sector. In structural terms, the sector falls between the automotive and textile sectors in the sense that firms tend to be of a smaller size than in the automobile sector but a large share of profit and value added is concentrated in the R&D segment of the chain where global competition is fierce. Product and skill profile have overtime become more sophisticated. Clearly, the causes of the sectoral or firm success which we identified hold for this sector: presence of foreign investment with long-term vision, government support, mostly in the form of investment subsidies, and a pre-existing tradition, are also found in the electronics industry.

With this conclusion, we have made two crucial steps in the wider argument of this report. The first was that over the last two decades groups of countries in Central and Eastern Europe developed different comparative advantages, which were captured in the different leading sector profiles – i.e. the profiles of those sectors that contributed most to exports. The second step was that foreign ownership played a key role, and that the success of a sector depended upon the development of cooperative networks that allowed the firms to resolve collective problems. In the next chapter we will develop the third step in the argument. We will again shift the level of analysis, and explore how these cooperative networks have emerged, and how governmental and associational and private actors interact in these networks.
IV. Firms and regional economic governance

The location decisions of foreign-owned firms in CEE were critically determined by the combination of low wages and high skills in the region. In effect, relocating part of their production, especially those low value-added segments that could no longer profitably be kept in the high-wage West, offered multinational companies a way out of a dilemma that they increasingly faced at home. While many in the west feared that this huge relocation process would eventually destroy manufacturing jobs in the home countries, the opposite was the case, however. As Becker & Mue ndler (2008) demonstrated, those companies that relocated low value added activities to low-wage jurisdictions improved their overall efficiency, increased market share as a result, and thus produced more jobs in the West.

But wages were not stable in Central Europe. As the sophistication of production and the complexity of the products grew, wages started to rise in line with labour productivity, and especially in the highly unionised engineering sector in general and the car industry in particular, the initial wage advantages were quickly eroded. This prompted the fears that, with low-wage jurisdictions moving further east, production would follow suit. Yet that did not happen: as we will see in the balance of this chapter, despite tight labour markets and skill shortages, and despite rising wages, many of the MNCs that had located in CEE by the mid-2000s stabilised or increased their investment. In addition, these firms creatively sought institutional means to cope with the bottlenecks that the tight labour markets had produced, which often resulted in complex networks of actors involving governmental, quasi-governmental, and private actors governing the production of collective goods in terms of training and technology transfer to smaller firms.

In this chapter we will analyse why these foreign-owned firms stayed in CEE-V4 despite the increasingly adverse labour market situation. We will start by looking back at the shift in strategies that turned CEE from a low-wage location into a high value-added manufacturing region. Once this shift has occurred, we will argue, firms have become much more embedded: their investment horizon is such that they cannot reasonably leave the jurisdiction. That implies that the bottlenecks which they face need to be resolved through the active construction of a novel institutional environment (rather than exit to a new jurisdiction) and a network-type governance structure that covers this new institutional setting. In the final section, we will analyse how and to what extent existing regional actors complemented this firm-based collective governance structure.

IV.1 From low-wage location to high value-added manufacturing

Most (possibly all) multinationals settled in the region in search of low labour costs – in the early 90s, wages in Central Europe were about one tenth of wage levels in the West, and even controlling for productivity, wage costs remained significantly below western levels. Moreover, many companies were aware of the relatively high-skill levels prevailing in CEE: even though the pre-1989 production and productivity statistics were deeply misleading, and Central Europe was not quite the industrial powerhouse that many westerners had thought for several decades, training systems in many Central European countries often were adopted during the Habsburg period and therefore resembled the (west-)German skill formation system. In addition, many governments made an effort, in an attempt to rapidly reindustrialise, to attract foreign capital through privatisations (as we saw above) and especially tax holidays and subsidies (often helped by the EU’s PHARE programme). Add to this the high unemployment rates, which made recruitment a relatively easy task, and made the workforce often relatively docile because they were happy to get a job at all in the rapidly unravelling Central-European labour market, and there is little doubt that the multinationals’ motivations may
have been severely skewed toward low costs. This location strategy of multinational companies was reflected in the initial low Relative Unit Values (RUV) of the products. Taking again the case of car production, when expressed in RUV, CEE started at a level that was less than one-fifth of the EU average in the early 1990s, and in the car industry specifically only about a quarter of the unit value relative to production in Spain and Portugal (Scepanovic 2008).

**Figure 4.1: Evolution of the relative unit value of exports of motor vehicles**

![Figure 4.1: Evolution of the relative unit value of exports of motor vehicles](image)

Source: UN COMTRADE; Scepanovic, 2008.

Around the year 2000, however, a break with this underlying model occurred. This break has been true for industrial production for exports in general, going beyond the automotive sector. Between 1992 and 1994, the export profiles of the different countries in CEE, as expressed in the proportion of complex products in total exports, were and remained remarkably similar (See again Figure 2.1 in Chapter 2). Even as late as 1996, in practically none of the V4 did complex products account for more than 40% of total exports, and the differences between the high-value added and the low-value added exporters remained relatively narrow for another few years. By the year 1998, however, the different profiles had become established, and for several years, these differences became more pronounced (before a slow upward move among the low-complexity exporters beginning after 2003).

In addition to export profile, an upward technological shift is also visible in the analysis of product (and process) profiles. Many of the multinationals, especially in the motor vehicle and related industries, shifted their production profile away from the relatively low-end, low value-added cars that they had been making to the high mid-end first, and high end cars and car parts afterwards. VW was the front-runner: by 2000, production in Škoda moved up from the low-tech Favorit to the sophisticated Octavia and Fabia, with more R&D autonomy for the years to come. Similarly, the VW factory in Bratislava shifted production from the entry-level VW Polo to the high-end sport utility vehicles (SUV) variably known as Audi Q7, VW Touareg or Porsche Cayenne; and Audi engine production in the Hungarian Győr has become

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5 The formula to calculate the RUV is: (Total value of exports in sector A for region X/total volume in units of exports in sector A for region X) / (Total value of EU exports in sector A/total volume in units of EU exports in sector A). RUV is a proxy to measure the degree of sophistication and value of the exported products, correcting for the endogenous developments within and cyclicality of the industry as a whole.
one of the world’s leading engine producer (Janovskaia, 2007a; Table 1.A in the Annex). At about the same time, sophisticated multinational complex systems suppliers such as Bosch, Valeo, VDO, and Delphi entered the region: by 2007, the Czech Republic was home to around 200 of them. Several of these – such as Siemens, VDO and TRW – set up R&D centers in the country (Janovskaia 2007b; for Slovak Republic see Figure 3.A in the Annex). Overall, as the data collected by Scepanovic (2008) suggest, the RUV of the car industry in CEE converged on and by 2002 slightly surpassed that of the Iberian peninsula (see again Figure 4.1).  

Whatever was at the basis of this slow but unmistakeable upgrading process in the car industry specifically and in complex industries in general in the V4, the effects have been important. Upgrading has several components that have to move in tandem in order for them to have the desired effect: skills need to be redefined and their acquisition organised, technology upgraded, supplier networks need to move, and infrastructure needs to be upgraded. While some of these processes are well within the control of the upgrading companies (especially capital investment), supplier links and infrastructure are less so. But the most interesting area is possibly in skills: the collapse of the firm-based training systems, the lack of public investment in education for a decade after 1989, the temporary emigration of a large section of the relevant young cohort, and the massive entry of foreign companies have turned a region which originally had an abundance of skilled labour into a region where significant skills shortages exist. In other words, the rapid process of upgrading produces bottlenecks, which cannot easily be resolved through a combination of public policies and deep (private and public) pockets. These bottlenecks and the interesting and surprising solutions they produce are the topic of the next section.

IV.2 Emerging forms of inter-firm coordination

While companies may initially have decided to invest in Central Europe for low labour cost reasons, around the turn of the century they started to discover that there were several problems associated with that strategy. The main one was that, as the Central European economies became more integrated in the EU economy, wages slowly started to rise alongside productivity. While trade unions appear careful not to negotiate inflationary wage settlements, and in fact still negotiate below-productivity wage increases in most V4 countries, real wages in the export sector in the V4 have increased substantially over the last decade. Another, related, issue was that companies began to face skill bottlenecks as the result of two mutually reinforcing processes. First, as more foreign companies took advantage of the beneficial labour market conditions in CEE, and an often large part of the relevant age groups sought employment outside their country of origin, the number of available workers fell rapidly. Second, companies lacked adequately qualified labour due to the complete (Poland) or partial (Slovakia, Czech Republic) dismantling of vocational and technical training systems that had been established before 1989. Finally, the remnants of vocational and technical training are simply in-

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6 It is too early to tell exactly why the V4 appear able to avoid the low-value added path in which southern Europe seems to be caught. One of the difficulties is that the key elements were very similar in both regions: low wages, a rapid transition, attraction of FDI through targeted government policies, and relatively weak labour unions. In fact, from a slightly broader political-economic perspective, conditions for an upward product market shift were possibly better in the Iberian peninsula: some recent acquaintance with capitalism (as opposed to a planned economy), a rapid expansion of government into the economy after 1975 and a more active stance with regard to supply-side policies afterwards (Boix, 1998; W.R. Smith, 1998), and trade unions who had been associated with opposition to the dictatorships instead of (with the exception of Poland) the transmission belts that unions often were in CEE.
adequate for the industrialization trajectory that the V4 have adopted, since they are organized along the traditional industrial lines which emphasise the skills for heavy-basic instead of complex industries.

The effect of these different pressures has been that the level of specific skills in younger age cohorts, and especially those of the type that such fast-growing high-value added export sectors require, has fallen rapidly. A similar development took place in the relations with suppliers: a large multinational firm in an assembly-based industry such as automobiles and consumer goods is ultimately only as good as its suppliers – of which there were few indigenous ones left after 1989. For a while firms avoided these types of bottlenecks by importing the necessary parts from the West, but transportation costs made such a strategy at best a temporary stop gap. Thus large firms were forced to negotiate with their suppliers how they would settle in CEE or arrange for domestic firms to upgrade their operations and become suppliers.

These types of issues – resolving the skills shortage and technical upgrading of suppliers – ran into well-known collective action problems. The problem takes its paradigmatic form in the area of skills: if company A sets up an in-house training programme to alleviate the skill shortages it experiences, then company B has a strong incentive NOT to do the same and instead poach the workers trained by A – which leaves A, in an open labour market (i.e. assuming that skills are to a large degree transferable and workers free to change jobs), with only two options: either abandon training (lest the company subsidises training in its competitors) or cooperate with B. The first option, which leads to a low-skill equilibrium, is far from optimal (though not unheard of, as Finegold & Soskice 1988 analyze for the UK); the result is that A abandons the training system and thus gradually ceases production as skills dry up. But the medium to long-term investment horizon of the newly established companies in CEE makes that a very unfavourable move: unless A is willing to divest after only a few years and thus incur significantly negative returns on its investment, A is forced to stay in the market. The alternative option – cooperation – is therefore a considerably more attractive one, but this one runs into the standard problem that in the absence of binding sanctions neither A nor B will contribute to the collective good that skills have de facto become. The stalemate that ensues as a result of this failure to provide collective goods is, other things being equal, impossible to overcome without a third party enforcing cooperation, a role usually played by the state or private associations in most OECD countries. Yet governments have been reluctant to play such a dirigiste role in the labour market of most CEE economies, and the few attempts to build non-state associational governance mechanisms to handle these types of collective action problems (by making membership of Industry Chambers compulsory, for example) were abandoned quickly in most of the (very few) places where they were (even) tried.

The growth in production volume in the region implied that (even when correcting for productivity growth) the growth of the workforce was significantly below the needs of the many multinational companies locating in the central region of the V4. Being large operations, car plants often rapidly depleted the available skilled workforce (a fortiori when they are located in the same area with a relatively tight labour market to begin with), and they face the skills bottleneck earlier than companies in other industries would. The solution to this hard constraint has been that car assembly plants, especially VW which was one of the earliest investors in the region, have started recruiting workers from a slightly wider area and train them themselves. But other companies have also increasingly located in the region, usually as a result of the positive network externalities associated with being a second-mover: they benefit from the policies and institutions that VW and local governments have put in place without having to invest in them. In Slovakia, for example, VW has been recruiting and training workers from 50-60 km away and bussing them into the Bratislava area. When Peugeot (PSA)
opened a car plant in the area of Trnava a few years later, most of the workers quite reasonably preferred to work close to home over the daily trip to Bratislava. VW thus not only implicitly trained workers for PSA but also failed to resolve the key problem at the basis of the reinstatement of firm-level training, since it lost its trained workers to PSA.

The solution was found in the construction of a complex network of non-market private actors which offered VW a chance to negotiate cooperation directly with PSA. VW used its strong relations with the local German Chamber of Commerce to open conversations with the French Chamber first – thus opening indirect deliberative communication with PSA – and other Chambers, especially the Slovak and the American Chambers, afterwards. Once agreement on cooperation had been reached between the main companies, these Chambers then set out to organize a de facto industry-wide training system with them – and acted as enforcers, less by stick than by carrot – using their economic clout to induce the local and national governments to fill in the institutional and policy holes (such as the provision of basic general industry skills and skill certification).

As the circumstances have forced major multinational firms to react to the issue, the process has seen an evolution from worker poaching in the case of PSA Trnava and VW Bratislava to different forms of coordination. Companies did not turn to existing institutions and organizations (which were largely absent anyway) but started building voluntarist forms of private network arrangements. These networks take different forms, but they usually seem to involve local Chambers of Commerce of the FDI-sending and of the FDI-receiving countries, local and regional authorities, and sometimes central support from, for example, the ministries of Labour, Education or Economic Affairs. The role of the Chambers of Commerce is perhaps the most surprising: since many of the companies were large firms (often of German origin), who were privileged partners of the local (German) Chamber, they used this institutional vehicle to build links with other companies, not directly but through the different Chambers, asking them to provide a cooperative framework that increased and secured contributions by individual companies to the collective good. These proto-institutional frameworks built around the Chambers and the large foreign investors became the building blocks for local forms of coordinated problem-solving in which collective goods – club goods, in fact, but often with spill-overs into the rest of the local economies – were produced and access to them was regulated through these governance networks.

Other forms of interactions to solve supply-side problems have gradually included an increased investment in in-firm training, various types of business-academic cooperation in comprehensive education reform where both state and private actors at central and regional levels communicate and coordinate training and education activities. Some training initiatives have been set up by car manufacturers or institutions affiliated to this industry in cooperation with various types of local and regional actors, such as business associations and chambers of commerce, self-governing bodies, regional labour offices, etc. Similar examples, albeit of a lesser scale can be found in metallurgical, steel or electronics industries. Below we provide three further short cases of the activities of three different automotive MNCs – Škoda-Volkswagen, PSA Peugeot Citroën and Audi.

Volkswagen was the first automotive multinational that entered the region already in the very early 1990s and invested in both member-states of then Czechoslovakia: in the Škoda plant in Mlada Boleslav near Prague and in Bratislavské automobilove zavody (BAZ) in Bratislava. Since around 2000, Škoda (which is wholly owned by VW, but is incorporated as an individual company in the Czech Republic) has been given considerably broader operational independence, which was reflected in more autonomy in the relations with suppliers. The implication is that any upward move that Škoda plans, in terms of volume, quality and market seg-
ment, has to be matched by a parallel upward move among its suppliers. When that failed to materialize at the pace that Škoda had envisioned, the company took a more active line and started organizing training sessions with the suppliers and the local government. The lack of technical specialists, exacerbated by quickly growing production capacities and supplier networks as well as the entry of other car manufacturing into the country (TPCA in 2002 and Hyundai in 2006) forced Škoda, to build its own new university complex to cover its personnel needs (Vavreckova et al., 2006). Škoda University, set up in 2000, has been run with active participation of schools and municipalities in the region and has been partly funded by the EU funds. A private tertiary-level school, to date it is the first and the only company-owned college in the Czech Republic. It assures an internship within the Škoda Auto Company and the Volkswagen Group for students and Škoda Auto specialists are active in the organization of training (www.savs.cz).

A similar case of cooperation between the government, educational institutions, municipalities and an investor emerged in the case of PSA Peugeot Citroën Slovakia. Throughout a period of three years, PSA trained for its own needs nearly 2,200 engineers (5,500 employees in total) and a number of teachers in different training centers. Combined, PSA Peugeot invested €2.3 million in a ‘Campus of occupations’ (Kampus povolani) project and a number of other projects have been set-up in cooperation with the Slovak and French Ministries of Education on the one hand, and the Trnava and Bratislava self-governing regions on the other. In 2008, a vocational high school, which had been run by PSA, took over the administrative competence of the training centers. Thus the established training institutes will be available not only to PSA but also to other companies (SME, 23.11.2007). Meanwhile, PSA Peugeot Citroen has set up a series of similar centers in other emerging economies, inspired by the logic of long-term investment strategy (www.sustainability.psa-peugeot-citroen.com).

Audi Hungaria has also been actively involved in education and training in Hungary. In 2001 the cooperation was set up between the company and Lukács Sándor technical high school in Győr when AUDI established an education center in the factory and in collaboration with the school a training program now operates for the skilled labour segment of the industry (Haderer, 2008). AUDI has recently further extended its activities to the level of tertiary education, establishing its own department of internal combustion engines in the Széchenyi István University in 2008. (http://ah-motorok.sze.hu/index.php?lang=en).

As these cases suggest, pushed by tight labour markets, the companies initiated the first move for setting up education and training arrangements with local schools and universities. Often they were represented by institutions such as Chambers of Commerce or Employers Associations. But regional governments and quasi-governmental structures also played a role. The next section we will analyze how sub-national governance levels - regional and local actors – tie into these frameworks and what is their role and activities in relation to the central governments as well as to private actors.

IV.3 The role of regional and local governance levels in dealing with supply-side bottlenecks

The impact of regional and local actors on economic development is an issue which has gained importance in the context of economic and political transition in Central Europe as regional authorities have been conceived of, through the logic of devolution of decision-making and other competences to the lower levels, as potential vehicles of economic development and political consolidation. This section investigates the extent to which sub-national authorities and regional and local level institutions have indeed served as effective governance levels. The question is one of the mechanisms and forms of interactions between firms and the state
at the sub-state levels. Regional governments have developed competencies in two relevant supply-side areas in particular: (1) economic development policies and (2) training and technology transfer.

The emergence of regional level actors in CEE countries has been encouraged by EU accession which required the acceding states to undertake significant administrative reforms. This encompassed the creation of regions according to the EU standards as well as the opportunity – but not the requirement – of a devolution of governing powers to regions. Originally, during the process of formal ‘regionalisation’ of Central Europe, and after realizing significant human and financial capacity constraints, the Commission receded from its original insistence on greater devolution of power to regional institutions. The concerns over the ability of the administrative systems of the new Member States to cope with the demands posed by planning and implementing of the long term socio-economic development goals even led to the introduction of a new facility in the structural funds to strengthen administrative capacity, thus providing states with additional incentives to invest in the professionalization and modernization of public management systems at all levels (World Bank, 2006: 1). Nevertheless, standardization of territorial structures and relations became part of EU conditionality which required the adoption of NUTS statistical classification system necessary, among other functions, for the access to and the implementation of the pre-accession and later Cohesion and Structural funds.7 The EU, however, imposed no firm guidelines in respect to the structure and status of regional institutions in the member states, providing space for maneuvering to domestic policy makers, which has in practice resulted in a wide variety of degrees of devolution of powers and types of agencies created in both the new and the old member states. As the outcome of this, for example, NUTS 3 as a level of territorial administration is absent in Poland where the so-called podregions serve purely statistical purposes. Decision-making powers were delegated to the voivodships (NUTS 2 level) and powaits (NUTS 4 level). Gmina or the municipalities are the lowest level of state administration which holds real competences. In the Czech Republic, Hungary and Slovakia, the relevant units are kraj-s (NUTS 3), termed megye in Hungary. All of these hold certain administrative powers which make them eligible, for example, to become members of cross-border frameworks.8 The lowest level – municipalities – remains of a crucial importance in all Visegrad states (Medve-Balint, 2008). Further, the CEE countries created various other institutional authorities, ranging from the Ministries of regional development to regional development agencies, some of which had been set up already in the early 1990s.9 The frameworks for regional-level economic development which have been similar across the CEE countries can be summarized as follows (partly based on Bachtler and McMaster, 2008):

a) Regional development agencies (RDAs). RDAs were among the first organizations to be established at the regional level with the specific regional policy. The RDAs cooperate with the state administration, regional and municipal bodies as well as businesses (chambers of commerce) and NGOs in various areas. The Slovak and Czech regional development agencies

7 The Nomenclature of Territorial Units for Statistics (NUTS) has three main levels, defined by the size of population that falls under each. NUTS I, NUTS II and NUTS III. NUTS II is used for defining eligibility for EU Cohesion fund support (Bachtler and McMaster, 2008:401).

8 Given these on ground difference, each time we use the term ‘region’ or ‘regional governance’, we refer to that NUTS level in each of the countries which actually holds real powers and competences and supersedes a mere statistical relevance. See Figure 4.A in the Annex for visual representation of regional administrative levels in Visegrad countries.

9 For example, the Malopolska Agency for Regional Development was established already in 1993, which is long before the actual accession negotiations were initiated.
are formally integrated into networks of RDAs. The activities which RDAs declare to be performing (but the actual implementation of which has been difficult to monitor) range from technical advice in structural funds and general information about all EU funds available, investment support and promotion, strategic planning of regional development to educational activities. The visibility and activity rates of the RDAs differ across countries, with the Czech RDAs being seemingly the most active and the most varied in their activities.

b) Self-governing regions. Self-governing regions have been created in the Czech Republic, Poland and Slovakia with the aim to facilitate more active regional and local participation. The self-governing regions have gained competencies over the regulation of secondary education (primary education is coordinated at the local level and tertiary education at the national level). Despite the relatively broad governance powers, the self-governing regions suffer from a lack of sufficient funding as well as from poor human resources (which, as we will show in the next chapter, tend to concentrate in the more prosperous areas where the opportunities are present). Importantly, regional administrative capacities tend to vary from region to region with the capitals and regions surrounding them outperforming the rest of the country in each of the CEE-V4 cases. Some evidence also suggests differences across the Visegrad 4 countries with the Czech regions being the most active and innovative in their activities and subsequently performing the best on indicators relevant for knowledge-economies that all of these countries strive to become.

c) Associations of municipalities. Institutions and bodies below the regional one, the local and municipal levels, have formed cooperative and collaborative associations of counties, districts and municipalities, such as the Union of Towns and Communities of the Czech Republic (SMOSR), the Association of Towns and Communities of Slovakia (ZMOS), the Association of Polish cities (ZMP), the Union of Rural Communes of the Republic of Poland (ZWGRP) or the Hungarian National Association of Local Authorities (TÖOSZ). Much economic activity, such as attracting foreign investment via the creation of industrial parks, has taken place at the municipal level. In addition, municipalities tend to be partners in projects competing for the EU Structural and Cohesion funds and have the greatest potential for improving conditions on the ground, since they control the funds for various infrastructure and development project within the municipal boundaries.

d) De-concentrated agencies of state. Various sub-national offices have been established along sectoral lines. An example of these are labour offices at the regional level that are often actively involved in training and re-training activities of the labour force, and therefore have the potential to act as a valuable source of information about specific labour market problems at the local level. Regional branches of investment agencies, which mostly act in the implementation stage of the investment project rather than in strategic planning or attracting and negotiating investment, are yet another example of de-concentrated state agencies.

These sub-national institutional frameworks are the main agencies and institutions where firms and the state at the level of regions and municipalities meet. What, then, is the relation between these regional authorities and the central government? To what extent have they complemented or supplanted the central government? Both the existing literature about regions and regional development and our empirical evidence suggests that regional governance levels remain weak, mainly because of poor funding to regional bodies in general, poor development of human resources, and a tight control by the central governments. The state and the local levels, rather than the regions, are therefore the key governance levels where supply-side activities are organized and implemented.
However, a process of gradual learning and capacity enhancement of these institutions seems to be taking place – but with mixed results. Anecdotal evidence suggests that regional governments suffers (more) from corruption and cronyism than the other levels due to limited monitoring capacities and a general lack of understanding by the population of the mandate that regional bodies have. Although central governments might be constrained and overburdened, regional level governance authorities suffer possibly even more from these problems. According to the World Bank, moreover, an increasing degree of politicization of senior appointments within all levels of governance has become apparent in the new member states after 2004 (World Bank, 2006).

A number of activities have emerged at the regional level, however, especially in response to labour market pressures. Municipal entrepreneurship has played a large role in the process of attracting FDI and implementing investment projects (local land registries and local employment offices meet the investors face-to-face). In contrast to rich investment attraction schemes or special economic zones largely coordinated by central governments, which have mostly followed the logic of zero-sum games (see for example Kolesar, 2006) and have exacerbated regional differences, industrial parks have been initiated by municipalities and local actors rather than the central level administration and its agencies. In such a setting, local governments with strong incentives to maintain local employment and increase local income have in effect become local entrepreneurs.

Training and skill formation is the other set of areas where regional actors have acted as institutional reference points. As regional governments hold vast competences at the level of secondary education, they have responded to the requirements and needs of large foreign companies who are important employers in the region and who, having often brought supplier networks with them, face the problem of recruiting a sufficiently large and adequately qualified workforce even in regions with high unemployment rates. In Slovakia, for example, various self-governing bodies (VUC), local/regional employment offices and the Association of the Automobile Industry (ZAP SR) have initiated a project of training and education initiatives, the so-called Pilot Centers. With ZAP SR responsible for the content of educational programs, the goal of the projects is to provide students with appropriate training for the needs of the labour market and improve education and skills of teachers at secondary (mainly vocational) schools. The pilot centers have served as a source of important experience for the preparation of regional education and training developmental plans which fall under the competencies of self-governing regions for primary and secondary levels of education. The Centers were opened up across Slovakia, not only in the Western part of the country where car industry is physically located (http://www.soudpo.edu.sk/pilotnecentrum.htm).

The preparation of the Slovak education reform in early 2008 provides another example of an instance where regional levels of governance play a crucial role in the provision of education and training. The Chambers of Commerce played an active role in the discussions in preparation of the Vocational Education Act, which transformed curricula in secondary vocational and technical training education. The reform suggestions were based on the idea that education curricula should respond to the local needs which are specific for each region and that cooperation of business and academia should be encouraged not only at the central state level but even more at the level of the regions. For that, two-level 4-partheid systems at both central and regional level, where the representatives of state, unions, employers associations and educational institutions will come together to exchange information and to develop a long-term strategy and vision, have been institutionalized in the Act in summer 2008. (www.rokovania.sk/appl/material.nsf/0/F9F103DCE5F50F47C12574A2002E475D).
IV.4 Conclusion

Foreign investors originally entered Central Europe in search of low-cost manufacturing sites, yet by the second half of the 2000s, the Visegrad 4 countries were producing high-value added products and their export profiles were dominated by complex industries. In this chapter we analyzed the dynamics of micro-level interactions between firms and their relevant environment. By developing forward as well as backward linkages, these firms have become embedded in the countries, which implied that the problems they encountered as a result of skill shortages could not be circumvented by exiting from the countries where they were located. Solving these problems required them to build embryonic forms of inter-firm coordination which required complex governance arrangements, including large multinational companies, international and local Chambers of Commerce, and local, regional and national authorities. Regarding the interaction of national and sub-national governance levels, we have found, as have Bachtler & McMaster (2008), that the regional level in the strict sense is underdeveloped and weak, and that the key levels of action remain at the national or local level.

Two important observations are in place, however. Firstly, it is apparent that the substance of what sub-state governance levels attempt to do and actually achieve is quickly changing over-time. The number of regional initiatives is mushrooming and even though regions are not necessarily the first-movers, they seem able to respond relatively effectively to calls on them by business and academia. With differentiated regional investment policies and further development of special economic zones and industrial parks, these levels seem to be gaining more experience, greater credibility as a result, and a more active role in the process. This slow affirmation of the regional levels is likely to be enhanced further in the future, in part as a result of the technicalities of the Cohesion and Structural Funds which require participation and co-financing of regional and local institutions.

Secondly, the level of activity (both in terms of frequency and of type of initiatives) differs across regions within as well as between countries. In some cases, regions are – exaggerating slightly – not much more than postal addresses or websites, while in others they are actively engaged in attracting new investors and providing them with institutional support in such areas as education and training, and technology transfer. As more sophisticated producers locate in Central Europe, this support role of regional actors, both governmental and nongovernmental, is likely to become more developed as well. In itself, this is likely to produce a virtuous dynamic, in which active regions are able to attract complex engineering manufacturing and even research and development centers, which themselves produce positive network externalities for subsequent generations of firms, thus raising regional income. But the upshot is that those regions which are not part of this dynamic are likely to fall behind in terms of economic development. This bifurcation in the dynamics of regional economic development is the key point that we will address in the next chapter.
V. Regional development and economic dualism

While the ownership and organisation of productive assets in CEE has received relatively wide attention, dynamics at the level of regions have not been very well-understood. Most of the attention to governance structures and levels has been directed to the national, and to some extent the local level. However, regional and local actors in economic development have gained importance in the context of economic and political transition in Central Europe as regional authorities have been conceived of, through the logic of decentralized decision-making and the devolution of power, as potential vehicles of economic development. Building on the evidence in the previous chapter about the regional governance level and its dynamics, we further review the extent to which the sub-national authorities and regional and local level institutions have contributed to regional growth and development. We will also examine the dual effects of regional development.

The evolution from low-wage manufacturing to sophisticated production has been defined mainly by the re-invention of a strong industrial sector and creation of an industrial heartland which strikingly resembles the patterns from the early decades of 20th century. This trajectory has been successful to the extent that in 2008 Central Europe might outperform the old member-states in attracting FDI (Ernst and Young, 2007 and 2008). However, this evolution has had less benign developmental outcomes, especially sharp regional economic inequalities. Regional (and national) growth policies usually have direct beneficial consequences but indirect and often longer-term negative effects through regional agglomeration dynamics. We will therefore critically assess the rapid economic development, as well as the place of the multinational, national and regional actors that have been at the basis of the narrative thus far. The basic idea that we will explore is that if we are correct in identifying leading sectors, in analyzing the mechanisms for inter-firm coordination and potential regional spill-overs of that, and in the role that local and regional authorities play in this economic development model, the outcome of these processes is a secular increase in inter-regional inequality. We will start with a historical-geographic analysis of the re-emerging manufacturing core in Central Europe: much of the region covering the Czech Republic, the south of eastern Germany, southwest Poland, western Slovakia and north-western Hungary was an area specialising in complex engineering and therefore a relatively wealthy region, in the inter-war years. We will then proceed by analyzing current socio-economic inequalities and link those to both the agglomeration effects and regional policies. The final section summarizes and concludes.

V.1 Industrial heartland in Europe’s east periphery?

A look at the map of Central Europe immediately yields a somewhat striking observation: judging by the dominant contribution of sectors (agriculture, industry or services) to GDP in 2004, what appears to have re-emerged in Central Europe is Europe’s industrial heartland geographically largely placed where it existed in the inter-war period. Figure 5.1 shows that in the V4 – and especially in the trans-national sub-region that we have identified earlier in this report – manufacturing is the dominant economic activity, and we also know that these manufacturing sectors in turn are dominated by complex engineering sectors. A similar conclusion can be drawn from data about the leading regions in employment in high or medium-tech manufacturing in 2005: one third of the leading regions in high-tech manufacturing is located in the V4. In the share of employment in high-tech – capital and skill intensive – manufacturing production, the Hungarian regions of Közép-Dunántúl (Central Transdanubia) and Nyugat-Dunántúl (Western Transdanubia) closely follow Freiburg in Germany, Europe’s leading high-tech manufacturing region. In addition, one fifth of medium-tech manufacturing
employment intensive regions are in the V4, mostly located in the Czech Republic (See Table 2.A in the Appendix).  

Figure 5.1: Dominating sector (NACE division A3) by NUTS 2, 2004


Two points follow from this. One is that a new manufacturing region is emerging in Central Europe (including southern and eastern Germany, i.e. roughly from Stuttgart to Budapest and from Munich to Katowice in Poland). In addition, and as we saw earlier in this report, industry in the V4 is characterised by sophisticated forms of complex manufacturing, which allows it to compete with Western Europe. How can we understand these rather surprising outcomes? One possible explanation deals with the historical economic geography of the region. An intriguing aspect of this newly (re-)industrialised region in the CEE-V4 is that it seems to overlap extensively with local production systems which existed in the inter-war period, which themselves date back to regionalized industrialization in the Habsburg empire, and which were perpetuated by the COMECON trading system. The rapid forced economic integration of Central Europe into the Soviet block has had the inadvertent effect of sustaining these re-

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10 Just to illustrate the contrast, in spite of clearly the lowest average wage per employee in business services within the EU27, in 2004, only two regions from the new accession states ranked among the top 30 most specialized regions in business services (NACE K 72 and K 74): the region of Praha in Czech Republic and Közép-Magyarország region in Hungary (Eurostat regional yearbook 2007).
gional specialisations. Compare this to the West, where the policy of national champions has led to the destruction of many of the locally specialised industrial systems under the aegis of (national instead of international) Keynesian policies (Piore & Sabel 1984). While many of the local economies in the West disappeared as a result of modernization policies, they survived in the COMECON trading system. Foreign investors thus linked up with an industrial structure that reflected the strong position of these regions in the mid-1930s, and resuscitated them in the 1990s. Some parts of the COMECON, e.g. today’s Slovak Republic, went through their phase of rapid heavy industrialisation during the last 20 years of the state-socialist regime. While the closure of arms factories hurt the economy in the initial stages of transition, much of the factories and workforce were integrated into today’s automotive industry in Slovakia.

Partly related to this economic geography argument, but more pragmatic, is the idea that skill formation systems which existed in CEE borrowed heavily from what we now call the German training system, which has a strong company (and association-) based component: pupils study and work in companies, training programs are defined by employers and sometimes trade unions, and organized by the Chambers of Commerce. Despite the dismantling of these systems after 1989, the stock of skills was relatively high during the initial years of the transition, and at the same time sufficiently fundamental to allow for a versatile deployment afterwards. Assuming that foreign firms located in CEE in order to do different things than what they did in their home base, it is likely that they experimented with different organisational and skill deployment models, and thus discovered more complex, up-market combinations of skills and technology along the way. Against the background of lower wages, this would ultimately lead to higher productivity (even if lower than in the West), and therefore lower unit labour costs. Tellingly, the large, complex semi-customised cars made in such plants as VW Bratislava also require more labour, and that is – holding constant skill levels – more easily found at low cost in the V4. The quality and availability of the work force after the initial transition recession has thus allowed to reproduce the industrial base in the Western CEE-V4.

Contemporary research on these regional economies suggests that the success of those regions in Central Europe which have done well depends on the pre-existing historical legacies, cooperative networks, and regional institutional capacity (Brown et al., 2007, Pavlinek and Smith, 1998; Horvath, 2004). The current patterns of regional inequality existed already before 1989 and the new industrial system grafted itself onto this. In other words, in the early 1990s, investors allocated their resources into areas within the countries which were already more developed in terms of infrastructure and human capital (Brown et al, 2007). The voluntaristic networks that we discussed in the previous chapter seem to grow only in those areas which were already relatively prosperous. But there is more to the story than just an accident of history. In the next two sections we will discuss the economic and political drivers of regional economic dualism.

V.2 Regional agglomeration and regional dualism
The upshot of the particular development model discussed above which relies on large foreign firms and instrumentally engages regional and local policy-makers, is likely to lead to profound regional inequalities. As regions around large foreign firms become wealthier as a result of local spillovers from investment and agglomeration effects, regions outside these fast-growing areas are likely to fall further behind in relative terms: growth in the first group of regions is likely to outpace any compensatory cross-regional redistribution or even positive growth effects of active regional supply side policies. Regional rigidities in other areas such
as housing market, weak transportation links and high transportation costs further exacerbate these problems.

Figure 5.2. shows regional income distribution in EU27 in 2004, and reveals that in CEE the capital cities and the regions surrounding them were by far the richest regions, and that they have successfully caught up with and sometimes even surpassed the EU average living standards. The eastern regions in the V4 are systematically poorer, especially in Slovakia and Hungary. The Czech Republic in part seems to have escaped this pattern since it benefits from being located between the rich southern German regions and the relatively wealthy south-west Polish, western Slovakian and north-western Hungarian regions.

**Figure 5.2: GDP per capita (PPS) by NUTS 2 regions, 2004 (EU27=100)**

Table 5.1 presents the distribution of GDP across Central Europe and its development over time. It shows that regional income inequality across the EU has increased nearly 2.5 times after Eastern enlargement, while the ratio of the most to the least developed region has grown from over 5 times (Ipeiros versus Inner London) to nearly 13 times (North-East Romania versus Inner London). Interestingly, while the regional disparities in 2004 compared to 2000 have remained relatively stable and even slightly decreased in Czech Republic, Hungary and Poland, in Slovakia inter-regional inequalities have increased. Further, average income growth between 1995 and 2004 has been the highest in Hungary, followed by Poland and Slovakia and is lowest in the Czech Republic.
Table 5.1: Regional differences in GDP per capita in Visegrad countries, NUTS 2 level

<table>
<thead>
<tr>
<th>Country</th>
<th>Least developed region</th>
<th>Most developed region</th>
<th>Difference 2004</th>
<th>Difference 2000</th>
<th>Average growth 1995-2004</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR</td>
<td>Central-Moravia</td>
<td>Prague</td>
<td>157.1</td>
<td>2.69</td>
<td>1.98</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>2.62</td>
<td>2.52</td>
<td>4.2</td>
</tr>
<tr>
<td>HU</td>
<td>North Great Plain</td>
<td>Central Hungary</td>
<td>101.6</td>
<td>2.42</td>
<td>3.88</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3.06</td>
<td>2.72</td>
<td>3.78</td>
</tr>
<tr>
<td>PO</td>
<td>Lubelskie</td>
<td>Mazowieckie</td>
<td>76.8</td>
<td>2.18</td>
<td>2.19</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>3.06</td>
<td>2.72</td>
<td>3.78</td>
</tr>
<tr>
<td>SK</td>
<td>Eastern Slovakia</td>
<td>Bratislava</td>
<td>129.3</td>
<td>3.06</td>
<td>3.78</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
</tbody>
</table>


Human capital development follows a similar path. In all CEE-4 countries tertiary education is concentrated in the capital regions with Prague and Bratislava having the highest concentration. On average, Poland had the greatest share of youngsters aged 20-24 years enrolled in tertiary education while the Czech Republic ranks the lowest (Table 5.2). In Slovakia, an exemplary case for these developments, the high and growing concentration of skilled and educated people into the capital city and Western regions, often the result of immigration from poorer areas further west, has led to a further depletion of human capital in the depressed regions. In addition to the concentration of students, science and technology and R&D is concentrated almost entirely in the Western part of the countries. While the Czech Republic seems to concentrate its brains towards the capital region the most, the remaining evidence demonstrates that relative to the rest of the V4, research and development or employment in science and technology is relatively evenly distributed across regions (Figures 5.3 and 5.4).

Table 5.2: Students in tertiary education as percentage of population aged 20 to 24 years old, by NUTS 2 regions, 2004

<table>
<thead>
<tr>
<th>Country</th>
<th>Highest Region</th>
<th>Lowest Region</th>
<th>Average</th>
<th>Standard Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>CR</td>
<td>Praha</td>
<td>Střední Čechy</td>
<td>4.0</td>
<td>43.45</td>
</tr>
<tr>
<td>HU</td>
<td>Közép-Magyarország</td>
<td>Közép-Dunántúl</td>
<td>37.6</td>
<td>52.86</td>
</tr>
<tr>
<td>PO</td>
<td>Mazowieckie</td>
<td>Podkarpackie</td>
<td>44.3</td>
<td>58.12</td>
</tr>
<tr>
<td>SK</td>
<td>Bratislavský kraj</td>
<td>Východné Slovensko</td>
<td>24.3</td>
<td>47.10</td>
</tr>
</tbody>
</table>

Source: Eurostat regional yearbook 2007
The Czech Republic stands out in a number of indicators. When regions are ranked on indicators such as R&D spending, human resources employed in science and technology or patent applications, the region of Prague (including the surrounding Stredni Cechy) leads, and after the capital regions from the three remaining countries, the runner-up areas are again from the Czech Republic. Moreover, the regions tend to be located in the Eastern part of the country (Severovychod, Moravskoslezsko, Jihovychod) and together with the western part of Slovakia, south-western part of Poland and the north-western regions in Hungary, they form the complex manufacturing base, especially in the engineering industry that we identified earlier in this report. This is a function of the fact that the automotive sector, which has become a leading sector in this area, and the electronics and electrical industries, have high clustering intensities. Clustering of industries induces education and training initiatives, contributes to R&D and enhances the scientific potential in the area – but it also indirectly fuels the agglomeration effects and aggravates the regional disparities.
V.3 Regional inequalities: the role of policies

Thus far, we have understood the emergence of regional dualism across many of the CEE states as the perverse outcome of the interactions between foreign investors and national and sub-national authorities in a particular economic development model. But (regional) economic policies have mattered as well. Figure 5.5, panel A reveals that the relative levels of GDP in the region cannot be explained by the average growth of GDP per capita over the preceding period 1995-2004.\(^\text{11}\) On the other hand, a change of share of regional GDP on national GDP over the period preceding the EU accession (1995-2004) explains the relative wealth in 2004 much better than the average regional growth (Figure 5.5, panel B). Moreover, a direct link can be made between the regional disparities: success would not have taken place had the worse–off regions not served as reservoirs of resources. Hence, regional differences allowed keeping wages down and have directly sponsored the growth in the rest of the country, supporting the competitiveness of the centers of industrial production.

Figure 5.5: Regional GDP per capita versus average growth and change in regional share on national GDP, 1995-2004 (NUTS2)

A. GDP per capita in 2004 and average growth 1995-2004

\(^{11}\) These findings, however, should be taken as indicative rather than conclusive: NUTS2 level regions which are captured by the Eurostat statistics in Figures 5.5, except for the Polish voivodships, do not coincide with administrative authorities which are in the case of Czech Republic, Slovakia and Hungary found at a lower level (NUTS3). This, in turn, prohibits us from making inferences about the impact of regional authorities on the level of economic development and thus few links can be made in respect to a potential effect of regional governance levels on development and regional inequalities.
Indeed, the evidence indicates that success can be found in the areas which were already better off to start with, a dynamic which followed from the policies adopted during the transition. Policies prior to the accession with the strongest effect on regional development were anchored in the strategy of job creation through the attraction of FDI by national investment agencies and trade promotion agencies: CzechInvest in the Czech Republic, SARIO in Slovakia, PAIZZ in Poland and ITD in Hungary (Trník, 2007; Radosevic, 2002). Regional developmental agencies and regional investor service centers play an active role in the preparatory and implementation phase of investment, but less so in strategic planning which has been largely kept at the centre. The period from the early 2000s until the EU accession was characterized by significant competition among the V4 states over foreign investment (Kolesar, 2006). The large incentives packages and secret deals often involved a show-case promotion of a particular industrial park or city, in most cases located in the most prosperous parts where the infrastructure for just-in-time delivery existed or could be relatively quickly improved to meet that goal. Table 5.3 gives the data on investment incentives, and demonstrates quite clearly that large sums were handed over in the attraction of FDI. The most extreme case was the Kia investment near Žilina in Slovakia in early 2004; the sum per job decreased slowly after that. The effect of the attraction of foreign investment has been that the within-country as well as within-region disparities grew (Wisniewski, 2005; Smith and Ferencikova, 1998).
The countries gradually introduced regionally differentiated policies for FDI attraction and support, imposing thresholds and greater transparency for investment deals. Pressured by EU regulation, all V4 countries have introduced zones within their countries with differentiated eligibility criteria for state support for foreign or domestic investment, based on the level of economic development of a region to which the investment enters as well as the type and capital-intensity of the investment (See Figure 5.A in the Annex). A recent decision by Mercedes to invest in the Great Hungarian Plain (Del-Alfold) 80 km south of Budapest indicates (among other things) that investors are willing and able to locate in comparatively less-developed regions.

Interestingly, while cut-throat competition among the countries in the region, including media and bidding wars, was the rule until recently, the shared problems of labour bottlenecks in the V4 countries, have instigated cooperation among the investment agencies and governments in order to promote the V4 region rather than just the countries individually. Similarly, having realized the threat of relocation of industries in the medium to long-term, investment agencies are enlarging the scope of their services to after-investment care and the governments try to embed the companies more deeply into domestic economies via incentives for training and increased funding for research and development.

The EU funds are the second set of policies to further regional development which are now also available to the V4 countries. As we know from the old member-states and their experience with the Cohesion and Structural Funds (CSF) since the mid-1980s, there are limits to EU regional policy and their effects, this even more-so when taking into account limited capacity of regional level authorities. The stylized picture of the effects of the CSF for Spain, Portugal and Ireland has been somewhat paradoxical: while the average income of the country has increased vis-à-vis the rest of the EU, at the same time the capital cities appear to have benefited more than the regions outside the capitals. The effect has therefore been that inequality across the member-states of the EU fell while within-country inequality has risen. The V4 countries have as of yet had only relatively limited access to the Structural Funds and the amount of pre-accession help can hardly be compared to the amount of redistribution available through these channels, and the full impact of EU funds is not yet clear.

### V.4 Conclusion

In this chapter we linked several of the elements in the previous chapters. In essence we asked the question ‘if economic development in the CEE-V4 assumes the relatively benign shape that we analyzed, with a concentration in sophisticated manufacturing, and in which local forms of inter-firm coordination are taking shape, what are the regional effects and how do these aggregate up into broader patterns?’ The answers to that question were somewhat sobering. Regional dualism, which already existed prior to 1989 (and to some extent before the Second World War), was, in fact, exacerbated by both the agglomeration effects associated
with rapid growth, and by the policies that were used to attract foreign investors. Spill-overs are, on the whole, limited and to some extent perverse: skilled people of working age in poorer regions move to the capital – thus ironically reducing the chances of foreign investment in the poorer regions.

This summary answer does not entirely do justice to the complexities of the situation, however, since the nature of and the driving forces behind the processes pre- and post-1989 have differed in several ways. Table 5.4, based on Horvath (2004), and augmented by our own observations (in bold), summarizes the main similarities and differences. What it demonstrates perhaps most strikingly is that the nature of state-socialist industrialization and modernization was very different from the upgrading identified in the transition to capitalism, and that some of the processes leading to increased inequalities are associated with different distribution of such factors of production as skills and knowledge. This finding is interesting in itself, since it suggests that Central Europe is in the midst of a gigantic industrial upgrading, based on the same elements as Western Europe. But the regional concentration of skills and knowledge implies that inequalities between those regions which have and those which do not have them are likely to grow. Central Europe may, as one of the participants in our workshops suggested, have modernized too rapidly: the skills are not there for the type of company that is settling in the region today. And the scarcity of skills is what ultimately leads to the sharp, and sharpening, regional inequalities.

Table 5.4: Characteristics of territorial inequalities in the countries of systemic change

<table>
<thead>
<tr>
<th></th>
<th>Before 1990</th>
<th>After 1990</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>The dimension of spatial disparities</strong></td>
<td>Between urban and rural areas</td>
<td>Within settlements</td>
</tr>
<tr>
<td></td>
<td>Within settlements</td>
<td>Between regions</td>
</tr>
<tr>
<td><strong>The tendency of disparities</strong></td>
<td>Decreasing inequalities between urban and rural areas</td>
<td>Increasing difference between regions</td>
</tr>
<tr>
<td></td>
<td>Decreasing inequalities between regions</td>
<td>Increasing difference between regions</td>
</tr>
<tr>
<td></td>
<td>Stabile inequalities between settlements</td>
<td>Stabile difference between urban and rural areas</td>
</tr>
<tr>
<td><strong>The driving force behind the development of disparities</strong></td>
<td>Industrialization</td>
<td>Structural changes</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Services</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Foreign direct investment</td>
</tr>
<tr>
<td></td>
<td></td>
<td>FDI incentives</td>
</tr>
<tr>
<td><strong>Decision determining disparities</strong></td>
<td>National level</td>
<td>Local level</td>
</tr>
<tr>
<td></td>
<td></td>
<td>National level</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Transnational level</td>
</tr>
<tr>
<td><strong>Indicators expressing disparities</strong></td>
<td>Demographic composition</td>
<td>Unemployment rate</td>
</tr>
<tr>
<td></td>
<td>Communal and social infrastructure</td>
<td>Wage level</td>
</tr>
<tr>
<td></td>
<td>Social incomes connected to the use of communal and social facilities</td>
<td>Knowledge production/education</td>
</tr>
<tr>
<td></td>
<td></td>
<td>R&amp;D</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Employment rate</td>
</tr>
</tbody>
</table>

Source: Horvath, 2004: 19 complemented by authors

While policies directed at compensating for these inequalities are likely to have effects, care is necessary: it might be too easy to place too much faith in them. We know from similar policies in the EU that they mainly reduce income inequalities between countries, but have little
effect within countries: the capitals often siphon off growth, and the effect is that regions outside the capital grow, but at a slower pace. Prague, Budapest, and Bratislava currently already are among the wealthiest parts in the region, and it is likely that this will remain the case, even if CEE modernizes at the pace at which it has been doing over the last two decades.

VI. Emerging capitalism and economic governance

By the mid-2000s, many Central European economies had successfully made the transition from a planned economy under state control to a market economy. Whatever the differences across the region, one thing unites them. Central and Eastern Europe (CEE) avoided the fate of other previously planned economies such as Russia, where the combination of a dismantled state and privatizations to insiders who were associated with the pre-transition central state led to what King (2007) has labelled ‘patrimonial capitalism’. Instead, the CEE economies all adopted a liberal form of capitalism based on the rule of law and a functioning competitive market very much like what exists in Europe. The state may have weakened after the collapse of state socialism, especially in terms of its capacity to steer the supply-side of the economy, but it was still capable of setting regulatory and legal frameworks that underpinned economic activity, of organizing privatizations to outsiders who were usually strong foreign companies, and of sustaining and developing a welfare state that could accommodate the many groups in the population whose livelihood was no longer assured in the rapidly changing labour markets of the 1990s and 2000s.

The CEE path appears to have three characteristics. The first is that a large part of the well-performing companies in the region today are in the hands of foreign owners, and that the strategies of these owners differed across the different countries. Assuming that export performance is a useful indicator, the analysis of the sectors that are leading the economies, suggests that two broad groups of countries have emerged in CEE. The profile of Slovenia and the Visegrad 4 (V4) is highly industrialised, specialised in complex sectors, and with attention to skills acquisition and training. The export profile of the Baltics, in contrast, is more concentrated in light and/or basic industries – with the concomitant lower investment in specific skills. All other things being equal, economies that are organized differently against the background of such differences in export profiles and factors of production, have very different political-economic institutional set-ups, since the needs of business are very different. In the V4, where we concentrated our empirical analysis, we saw that the emphasis on complex manufacturing – up to the point where the region within a 250 km radius around the Czech city of Brno is on the point to regaining its inter-war status of ‘workshop of Europe’ – is producing novel forms of cooperation among the foreign companies, tied in with the local socio-economic actors.

This pertains to the second point that we examined. Under specific circumstances, which are present in most complex manufacturing industries in that region but not necessarily elsewhere, firms develop forms of coordination which differ from what we anticipated in the sense that they are neither the product of long-standing network relations (although that seems to be at the basis of inter-firm cooperation in Slovenia), nor of an indigenous capitalist class that structured links between business. Instead, the particular constraints associated with long-term investment (a characteristic of complex manufacturing with high fixed costs) and shortages in input factors such as skills and suppliers, led the large foreign-owned firms to devise frameworks that would allow them to produce collective goods. The start of this process was the production of club goods that resolved the joint problems of the large firms, and which was governed by associational networks involving foreign and local Chambers of Commerce, regional and central governments, and possibly other stakeholders. But as more foreign com-
panies settled in the region, attracted by the presence (and possibly reputation) of the first generation, local spill-overs increased: schools and universities were founded, reorganized, and refinanced, local industrial associations were revamped to organize small firms, and technology transfer programmes were started up. One caveat is in order here. Whilst these cooperative links are far from present everywhere (though their presence is growing), and they are certainly not as strong as in successful areas such as Baden-Wuerttemberg where this type of dense cooperation and governance is widespread, exceptionally effective and encompasses labour as well as capital, a pattern of inter-firm coordination and regional associational cooperation seems to be emerging that few of us would have deemed viable only ten years ago.

The third is that economic development has been very fast on the whole, with many countries and especially sub-national regions within them quickly regaining output levels that matched those of the late state-socialist period. Furthermore, growth in those regions seems assured, as more multinational companies locate there, induce local, regional and national governments to play a more active supporting role, and thus make the area attractive for more long-term foreign investment. But this extraordinary development path has also produced problems. Beside the burden on welfare states resulting from massive dislocations of large parts of the population, the most problematic aspect of this industrialization model may well be that important inequalities across sub-national regions (re-)emerged as a result. Regional agglomeration of strong industries implies that more such regional inequalities will emerge, and it is unclear to what extent deliberate policies aimed at overcoming them can be effective against this structural background.

In what follows, we will take this stylized picture of developments in CEE as a starting point for wider hypotheses and conclusions that we draw from this research. We will start by raising some points on the implications of this analysis for our understanding of the emergence of capitalism in Central Europe and then raise some broader points on the organization of capitalism, both East and West, more generally, before concluding.

**VI.1 Understanding Central European capitalism**

The single most important finding of this report, and which confirms several analyses that preceded it, is therefore that capitalism in the CEE region writ large is not a homogenous system. Countries in the region differ tremendously in terms of industrial and governance profiles. The CEE-V4 have taken a path that is very distinct from the one adopted in the Baltics or in South-East Europe. In this sense, the basic idea that there is significant variety in the organization of capitalism in the developed capitalist world also offers a useful perspective in the context of CEE (Bohle & Greskovits, 2007; King, 2007). In large part this is related to the surprising development path and the particular character of production in the well-performing areas in the V4. Very few would have anticipated a decade ago that an ‘industrial heartland’ would emerge in the CEE-V4 region, which included sophisticated forms of production and product upgrading and that mark a shift in firms’ strategies that turned CEE from a low-wage location into a high value-added manufacturing region.

A comparison with the Iberian peninsula in its first two decades after the introduction of democratic capitalism is useful since it allows us to compare developments of *prima facie* similar processes with different outcomes. Most analyses of the region are based on what appear to be ‘natural’ comparisons with developments in Western Europe (e.g. Bohle & Greskovits, 2007; Crowley 2008). But such implicit Eurocentrism may obfuscate as much as enlighten our understanding of adjustment in Central Europe, and a comparison with the parallel Spanish and Portuguese experiences in the 1980s and 1990s leads to a slightly different evaluation. Judging from the data that we presented in chapter 3 (see Scipanovic 2008 for a more detailed
The newly industrialized economies in the V4 were significantly outperforming their Iberian counterparts by the end of the second decade into their transition, and governments at all levels began to consider more carefully how to support such a complex manufacturing-based supply model through educational and technology transfer policies. It is very likely that investment in the V4 has come at the expense of investment in Spain and Portugal – comparing the type of goods that investors are manufacturing in CEE today with those in Spain and Portugal, however, suggests that more was going on than a simple substitution in the investment portfolio of foreign companies.

Historically existing patterns played a crucial role in this process and in these outcomes. The network-type governance structures that we identified may have emerged in response to the immediate strategic needs and requirements of private business actors, but many of the institutions that we see today, such as the education and training systems, existed in some form already (long) before the fall of the state socialist regimes in 1989. Their long shadow may well have been a determining factor in the decisions of large multinational companies to locate sophisticated production facilities in Central Europe. In chapter 5 we also raised the possibility that the forced integration of Central Europe in the post-war Soviet trading block helped the survival of regional industrial specialisations in the current V4 throughout the entire state-socialist era. Despite the relatively weak role of the state in the supply-side of the V4 economies, therefore, when foreign investors arrived in large numbers in the 1990s and 2000s, they did not find an institutional desert but some well-developed industrial systems, and a skilled workforce. What both lacked was a level of sophistication commensurate with the West, but given the relatively low wages, that did not present itself as an insurmountable obstacle at first, and as industrialization progressed, the existing skill basis could be developed in ways that articulated more effectively with the needs of foreign investors.

Finally, and looking at the CEE region as a whole in comparative perspective, varieties of transition exist alongside varieties of capitalism in Central and Eastern Europe. Whereas in Central and Eastern Europe the state remained an active, autonomous agent who managed to distance itself from pre-existing economic interests, in the CIS, as King (2003) has argued, the state was colonized by insiders who used that position to enrich themselves and seemed to have little interest in wider issues of economic development. But there may be more variation than this one-dimensional view allows for. The case of Slovenia, which we have only tentatively looked at in this report, is a useful case to explore in this regard. Slovenia also privatized to insiders, as in the CIS, and FDI has been very low as a result. Yet the export and production profile as well as the governance mechanisms of the Slovenian economy today are much closer to the rest of CEE (and in fact sufficiently close to the rest of EU that Slovenia was the first of the CEE economies to join EMU): complex exports dominate, and the country boasts a corporatist socio-economic decision-making model. Solving this puzzle, we hypothesize, may require paying more attention to the basic pre-1989 organization of the economy. Slovenian enterprises had, even under state socialism, highly decentralized governance structures and the economy as a whole included decentralized decision-making systems that were remarkably well articulated with the introduction of a market economy and a price system. The insider privatization that Slovenia adopted, therefore found itself grafted onto a proto-capitalist firm-level and economy-wide structure, in other words, and precisely that combination furthered the development of an economy based on high skills, complex manufacturing and cooperative relations across and between firms. As of yet, this is a hypothesis we propose, but this interaction between mode of privatization (insider/outside) and the nature of the economy prior to the transition (centralized/decentralized) may well help shed light on some of the dramatic differences between capitalism in CEE and the CIS.
VI.2 Understanding the nature of capitalism

An entirely different set of conclusions from our research relates to broader, more theoretical points on the nature of capitalism as a political-economic system. We started this report with the idea that understanding the emergence and development of capitalism in CEE would also allow shed light on how capitalism as a generic system emerged. One key insight is related to the emergence of inter-firm coordination, possibly the key characteristic to differentiate between different modes of organization of advanced capitalism (Hall & Soskice, 2001). Whereas most of the literature in this area argues that backing by strong actors outside the immediate scope of the relation and a historical basis of business coordinating capacity are necessary conditions for such forms of coordination to emerge, the cases that we discussed in chapter 4 and summarized earlier in this concluding chapter suggest that inter-firm coordination can also emerge on an ad hoc basis, under specific conditions that incentivize and constrain firms in alternative strategies. A particularly fascinating role is played here by international Chambers of Commerce, who act both as deliberating forums and as one of the pillars of governance of these coordinating networks. This finding also raises some interesting questions about the often implicit causalities associated with coordination. The standard view seems to be that inter-firm coordination enables – and thus leads to – upward shifts in product market strategies toward what Hall & Soskice (2001) call ‘high-quality incremental innovation’, which includes the complex manufacturing sectors that emerged in CEE. The cases we analyzed, however, suggest that coordination can also emerge as a result of the product market strategies themselves, and not just the other way around: what drove firms in CEE to think about resolving unexpected and dramatic collective action problems in the labour market, was their shift upward in terms of complexity of production after an initial start in which they regarded the region primarily as a low-cost production area.

This may help us understand better the role that the state and large firms play in organizing capitalism (see Hancké et al. 2007: 24 for a more elaborate version of this discussion). One basic insight is that if economic actors are strong, the state is able to assume a more distant regulatory role and set broad frameworks within which socio-economic actors can negotiate relevant outcomes – as in what Hall & Soskice (2001) call ‘coordinated market economies’. If business and/or labour are relatively weak, however, there seem to be two possible outcomes. One is that state activity (and subsidies) compensates for the weaknesses of these actors; the other may be that the production of collective goods is ‘hijacked’ by strong actors such as large firms who substitute for the state but then end up hierarchically organizing their institutional environment around their needs, as in the restructuring in France since the mid-1980s (Hancké, 2002). What we discovered in CEE bears some distant resemblance to the French pattern, but it seems to have a much stronger associational governance structure at the basis of this. This suggests an intriguing question for further research: it implies that the positions of state, associations, and large firms as economic governance structures may be as much complementary (the situation in CEE) as competing Western Europe).

The prevailing view in political economy – which is, in all fairness, mainly voiced by orthodox economists today but seems to have a powerful hold on many policy-makers as well – is that the question of the relation between the state and the market in a capitalist economy is settled. Because of their allocative efficiency, markets should rule wherever possible, and the state governs only where necessary. The different analyses of Central Europe that we have evoked in this report, both our own and those of others, suggest a more complex pattern of interactions between state and market – and other non-state non-market actors. Consider for example how the market was actively kept out of key processes in the transition. It is unclear how privatization would have happened without the steering hand of the state: strategic priva-
tizations to (often foreign) outsiders, elements that we have identified as one of the key explanations for the success of the V4, rely to a large extent on suspending an open capital market, and asking future owners to assume a more directive role, which includes a planning horizon of several years to decades. Relying on the labour market would in a parallel way have led to an undersupply of skills: complex collective action problems produce market failures that lead to deadlocked low-skill equilibria. And any major economic restructuring of the type that Central Europe has gone through over the last two decades requires a political mechanism to ensure that the ‘losers’ of the transition would remain loyal to the new regime that was being built: the welfare state provided exactly that.

Building capitalism in Central Europe was therefore as much a process of discovering how markets function as it was one of designing governance structures that support these markets and allow them to be efficient. Since markets fail in the absence of complete and perfect information (and the least one can say is that CEE economies in 1990 were riddled with such information problems), governance institutions were a necessary condition for making markets work. The particular form that these governance institutions took was determined by many factors: history, strategic action by large firms, interactions between local and national governments, employers and sometimes re-emerging labour unions, and the ability of non-governmental actors to raise questions and provide forums to resolve problems. And often they had to be designed outside the conventional boundaries: if high-tech, complex manufacturing spans a region across several national boundaries, governance mechanisms slowly (have to) follow suit. But as the initial phases of the transition drew to a close, we discovered that while new arrivals on the capitalist scene may look very different from the outside, they are remarkably similar in terms of the problems that more sophisticated capitalist economies have to resolve. In short, the emergence of capitalism in Central Europe shows us that capitalism still produces its own contradictions – and that the way to handle these is just as historically and politically contingent as it was in the West’s past.
## Table 1.A - Major Car Manufacturing Investments in Central Europe after 1989

<table>
<thead>
<tr>
<th>Country</th>
<th>Investor</th>
<th>Location</th>
<th>Start Date</th>
<th>Type of Investment/activity</th>
<th>Products</th>
<th>Volume per year</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Czech Republic</strong></td>
<td>Volkswagen/Škoda</td>
<td>Mladá Boleslav, Kvasnice, Vrchlabi</td>
<td>1991</td>
<td>Brownfield</td>
<td>Octavia, Fabia, Roomster, Superb, Peugeot 107, Toyota Aygo, Citroen C1</td>
<td>450,000*</td>
</tr>
<tr>
<td></td>
<td>TPCA</td>
<td>Kolin</td>
<td>2002</td>
<td>Greenfield</td>
<td>Peugeot 107, Toyota Aygo, Citroen C1</td>
<td>300,000*</td>
</tr>
<tr>
<td></td>
<td>Hyundai</td>
<td>Nošovice</td>
<td>2006</td>
<td>Greenfield</td>
<td>i30</td>
<td>300,000*</td>
</tr>
<tr>
<td><strong>Hungary</strong></td>
<td>Suzuki</td>
<td>Esztergom</td>
<td>1992</td>
<td>Greenfield</td>
<td>Ignis, Justy, Swift, SX4, Fiat Sedici, TT</td>
<td>300,000*</td>
</tr>
<tr>
<td></td>
<td>Audi (VW)</td>
<td>Gyor</td>
<td>1992</td>
<td>Greenfield</td>
<td>Car assembly until 1998, since then car engines</td>
<td>40,000*</td>
</tr>
<tr>
<td></td>
<td>Opel (GM)</td>
<td>Szentgotthard</td>
<td>1992</td>
<td>Greenfield</td>
<td>Car assembly until 1998, since then car engines</td>
<td>40,000*</td>
</tr>
<tr>
<td><strong>Poland</strong></td>
<td>Daimler Chrysler</td>
<td>Kecskemét</td>
<td>2008</td>
<td>Greenfield</td>
<td>Mercedes, Seicento, Panda, Transporter, Caddy, Nubira, Matiz</td>
<td>100,000*</td>
</tr>
<tr>
<td></td>
<td>Fiat</td>
<td>Bielsko-Biała</td>
<td>1991</td>
<td>Brownfield</td>
<td>Seicento, Panda, Transporter, Caddy, Nubira, Matiz</td>
<td>250,000*</td>
</tr>
<tr>
<td></td>
<td>Volkswagen</td>
<td>Poznan</td>
<td>1993</td>
<td>N/A</td>
<td>Transporter, Caddy</td>
<td>50,000*</td>
</tr>
<tr>
<td></td>
<td>Daewoo/FSO</td>
<td>Warsaw</td>
<td>1996</td>
<td>Brownfield</td>
<td>Nubira, Matiz</td>
<td>35,000</td>
</tr>
<tr>
<td></td>
<td>Opel (GM)</td>
<td>Gliwice</td>
<td>1998</td>
<td>Greenfield</td>
<td>Agila, Astra, Zafira, Wagon R+</td>
<td>120,000*</td>
</tr>
<tr>
<td><strong>Slovakia</strong></td>
<td>Volkswagen</td>
<td>Bratislava</td>
<td>1991</td>
<td>Brownfield</td>
<td>Polo, Touareg, Audi Q7, Porsche Cayenne (assembled in Leipzig)</td>
<td>300,000*</td>
</tr>
<tr>
<td></td>
<td>PSA</td>
<td>Trnava</td>
<td>2003</td>
<td>Greenfield</td>
<td>Citroen C3 Picasso, Cee’d Sportage</td>
<td>450,000*</td>
</tr>
<tr>
<td></td>
<td>Kia</td>
<td>Žilina</td>
<td>2004</td>
<td>Greenfield</td>
<td>Cee’d Sportage</td>
<td>300,000*</td>
</tr>
</tbody>
</table>

Source: Jakubiak et al, 2008 and various other sources for the most recent investments and models.
Note: * - planned.
Figure 1.A: Current and forecasted production of cars in 2004-2010

![Graph showing car production in 2004-2010 for Czech Republic, Hungary, Poland, and Slovakia]

Source: Jakubiak et al. 2008

Figure 2.A: Evolution of employment in different industries in EU 27

![Graph showing the evolution of employment in different industries in EU 27 from 2000 to 2006]


(See Appendix 2 – 5 Sources of data and definitions of variables used in the report – STS variable – Number of persons employed)
Figure 3.A: Suppliers to automotive industry in Slovakia, 2003.

Source: SARIO
Figure 4.A.: NUTS 2 and NUTS 3 level regions in Visegrad 4

Table 2.A: Central European regions among 25 leading regions in employment in high and medium high-tech manufacturing from EU25, by NUTS 2 regions, 2005

<table>
<thead>
<tr>
<th>Rank</th>
<th>Region</th>
<th>High-tech manufacturing</th>
<th>Medium high-tech manufacturing</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Percent of total employment</td>
<td>Total number in 1000s</td>
</tr>
<tr>
<td>1</td>
<td>Freiburg (DE)</td>
<td>4.7</td>
<td>49</td>
</tr>
<tr>
<td>2</td>
<td>Közép-Dunántúl (HU)</td>
<td>4.6</td>
<td>21</td>
</tr>
<tr>
<td>3</td>
<td>Nyugat-Dunántúl (HU)</td>
<td>4.3</td>
<td>18</td>
</tr>
<tr>
<td>13</td>
<td>Új-magyarország (HU)</td>
<td>2.7</td>
<td>12</td>
</tr>
<tr>
<td>17</td>
<td>Dél-Dunántúl (HU)</td>
<td>2.4</td>
<td>9</td>
</tr>
<tr>
<td>19</td>
<td>Západné Slovensko (SK)</td>
<td>2.3</td>
<td>19</td>
</tr>
<tr>
<td>23</td>
<td>Új-zápaď (HU)</td>
<td>2.1</td>
<td>11</td>
</tr>
<tr>
<td>24</td>
<td>Jihozápad (CZ)</td>
<td>2.1</td>
<td>12</td>
</tr>
<tr>
<td>25</td>
<td>Severovýchod (CZ)</td>
<td>2.0</td>
<td>14</td>
</tr>
</tbody>
</table>


Figure 5.A: CEE-4: Regional State Aid Maps 2007-2013

Due to relatively lower GDP level in Poland the levels of admissible state aid are higher than in most other EU countries.
A fenti területi besorolás szerinti támogatási intenzitások – a szállítási ágazat és a nagyberuházások kivételével – kilétálkozások beruházási esetében 20 százalékponttal és középvállalkozások esetében 10 százalékponttal növekednek.
<table>
<thead>
<tr>
<th>NUTS II Region</th>
<th>NUTS III Region</th>
<th>Ceiling for Regional Investment Aid</th>
</tr>
</thead>
<tbody>
<tr>
<td>SK02 Západné Slovensko</td>
<td></td>
<td>60%</td>
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<tr>
<td>SK03 Stredné Slovensko</td>
<td></td>
<td>50%</td>
</tr>
<tr>
<td>SK04 Východné Slovensko</td>
<td></td>
<td>50%</td>
</tr>
</tbody>
</table>


VIII. Bibliography


Feldman, Magnus. 2007. ‘The origins of varieties of capitalism: Lessons from post-socialist transition in Estonia and Slovenia’ (in) Bob Hancké, Martin Rhodes & Mark Thatcher


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PRAVDA – [www.pravda.sk](http://www.pravda.sk)