The institutional embeddedness of transnational corporations: dependent capitalism in Central and Eastern Europe

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INTRODUCTION

The corporate landscape of the countries of Central and Eastern Europe (CEE) is dominated by foreign-owned firms. Foreign enterprises are responsible for nearly half of the total gross domestic product of Hungary, the Czech Republic and Slovakia, and about one-third in Poland (OECD 2010). The highest levels of foreign ownership are found in the main export industries, such as automotive and electronics, as well as in the banking sector, where over 80 per cent of assets are controlled by outside firms.

CEE countries' extensive reliance on foreign capital is well documented in the literature, which has variously described these economies as 'capitalisms from without' (Szelényi and King 2005), 'dependent market economies' (Nölke and Vliegenthart 2009), or 'foreign direct investment (FDI)-based economies' (Drahokoupil and Myant 2011). Yet while their outstanding dependence might make them somewhat exceptional in the international comparison, it is also symptomatic of broader trends. The revival of state interventionism and national champions in the so-called BRICS countries – Brazil, Russia, India, China and South Africa – has in recent years diverted scholarly attention towards alternatives to neoliberal globalization, but in most countries of the world the importance of transnational firms continues to grow (UNCTAD 2016).

These trends pose a challenge to the literature on comparative capitalisms, which, despite the ongoing transnationalization of markets, regulation, as well as corporate structures, continues to stress the primacy of discrete national institutional systems in determining the behaviour of economic actors (see, e.g., Hall and Soskice 2001; Hancké et al. 2007; Whitley 2007; see also Chapter 9 by Eckert and Chapter 11 by Witt in this volume). The emphasis on the persisting capitalist varieties may have been a welcome corrective to the earlier prophecies of a world rendered 'flat' by encompassing liberalization, but it has done so at the cost of downplaying the empirical reality of the growing influence of transnational corporations. Foreign capital is expected to either adapt to or even reinforce the existing institutional structures, as the corporations select investment locations whose institutionally underwritten comparative advantages are best aligned to their profit strategies (Hall and Soskice 2001; Goyer 2006). Such arguments have been challenged even in the countries whose market power and institutional strength should allow them to impose rules on transnational firms, but are especially difficult to maintain for places where the foreign firms are dominant and the institutions more fluid, as is the case in developing and transition economies. In these economies at least, large foreign firms do not simply fit into the existing institutional environment – they actively reshape it.

In this chapter, we explore the consequences of dependence on transnational capital for the institutional structures of Central and Eastern European countries. We focus on Hungary, the Czech Republic, Slovakia and Poland, which represent the clearest examples of dependent capitalism in the region, not only because of the high levels of foreign capital but also because they have gone the farthest in adapting their institutional systems to attract and 'embed' foreign corporations (Bohle and Greskovits 2012). We argue that a combination of state efforts, activities of foreign corporations themselves and the European Union (EU) has led to the emergence of a transnationalized institutional sphere that supports the operations of outside firms. These transnational institutional solutions have emerged and exist quite independently of institutions geared towards the domestic sector, creating a segmented institutional environment (see also Martin 2013). So far, this segmentation has only allowed some fractions of domestic capital to survive in the shadow of the dominant model of dependent capitalism. However, with the recent ideological shift in the region, the domestic institutional segments may also become the springboard for the politicians or domestic businessmen to attempt the construction of more 'national' forms of capitalism.

Our chapter proceeds as follows: the next section discusses the basic outlines of dependent capitalism as described in the existing literature. We show how the importance of the external dimension has made it difficult to fit the CEE states into pre-existing capitalist types based on their institutional profiles. While some of the literature has acknowledged this, the subsequent efforts to refocus attention on external dependence have in turn led to the neglect of the importance of domestic institutions. Next, we combine the two in order to get a more complete picture of the institutional structures of dependent capitalism. We argue that dependent economies create separate transnational institutional spheres to support operations of transnational firms, and that this leads to a segmented institutional environment which keeps foreign firms separated from the rest of the economy. We demonstrate these twin processes of transnationalization and segmentation, and the consequences for other market actors, on the examples of two institutional domains: finance and inter-firm relations. Space prevents us from discussing other institutional domains, such as industrial relations and skill formation. However, our findings for finance and inter-firm relations are characteristic for other institutional areas, too. In the following section we discuss the recent political changes and the possible challenges to the dominant model of dependent capitalism in Central and Eastern Europe. We show that a radical rhetorical shift towards economic nationalism notwithstanding, the dependent model of capitalism is likely to survive. The final section concludes.

DEPENDENT CAPITALISM IN CEE: AN OVERVIEW

Early attempts to incorporate Central and Eastern European economies into the literature on capitalist varieties gave only cursory recognition to the importance of foreign firms (Lane and Myant 2007; Feldmann 2006). Many of them were simple applications of the 'varieties of capitalism' framework, which divides economies into 'coordinated market economies' (CMEs) and 'liberal market economies' (LMEs), according to the prevailing method used by their firms to resolve coordination problems with each other and with other actors, such as investors or labour (Hall and Soskice 2001; Hall and Gingerich

2004; Eckert, Chapter 9 in this volume). Different coordination mechanisms gave rise to alternative institutional solutions to firms' problems: while the LMEs boast open capital markets, a preference for general education and individualized labour relations as well as arm's-length contracts with suppliers, the CMEs rely on long-term relations between firms and banks, specific industrial skills and collective bargaining, and close networks of firms organized into business associations.

Attempts to fit the CEE into this framework by assessing the relative prevalence of institutional forms associated with either model only led to vague and often contradictory categorizations (see also Bluhm 2010). The preference for bank credit over capital markets and high prevalence of vocational skills placed these economies closer to the CME model, but the flexible labour market and the weakness of both unions and employer organisations made them more similar to the LME type. Worse, from the point of view of the original ambition of the varieties of capitalism literature – understanding how different institutional environments structure corporations' access to capital, labour and technology – they were putting the cart before the horse. For instance, the fact that banks outweigh stock markets makes little difference in economies where neither contributed very much to capital formation (Köke and Schröder 2003). Importantly, the fact that both were eclipsed by the significance of cross-border investments meant that any meaningful analysis of the institutional underpinnings of capitalism in CEE would have to take this external dimension into account.

Several authors have consequently taken the external dimension as the starting point for their characterization of East European capitalisms. Myant and Drahokoupil (2011; see also Greskovits 2008) distinguish between East European capitalisms by the dominant pattern of integration into the world economy. In their typology, the Visegrád countries stand out for their complex product exports, such as cars, pharmaceutical and electronics. While Myant and Drahokoupil descriptively map Eastern European export profiles, Nölke and Vliegenhart (2009) tease out the problem of external dependence on transnational corporations for the region. In their seminal article on dependent market economies (DMEs), they argue that in Eastern Europe a third variety of capitalism has emerged, which does not rely on markets or strategic coordination but on transnational corporations to supply the necessary inputs in the realms of finance, labour relations, training and technology. In DMEs, foreign firms finance investment directly through the parent company and transfer technology in the same way without having to rely on local institutional structures. Similarly, in the domain of labour relations, TNCs prefer flexible labour markets for their lower cost, but are willing to conclude company-level agreements with their employees in order to ensure workforce cooperation. Because technology is developed in the headquarters of the parent company and only transferred to the subsidiaries in the DMEs, these firms have no need for highly skilled staff (such as the type of the German *Facharbeiter*) and are reluctant to invest in training. Instead, they benefit from the medium-level manufacturing skills provided by the public vocational training systems of the post-socialist countries which, in combination with the imported capital and technology, gives these economies a competitive advantage in exports of semi-standardized industrial goods, such as car parts (Nölke and Vliegenthart 2009).

This poignant sketch captures well the main features as well as the key weaknesses of CEE economies: the lack of local technology development and therefore the difficulty in moving towards more skill- and innovation-intensive activities. At the same time, it actually tells us very little about the institutional environment of dependent capitalism. In Nölke and Vliegenthart's account, transnational corporations are their own solutions: the domestic institutional environment matters only insofar as it refrains from imposing costly expectations on firms, be it in terms of taxation, labour protection or skill development. Yet this is precisely what makes this succinct description of the 'dependent market economies' problematic, both empirically and theoretically. At least one key input of this model – the workforce skills – is produced outside of the firm, yet the authors spare no mention of the structures that have been put in place by the host states to continue producing relatively high levels of industry-specific skills even when (or indeed especially when) the multinationals refuse to participate in their provision. Nor does the assertion that capital is simply transferred via firm hierarchies do justice to the complex institutions developed to attract and steer foreign investment in the region (Bandelj 2008; Drahokoupil 2009). More importantly, the exclusive focus on firms makes it difficult to distinguish theoretically the DME model that is meant to be characteristic of the CEE countries from, for example, the Baltic states that are similarly dependent on FDI but exhibit very different skill profiles and a different specialization within the world market (Myant and Drahokoupil 2011; Bohle and Grekovits 2012).

These problems have been dealt with most extensively by an alternative typology of capitalist varieties in post-socialist economies that takes into account not only the extent of liberalization, including openness to foreign capital, but also the attempts to compensate the costs of liberalization through social policy and regulations that would bend the firms' strategies towards local developmental aims (Bohle and Greskovits 2012). Viewed through this Polanyian lens, the 'embedded neoliberal' economies of Central and Eastern Europe are set apart from other variants not only by their openness, but also by the degree of institutional effort expended to manage the resulting dependence on foreign capital. Thus, in contrast to the view that DMEs are exclusively coordinated from the outside, Bohle and Greskovits's concept stresses the fact that transnational corporations in the Visegrád countries have become embedded in a set of broader social and economic institutions, which allowed them to develop their competitive edge. In the following section we bring these insights together to show how the activities of TNCs and the host states interact to create a specific institutional structure of dependent capitalism.

INSTITUTIONAL STRUCTURE OF DEPENDENT CAPITALISM: TRANSNATIONALIZATION AND SEGMENTATION

In the previous section we argued that dependent capitalism has a peculiar institutional structure which emerges from the efforts of both the host states and the multinational firms to create institutional arrangements that would facilitate multinationals' dealings with other actors: above all with other firms and the states themselves, but also with labour. What is specific about these arrangements is that they often involve actors and institutions outside of the host state, including extensions of the firms' home country institutions and transnational structures such as the EU. In that sense, the institutional environment of dependent capitalism becomes transnationalized, at least in the areas that deal directly with multinationals.

This transnationalized sphere provides a degree of coordination that goes beyond the bargains of individual firms and states. On the one hand, it can stabilize mutual expectations and impose certain limits on firms' demands. Thus, for example, EU regulations on state aid limit the extent of support that states can offer in order to attract investment. On the other hand, it facilitates interaction by providing actors with the resources that would not be available locally, as in the case of EU financing development and training and the organizational support provided by home country chambers of commerce and, occasionally, trade unions.

However, the transantionalized institutional sphere is also quite 'thin' in that it involves relatively few firms and has limited enforcement capacities. It also creates a segmentation of the institutional environment, as not all of it is accessible to domestic firms. To some extent, this can shield domestic companies from direct competition for resources with outside firms, if they can make use of alternative institutional channels. At the same time, it also cuts them off from the most dynamic segment of the economy, thereby making it more difficult to spread the benefits of successful integration into world markets. The following sections demonstrate in more detail the process and consequences of transnationalization on the examples of firm financing and inter-firm relations.

Access to Finance

Access to investment capital may be one of the biggest obstacles for firms in capital-poor developing and transition countries, which makes it one of the chief headaches for their governments. It was certainly one of the main reasons that CEE countries turned to foreign capital at the start of transition to revive their ailing industries. The advantage of foreign direct investment (FDI) is that it resolves several problems at once: unlike other forms of financing, FDI bundles together capital with technology, know-how and access to export markets. It is thus much more effective at improving the performance and productivity of the host economy. This is also the reason why it is not easy to attract FDI, as evidenced by a sharp rise in competition for the most coveted investments by transnational firms (OECD 2003; Thomas 2011).

In many countries of the world, including CEE countries, this competition has spurred the creation of separate institutional structures for dealing with the outside firms: incentive programmes, special investment zones and investment agencies that have become the centrepiece of these 'investment promotion machines' (Drahokoupil 2008). Sponsored by the EU, these agencies were set up by national governments across the region (ibid.), with the EU also providing staff training (Medve-Bálint 2014). Investment agencies not only act as contact points for prospective investors, they also actively seek to attract them by promoting the country in various international fora. They also provide a broad range of services, from identification of promising investment locations, to proactive purchase and preparation of land, negotiation of infrastructural investments and assistance with recruitment and training of workers. In this sense, these investment agencies indeed help foreign corporations to resolve various 'coordination problems' by mediating between them and local private and public actors. With regard to firm financing, however, the most interesting role they play is as financial intermediaries, by helping investors to obtain subsidies and thus lowering the cost of investment.

Though hard to justify from the point of view of efficient capital allocation, competition for investment has ensured that financial incentives to investors have become commonplace. In CEE, where by 2000 all countries had converged on the same model of FDI-led development, the extent of investment subsidies had at some point risen so high as to bring these countries into direct conflict with the European Commission (Bohle and Husz 2005). In the case of large flagship investments, such as those by the leading car makers, the incentives could reach up to one-quarter of the total investment value, and the amount of incentives per job still averages about €20 000–€30 000 (Kolesár 2006; Šćepanović 2013).

The only thing that keeps these incentives in a relatively predictable range and prevents the escalation of costs for the host governments is the EU state aid regime. In fact, the EU has contributed to the institutionalization of CEE dependent capitalism in more ways than one. As argued above, investment promotion agencies in Hungary, the Czech Republic and Poland have been established with support of the EU pre-accession funds, and the EU has been instrumental in dismantling barriers to foreign capital that some of these countries had originally erected in the name of developing a more 'national' form of capitalism. At the same time, the EU state aid control helps to 'tie the hands' of the governments eager to attract FDI at all costs: while the competition policy allows investment subsidies in less developed areas in order to promote growth, it prescribes standard ceilings for aid, limiting them to a certain percentage of investment.[1] Meanwhile, the cohesion policy makes additional funding available that can further facilitate negotiations by lowering the cost of investment for both the governments and the firms. To be sure, investment promotion agencies, state aid and cohesion policies were not planned in such a way as to complement each other seamlessly. It took the creative agency of transnational corporations and national governments to meld them into a coherent institutional system (e.g., Šćepanović 2013; Medve-Bálint 2014).

All in all, these instances of top-down and bottom up Europeanization (Schimmelfennig and Sedelmeier 2005) are precisely what makes the institutional structure of investment promotion highly transnational: they not only operate within an external regulatory framework, but can also draw on outside resources to offer investors more advantageous terms. Increasingly, the offers of investment promotion agencies include not only assistance in obtaining incentives from local sources but also support in applying for EU funding to cover some costs of the projects (Medve-Bálint 2014).

Local companies have largely been left out of this transnationalized system of investment support. They are, of course, equally eligible for EU funding, but there are no agencies that would provide them with the same level of targeted assistance, although some of the larger local firms are able to profit from political connections to obtain support in accessing these funds. They also find fewer opportunities to exploit the EU state aid regime: despite their lenience in the case of subsidies to new investments, EU regulations are far more intransigent in the cases of rescue and restructuring aid, which is still commonly required by larger domestic corporations. In that sense, although there may have been some opportunity cost involved in the diversion of subsidies from domestic to foreign firms, the arrival of the multinationals and the creation of a separate institutional sphere to handle cross-border financing had few direct repercussions on the ability of local firms to raise finance.

Another question concerns the effect which the rise of a dominant externally funded sector has on the availability of corporate financing through more 'traditional' channels such as banks and capital markets. The latter is a clear-cut case of institutional

Table 10.1 Sources of corporate financing, 2005–2007 (% of gross fixed capital formation)

	Bank credit	Capital markets		FDI
		Stocks	Bonds	
Czech Rep.	10.4	0.3	1.3	16.3
Hungary	12.0	0.1	0.0	17.6
Poland	7.9	7.1	1.9	20.0
Slovakia	13.2	0.0	0.4	12.9
CEE	9.8	3.3	1.3	17.9

Note: Includes only non-financial corporations.

Sources: Eurostat National Accounts; ECB Monetary statistics and Securities Issues Statistics; National central banks; World Federation of Exchanges and national stock exchanges; WiiW FDI database.

segmentation: foreign firms do not participate in the local stock markets, which remain the preserve of a handful of large domestic companies (Ozsvald 2014). But while these firms might have benefited from a lack of foreign competition, the absence of the region's most successful firms in their stock markets probably contributed to their generally anaemic state. Overall, the ratio of stock market capitalization to gross domestic product (GDP) is lower in the CEE than in other economies of comparable level of development: just over 30 per cent in Poland, 15 per cent in the Czech Republic and Hungary, and as low as 5 per cent in Slovakia (Adarov and Tchaidze 2011). With the exception of Poland, which has the largest stock market in the region, the contribution of stock markets to firm financing also remained low. Even in the boom years just before the global economic crisis, the total amount of capital raised by the CEE firms through sales of corporate equity and bonds was less than 5 per cent of the gross fixed capital formation (Table 10.1).

The situation is more complicated with regards to bank credit, where there is some evidence of competition between MNCs and local firms for capital. The degree of competition, however, is very difficult to estimate, as there is very little research on the extent to which the MNCs borrow locally. Another twist comes from the fact that the banking sector is itself highly transnationalized: with one or two exceptions in each country, all larger banks have been taken over by foreign banks. Some of these banks came to the region following their clients, and were indeed more likely to lend to large foreign corporations than to local firms, especially small and medium-sized ones. But, as in the case of equity, what is most striking about the CEE credit market is not so much the composition of banks' portfolios as its overall underdevelopment. The amount of credit as a percentage of GDP increased from an average of 32 per cent in 2001 to 48 per cent in 2008, but the growth was largely concentrated in consumer and mortgage lending (Bohle 2014). Meanwhile, between 2005 and 2007, bank loans only accounted for between 8 per cent and 13 per cent of gross fixed capital formation (Table 10.1). This is clear evidence of consistently low importance of bank credit in investment financing.

Overall, as can be seen from Table 10.1, foreign direct investment by far outweighs the credit, bond and equity markets in the CEE as a source of investment finance. Thus, while the four countries have been able to benefit from a high influx of foreign capital in terms of industrial transformation and development, they have remained poor on capital and continue to depend on outside funds for further growth. Investment promotion agencies play a crucial role in attracting FDI and managing EU subsidies and other external financial flows. Meanwhile, some large domestic firms have managed to preserve the dominant position in local capital markets and have also been able to draw on the support of a few remaining domestic banks, often with the help of the state. Small and medium-sized enterprises are in the most difficult position, as they have not been able to profit from the inflows of fresh capital brought by the transnationalization of the banking sector. As we will see in the coming section, they are also the ones most likely to lose out from the institutional segmentation that occurs in the realm of inter-firm relations.

Inter-Firm Relations

In the literature on comparative capitalisms, the area of inter-firm relations encompasses a broad set of rules and institutions that regulate relationships between individual companies and their suppliers, customers and competitors to resolve potential conflicts and regulate joint undertakings. At one extreme are the arm's-length contractual relations enforced by the legal institutions; at the other are networks of business associations that handle a variety of tasks, from information-sharing to cooperation on joint technology projects, collective bargaining and training coordination (Sako 1992; Whitley 1999).

In many ways, the CEEs are closer to the cooperative pole, but with two important caveats. The first is that close cooperative relations are reserved for the firms belonging to the same business segment; across segments, the relations are weak and often contractual. The second is that although various business associations can act as mediators between firms, their strongest function is to coordinate communication between the corporations and the state.

One factor that reinforces segmentation in the domain of inter-firm relations is the globalization of firms' supply chains. In many industries that form the backbone of the CEE export-oriented economies, such as automotive and electronics, suppliers routinely follow the lead firms into new markets (Herrigel and Zeitlin 2010). This is especially true of suppliers of more complex inputs that share co-specific technologies with their final customers and are often themselves large multinational corporations. In CEE, the proximity to the multinationals' home countries has even amplified this trend, as also smaller Western companies can easily move to the region. Direct transplantation of large portions of the supply networks has not only simplified inter-firm relations in the new production locations but has also ensured that the mechanisms regulating exchanges between the lead firms and their customers has remained highly transnational. The majority of purchasing decisions as well as the development of new parts and technology remain concentrated in the headquarters (Pavlínek 2012; Šćepanović 2013). This way, the support for technological cooperation, quality certification, and even training of local workforce is 'borrowed' from home country institutions, which facilitates interaction among the foreign firms but makes it more difficult to local actors to break into these networks. The dense interaction between firm headquarters, home country institutions and host country affiliates is especially true for firms that have their headquarters in close geographic proximity of CEE: Germany, Austria and, to a lesser degree, the Netherlands.

The recourse to home country institutions is only one aspect of transnationalization of inter-firm relations within the corporate segment dominated by foreign firms. The other is their reliance on a network of foreign chambers of commerce and other investor associations to resolve issues that arise locally, such as the relations with firms from other countries, and especially the relations with the host state. The chambers collect intelligence, formulate policies on behalf of their members and act as powerful lobby groups (Drahokoupil 2008). The American and German Chambers of Commerce have been particularly active in promoting tax reforms and other measures to 'improve the business environment', and more recently they have been behind the region-wide push to reform vocational training. Part of their persuasiveness comes precisely from their transnational nature, which allows them to claim broader expertise as well as to kindle regulatory competition among the CEE states.

Their influence is especially striking when contrasted with national business organisations. Employer associations in particular are remarkably weak in the region, with little coverage and less policy influence, despite their formal status in many policy advisory bodies. Their weakness is often cited as one of the key reasons behind low collective bargaining coverage and the near-absence of multi-employer agreements outside of the public sector (Meardi 2012). Multinational corporations (MNCs) are often members of national associations, but prefer to use their own or transnational channels for policy lobbying. Even in Slovakia, where sectoral-level collective bargaining is well established and the employer associations are somewhat stronger, recent demands for reform of vocational training by the MNCs were fielded through the automotive industry association and the German Chamber of Commerce and not, as could be expected, through the employer association. As a result, the reform ended up being heavily skewed towards the needs of the car industry and of limited use in other sectors (Vantuch and Jelínková 2012). Given the dominance of the car industry in Slovakia – often dubbed the 'Detroit of Eastern Europe' – it is not surprising that this industry has the ear of the government more than any other (VoxEurop.eu 2014).

The existence of a transnational support network for inter-firm relations in the CEE is part of the reason for the region's rapid catch-up to the West European standards of productivity and competitiveness. It has allowed lead MNCs to draw on the existing networks of suppliers and partners, instead of having to wait for the local firms to adapt to their requirements. In the same way, it has provided them with a new channel to address regulatory bottlenecks, instead of having to forge coalitions with a broader network of firms within the national associations. However, institutional transnationalization and segmenation of the business environment only increased the entry barriers for domestic firms into the most successful national industries. Since purchasing decisions and technology cooperation remain abroad, local firms can only enter these networks at the very bottom, where they become suppliers of simple, standardized parts that do not require co-specific investments (Domański and Gwosdz 2009; Pavlínek and Janák 2007). This is a problem for the theories of development that put much stock by the expectation that 'spillovers' from foreign to domestic firms would drive development (see, e.g., Blomström and Kokko 1998; Moran et al. 2005). First, joining foreign production networks as suppliers of simple, cost-intensive parts is likely to limit learning: evidence shows that intensive sharing of technology and know-how can only be expected at the upper level of the value chain (Lorentzen et al. 2003). Second, even if they possessed the requisite skill and technology, the lack of access to the transnational networks of inter-firm relations puts local firms at a systemic disadvantage in the competition for lucrative supplier contracts. The result is a vicious circle of exclusion and low capacities in which the local firms, with very few exceptions, disappear from the leading export industries.

Institutional segmentation thus reinforces divisions among companies along sectoral lines: the firms most negatively affected by the segmentation are small or medium-sized enterprises in manufacturing industries which have neither the economic weight nor the political capital to warrant much government support. In contrast to their counterparts in CMEs, small and medium-sized enterprises (SMEs) in CEE are of recent origin, and because of the segmented nature of the business system have not been able to gain much economic sophistication. Meanwhile, large domestic firms occupy a segment of their own. These are typically firms with a longer history of state ownership or firms in which the state still holds significant shares, but there is also a handful of newly founded privately held corporations. While the transnational segment gathers export-oriented firms, many of the large domestic corporations thrive on the local markets: energy companies, utilities, defence, a handful of firms in chemical and pharmaceutical industries and construction, as well as the few domestically owned banks and insurance companies. The relations among these firms are embedded in a network of close personal and political ties rather than in formal business associations, but they are further cemented by cross-holding of shares and interlocking directorates, with more intensive levels of coordination occurring among firms with the same political party affiliation (McMenamin and Schoenman 2007; Stark and Vedres 2012). This also means that their relationship with the state and policy influence occurs through direct contacts with political parties rather than through the formal institutional channels.

The result of the sectoral and institutional segmentations in inter-firm relations is a peculiar paradox from the point of view of comparative capitalism literature. In CEE, inter-firm relations are closely coordinated, rather than market-based, but this coordination occurs within different segments and via alternative institutional channels. At the same time, the 'traditional' institutional platforms for coordination – business and employer associations – remain weak and ineffective.

DEPENDENT CAPITALISM IN CRISIS

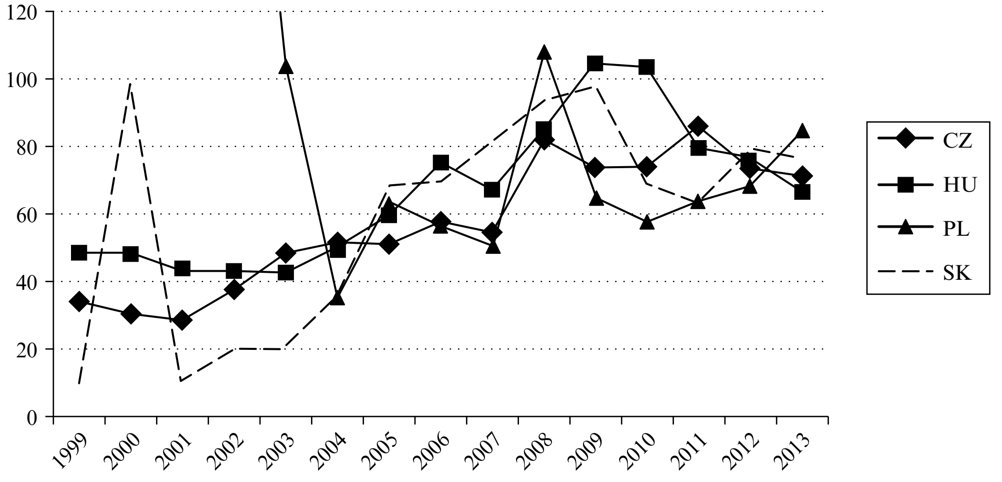
The peculiar institutional structure of CEE's dependent capitalism is partly responsible for the region's remarkably successful integration into the European and world markets, as well as rapidly catching up with Western competitiveness and productivity. At the same time, it also has downsides: on the one hand, the ease with which the foreign firms can 'borrow' institutional solutions and technology from their home countries removes most incentives to create them in the new production locations, and thus limits the potential for these countries to move towards more skill- and technology-intensive activities. On the other hand, the segmented business structure leads to frictions between foreign- and domestic-owned companies, especially because state efforts to develop a home-grown competitive sector have been few and far apart. Several reasons account for this. Efforts in the Czech Republic, Slovakia and Poland to create national capitalisms had ended in crises (Myant 2003; Bohle and Greskovits 2012). Politically, supporting a domestic bourgeoisie proved controversial, as it raised suspicions of corrupt insider capitalism (e.g., Altshuler 2001; Staniszkis 1990). Further, although all governments paid lip service to the importance of SMEs, none found them important enough to expend sufficient funds for their growth. Recently, however, the mood has begun to shift, though more radically in some countries than in others.

The impetus for change came with the Great Recession, which highlighted the vulnerabilities of the dependent capitalist model. The CEE states were heavily affected by the contraction in Western European markets: exports fell by 20–25 per cent across the region between 2008 and 2009, dragging down overall GDP growth. The foreign-dominated banking sector proved to be another liability, as some of the banks began for a short time to pull capital from their CEE branches in order to shore up the balance sheets of their parent companies (Epstein 2014). In Hungary, and more recently in Poland, foreign banks were also held responsible for irresponsible mortgage lending, exposing the citizens to foreign currency loans (Bohle 2014).

In truth, the crisis revealed the resilience of the CEE dependent capitalism rather than its vulnerability. Partly thanks to the transnationalized institutional and regulatory structures, CEE countries could recover much faster than some of their Western counterparts. Thus, the CEE car industry became the main beneficiary of the Western European scrappage schemes. It also benefited from the EU's anti-protectionist policies which ensured that Western European governments could not limit benefits to their own locations. For the banking sector, the International Monetary Fund (IMF) and the European Bank for Reconstruction and Development (EBRD) launched the so-called Vienna Initiative, a series of accords signed by several CEE states with major European banks and the IMF to maintain the presence of exposed banks. In the agreements, parent banks committed to support their subsidiaries in the region, roll over their credits and capitalize them adequately (Epstein 2014).

Yet, the crisis had accentuated some worrisome trends in the structure of FDI in the region. First, even before the crisis, the inflow of foreign capital had started to level off: very little new capital was coming across the border, and most of the 'foreign' investment in the region now came from the reinvested earnings of the resident foreign firms. Second, an ever larger portion of these earnings was being sent back to the headquarters rather than reinvested in the host economy (Figure 10.1). Third, the increase in the FDI stock was increasingly concentrated in services, such as financial intermediation, telecommunications and energy: sectors focused on the domestic markets where foreign firms were more likely to encounter competition from domestic companies than in export-oriented manufacturing (Hunya 2011, 2015).

Its mixed record notwithstanding, the crisis served as a catalyst that brought more nationalist governments to power in some of the region, which started to fundamentally question the wisdom of dependent capitalism. Hungary, which in the 1990s was the first state to turn towards FDI, has gone the furthest in opposing it. Especially the second Orbán government (2010–2014) aimed at the nationalization of strategic sectors with view of an overall stronger role of the state in the economy. The largely foreign-owned banking sector was among the first targets. The government blamed it for the soaring levels of consumer debt and the failure to extend enough credit to industry. Banks were made to shoulder parts of the burdens of the crisis. The government levied a special tax on them, and also forced them to convert foreign currency loans into forints partly at preferential exchange rates (Bohle 2014; Johnson and Barnes 2015). It also explicitly



Note: Repatriated earnings include distributed dividends and repayments of intra-company loans.

Source: Eurostat, national accounts.

Figure 10.1 Share of repatriated earnings as a percentage of total income of foreign corporations in CEE

aimed at expanding the domestic share of the banking sector. In addition, the state bought 20 per cent of shares in the Hungarian energy company MOL and took over utility companies previously owned by German firms RWE and E.ON. Another target was the foreign-dominated retail sector (Djankov 2015). Similar calls for re-nationalization of the economy had been heard in Poland, even before the election of the PiS government in 2016 (Naczyk 2014). Though the policy intervention has not gone as far as in Hungary, the government has made repeated calls to reclaim ownership of key services such as banking and media.

While the change in rhetoric is certainly radical, and some economic changes are real, it is unlikely that the surge of economic nationalism in the region heralds a radical break from its model of dependent capitalism. The sectors and corporations targeted by the governments – utilities, media, retail and banking – are politically valuable, as they have an immediate effect on the perceptions and well-being of citizens. They are also tied to the domestic market, where government activities have much more influence on the distribution of rents and profits than in the highly competitive export sectors. This all suggests that the campaign to 'renationalize' the economy is more likely an attempt to reinforce client and patronage networks than to truly rear new national champions. Indeed, despite its inflammatory rhetoric against the 'multis', the Hungarian government has gone out of its way to reassure investors in the key export industries of its friendship. Since 2013, it has signed over 60 'strategic partnership agreements', most of them with foreign investors, promising them continuing support and incentives. It also launched a comprehensive reform of vocational training that incorporated many of the long-standing demands of lead investors.

CONCLUSIONS

This chapter has argued that CEE's extensive reliance on foreign capital has been brought about and reinforced by a particular institutional landscape. Specifically, the rise of a separate, transnational institutional sphere has allowed transnational companies to draw on external resources to facilitate interaction among firms, transfer technologies and know-how, and to resolve regulatory bottlenecks. It has also provided them with a direct channel of communication with the host states for issues that require domestic policy action, such as workforce training. Further, the EU has provided a framework for interactions between corporations and states, supplying states with external resources to ease the cost of obtaining foreign capital, while also designing a set of rules that constrain states and allow them to refuse more excessive demands on the part of foreign capital. A responsive but relatively autonomous state, and the possibility to 'import' institutional resources not available locally, has allowed the foreign firms to settle more easily and to rapidly transform the industrial landscapes of Central and Eastern Europe into veritable export powerhouses. Meanwhile, segmentation of the institutional environment has also provided sheltered spaces for some domestic firms that might have lost out in competition with the multinationals. These have allowed states to preserve a handful of 'domestic champions'.

While this institutional structure has allowed CEE to catch up with Western levels of competitiveness and productivity, the global financial crisis and its repercussions in the region have led to a re-evaluation of the dependent capitalist model by nationalist political forces. However, instead of challenging the model wholesale, these forces mostly seek to bring under national control sectors that cater to domestic markets, are crucial for the well-being of their citizens and have the capacity to generate sizeable rents. Ironically, in this situation, the institutional segmentation that emerged in the region appears to have been a source of additional stability, allowing the states to manipulate the domestic part of the economy for political purposes without endangering their external competitiveness. At the same time, for all their proud nationalism these interventions have done little to address the problems that the crisis has brought to the fore. Dependence on foreign capital is likely to remain a defining characteristic of these economies for some time to come, and the governments of Central and Eastern Europe may do well to leverage some of their newfound confidence vis-à-vis the investors, not to seal them off from certain sectors and activities, but to link them more firmly with the local institutional environment.

NOTE

1. The amount of aid a location is allowed to offer is linked to the level of 'deprivation' relative to the EU average. The 2007–2013 EU regional aid guidelines set the aid intensity ceilings from 30 per cent of total investment for regions with per capita GDP below 75 per cent of the EU-25 average to 50 per cent for regions below 45 per cent of the EU-25 average. Further restrictions apply to very large investments; see European Commission (2006).

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