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Market Liberalism and Economic Patriotism in the Capitalist World-System

Edited by Tamás Gerőcs · Miklós Szanyi

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Abbreviations

AfD	Alternativ für Deutschland (Alternative for Germany)
APE	Agence des participations de l'État
BNP	Banque nationale de Paris
CCF	Crédit Commercial de France
CEE	Central and East Europe
CEO	Chief Executive Officer
CGE	Compagnie générale d'électricité
CIA	Central Intelligence Agency
CIC	Crédit industriel et commercial
CII	Compagnie internationale pour l'informatique
CNP	Caisse Nationale de Prévoyance
CPE	Comparative Political Economy
DME	Dependent Market Economy
DS	Developmental State
EDF	Électricité de France
EEDC	Egyptian Economic Development Conference
EEMU	European Economic and Monetary Union
ENA	École nationale d'administration
EP	Economic Patriotism
EU	European Union
EWCS	European Working Conditions Survey
FDI	Foreign Direct Investment
FHB	Földhitel és Jelzálog Bank
FIDESZ	Fiatal Demikraták Szövetsége, (Fidesz—Hungarian Civic Alliance)
GAN	Groupe des Assurances Nationales
GDF	Gaz De France

GDP	Gross Domestic Product
GERD	Gross (Domestic) Expenditure on Research and Development
GINI Coefficient	Gini ratio is a measure of statistical dispersion
GVC	Global Value Chains
HDI	Human Development Index
HEC	École des hautes études commerciales
IKCO	Iran Khodro Company
ILSA	Iran Libya Sanctions Act (since 2006: ISA—Iran Sanctions Act)
IMF	International Monetary Fund
INSEE	Institut National de la Statistique et des Études Économiques
ISI	Import Substituting Industrialisation
IT	Information Technology
ITT	International Telephone and Telegraph
IWE	Institute of World Economics
KLM	Koninklijke Luchtvaart Maatschappij
MB	Muslim Brotherhood
MENA	Middle East and North Africa
MKB	Magyar Külkereskedelmi Bank
MNC	Multinational Corporation
NAFTA	North American Free Trade Agreement
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
PAC	Growth and Acceleration Program in Brazil (Programa de Aceleração do Crescimento)
PiS	Prawo i Sprawiedliwość (Law and Justice Party)
PKPP	Polska Konfederacje Pacodawcow Prywatnych
PMDB	Brazilian Democratic Movement Party (Partido do Movimento Democrático Brasileiro)
PPI	Investment Partnership Program in Brazil (Programa de Parcerias de Investimentos)
PPP	Purchasing Power Parity
PT	Workers' Party in Brazil (Partido do Trabalhadores)
PTT	Postes, Télégraphes et Téléphones
R&D	Research and Development
RECME	Répertoire des entreprises contrôlées majoritairement par l'État
RWE	Rheinisch-Westfalisches Elektrizitätswerk
SA	Société Anonyme
SCAF	Supreme Council of the Armed Forces (in Egypt)
SEM	Single European Market
SES	Structure of Earning Survey
SG	Société Générale

SICAV	Société d'investissement à capital variable
SNCF	Société nationale des chemins de fer français
SOE	State-owned Enterprise
SSA	Social-structures of accumulation approach
SVOC	States in Varieties of Capitalism
TF1	Télévision Française 1
TI	Transparency International
TIH	Transparency International Hungary
UAP	Union des assurances de Paris
UKIP	UK Independence Party
ULC	Unite Labour Cost
UN	United Nations
UNCTAD	United Nations Conference on Trade and Development
UNESCO	United Nations Educational, Scientific and Cultural Organization
UNSC	United Nations Security Council
US	United States
V4	Visegrád Four Countries (Poland, Czechia, Slovakia, Hungary)
VAT	Value-Added Tax
VoC	Varieties of Capitalism
WDI	World Development Indicators
WTO	World Trade Organization
WWI	World War I
WWII	World War II

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CHAPTER 1

Introduction

Miklós Szanyi

The great economic crisis of 2008–2009 undermined popular beliefs in the omnipotence of neoliberal economic concepts. The abrupt end of the "Great Moderation" was a signal that despite the seeming perfection and fine-tuning of market institutions, business will always evolve and innovate so as to keep one step ahead of regulators. In cases where regulators are unable to control market developments (as has been the case in many areas currently being transformed by the process of globalization), emergency situations often require direct state intervention into the economy, which measures may be imposed despite their distortions of market mechanisms.

In fact, governments were already expanding their roles in their economies even before the outbreak of the crisis. For example, active structural policies were suggested by various multilateral organizations (the OECD, the European Commission) and implemented by numerous governments (Warwick 2013; Stiglitz et al. 2013). In other cases, growing

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international competition (mainly from emerging market economies) induced governments to take measures either to improve their national firms' competitiveness or to increase barriers to entry for foreign companies. These steps were taken alongside liberalization measures promoted mainly within the framework of the World Trade Organization. This new combination of various types of policies was to serve the "national interest"; however, this term was defined or understood in different countries. The new, rather eclectic set of practices which evolved during the 2000s came to be called "economic patriotism" (Clift and Woll 2012).

The declining trust in neoliberal policy solutions and empirical facts of increasing statism has influenced comparative economic research. Parallel with the time of the "Great Moderation" much of the efforts in comparative economics was devoted to the research of varieties of fundamentally liberal market economic systems. The varieties of capitalism (VoC) literature dealt mainly with the economic systems of developed market economies enriching the original typology of liberal and coordinated market economies (Hall and Soskice 2001) with finer nuances (e.g. Lane and Myant 2007; Farkas 2016; and others) but still working in the same, rather static cross-sectional research framework. Empirical facts of the 2008–2009 crisis bound mainly to increased state involvement called for more dynamic approach and also for the treatment of economic systems fundamentally different from the archetype VoC models.

Increase in the direct economic involvement of the state has provided fertile soil for economic research. The Institute of World Economics at the Hungarian Academy of Sciences was one of the institutions which launched major research programmes on this topic, and among its efforts, special attention should be paid to a series of conferences entitled, "The Role of State in Varieties of Capitalism". These annual SVOC conferences have attracted scholars from many different countries; they have used the discussions to identify several major topics related to the different patterns of direct state involvement in various types of economies. The present volume introduces a few of the key trends which define this very rich research agenda.

The cornerstone of the chapters in the first part of this book is the concept of "economic patriotism", as elaborated by Ben Clift. It is important to differentiate this notion from classic economic nationalism and protectionism, though the aims of such measures are similar: they favour national businesses over foreign (or, today, multinational) competition. Advocates of economic patriotism propose measures which will create larger, more competitive domestic firms or temporarily minimize the local effects of international competition so as to make domestic players more able to withstand international competition in the future. Very similar elements were at work in classic economic nationalism, the ideological justification for which was provided by the concept of the developmental state; such measures are frequently adopted by transition economies and codified into multilateral regulations to protect infant industries. One new feature of economic patriotism is its extensive toolkit, which includes selective liberalization and reregulation. Another feature of this concept is a flexible understanding of the term “patrie”, which—unlike in classical theories of economic nationalism—can include subnational, national, and/or supranational communities in its definition of “insiders”. For example, economic patriotism, in the form of “common European interests”, motivates many of the measures adopted by the EU.

However, the term is also frequently misused as a label for non-patriotic movements. Eurosceptics regularly argue that in practice “common European interests” are often merely the interests of the multinational firms from larger and richer European countries, which argument reflects the classic core-periphery conflict. In other cases, mainly in transition economies, economic patriotism and the concept of the developmental state are simply used as cover for political rent-seeking. Both of these deviations from the original concept are discussed in this book.

The core-periphery hierarchy is reflected in many of the current conflicts between liberal and more statist approaches to development in countries with very diverse economic, social, and cultural backgrounds. In fact, the divide between these two concepts and the central developmental dilemma—that is, whether to follow Western liberal or Eastern feudal (authoritarian) patterns—can be traced back to the Age of Enlightenment and enlightened absolutism. The intensification of bourgeois development led to greater economic growth but was rather fragile politically, especially for feudal rentiers. Traditional feudal societies did not provide education or freedom of enterprise for the majority of their members; hence, their economic potential was much more limited. On the other hand, the system was politically more secure for traditional rentiers. This dilemma hindered the development of the European (semi)periphery and, after some delay, other peripheries of the capitalist world-system as well. This volume includes case studies of Iran’s resistance economy and Brazil’s post-developmental state, which contextualize this dilemma within the special circumstances of Muslim tradition and the historical heritage of Latin

America. Every peripheral region exhibits frequent shuttling between these two poles—liberalism and authoritarianism.

The conflict between the two developmental concepts is often complicated by rent-seeking. In this volume, we have used the broader, Weberian definition of this term suggested by Mihályi and Szelényi: rents are created when "closed groups monopolize advantages by occupying scarce and desirable positions". We have paid special attention to political monopolies as sources of rents; the economies of traditional authoritarian political regimes are organized around these types of rents. The current Central European followers of this model have been creating institutional frameworks suitable for systematic rent-seeking. Several of the chapters herein deal with various sides of this issue using mainly—though not exclusively—Hungarian evidence. Varju and Papp have described the ways in which these new institutional settings can (or cannot) be harmonized with the liberal multilateral regulations of the EU. Mihályi and Szelényi have provided a systemic overview of the various types and sources of rents characteristic of post-communist economies' transition processes. My own chapter deals with the selective application of business laws to multinational firms in Hungary.

Peripheral regions' oscillations between liberal and authoritarian approaches can be attributed to cyclical ruptures in their development. Long waves of economic growth (as elaborated by Kondratieff) and technological cycles (within the framework of evolutionary economics) are among the theories which explain cyclical movements in capitalist development and the resulting shifts between liberal and statist economic policy regimes. And though conceptual comparisons of the two regimes have proved to be difficult, we can still find some parallels which corroborate these theories. Using Polányi's concepts, May and Nölke (2015) have differentiated liberal and organized phases of capitalist development over the course of the late nineteenth and twentieth centuries. The time frames of these institutional changes coincide with the inflection points of the economic and technological long waves of the twentieth and early twenty-first centuries. These turning points were marked by the three major crises of this period (1929–1933, 1974–1978, and 2008–2009). The last turning point is of particular interest, since it can be regarded as the starting point of the current developmental phase.

Foresight into the various aspects of development is rather difficult and often vague. We have very little idea what these new business models will look like. How will typical transactions be organized? How will the legal and institutional framework change in order to serve these new business models? Nevertheless, basic findings can be articulated. Nölke contends that the current period of capitalist development is an organized phase marked by increased direct state intervention. Nölke also suggests that large, emerging market economies like China and India will dominate the world economy not only in terms of output and economic potential, but also by imposing their institutional pattern, which he calls the "state-permeated market economy" (Nölke 2012). Despite big differences in these countries' political systems and cultural heritage, their various modes of state involvement exhibit certain common elements: a kind of government planning and steering of markets (familiar from the developmental state concept), the marked role of state-owned companies in fulfilling developmental targets, and a weak separation of business and politics, latter feature of which also provides opportunities for rent-seeking. Another common feature of these state-permeated economies is growing inequality.

Inequality and the social perception of it are important determinants of political stability and economic performance. The two competing political and economic systems—Western liberal and Eastern authoritarian—are also different from this perspective. Social inequalities are usually greater in authoritarian regimes since political monopolies provide rent-seeking opportunities to only a selected few at the pinnacle of the given society. The political competition of liberal democracies, along with effective social control devices, ensures a more even distribution of national income. Even so, greater inequality does not necessarily threaten the social and political stability of authoritarian regimes. What the average person or voter is most concerned about is his or her own income relative to others in the same social stratum. This is why, for example, Hungary's ruling party had its political monopoly reaffirmed by the greatest margins in that country's poorest regions in its 2018 national elections.

On the other hand, inequality—and, more importantly, wage differences—have a more significant impact on more educated and better-informed social strata. Drahokoupil and Piasna (2017) have argued that there is a large wage gap between more developed European countries and their less-developed semi-peripheries. This gap is largest in more skilled occupations. This may be an important reason for the massive emigration from Central and Eastern Europe, as well as from other, more distant peripheries. The reasons for this wage gap are manifold, but in the case of Central Europe's transition economies, weak labour organizations, underdeveloped social networks, and feeble civil-society institutions have played an important role. Hungary and Poland have abandoned the concept of the liberal competition state, as illustrated by their systematic weakening and even destruction of such institutions. These governments' interest in doing so is twofold. On the one hand, weak civil control strengthens their political monopolies. On the other hand, existing wage gaps serve the interests of multinational businesses, which are significant players in these economies. Cooperation with selected manufacturing multinationals has provided these countries with a certain degree of macroeconomic stability.

This SVOC work continues. The aforementioned exciting topics continue to deliver insights into this segment of the VoC research agenda. This volume is a concerted effort to detect the direction of economic patriotism after 2008 in both advanced and developing countries in order to broaden the scope of "comparative capitalism" within VoC tradition. If the prediction that state-permeated economies will soon play a defining role proves to be correct, we can expect major changes in the currently liberal multilateral institutional environment. Perhaps the Anglo-Saxon, liberal world economic model will be replaced by a new state-orchestrated framework? Or will the current wave of organized economic development lose steam when its inherent problems—such as inequality and rent-seeking—begin to limit the potential advantages of state coordination? Liberal economies will also change and try to improve their systems—but will the EU successfully reform its ailing structures and create a model capable of competing successfully with the Eastern state-permeated economies? These are the questions posed by this volume, questions we hope will inspire further research.

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CHAPTER 2

Economic Patriotism, the Politics of Market-Making, and the Role of the State in Twenty-First-Century Capitalism

Ben Clift

Contemporary politicians, particularly those with demagogic inclinations, have a very naïve (mis)conception of state-market interactions. They presume, or pretend to their electorates, that they can pull all the necessary levers of economic policy to exert control over their national economic futures. 2016 provided powerful examples on both sides of the Atlantic. The Brexit campaign promised to 'take back control', a vision that was also integral to Trump's pledge to heal America's economic wounds by reversing the industrial decline of rustbelt states. This is clearly a seductive vision, but unfortunately it ignores the reconfiguration of economic and political space which the interdependence of markets and multi-levelled economic-governance regimes entail. The real world of political economy is much more complicated.

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Private-sector actors, large firms, and other forms of private authority, as well as international treaties, regimes, and agreements all greatly curtail government autonomy and the capacity of economic policy-makers to enact their visions for the governance of the economy. That this often goes unacknowledged when politicians articulate promises to exercise greater 'control' over the economy, jobs, and growth is both very troubling and enormously damaging to the quality of debate and commentary on political economy and economic policy.

Economic Patriotism

This short chapter demonstrates the worth of economic patriotism (EP), and its particular way of understanding the politics of market-making and the role of the state, for understanding the limits of control. A few years ago, Cornelia Woll and I developed a novel formulation of the theoretical framework known as 'economic patriotism' in which we focus on the overlapping economic-governance regimes and dense international jurisprudence regulating them in which national economies and governments are enmeshed. EP reflects profound if not self-evident contradictions between international market integration and spatially limited political mandates. This is the root of a profound disjuncture between what kinds of promises these politicians articulate to their citizens about 'control' over economies and economic outcomes such as growth and jobs—and the much more complex realities of achieving economic governance under twenty-first-century complex economic interdependence (Clift and Woll 2012a, b).

EP highlights the limits that things like production, process and safety standards, and rules-of-origin requirements associated with the Single European Market (SEM) and World Trade Organization (WTO) membership place on national economic policy-making, and what governments can do about them. These complexities explain why it can take seven years to finalise a trade agreement. The rules of the transnational market order and the disjuncture between international market integration and spatially limited national political mandates place serious limits on how much 'control' national politicians can plausibly exert.

We have argued that EP refers to an impulse by policy-makers to enact particular forms of market-making. It entails 'a form of economic partiality: a desire to shape market outcomes to privilege the position of certain actors'; thus, it entails assumptions about who forms part of the economic community—who is, or should be, 'in' and 'out'. EP offers an analytical lens to study how policy-makers seek to resolve the tension between interdependent economies and political territoriality. As defined by Clift and Woll, 'economic choices which seek to discriminate in favour of particular social groups, firms, or sectors understood by the decision-makers as insiders because of their territorial status. Unlike economic *nation*alism, EP is agnostic about the precise nature of the unit claimed as *patrie*: it can also refer to supranational or subnational economic citizenship' (Clift and Woll 2012a, p. 308).

EP entails market-making and market-shaping interventions to privilege the position of certain actors. Intuitively, EP evokes the subordination of economic objectives to the protection of homeland interests. Used as a synonym for economic nationalism, it has been equated with (neo-) mercantilism. However, unlike economic *nation*alism, EP is not tied to national-level activism, nor to the nation-state as necessarily the most instructive unit of analysis. Membership in the patrie at the heart of EP can take various forms, including supranational and subnational economic citizenship. Indeed, part of the salience of EP is that for all the contemporary bluster around revived economic nationalism, transfers of political economy authority between these supranational, national, and subnational levels are increasingly common.

The full complexity of contemporary market-making interventions in the economy cannot be adequately addressed with the notion 'economic nationalism'. Focusing on EP rather than economic nationalism frees us from the shackles of methodological and conceptual nationalism. In Europe, insistence on the defence of economic interests increasingly lists European interests alongside national ones. Indeed, EP can shift scales and create 'European champions'. Inversely, it can also shift downward to local interests. For example, the defence of labels of protected origins in the WTO constitutes local EP —or '*Lokalpatriotismus*', a common term in the German language.

One way of clarifying this concept is to ask, "What is *not* EP?" The defence of territorial interests is, after all, very common in economic policy-making. One limit to the applicability of the concept of EP is implied in the continuum based on the tension between territorial interests and market opening. Although we have identified liberal versions of EP, we recognise that some liberal policies are motivated solely by economic ambitions and disregard the differential effects a policy might have on a given territory.

There are also limits to EP that do not reflect an ideological commitment to market opening and nonetheless disregard territorial effects. The literature on risk regulation and sustainable development has underlined that policy choices require balancing economic objectives against social and environmental objectives. In the course of these negotiations, one can imagine many new regulatory regimes that are not unconditionally liberal, but that prioritise health objectives, social standards, or environmental goals without favouring any one of the existing regimes and without targeting territorial insiders specifically. Put differently, when the defence of territorial interests is not the ultimate factor in a political decision, it would be of little analytical value to speak of economic patriotism.

EP is nevertheless a very widespread phenomenon, endemic within interdependent markets and economic jurisdictions. Two further points help bring the distinction between EP and economic nationalism into sharper focus. First, EP, like economic nationalism, needs to be defined by its territorial references and its underlying conception of political-economic space, not by its supposed policy content. Although liberals have long used 'economic patriotism' as a term of abuse, equating it with protectionism, this obscures the importance and the multiple facets and forms of the contemporary phenomenon, varying widely across countries and regions. In particular, it does not allow for analyses of politicians' choice of liberal economic policies as a selective strategy to further territorial 'insider' interests.

Second, although economic nationalism is as old as nation-states themselves, we are currently observing some novel departures. Present-day EP is a response to the reconfiguration of economic governance and the interdependence of markets that only fully developed following increasing economic liberalisation in the wake of the breakdown of Bretton Woods, the deepening of European integration in the 1980s, and the fall of communism in 1989. The integration of markets and the concurrent weaving together of regulatory frameworks put pressure on advocates of national economic intervention to eschew old-style industrial policy (see Clift and Woll 2012a, pp. 312–14).

EP is conceived here as economic interventions which are intended to advance, by a number of means, the perceived economic self-interest of particular groups and actors (firms, workforces, or sectors) defined according to their territorial status. EP is always a feature of economic governance. Examples include inscribing 'domestic' process—or product standards into supranational regulation as templates, as in the case of post-crash liberal financial re-regulation, or liberal openings which welcome awards of foreign direct investment (FDI) as a deliberate 'industrial-policy' strategy for acquiring technological transfers from multinational corporations (MNCs).

EP is not just about shaping market outcomes, but also market structures, institutions, and processes. It can take multiple forms.

EP, as a framework, offers an analytical lens to study how policy-makers seek to resolve what we see as perennial tensions between interdependent economies and political territoriality, between the international, the national, and the subnational. The potential fruitfulness of this avenue of inquiry has been demonstrated by the Brexit campaign, the early period of Theresa May's new government, and the Trump victory. This is because an important backdrop to the economic-patriotism framework is that in a world characterised by an overlapping network of economic-governance regimes, politicians face the 'paradox of neo-liberal democracy' (an idea developed by Colin Crouch). The overlapping network of economic-governance regimes at the heart of an EP analytical approach means that politicians' 'political mandates are to pursue the political-economic interests of their citizenry under conditions of complex economic, legal and regulatory interdependence where large parts of economic governance are no longer exclusively within their control' (Clift and Woll 2012a).

The global financial crisis and banking and sovereign-debt crises in Europe have unleashed new forms of economic intervention, such as the construction of supranational banking resolution mechanisms in Europe. These may have revealed EP contradictions more vividly, but this is a universal phenomenon endemic within interdependent markets. The profound, if not self-evident, contradictions between international market integration and spatially limited political mandates are a permanent feature of contemporary capitalism. The Great Recession and the Eurozone crisis have brought these into sharp focus—underlying causes have roots that extend far beyond the Eurozone crisis.

Contemporary politicians such as Boris Johnson, Theresa May, and Donald Trump *never* acknowledge the inexorable constraints economic interdependence places on policy and action. Their pronouncements and programmes imply the possibility of 'taking back control' on a scale which is deeply unrealistic for *any* government. As the Brexit campaign proved for the UK, it is all but impossible in our current media and political environment to have a 'grown-up' debate about the complexities of achieving economic governance, acknowledging the role played by the European Union (EU) and other supranational bodies within national political economies. Assuming away these facts of twenty-first-century economic life is tremendously detrimental to the quality of political discourse. As this volume explores, this is very troubling. It will sow further disappointments amongst already-disaffected voters and citizens. This in turn will threaten the institutional edifices (such as the EU, WTO, and North American Free Trade Agreement (NAFTA)) which instil and protect a broadly liberal approach to international economic relations—and have done since Bretton Woods.

Any EP programme, whether protectionist or more liberal (and it is important not to conflate protectionism and economic patriotism) is built on a conception of who is 'in' and who is 'out'. EP entails the state's reinforcing and instantiating those divisions. It entails assumptions about who forms part of the community whose interests are being advanced and protected. The contemporary upheavals in Europe and the Middle East and Africa, and the ensuing migrant crises throw into sharp relief the issue of who remains 'inside' the moving definition of 'patrie'.

Euroscepticism, a consistent undercurrent of British politics (which has now, in part, led us to Brexit), is one response to the tensions of international market integration and spatially limited political mandates. In a troubling twist, an array of European political forces, from the Alternative für Deutschland (AfD), the French Front National, the Five Star Movement in Italy, Orbán in Hungary, and Kaczynski in Poland, to the UKIP and the Conservative Party in the UK, are seeking to 'resolve' these tensions in ways more directly tied to racist populism.

The discriminatory and indeed xenophobic elements of contemporary EP are becoming more pronounced, less apologetic, and less the stuff of dog-whistle politics. It is in this light that we should interpret the announcement by ministers at the 2016 Conservative Party conference that UK firms, universities, and schools will be required to supply lists of foreigners at their institutions. It provides a chilling example of the state's instantiating and reinforcing distinctions between those who are 'in' and those who are 'out'. Trump's campaign was similarly grounded in exploiting xenophobic resentments against immigrants, promising the construction of an 'impenetrable, physical, tall, powerful, beautiful southern border wall' to substantially limit immigration. Trump also promises to take back jobs that American firms have outsourced to Mexico and other emerging markets.

Failure by politicians to explain the limits of their control over economic policy and to acknowledge the contradictions and tensions between international market integration and spatially limited political mandates will sow further disappointment amongst already-disaffected voters and citizens. Brexiteers in the UK, populist European leaders, and Trump all fan the flames of popular discontent with established politics and economic policy.

Le Pen, Trump, and others talk in terms of EP, using it as a hotbed for the kinds of demagoguery and simplistic responses which fail to offer plausible or actionable 'solutions'. May, Trump, Johnson, and others seek to appeal to those 'left behind' by globalisation but risk letting them down once more. All these simplistic 'solutions' offer no real answers to a series of complex and perhaps intractable problems, including securing a country's economic future within these overlapping jurisdictions and international regulatory regimes. Populists ignore the realities of market-making, the density of international jurisprudence, the paradox of neo-liberal democracy, and the difficulties, indeed impossibility, of 'taking back control'.

The profound disjuncture between the promises which xenophobic populists politicians make in office about 'control' over the economy, and the much more complex realities of twenty-first-century interdependent economic governance poses an existential threat to the institutional edifices (EU/WTO) of a broadly liberal approach to international economic relations. The stakes are incredibly high. As Andrew Gamble recently noted, post-Brexit, post-Trump disaffections and destabilisations threaten 'to unravel the western economic and political order which has been the framework of world politics for the last seventy years'.

Economic Patriotism and the State in Contemporary Capitalism

How do ideas or EP impulses get reflected in policy regimes? Addressing this question requires two intellectual moves consistent with the EP analytical framework. Firstly, it requires understanding state-market relations as embedded in society, and recognition of the mutual constitution of states and markets. The conception of state-market relations underlying this analysis of EP is informed by Karl Polányi's work and economic sociology, both of which insist on the inescapably embedded nature of market activities (Polányi [1944] 2001; Block 2003; Block and Evans 2005).

Secondly, market relations need to be understood as always subject to the politics of market-making; that is, markets are political constructions (Clift 2014). This is because the idea of a tug of war between the 'state' on the one hand and the 'market' on the other is a very unhelpful way to conceptualise state-market relations in comparative political economy. It is more helpful to think in terms of the mutual constitution of the state and the market. The market is not conceivable outside the sphere of state activity. The state is circumscribed by the market power of large firms and varied forms of private market-based authority.

There is inevitably and always political intervention in and shaping of the operation of markets. Markets are *not* natural phenomena, but have to be politically constructed and politically maintained. Markets, in short, have to be made and this is a deeply political process. We need to understand political economy not just in terms of the operation of markets, or the reproduction of market relations, but also in terms of the politics of processes of market-making which always accompany such operations. The operation of markets does not take place separate from its societal, historical, and political context, and therefore market relations should be analysed as embedded in this context—as a set of *social* relations of production. Polányi's insight that liberal markets need constant state intervention entails a view of economic liberalism as coming in many variants.

In seeking to unearth and explain what *form* this multifaceted politics of market-making takes in any given setting, EP foregrounds an *embedded* understanding of state-market relations. This is why other great political economists such as Smith and Marx always referred to sets of social relations of production. In my last book (Clift 2014), I made a case for a comparative approach to political economy, alive to the embeddedness of market relations in ways which reclaimed the lineage of classical political economy (of Marx, Smith, List, Polányi, Weber, and others). Such a comparative approach to embedded market relations implies that economic liberalism is *not* a singular, monolithic political-economic tradition, but can take manifold forms. In each country, the complex of state-society relations develops a set of historically contingent societal negotiations of what kind of capitalism gets constructed and reproduced. These societal negotiations draw on distinct state traditions, from ordoliberalism in Germany, to *dirigisme* in France, to neo-liberalism in the UK.

The role of the state within *Varieties of Capitalism* and comparative-capitalisms analysis has rightly become a major focus for recent scholarship, as well as the conference on which this volume is based. This important work is updating a first wave which was all but silent on the state as an actor. Our account of EP entails a more encompassing vision of state action and activism than the governmental defence of institutional comparative advantage suggested, *sotto voce*, in Hall and Soskice (2001). EP offers a conception of market relations as always subject to political acts of market-making and market-shaping, and of states as primary authors of interventionism—a more state-centric account of socio-economic governance (Clift and Woll 2012a, b).

If we think of markets as embedded in a societal context, then their governance will always reflect power struggles between competing groups. EP is helpful in bringing the state back in a way which foregrounds the politicisation of economic policy and practices. States themselves should enter our research designs as *independent* variables, enjoying a degree of 'relative autonomy' from their social and economic contexts. State actors (interacting with the private sector) mediate external factors and shape capitalist change. This is an important counter to functionalist views of 'natural' adjustment to economic fundamentals by a pliant state.

Capitalism rests upon sustained, extensive, and politically contested legal and legislative interventionism in economic activity by the 'liberal state' (Polányi 2001, pp. 79–80; pp. 136–9). As Polányi noted of the nineteenth-century expansion of capitalist social relations of production, 'Laissez-faire itself was enforced by the state … an outburst of legislation repealing restrictive regulations, … an enormous increase in the administrative functions of the state' (Polányi 2001, p. 145).

Deregulation, of course, involves not simply removing restrictions but active *re*-regulation: the new regulatory frameworks differ between countries, regions, and sectors in ways that are designed to promote particular outcomes. As Vogel (1996) put it, 'Freer markets, more rules'. This insight was also central to Friedrich List's analysis—political intervention and the shaping of market outcomes are inextricable parts of capitalism, even liberal capitalism. For List, 'free trade' is never really free: it is 'folly to speak of unrestricted competition between individuals of different nations' (List [1841] 1856, p. 261). The need for re-regulation gives politicians the means to continue influencing the economy in pursuit of territorially beneficial outcomes. Differing varieties or models of capitalism—whether they are neo-liberal, *dirigiste,* ordoliberal, or indeed illiberal—are manifestations or instantiations of different societal negotiations of these issues (Tables 2.1 and 2.2).

EP notes how regulation can take different forms. It may enshrine traditional product- and process-standards, thus favouring insiders already acquainted with the system (Q3). Licensing procedures, the recognition of professional qualifications, and the German '*Meister*' system are all examples of that. This is not explicit discrimination against foreigners, but rather a defence of national quality standards which are difficult for outside producers or foreign service providers to meet. Helleiner (2014, p. 111) makes a similar claim about international re-regulation of global

Table 2.1 Forms of economic patriotism

	Liberal economic patriotism	*Conservative economic patriotism*
Supranational economic patriotism	Strategic regional integration	Defensive regionalism
Economic nationalism	Liberal economic nationalism	Classic protectionism
Local economic patriotism	Liberal policies that facilitate the creation of sub-national champions	Defence of local production

Table 2.2 Classifying the policy content of economic patriotism

		Ideological affinity	
		Liberal	*Protectionist*
Policy target	Favouring of insiders	Q1 e.g. selective liberalization in strategic sectors	Q3 e.g. regulation to maintain traditional product- and process-standards; state subsidies
	Resistance to outsiders	Q2 e.g. risk regulation or competition rules that prohibit standards which are common abroad	Q4 e.g. classic barriers to trade

Source: Clift and Woll (2012a)

finance since the global financial crisis, with the US as first movers, introducing standards which acted as focal points for international standard-setting. The US template and standards for OTC derivatives and hedge funds have become benchmarks for international standards.

Another type of regulation is not designed to favour insiders, but prohibits product- and process-standards which are common abroad (Q2); this constitutes another form of economic-patriotic intervention. Is it protectionism to refuse textiles produced with child labour, when the countries affected by such a decision can be clearly identified? Can the EU's 'precautionary principle' for food standards and norms prohibit hormone-treated beef, even though almost all US beef is targeted by such decisions? The struggle over the 'right kind of regulation' needs to be understood as the result of the need to provide political answers to citizens' concerns despite ambitions to facilitate economic integration—that is, against the backdrop of the paradox of neo-liberal democracy. This is where the new politics of industrial policy plays out—a crucial terrain of EP, hinging (as noted above) on who is 'in' and who is 'out'.

Conclusion: The Political-Economic Debate of Our Age

EP as an analytical approach is necessary for an adequate understanding of the dialectic between the politics of liberalisation and the regulatory, legal, and political processes of market-shaping intervention in open economies. What kinds of political interventionism and what kinds of markets are to be supported, tolerated, and encouraged, and which forms are to be proscribed? EP provides a compelling lens through which to explore this. Is market-making becoming more liberal? More discriminatory? Or clientelistic? Is it degenerating into oligopoly, propping up lame ducks and leading to ever-greater aggregations economic and political power?

Analysing EP facilitates the study of the multiplicity of solutions enacted for governing the economy. Different kinds of market-making and market-shaping interventions inscribe local and regional standards into complex webs of international agreements to advantage particular (territorially defined) groups and producers. Within the general move towards market-based solutions and amidst an increasing density of transnational jurisprudence to maintain open markets, the questions for governments everywhere are *what kind* of economic liberalism to espouse in order to defend local economic interests in interconnected markets and what kind of state action or activism is needed to achieve it.

EP helps us conceive of the terrain as political choices between a more differentiated range of possible paths of adaptation, each orchestrated to a significant degree by governmental action. The dichotomous opposition between open and closed markets maps very poorly onto a much more complex and differentiated political-economic reality (see our four quadrants). The politics of present-day economic regulation and market-making reveals a great variety of instruments and adaptation strategies, within a regulatory scheme for economic activity which is deeply internationally intertwined. Differing views about the desirable distribution of the fruits of growth within firms and across society (who's 'in' and who's 'out'?) generate ongoing political struggles over how to regulate capitalism. Meanwhile, political discourse assumes away that intricate web of economic interdependence that puts enormous pressure on policy-makers.

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CHAPTER 3

Liberal Versus Organised Capitalism: A Historical-Comparative Perspective

Andreas Nölke and Christian May

In this article, we have developed a research programme for the historical comparison of different stages of capitalism. The foundation of this programme is a juxtaposition of the liberal and organised phases of capitalism. Departing from historically comparative theories of capitalism (such as world-systems theory, regulation theory, and the social-structures-of-accumulation approach), we have sketched a model that draws in particular on a Polanyian approach to capitalist dynamics and theories of organised capitalism. We validate this model by discussing the current crisis of liberal financialised capitalism and by using the contemporary economic model of state capitalism in large emerging economies as a symbol for a new stage of organised capitalism. This model allows us to provide proper context for a number of contemporary developments, such as the emergence of

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economic patriotism in Western capitalism, state-capitalist economic systems in Eastern Europe, growing concerns about corruption, opposition to supranational liberal institutions such as the EU, and the rise of state-permeated capitalism in emerging markets.

Introduction

Since 2007, we have witnessed a series of intense economic crises that can be compared only to the global economic crisis of the late 1920s and early 1930s. In contrast to phases of economic stability, such phases of crisis invite us to think more fundamentally about capitalism, as did the—somewhat smaller—crisis of the late 1960s and early 1970s. Particularly, the real (and supposed) outcomes of the two more recent major economic crises and the changes of capitalism after the global economic crisis of the interwar period lead us to the question whether we are currently observing a similar major turning point in the history of capitalism. Moreover, it raises questions about the future direction of capitalism (Hall 2013). Although it will take years (or decades) to formulate definitive answers to these questions, we should nevertheless try to move beyond pure speculation or general remarks about the contingency of capitalist development.

We depart from the customary range of research programmes which investigate the long-term historical development of capitalism. We are less interested in the general development of all capitalist formations (Streeck 2011) than in the differentiation of specific historical phases of capitalist development. These types of research programmes offer us important methods for identifying a historical change of tides, for identifying a stable phase of capitalism, and judging whether we observe a more or less linear series of phases in a certain direction (as suggested by Marx and other critical economists), an oscillating pendulum between two poles (as described by Polányi), or a combination of both: a long-term development in the form of pendulum-swings or cycles as postulated in the versions of world-systems theory developed by Arrighi (1994, 2008) or Wallerstein (2000). Subsequently, we will develop a hypothesis in order to illustrate what a contemporary research programme which compares historical phases of capitalism might look like. Reorienting the institutionalist comparative-capitalism research programme (which has dominated comparative political economy in recent decades) towards an intertemporal dimension will open up a broad spectrum of potential research questions and theoretical frames of reference.

Our point of departure is a popular diagnosis of current developments in and of capitalism that will be enriched by theoretical abstractions, which will allow us to arrive at a more systematic and specific prognosis. This diagnosis assumes that the current period of crisis is an indication of the end of a particular period of capitalism. This period of capitalism started during the crisis of the 1970s and is usually labelled *neoliberal* or *financialised*. This neoliberal epoch of capitalism—which has lasted three or four decades—followed a period of three decades which is usually referred to as Keynesian or Fordist. The latter period of capitalism, in turn, emerged after the crisis of the late 1920s (Table 3.1).

The periodisation of past historical trajectories is rather easy. Forecasts, however, are difficult, and, thus, it is less clear what the next phase of capitalism will look like. Since the global financial crisis, we have seen the emergence of a rather optimistic prognosis, frequently based on Keynesian ideas, which assumes that the next period of capitalism will be characterised by less inequality and an increasing de-commodification of society (e.g., Wade 2008; Caporaso and Tarrow 2009; Hall 2013).[1] We do agree that we can see the beginning of a "Polanyian pendulum" swing away from a particular liberal form of capitalism. However, we disagree about the essence of this new form of capitalism and with this diagnosis of the current state of capitalism. As for the former, Western capitalism is currently in the process of financialisation, which, despite the optimists' diagnosis, is still ongoing and has not been affected by the current re-regulation of financial markets. A high degree of financialisation (understood as the dominance of short-term financial profit over other sections of the economy), as other types of extremely liberal capitalism show, is inherently instable and will sooner or later lead to another deep economic, political, and societal crisis. Moreover, we are also less optimistic with regard to the substance of the next developmental phase of capitalism. We do expect a process of re-embedding of capitalism in social relations and a turn away from the liberal capitalism of recent decades. At the same time, we think that the next phase of capitalism will be marked by hierarchies and

Table 3.1 Different periods of capitalist development in the twentieth century

1900s–1920s	Progressive era
1930s–1960s	Fordism
1970s–2000s	Financialisation/Neoliberalism

inequalities of the sort that have developed in the large emerging economies of India and China, and by the neo-protectionism that has developed in the West.

In order to support this hypothesis, we will first present a number of theoretical options for historical comparative-capitalism studies, before developing our own model. In order to provide our model with at least preliminary empirical support, we will then discuss current tendencies which typify crises of financialisation and their possible connection to the next phase of capitalism, as suggested by the current economic model in large emerging markets.[2] The latter juxtaposition will also help us make sense of current tensions between market-liberalism and economic patriotism in capitalist systems.

Theories of Intertemporal Comparison of Capitalisms

In the wake of the rise of comparative capitalism in political economy (e.g., Hall and Soskice 2001; Nölke and Vliegenthart 2009), many of the theoretical traditions which engage in historical comparisons of capitalisms have been relegated to the background. We suggest revising the temporal analysis of capitalism by building upon previous theoretical achievements which highlight the historical variation within capitalism even if—as will be demonstrated subsequently—none of them fully satisfies our requirements. In particular, we would stress the importance of a periodisation of capitalism which not only analyses current and historical developments, but also predicts future developmental phases. Furthermore, given the observations discussed above, we prefer theories that highlight historically open cycles, as opposed to theories which assume a strictly linear logic of development, such as orthodox Marxism or classical economic-modernisation theory. Finally, we want to engage with theories that focus on politico-economic cycles or phases, including those which focus primarily on political developments, such as theories of hegemonic stability in international relations (Modelski 1987), or theories such as Kondratieff's (1926), which focus solely on economic cycles, or the theory of "long waves" (Mandel 1980).

An obvious candidate for historical developments of capitalism is world-systems theory. The most well-known version of this theory, developed by Wallerstein, incorporates not only spatial but also temporal elements, particularly secular elements (such as commodification) including cycles (e.g., Kondratieff-waves) and crises which lead to transformations into other types of world-systems. Wallerstein even predicts that the current world-system will reach a final crisis by the mid-twenty-first century, but cannot make precise predictions about the specific shape of the future system (Wallerstein 2000, pp. 435–453). For our purposes, the version of world-systems theory developed by Giovanni Arrighi (1994, 2008), which is based on cycles of political-economic hegemony, is particularly interesting. Arrighi assumes that hegemonic downturns are always characterised by a financialisation of the world economy. Currently, this is the case for the hegemonic transition from the US to China. Even if China is hardly to be expected to become a global hegemon in near future, we still think that the ideas of repeating—but always specific—cycles of capitalism (with rises and crises), the combination of financialisation and hegemonic downturns, and the search for the core of the next developmental phase of capitalism outside of the West are very interesting.

Another obvious theoretical option for intertemporal comparisons of capitalism is regulation theory. As in the contemporary debate, this research programme took a real crisis (the growth crisis of the 1970s) as a point of departure for reconsidering the general nature of capitalism. Its underlying assumption was the Marxist notion that capital accumulation inherently produces tendencies and contradictions which could potentially undermine the conditions of its own continued existence. Given this basic fragility, the theoreticians of this school wondered why crises were not the rule for this system, but rather the exception (Boyer 1990, p. 35). The answer they gave—even as early as the 1980s—was that capitalist economies are institutionally embedded and that these institutions are not subject to the logic of pure accumulation. More specifically, economies are stabilised by five institutional means: the regulation of money, labour, and competition, which are complemented by the form of the state and the international embeddedness of the economic system (Boyer 1990, pp. 34–37; Boyer and Saillard 2002). A periodisation of types of capitalism can be established along these lines, as different capitalisms exhibit different combinations of—and hierarchies among—these institutional forms. The most impressive achievement of regulation theory has been the identification of a Fordist variety of capitalism, whereas the identification of the nature of post-Fordism remains somewhat vague, although financialisation is one of its major characteristics (Aglietta 2000; Jessop and Sum 2006). Still, we find this theoretical programme useful because it explains the existence of capitalist formations by referring to the stability of their institutional configurations, not only by referring to the existence of political hegemonies, as do the hegemonic-stability theories in the field of international relations. If the mode of regulation, that is, the ensemble of institutions that support capital accumulation, is relatively coherent, even fragile forms of accumulation—such as the current form of financialisation—can be stabilised over longer periods of time.

A school of intertemporal comparison of capitalism which is similar to regulation theory but less known is the social-structures-of-accumulation approach (SSA). This body of thought was also developed towards the end of the 1970s and is grounded in reflections on the long boom period after the Second World War. According to this theory, the establishment of a new SSA is equivalent to the beginning of a new phase of capitalism, whereas the implosion of its institutions marks its end (McDonough 2013, p. 215). The main differences between the SSA approach and regulation theory are: (1) their theoretical origins—regulation theory has been based on Marxian categories, whereas SSA tends to follow Keynesian analyses; (2) their assumptions about the end of a phase of capitalism—regulation theory assumes that the end of a phase is rooted in a crisis of the accumulation regime, whereas SSA identifies the end of a phase with a crisis of the corresponding institutions; and (3) regulation theory's stronger focus on capitalist structures, as opposed to SSA theory's focus on actors (Kotz 1994). However, these differences have since been reduced by further developments in both approaches (McDonough 2013, pp. 217–219). Importantly, the SSA approach assumes that liberal and regulated phases succeed each other and that this succession is mediated by specific crises which are inherent in each phase. A liberal SSA will lead to an under-consumption crisis because of capital's ability to rule over labour. This will reduce the wage share in the economy and subsequently lead to insufficient demand. These liberal crises are usually remedied through a strengthening of labour, limits on the distribution of income, and a regulation of demand and finance—and, therefore, lead to the foundation of a regulated SSA. A regulated SSA, in turn, is sensitive to profit-squeeze crises, which are the result of increasing wages and the demand for state protection. They are usually overcome by the strengthening of capital in relation to labour and by the promotion of deregulation, thus by the creation of a liberal SSA (McDonough 2013, pp. 220–221). Even if the model currently under discussion seems quite daunting and the types of crises inherent in it are latent and contingent, the juxtaposition of liberal and regulated phases of capitalism seems to be quite helpful for our purposes because it predicts a crisis of the current liberal form of capitalism and the emergence of a regulated form.

The notion of Fordism, which is essential to regulation theory, was established by Antonio Gramsci (1999) for his analysis of the new capitalism of the early 1930s. Gramsci pointed out not only the changing societal fundamentals that were necessary for the realisation of Fordist mass production, but also the novel quality of this phase of economic development. The changing relationship between society, state, and capital has since been taken up by neo-Gramscian theorists and been partly combined with regulationist categories (Bieling 2013). The Amsterdam School of neo-Gramscianism, in particular, has tried to identify hegemonic cycles within capitalism—focusing less on the systematic strengths or weaknesses of a mode of production and more on the struggles between different fractions of capital (Overbeek and van der Pijl 1993). Phases of capitalism, therefore, have to be linked to dominant fractions of capital (e.g., productive or financial capital) and their hegemonic concepts, that is, capitalist "philosophies" (Overbeek 2008, p. 197). Sequences of different types of capitalism are a consequence of power struggles within the capital class, where the winning fraction is able to implement the conditions that are most favourable to its accumulation interests. In this context, crises are auspicious moments only for the disadvantaged class fraction(s) which become active in re-modelling capitalism according to their own interests. While the theories discussed above may tend to neglect the political significance of societal conflicts, the (later) Amsterdam School tends to neglect the economic mechanisms and logic of capitalism. From the perspective of the Amsterdam School, different types of states and societies are more important than the institutions of capitalism.

An important theoretical account that can provide us with some indications for the future development of capitalism is the historical analysis by Karl Polányi (1977, 1978). The Polanyian idea that capitalism is not only an economic system but also a societal formation, however, has only been developed to a limited degree. Most studies are limited to a recapitulation of Polányi's theses about the embeddedness of markets and the pendulum swings of the "double movement" (Beckert 1996, 2007; Krippner 2001; Ruggie 1982). These mechanisms are helpful as heuristic devices, but need to be elucidated further in order to understand current developments in capitalism. For one thing, the concept of "embeddedness" has become so general as to have hardly any analytical substance left; for another, we need to specify which forces are actually driving the pendulum mechanism. For Polányi, these forces were not simply powerful political groups, but rather a dynamic feature of all political economies; he conceived of the pendulum swing towards embeddedness as an expression of societal self-protection. Polányi followed Tönnies in his understanding of "society" as local or national communities, which becomes problematic as modern capitalism is organised transnationally and thus transcends these communities. Even so, this does not mean that capitalism will automatically be transnationally organised forever, as will be demonstrated below. Furthermore, Polányi could still assume that fundamental crises are singular phenomena. And although they are implicit in this Polanyian concept, repeated or cyclical crises have not been sufficiently accounted for in the development of the pendulum-swing mechanism. Both elements, however, point towards the importance of capitalist *Vergesellschaftung* (socialisation) for the intertemporal analyses of capitalism that are neglected by both regulatory and hegemonist approaches. Polányi distinguished the market, redistribution, and reciprocity as three fundamental but different modes of economic integration (1977); this distinction was originally part of a comparison between capitalist and non-capitalist societies, but can be used to distinguish capitalist phases as well. From our perspective, only liberal capitalism is characterised by comprehensive dominance through the market—whereas, for example, redistribution played a prominent role in Western post-war capitalism, reciprocity played an important role in many formations of non-Western capitalism.

Classical theories of organised capitalism (Hilferding 1910; Naphtali 1928; Pollock 1933; Sombart 1932) developed a distinction between organised and liberal (or disorganised) capitalism at an early stage and emphasised the existence of repeated phases of liberal and organised capitalism in the early twentieth century (Offe 1985; Lash and Urry 1987). Martin Höpner (2007) engaged with these theories for the purpose of analysing modern capitalism—without, however, utilising them for empirical studies.[3] For Höpner, the crucial distinction lies in the extent to which the economic interests of companies are dominated by collective interests beyond these companies: "On the one end of the spectrum, firms are the private business of the owners and insiders. On the other, they are quasi-public infrastructures and, therefore, constrained in their economic decisions by institutionally sanctioned collective interests" (ibid., pp. 6–7). According to Höpner, it does not matter whether the observance of these collective interests is motivated voluntarily or by force. Moreover, we can imagine very different incorporations of this collective interest, which could include the class interest of employers, networks of managers, or sector interests; they could also be established on regional or transnational levels. In any case, it is crucial for organised capitalism that company resources be used for purposes that defy the narrow perspective of a single company. This also implies that organised capitalism—in contrast to the later idealisation of the term by which organised capitalism has been implicitly equated with corporatist capitalism—is not necessarily associated with social embeddedness as highlighted by Polányi. The higher purpose of organised capitalism can also be class warfare, as evidenced by the anti-labour policies of the late Weimar Republic.

All of these theoretical approaches point towards (a) a cyclical tendency of political economies to change their structural or institutional forms and (b) a (not sufficiently specified) mechanism which drives such changes. By this, theoreticians assume that these large-scale changes are driven predominantly by endogenous dynamics which stem from the nature of capitalist development and not by exogenous shocks and ruptures. As these approaches to the long-term development of capitalism share roughly similar traits and objectives, we can—for now—make a selection which combines elements of all these theories in an eclectic manner so as to develop a heuristic model which will guide our empirical analysis. Using the research programme of critical institutionalism (May and Nölke 2015) as our basis, we will assemble a theoretical framework based on a Polanyian pendulum mechanism combined with aspects of theories of organised capitalism, the SSA approach, world-systems theory, regulation theory, and neo-Gramscian theories.

Polányi's Pendulum and Theories of Organised Capitalism: A Phase Model

Modern capitalism oscillates between liberal and organised phases. Following Höpner (2007), we refer to an "organised" type of capitalism in which the decisions of individual companies are frequently motivated by some kind of higher purpose. "Liberal" (or disorganised) phases are those in which actors can freely follow their individual capitalist rationales. Actors which have historically placed strict limits on the rationales of individual companies in the context of capitalist systems include central state authorities (e.g., the early developmental states of Japan and South Korea), but also the German system of financial capital, in which German companies such as Allianz, Commerzbank, and Deutsche Bank allowed limited competition between production-sector companies by supporting the organisation of cartels (Höpner 2007, p. 17).

While Höpner uses the concept of organised capitalism only for empirical studies of individual countries, we consider it applicable to the developmental phases of capitalism as a whole, given that it allows for an extrapolation of historical dynamics. One then has to look at those world regions which are paradigmatic for a specific developmental phase of capitalism. Until the First World War, these paradigmatic regions were England and the US, with Germany and Japan added at a later stage. In the next developmental phase of capitalism, we expect large emerging markets like China and India to be able to put their imprint on the global development of capitalism. We therefore depart from the idea that there is "one single world capitalism," which is often analytically conflated with capitalism in the developed world of Organisation for Economic Co-operation and Development (OECD) countries. Thus, a simplified distinction between liberal and organised phases of capitalism does not relate to all capitalist economies at the same time. Individual economies can also omit developmental phases—for instance, economies which are in the process of late industrialisation. These economies may 'miss' phases because successful late industrialisation usually implies a strong degree of organised capitalism. This category also includes economies of the periphery that are only loosely integrated into global capitalism. Likewise, the juxtaposition of liberal and organised phases does not mean that these phases are particularly similar—history does not repeat itself in an identical fashion. Similarly, the expectation that one obvious consequence of the current crisis of liberal financialised capitalism would be a return to Keynesian ideas (e.g., Blyth 2013, footnote 14) is not particularly imaginative. Finally, clearly distinguishing these phases does not imply that they occur in discrete periods; a new phase of capitalism will usually develop before the end of the preceding phase.

From this perspective, the period before the Great Depression (in particular the Roaring Twenties) and the era of financialisation (1980s–2010s) can be identified as liberal phases of capitalism; organised periods include the age of Fordism (1930s–1960s) and—according to our hypothesis—the future phase of capitalism that will become dominant after the expected crisis of financialisation. Phases of capitalism may vary considerably by country, as was the case with the German, Italian, and Japanese war economies and the US New Deal of the 1930s. We are also investigating the possibility of identifying additional phases of capitalism in the leading economies of the late nineteenth and early twentieth centuries—the UK and the US—by juxtaposing early laissez-faire capitalism with the later

Gilded Age dominated by trusts, for example. Of course, similarities between processes of liberalisation (or organisation) in different fields of economic life could also be purely coincidental. However, such coincidences would be miraculous. More plausible is the common logic of parallel empirical developments such as the liberalisation of employment protection, of health support, and of capital markets. At this stage, the logic of the phase models of capitalist development in general and of Polányi's pendulum in particular come into play. From this perspective, liberal capitalism is particularly unstable and periodically leads to deep societal, political, and economic crises. To put it simply, these deep crises lead to the mobilisation of societal opposition to liberal capitalism, as was the case after the enormous economic crisis of 1929. Subsequently, forms of organised capitalism emerged (Table 3.2).

Organised capitalism can also take very different forms. As highlighted above, this includes the socially "embedded" form of the New Deal, but also the Fascist economic organisation of Germany, Italy, and Japan, to name only those which sparked the formulation of Polányi's theses. This means that the next phase of capitalism will be an organised, but not necessarily a social, one. We therefore do not agree that the opposite of liberal capitalism is a socially reformed (somewhat "good") form of capitalism. Although the previous phase of organised capitalism (Fordism) was strongly embedded in a way that corresponded to the need for social reproduction (e.g., through the function of mass consumption), this is not a necessary condition of organised capitalism. Polányi himself formulated his 1944 theory against the backdrop of the rise of fascism (Höpner and Schäfer 2010, p. 8) and identified both the rise of fascism and the rise of Russian socialism as direct reactions to the "impasse of liberal capitalism" (Polányi 1977, p. 314).

According to Polányi, however, a successful alternative to liberal capitalism will undermine the efficient provision of consumer goods in the long run (1978, p. 307), and will therefore make liberal models increasingly attractive. We find this particular movement from organised to lib-

Table 3.2 Periods of capitalist development and their crises

Liberal	Progressive era	Ended by the great depression
Organised	Fordism	Ended by the stagnation crisis of the 1970s
Liberal	Neoliberalism	Ended by the subprime/financial crisis?
Organised	???	

eral phases of capitalism not only in Polányi but also in world-systems theory, SSA approaches, and other Marxist-influenced theories related to the long-term logic of commodification. Capitalist actors—after a period of re-embedding of organised capitalism—will try to reimpose their capitalist logic without major constraint. Constraints on capitalist rationality are perceived—and not only by companies—as detrimental to efficiency and should thus be gradually removed. Economic crises also play a role in changes from organised to liberal capitalism. However, they are generally not as severe as crises which mark the ends of liberal phases of capitalism. They tend to take the form of a long phase of stagnation in which liberal ideas regarding economic reforms regain more and more support in public discourse.

This reference to societal conflict suggests that the swinging of Polányi's pendulum does not proceed automatically or smoothly, but is accompanied by massive sociopolitical conflicts (Beckert 2007, p. 17; Höpner and Schäfer 2010, p. 7). Such conflicts are often studied by neo-Gramscian theorists who highlight not only rival social groups' competitions over resources, but also their contests over interpretations and hegemonic concepts. These battles are waged not only between capital and labour, but also between different fractions of capital such as trade, industry, and finance—as well as fractions of capital with national or international orientations (Overbeek 2004). Even so, struggles over the future shape of capitalism are not the only factors which will determine the actual form of capitalism to come. Thus, we should not overestimate the coherence and the radical character of the change from one phase of capitalism to the next. Social forces are not always able to impose their visions upon other groups; they generally require some kind of compromise, either in the form of explicit consent (as in the New Deal) or by way of a hegemonic incorporation of competing interests. Furthermore, unintended consequences may play an even more prominent role (Krippner 2011; Nölke et al. 2013).

So far, we have developed our model under the implicit assumption that there exist national societies without external restrictions. However, this has been an illusion for several decades. In addition to transnational activities in trade and investment, there are also international institutions (regimes and organisations) which support specific phases of capitalism (Murphy 1994). For instance, the Bretton Woods system was essential for safeguarding organised capitalism in the post-war period (Ruggie 1982). Likewise, institutions such as the Basel Accords and the standards developed by the

International Accounting Standards Board are important ingredients of the new liberal constitutionalism (Gill 1998) in the current phase of financialisation. Such liberal institutions have become particularly powerful on the level of the EU as liberal principles have gained supranational legislative status. As a consequence, the fault line between national and transnational forces of capitalism becomes a further determinant for a swing of the pendulum towards organised capitalism.

In the following section, we will show how the heuristics developed above can be used to stimulate empirical research programmes. We will focus on two aspects of contemporary capitalism which are likely to determine the shape of things to come: the probability of a deep crisis of the current liberal model of financialised capitalism and the rise of state-permeated capitalism in the large emerging economies.

The Crisis of the Liberal Phase of Capitalism and the Nucleus of a New Organised Phase of Capitalism

Like earlier phases of markedly liberal capitalism, the current phase of financialised capitalism is particularly prone to intense and sudden crises. This tendency became more than obvious during the subprime financial crisis between 2007 and 2009. Even if the specific causation of this crisis—like other major financial crises'—cannot be explained only by high-level theoretical abstractions, it seems clear that the structural process of financialisation was a crucial constituent of this crisis. The relevant factors include the inherent tendency of financial markets to produce phases of boom and bust, the tendency of highly interconnected financial markets to export a crisis rapidly from one world region to another, and the need to rescue too-big-to-fail financial actors with taxpayers' money (Heires and Nölke 2011).

As a consequence of this financial crisis, Western governments have implemented a number of measures which regulate financial markets much more thoroughly (Mayntz 2012). These alterations, inter alia, comprised increased capital-adequacy requirements for banks, greater transparency for the activities of hedge funds, private equity, and rating agencies, and more vigilant monitoring of derivatives trading. None of these measures, however, has been able to reverse or even reduce the process of financialisation or to minimise the corresponding risks to economic stability. Many long-standing observers of financial markets are highly sceptical about these current regulatory measures and their effectiveness in ensuring future financial stability (Haldane 2013; Helleiner 2014; Moschella and Tsingou 2013). A large share of financial-market transactions is still conducted in the shadow-banking sector, without any substantial regulation. Similarly, the highly problematic level of concentration in the financial sector (which has resulted in too-big-to-fail institutions) has not been reduced, while the strongly transnational nature of the interactions in this sector continues to make it a fertile ground for rapidly spreading crises. In contrast, measures that could reduce the amount of financialisation—such as capital controls; the introduction of comprehensive financial-transaction taxes; the interdiction of many types of derivatives, hedge funds, and other shadow banks; and the de-concentration of large banks—have not been pursued and will not be pursued in the foreseeable future. Given the high level of interconnectedness between political decision-makers and representatives of the financial sector, the prospect of strong re-regulation measures continues to be unrealistic. Moreover, the Eurozone crisis continues to threaten the stability of Europe's financial systems. In contrast to the situation before the last financial crisis, both governments and private households are heavily indebted, which will inhibit the quick mobilisation of large rescue packages in the event of another financial crisis. We can thus assume that the next financial crisis (and there is one coming; that much is certain) will have much more severe repercussions than the last one. We may also assume that another major economic crisis will lead to the comprehensive de-legitimisation of liberal modes of capitalism. Alternative models of capitalism, particularly if those models have proven to be viable in other regions or time periods, will become more plausible. From the perspective highlighted above, the most likely candidate for the next organised phase of capitalism will be based on the model of state capitalism in large emerging economies—the only regions where economic growth actually took place during the last two decades.

In the global South, the nucleus for a new phase of organised capitalism is forming. What we call "state-permeated capitalism" in large emerging markets such as China and India is a decidedly non-liberal type of capitalism where markets play a much smaller role in the coordination of economic activity and where a strong domestic orientation of business and policy-makers prevails; the same applies to a more limited degree to Brazil during the Lula/Dilma presidencies and to Iran (see the chapters by Judit Ricz and by Erzsébet N. Rósza and Tamás Szigetvári in this volume).

Finance capital represents only a tiny fraction of the overall accumulation process, and, as a consequence, state-permeated capitalism is much less sensitive to fluctuations on global capital markets even if it is not completely isolated from global economic developments. During the current crisis, the periphery of the global economy has been much less affected than its traditional centre, in marked contrast to the crises of 1929 and 1973. We would even argue that today we cannot distinguish between the periphery and the centre of the global economy in this manner anymore, given the substantially increased weight of the large emerging economies in global capitalism.

Our research (Nölke et al. 2015) has highlighted a coherent institutional framework for state capitalism in large emerging economies. However, in contrast to the second wave of state capitalism after the global economic crisis of the 1930s (the first wave of state capitalism having taken place during the nineteenth century), this form of state capitalism is not dominated by a centralised, hierarchical developmental state but rather steered by a number of coalitions of state and economic actors. This arrangement is, inter alia, a consequence of the weakness of the central state in these large emerging economies and of the relatively substantial leeway that local and regional authorities have in the local political economy. However, the absence of a strong centralised state does not mean that this type of capitalism is automatically liberal. In contrast, this nascent phase of capitalism will also depend on the organising function of personal relationships based on reciprocity within and between the economy and state institutions (May 2013). As Polányi (1977) framed it, reciprocity is a means of coordinating economic activity which is fundamentally different from the market (predominant in liberal capitalism) and from redistribution (predominant in households, communism, and social-democratic "embedded" capitalism).

In contrast to other neo-Polanyian perspectives, our view of the future development of capitalism does not emphasise the idea of a social democracy with high taxes, full employment, and strong labour unions, but instead assumes the rise of a politically particular capitalist oligarchy marked by social inequality. We do find that the typical prerogative of organised capitalism—the subordination of the profit-seeking activities of individual companies to a collective purpose—guides economic activities in countries such as China and India where actors are always compelled to follow the overarching target of a general national-development strategy. However, the focus of this form of re-embedding is a state-driven countermovement against the previous domination of the global economy by Western financial markets and multinational companies. The large emerging economies thus hope to avoid the fate of the Central European-dependent market economies (Nölke and Vliegenthart 2009; see also the contributions which Péter Mihályi and Iván Szelényi, Jan Drahokoupil and Agnieszka Piasna, Márton Varju and Mónika Papp, and Miklós Szanyi have made to this volume). It does not take much imagination to interpret the form of Southern state capitalism as a direct countermovement against liberal capitalism.

This countermovement is not limited to the southern hemisphere. The rise of economic patriotism (see Ben Clift and Miklós Somai's contributions to this volume), the growth of right-wing populism across Europe, the Brexit vote, and Donald Trump's victory in the US all indicate the growing de-legitimisation of liberal capitalism even in its heartlands. Of course, none of these countermovements offer a coherent blueprint for the organised capitalism at hand. However, the fact that all of them explicitly refer to economic conditions suggests that a re-modelling of capitalism is on the agenda (Nölke 2017). This is perhaps most explicitly formulated in Trump's economic policies, which centre on a de-coupling from global capitalism and a return to a national economy (as unrealistic as this might be). If this is not indicative of the urge for the "self-protection of society" (Polányi 1978), what else might it be?

Our concern—that the next form of organised capitalism (which appears to be gaining popularity in the former heartlands of liberalism) will be more nasty than progressive—seems to be justified. Organised capitalism is collectivist in nature; however (unfortunately), it is not based on mutual solidarity, but rather on national and particularistic ideas. It is no wonder that over the past 30 years the hegemony of liberalism—with the associated ideas of individualism, non-solidarity, competitiveness, and ruthless political pragmatism—has produced an intellectual and political vacuum in which no progressive ideas or blueprints have served as the basis for any viable political movements. Intellectuals and the well-educated tend to despise the ideas behind "populist" movements, but often forget that the social forces which are usually responsible for formulating progressive ideas, blueprints, and policies (intellectuals, the left, green, and social-democratic parties, etc.) have blatantly failed to do so. They have blown into the horns of (neo-)liberalism rather than producing alternative projects based on material social equity. While they withdrew into the urban leftist niche which cherishes cosmopolitanism, identity politics, and human rights, the real incomes of the lower and middle classes shrank significantly. That they are appalled by what they now denounce as "populism" is at the very least indicative of a broader class struggle of the middle against the lower classes. Faced with an ever-shrinking share of material wealth, the middle classes (no matter their political orientation) oppose a fairer redistribution of social welfare simply because they assume that their fears of socio-economic descent are more important than the further impoverishment of the lower classes. The way in which the "established" made fun of supporters of European populists—as well as Brexiteers and Trump's followers—as dumb and primitive reveals the disgust with which the liberal establishment regards the lower classes.

However, the simple realisation that the elites "up there" (whether this means the transnational policy elites of the EU and the US or the national political elites in Washington and London) are ignorant of the needs and hardships of the masses "down here" (whether these are the bulk of developing countries or the bulk of the marginalised middle class and underclass in advanced economies) unmasks the neoliberal ideology of universal values and world society. Obviously, it depends on the strength and organisational capacity of the relevant politico-economic groups such as fractions of capital, labour unions and state bureaucracies when and whether an organised form of capitalism will materialise. Polányi's *Great Transformation* mentions numerous examples of collectivist, non-liberal projects which had the "self-protection of society" as their focus, but proved to be too weak to challenge liberal capitalism.

Conclusion

We argue that the intertemporal analysis of capitalism is necessary and possible. All previous theories about long waves, historical cycles, recurrent crises, and pendulum swings suggest that economic dynamics can actually trigger evolution in the forms of capitalism. This means that really existing capitalisms are not historical "accidents" or mere conjunctures, but are at least partly the result of a systematic tendency—a mechanism of expansion and contraction, of opening and closure, of liberal and organised capitalism. Using such mechanisms as a framework, we can legitimately attempt to formulate forecasts about the future development of capitalism. Importantly, this does not entail a determinist stance, for while these mechanisms enable us "to explain but not to predict" (Elster 1998, p. 45), we can nevertheless extrapolate from them. And here it makes sense to differentiate between prognosis and prediction (see Glynos and Howarth 2007, p. 3); even if we cannot offer definitive predictions about outcomes in accordance with a covering-law model, it is nevertheless possible to use the regularity of these mechanisms in formulating cautious propositions about the future.

Our approach might also invite remarks about economists' alleged tendency to understand sociopolitical developments as the inevitable product of the economic dynamics of capital accumulation. Perhaps there is a grain of truth in this observation, but recognising the large body of theoretical literature in this vein, we consider ourselves to be in good company. We posit instead that the failure to incorporate the inherent tendencies of capitalist development into such accounts is a major omission. And as we do not subscribe to the economic orthodoxy, we do not assume general equilibrium, but rather the tendency of capitalism to produce cycles, waves, and recurrent crises. There is an endogenous dynamic quality in capitalism that serious researchers have to account for, whether as a variable that is causal or that is at least controlled for. The alternative—failing to look at economic fundamentals—often results in the naive, inherently pluralist idea that in times of crisis, "windows of opportunity for new thinking" emerge and new forms of capitalism can be designed or engineered, which idea is theoretically unfounded. Finally, given our materialist approach, we try to take into account that political and social mobilisation (which causes the pendulum to swing) arises first and foremost as a result of people's need to maintain their well-being today and in the future. If this existential requirement is under threat, people naturally start to worry. It is here that a Polanyian way of thinking becomes important: capitalisms are not just macro-economic concepts; they find their real expressions in ordinary people's daily endeavours to survive and to improve the conditions of their lives.

Notes

1. This prediction is even more prominent in the public pronouncements of leading Keynesian economists like Paul Krugman and Robert Stiglitz; see Konings (2009, p. 109).
2. In this contribution, we build upon ideas previously developed in Nölke (2012) and in Nölke and May (2014).
3. Empirical studies of organised capitalism have been conducted by historians such as Jürgen Kocka, Hans-Ulrich Wehler, and Heinrich August Winkler; see Winkler (1974).

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CHAPTER 4

Dependent Market Economies and Wage Competition in Central and Eastern Europe

Jan Drahokoupil and Agnieszka Piasna

Introduction

Economic models prevalent in Central and Eastern Europe (CEE) are characterised by competition for foreign investment and export market shares through lower wages. Wages in the region are indeed much lower than those of Western Europe; large differences remain even if wages are adjusted for differences in price levels. Low wages, it has been argued, are among the imperatives of the specific form of liberal economic patriotism whose advocates have pursued industrial policies built on foreign direct investment (FDI). Accordingly, the dependent market economies that emerged in the region have attempted to attract foreign investors through lower wages and a second-rank supplier position in global value chains, which constrains the market power of labour and of supplier firms (Nölke and Vliegenthart 2009). As argued in the chapter by Miklós Szanyi, the exhaustion of FDI-led growth models has paved way for the emergence of illiberal patronage states in Hungary and Poland. The wage inequality has arguably played an important political role across the region, shaping the

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political landscapes that provided a fertile ground for various types of populist and authoritarian political entrepreneurs, often exploiting the nativist and anti-European sentiments.

This chapter is a detailed analysis of the nature of wage competition in CEE—including the differences in the composition of the workforces and firms that operate there—in which we have attempted to identify those sectors and occupations which contribute most to these wage gaps. Lower wages are commonly explained as the result of lower productivity (i.e., value added per working hour). By implication, the argument goes, any increase in wages over the level of productivity harms competitiveness and thus employment prospects as well. Differences in workers' skills, technologies employed, managerial efficiency, and the quality of local infrastructure could indeed lead to a productivity gap which justifies wage differentials. Even so, there are reasons to be sceptical about such arguments. In fact, wage differences between the East and the West do not seem to correspond to differences in productivity levels. Nor can changes in unit labour costs (ULCs) be directly linked to changes in competitiveness. As Galgóczi has demonstrated (2017), the value added produced by a unit of labour cost in manufacturing is much higher in East European countries than in Germany, which suggests a scope for wage increases in the sector most exposed to international competition.[1] Another estimate, based on differences in capital stocks rather than labour productivity (Collignon and Esposito 2017), also indicated significant wage undervaluation in CEE countries. This econometric exercise demonstrated a significant scope for wage increases without bringing returns to capital stock below the average level of the European Economic and Monetary Union.

However, measuring and comparing levels of productivity—defined as value added per unit of labour (or capital) input—is problematic. Much of the analysis informing policymaking thus focuses on relative changes in ULCs, proceeding from an arbitrary starting point, a point in time when wage levels were assumed to have been in equilibrium. Another problem in measuring productivity is that productivity differences can be an accounting artefact, reflecting differences in wage levels and/or profit margins. This is most apparent in the public sector, where productivity is often measured by wages paid to employees. Moreover, wage levels can also determine recorded value added in the private sector. Hence, a shift of an activity within the network of a multinational corporation from a high-wage location to a lower-wage one is likely to reduce this activity's value added, even if capital infrastructure and labour inputs remain the same. In a lower-wage country, the same activity will thus record lower productivity because of the wage differential alone (Myant 2016).

In this chapter, we address this problem by comparing wages across Europe in relation to the characteristics of workers and firms. One possible measure independent of value added (and hence wage levels), worker and workplace characteristics, can be taken as a proxy for labour productivity. This measure remains imperfect as productivity is also likely to be determined by other factors that are not directly related to the observed worker and workplace characteristics. These can include better infrastructure or differences in innovation capacity. However, our data allow us to take into account much more detailed information about workers and workplaces than that of other empirical studies which use worker endowments as a proxy for labour productivity.

Our analysis allows us to distinguish between differences in workforce and workplace endowments and differences in returns on these endowments. For instance, a higher share of low-paid jobs, such as those typically found in agriculture or catering, could explain why a country records lower average wage levels. Similarly, a country which employs more experienced engineers can be expected to record higher wage levels than a country specialising in low-skilled assembly operations. Our analysis controls for these differences, taking into account differences in the observable characteristics of workers and workplaces as well as differences in sectoral structures.

Our data also allow us to provide a comprehensive picture of wage differences between sectors and occupational groups. We are able to take into account the public sector, smaller firms, and the self-employed, which are typically excluded from analyses due to data limitations. In this way, we are able to decompose the observed differences in returns on worker and workplace characteristics by identifying the sectors and occupational groups that contribute the most to the wage gaps observed at the aggregate level.

The analysis uses Germany as a frame of reference. Germany is the main trading and investment partner for most Central and Eastern European countries and is closely intertwined with them through links in production networks controlled by multinational corporations. Choosing Germany as a reference point may make our estimates of wage undervaluation conservative, as it can be argued that Germany pursues a low-wage competition strategy (Lehndorff 2016).

Our analysis shows that once we control for differences in the productivity-related characteristics of workers, work, and workplaces, the differences in wages between low-wage countries in Central and Eastern

Europe and high-wage countries in other regions of Europe actually appear larger than in a simple comparison of average wages. In contrast, the differences in wages between high-wage countries diminish when we control for productivity-related endowments. The wage gap between the East and the West thus seems to be the result of a much lower return on skills, not of differences in the composition of workforces and firms. In other words, the actual wage gaps are higher than those suggested by the aggregate figures.

A decomposition of the differences in returns reveals which sectors and occupational groups in low-wage countries suffer from the highest negative returns. In CEE countries, a broad set of sectors is characterised by larger wage gaps. Larger relative wage undervaluation is thus common to a wider set of activities including manufacturing, construction, professional sectors, and public-sector activities, especially education. In contrast, wage disparities are less acute across these countries in more labour-intensive and lower-paid service sectors, such as accommodation and food-service activities, administrative support activities, and wholesale and retail. Finally, wage gaps between occupational categories largely correspond to the sectoral pattern. There are notable differences across country groups, but the overall picture shows a higher relative wage premium for high-skilled workers in high-wage countries, among both manual and clerical occupations.

We thus conclude that CEE countries have developed a low-cost and low-wage model in general, with relative returns which are particularly low for higher-skilled workers and those working in the education sector. Contrary to expectations based on the dependent market economy model, factors like FDI intensity and exposure to international competition do not seem to widen the wage gaps between the East and the West. In fact, the public sector is as important a driver of wage differentials as FDI-intensive export sectors.

An Overview of the Literature: What Explains Lower Wages in Central and Eastern Europe?

According to the dependent market economy model, CEE's reliance on FDI is a constraining factor for wage growth (Nölke and Vliegenthart 2009). This seems intuitively plausible as lower wage levels have motivated many foreign investors to locate production in the region (e.g., Myant and Drahokoupil 2011). However, empirical evidence of the negative link between FDI intensity and wages is ambiguous at best. Sectoral analyses typically show that foreign-owned firms pay higher wages in jobs with higher productivity (Galgóczi et al. 2015). In their assessment of wage determinants, Onaran and Stockhammer (2008) found that FDI had positive effects on capital- and skill-intensive sectors in the short term, but that its overall effect turned negative in the medium term.

The standard explanation of wage differences which links them to productivity is rooted in the neoclassical economic model which attributes wage levels to the value created in the production process. Critics of the neoclassical model have pointed out that the marginal productivity of workers cannot, in fact, be separated from the marginal productivity of the capital that they use (Robinson and Eatwell 1973). Accordingly, profits are not determined by the production process, but should instead be understood as a residual that remains after a capitalist covers the costs of capital and labour. Similarly, whether they are managers, skilled workers, or routine labourers, individual workers' contributions to the overall value added cannot be measured separately for each participant in the cooperative production process. According to this view, the profits and wages of individual classes of workers are determined historically and are the result of political struggles.

Mainstream economists have largely ignored this critique, but it addresses the inadequacy of the models which assume perfect competition through bargaining, even those which are somewhat more realistic about the process of wage determination and which allow for the possibility that bargained wages may also be economically efficient (i.e., not harmful to employment, or perhaps even resulting in better employment outcomes).[2] Accordingly, wage levels are determined by bargaining between capitalists and workers over the distribution of value added. In this context, both employees and firms can enjoy rents from their market power. Such rents are then split between employers and employees in a bargaining process over wages (see Boeri and van Ours 2013). High-profit firms can thus be expected to pay higher wages. The low rate of unionisation and higher levels of unemployment are likely to undermine the market power of employees, which is often taken as an explanation for the low wage share observed in many CEE countries.

Empirical studies of European wage differences, independent of the recorded value added, include three types of research agenda. They all aim to distinguish the relative effects of differences in endowments (i.e., characteristics of workforces and, less often, workplaces) from the effects of differences in returns on endowments. They typically find significant differences in returns on endowments, which undermines the assumption of a perfectly competitive labour market. There is, in turn, considerable support for a contextual and historical process of wage formation—or, in the language of bargaining models, for an importance of rents[3] and the ability of workers to secure their share in them.

First, there is a body of research, albeit rather small, on wage differences across countries in Europe (Behr and Pötter 2010; Brandolini et al. 2011; Pereira and Galego 2016). These researchers attribute wage differences between countries to differences in returns on individual attributes (or returns-to-skill functions) rather than to differences in workforce composition.[4] By comparing the 2008 wages of male workers in eight EU countries in relation to the UK, Pereira and Galego (2016) found no statistically significant differences between the wage differentials in the richer countries (namely, Austria, Spain, and Ireland) and in the UK, while there were significant differences between the wage differentials in the UK and those of southern Europe (Greece and Portugal), and particularly those of CEE countries (Hungary and Poland). They found compositional effects—mainly, a higher percentage of university graduates, workers with supervisory responsibilities, and those in top occupations in the UK—but the effects of returns on endowments were dominant. However, in all these studies, the large variation in returns on skills may also be attributable to omitted variables. Pereira and Galego (2016) suggest that these are likely to be factors other than human-capital variables, such as innovation systems or the quality of public infrastructure, but this line of research has yet to identify such factors.

It is to this latter body of research that this chapter contributes. Our analysis has similar limitations, but our dataset allows us to take into account more detailed information about worker and workplace characteristics.[5] Our indicators should thus represent a better proxy for labour productivity. We are also able to report more recent data and compare differences across sectors and occupational groups in greater detail.

Differences between sectors have typically been analysed within (the same) countries. This second, much larger body of literature is also concerned with identifying the factors behind the differences in returns on endowments (e.g., Martins 2004; Magda et al. 2008; Du Caju et al. 2010). Controlling for both worker and workplace characteristics, these researchers have found large differences between sectors in returns on endowments. These have been attributed to differences in rent-sharing mechanisms, including, at the aggregate level, corporatist institutions which tend to narrow the differences in inter-industry wage differentials (Magda et al. 2008). At the sectoral level, a higher degree of (firm-level) collective agreement coverage is associated with greater rent-sharing between firms and workers (Du Caju et al. 2010). There is also evidence that sectoral wage differentials (i.e., higher returns on characteristics) are positively correlated with profits (e.g., Kouwenberg and van Opstal 1998), as bargaining models would lead us to expect. International exposure has also been found to influence the extent to which workers can secure rents: workers in industries facing intensive import competition have lower wage premium, while those in export-intensive sectors enjoy larger wage premium (see the overview in Rycx and Tojerow 2007). Finally, returns on attributes are positively associated with product market regulations which restrain competition (Jean and Nicoletti 2002).

Third, the relative importance of endowments and the returns on them has been analysed in comparative inequality studies. This literature tends to point to the importance of differences in returns on workplace and workforce attributes—rather than differences in endowments—in explaining wage inequality within countries (e.g., Blau and Kahn 1996, 1999; Devroye and Freeman 2001; Simón 2010). However, when measured by means of cognitive tests, differences in endowments still appear important, particularly when the net supply of labour is taken into consideration (Leuven et al. 2004).

Our Approach, Data, and Methods

We have analysed wage differences between EU countries using the 2015 wave of the European Working Conditions Survey (EWCS).[6] The use of the EWCS dataset has allowed us to include detailed information on the properties of workers (related to human-capital formation), job content, and the business establishment. In this way, we have partially addressed the unobserved-characteristic problem encountered by other researchers who use more limited information on worker skills and experience. The EWCS also covers a wide range of business establishments, including smaller firms and the public administration sector, which are not covered by the European Structure of Earnings Survey (SES).

The EWCS measures net monthly earnings from respondents' main jobs in national currencies, which are then converted into euros. We have adjusted their reported earnings by using Eurostat's PPP index. In addition, we removed a small number of outliers by coding the top and bottom 0.25 per cent of the income distribution as missing. On this basis, we computed a harmonised monthly income variable, largely following the measurement which Green and Mostafa (2012) developed from the EWCS data as part of their job quality index. With a median (the midpoint of the distribution) of €1213 and a mean of €1375, net monthly earnings data for the EU28 have a normal distribution with the slight positive skew, which is the result of a small number of respondents with very high earnings.

Adjusting for PPP is common practice, given that standard models of wage-setting work with real, rather than nominal, wages. This accounts for differences in prices between countries and thus compares earnings between countries in real terms. Real wage differences are key to inequality within Europe. They should also be more relevant than nominal wage differences from the perspective of workers. At the same time, it can be argued that differences in nominal rather than real wages are relevant for companies that sell internationally and can decide where to locate production. However, in non-tradeable sectors, labour costs need to be considered in relation to local prices. In any case, estimated differences in wages expressed in PPP can be reinterpreted in nominal terms by means of a simple multiplication. Our analysis can also be interpreted as identifying differences in wages beyond differences in price levels which are well known or readily available. The use of PPP—rather than market exchange rates—also makes our estimates of wage gaps more conservative.

For reasons of data availability, we use net, rather than gross, monthly wages. This is a limitation. For instance, the net figures do not include subsidiary elements of overall income, such as employers' contributions to occupational pension schemes. Moreover, deductions of taxes and social insurance contributions vary considerably from country to country. The net figures thus differ from the labour costs borne by employers. In addition, taxes and social insurance may be considered as another subsidiary element of the reward package that is consumed by the worker through the use of public services and insurance.

In our analysis, we control for differences in worker, work, and workplace characteristics as well as the sectoral composition of the relevant economies. Worker and workplace characteristics can be taken as proxies for labour productivity, measures which are independent of value added and hence of wage levels. Individual worker characteristics include gender, age, and educational attainment.[7] The work characteristics controlled for in this analysis include workers' tenure in their current jobs, measured in years. The category "supervisory responsibility" groups workers into those who do not have anyone working under their supervision, those who supervise up to 9 people, and 10 or more people. We also control for the use of technology at work (based on the frequency of work performed with computers, laptops, smartphones, etc.) and for task complexity. Work characteristics also include forms of employment (indefinite contracts, fixed-term contracts or agency work, work without a formal contract, and self-employment).[8] The category "size of establishment" differentiates between workers who work alone and those in workplaces with 2–9, 10–249, and 250 or more workers. Finally, we adjust for differences in numbers of weekly working hours.

We estimate wage differences between countries by including country or country group dummies. These country effects then capture the difference in the average return on worker and workplace characteristics in each country relative to Germany. Country effects thus include institutional and market-power factors that may influence returns on endowments. At the same time, these country effects include the differences in returns on unobserved characteristics, which may include other human-capital endowments (e.g., the quality of the education system) as well as other productivity-determining factors (e.g., the quality of infrastructure and differences in innovation systems).

To analyse the size of wage differences across countries, we employ linear regression (OLS) models. In the first step of this analysis, we included 28 countries which were members of the EU in 2015, covering a total of 29,683 respondents who provided information about their earnings. Our baseline model contains only country dummies. We then included a set of control variables to account for differences in the structures of these economies as well as the composition of the workforce in each of these countries.

In the second step, we focused our analysis on Central and Eastern European countries and compared them to Germany. To ensure sufficient sample sizes across various segments of the workforce, we grouped Central and East European countries into four geographic clusters. We then decompose country effects by modelling interactions between countries and sectors and between countries and occupations. These interactions allow us to explore the effects which individual sectors and occupations have on returns on skills relative to Germany. Our analysis thus allows us to identify the sectors and occupations which contribute to the relative difference in returns on endowments captured by country dummies.

The Role of Economic Structure and Workforce Composition

Figure 4.1 compares two measures of average monthly wages across Europe, both adjusted for PPP: gross monthly wages as measured by the SES in 2014 (the most recent year for which data were available), and net monthly wages in the 2015 EWCS (the dataset we have used in the analysis that follows). The comparison shows a familiar pattern: high-income countries in northwestern Europe have higher average wages, while CEE countries are clustered at the bottom of these income rankings. Both means of measurement have their limitations and the two datasets are not directly comparable; most notably, the SES data do not include small enterprises with fewer than 10 employees.[9] However, the comparison of gross and net wages points to some possible biases in the EWCS dataset. Most notably, Lithuania's average net wages as reported in the EWCS appear higher than its gross wages as reported in SES, which suggests an over-reporting of net income in that country.[10] In contrast, net wages appear to be under-reported in Hungary; this could be related to the particularly low response rate in that country

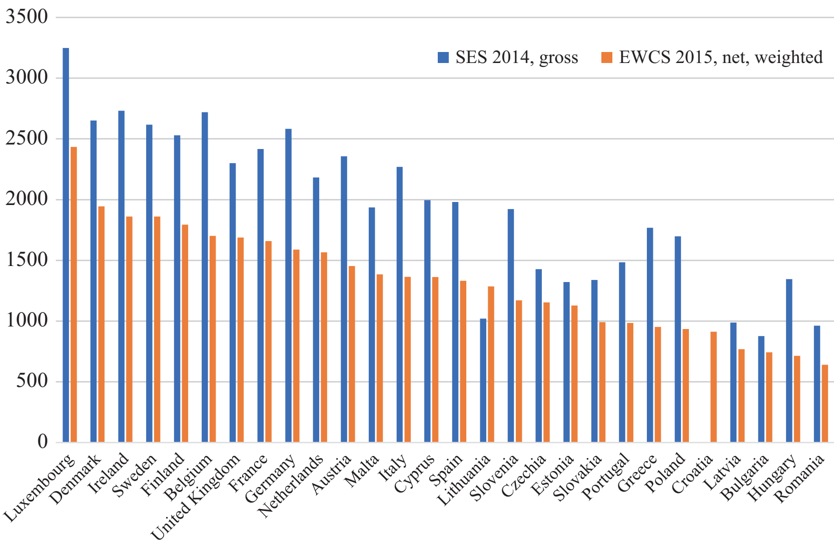

Fig. 4.1 Monthly wages in the EU (adjusted for PPP)—a comparison of two surveys

(46.1 per cent).[11] Such distortions in reported net wages might also have influenced the EWCS-based rankings of Poland and Greece, both of which reported much lower wages in the EWCS than in the SES. Overall, however, CEE countries tend to report higher net wages relative to the gross levels reported in SES than would be justified by differences in the tax wedge.[12] The EWCS dataset that we have used in this analysis may thus in fact overestimate wage levels in CEE, which would make our estimates of wage differences conservative.

In order to control for the different compositions of workforces and the types of jobs performed in these countries, we have used the EWCS dataset to compare a baseline model—which uses only country dummies and Germany as a frame of reference—with a model that uses country dummies while also including worker and workplace characteristics. As these characteristics can be expected to be related to the productivity of workers, the productivity explanation (or the perfect-labour-market-competition model) implies that the absolute values of the country residuals—which indicate the relative differences in monthly wages across the EU, as compared to Germany—should drop once firm and workforce characteristics have been controlled for. As shown in Fig. 4.2, this is indeed the case in Luxembourg, the UK, the Scandinavian countries, and Belgium.

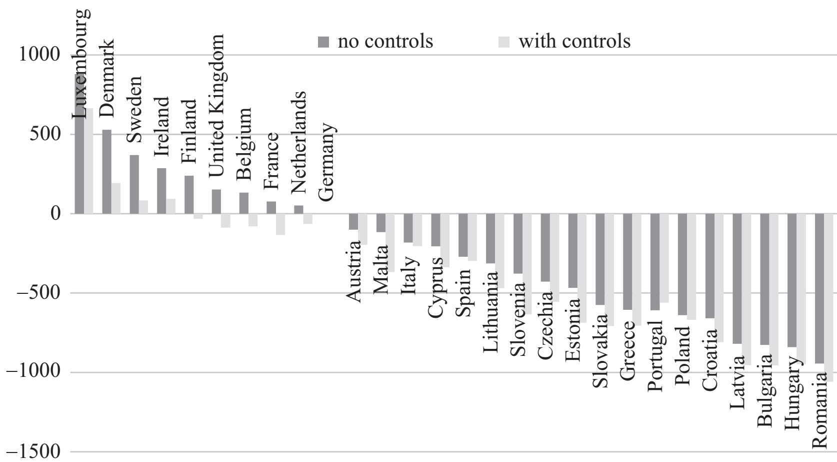

Fig. 4.2 Differences in net monthly earnings (in euros and adjusted for PPP) across EU28 countries, compared to Germany. (Source: Authors' analysis from EWCS 2015)

In the case of all these high-wage countries, their distances from Germany diminish once economic structures and workforce composition have been controlled for. In France, Belgium, the UK, and the Netherlands (countries which have wage levels similar to those of Germany), the residual country effects turn negative.[13] This suggests a possible undervaluation of wages relative to Germany, but the country effects remain low for all of these countries, with the exception of France, where it exceeds €100 (adjusted for purchasing power parity (PPP)).

Interestingly, however, in countries that have wage levels lower than those of Germany, country effects actually increase once we control for worker and workplace characteristics. In other words, comparing the same type of workers in the same type of workplaces increases the observed wage gap between Germany and low-wage European countries. The notable exception is Portugal, where lower wages (in comparison to Germany) are at least partly explained by the prevalence of lower-paid segments of the labour market.

It should be noted that using Germany as a benchmark does not imply that relative wage levels in Germany are at an equilibrium. On the contrary, Germany's persistent current-account surpluses and long-term trends in its ULC development relative to other European countries suggest that German wages are, in fact, undervalued (e.g., Lehndorff 2016; see also Collignon and Esposito 2017).

This analysis thus does not support the argument which explains lower wages by referring to the role of economic structure and the skill profile of the workforce. The results point to quite the opposite situation: once we compare similar workers in similar jobs, the average wage penalty compared to Germany is even wider in all low-wage countries. Portugal is the only exception: the different composition of its workforce explains, at least in part, the gap between its real wages and Germany's. In the next step, we identify those sectors and occupations which contribute the most to the observed wage penalties.

The Role of Sectors and Occupational Levels

In order to decompose the observed differences in returns on endowments, we will now analyse the extent to which country effects differ in individual sectors and occupations. We can identify those sectors and types of occupations which contribute the most to the wage gaps observed at the aggregate level by employing regression models with interaction terms.[14] In this way, we can estimate, for instance, the extent to which wage gaps relative to Germany are different in manufacturing and construction. To ensure sufficient sample sizes, we have grouped CEE countries into six clusters: the Visegrád four (Czechia, Hungary, Poland, and Slovakia); South-East Europe (Bulgaria and Romania); the Baltic States (Estonia, Latvia, and Lithuania); and former Yugoslav republics (Croatia and Slovenia).[15] The contributions of individual countries to their respective groups are weighted by their population size.

Wage differences across country groupings are shown in Fig. 4.3. Average monthly wages in Germany, adjusted for PPP, are approximately €1588; they are lower by 40 per cent in the Visegrád group (€955), by 58 per cent in Romania and Bulgaria (€668), by 31 per cent in the Baltic group (€1091), and by 36 per cent in Croatia and Slovenia (€1011). The relative position of the Baltic cluster may be affected by the apparent overestimation of wage levels in Lithuania. The gap widens further if only employed men are taken into account, in large part due to the prevalence of part-time work among women in Germany and the very low incidence of part-time work in CEE countries.[16]

Consistent with our analysis of individual countries in the previous section, the effects of country clusters increase once worker and workforce characteristics, including the incidence of part-time work, have been controlled for (see Fig. 4.4).

Our analysis of the interaction between sectors and country clusters, illustrated in Table 4.1, shows that CEE wages are undervalued across economic sectors. The size of these wage gaps, however, varies considerably. The figures in Table 4.1 are based on predicted wages in individual sectors in Germany and the four country clusters. These are average wages in each sector, calculated after holding all the factors in the analysis constant (i.e., differences in workforce and workplace characteristics).

Table 4.1 thus shows the effect of country groups on wages in selected sectors relative to wages in those same sectors in Germany. In other words, these values show the extent to which wages in a particular sector are lower on average than wages in that sector in Germany (expressed in euros and adjusted for PPP). The values in bold indicate statistically significant differences from the average negative premiums observed in manufacturing.[17] It shows larger wage gaps in a number of sectors, including manufacturing, professional, scientific, and technical activities, and the financial sector. Public-sector activities, public administration, and education are also characterised by a large pay gap. We do not find statistically significant sectoral differences in Croatia and Slovenia, but that may be due to the

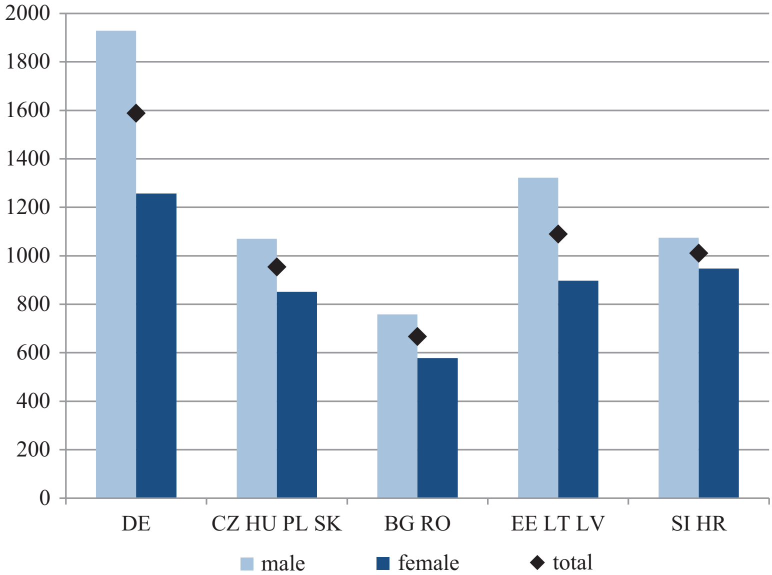

Fig. 4.3 Average monthly wages (in euros and adjusted for PPP) by gender and country group. Notes: Weighted means. (Source: Authors' analysis based on EWCS 2015)

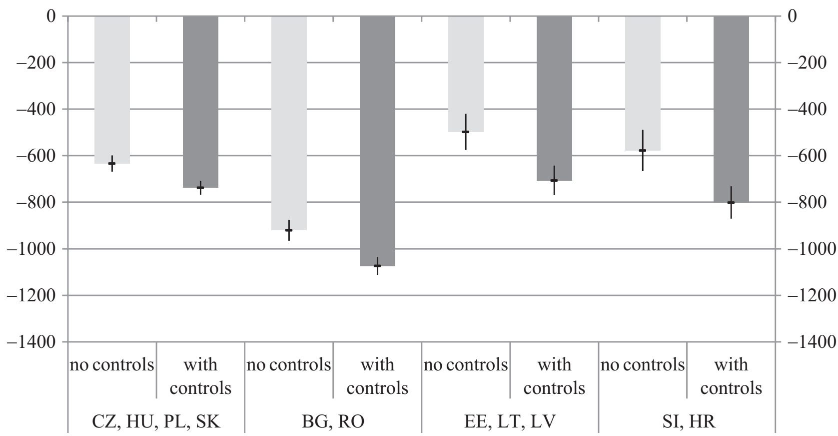

Fig. 4.4 Estimates of regional effects on wages, compared to Germany. Note: Lines represent 95-per cent confidence intervals. (Source: Authors' analysis based on EWCS 2015)

Table 4.1 Differences in net monthly earnings (in euros and adjusted for PPP) relative to Germany, selected sectors

	DE	*CZ HU PL SK*	*BG RO*	*EE LT LV*	*SI HR*
Manufacturing	*0*	*−833*	*−1175*	*−781*	*−903*
Construction	0	**−688**	−1169	−635	−800
Wholesale and retail	0	**−606**	**−905**	**−509**	−739
Transport and storage	0	**−665**	−1063	−531	−756
Accommodation and food	0	**−404**	**−910**	**−404**	−700
Information and communication	0	−835	**−534**	−761	−755
Finance and insurance	0	−797	−1234	−722	−682
Professional, scientific, and tech	0	−829	−1051	−796	−938
Admin and support services	0	**−572**	**−737**	**−295**	−505
Public administration	0	−891	−1276	−899	−895
Education	0	**−1017**	**−1374**	**−1089**	−924
Health and social work	0	−827	−1067	−807	−737
Arts and entertainment	0	**0**	**−713**	−632	**−278**
Other services	0	**−519**	−1064	−711	−601
Activities of households	0	**−182**	−828	−539	−645

Note: Marginal means estimated from our regression model, adjusted for all control variables. Bold type indicates statistically significant differences ($p \leq 0.05$) from the negative return in manufacturing

small size of this cluster. Accordingly, workers in education suffer from the highest wage penalties. The negative wage premiums in the financial sector, professional activities, public administration, and health and social work are as large as in manufacturing. In contrast, the wage gap is lower in wholesale and retail, accommodation and food-service activities, and administrative support. The construction and transportation-and-storage sectors appear to be less undervalued in the Visegrád clusters. And finally, the information-and-communication sector is less undervalued in the South-East Europe cluster.

As discussed above, the empirical literature on sectoral wage premiums identifies a number of factors that explain differences between sectors, including profitability, import competition, export intensity, product market regulation, FDI intensity, and exposure to imports. However, these factors are not directly applicable to our analysis; rather than comparing wages across sectors in a country, our analysis compares sectoral wage premiums across country groups. The observed differences in sectoral wage premiums could thus be explained by the different profitability or export intensity of an individual sector in Germany and in other country groups. However, the basic properties of individual sectors, such as exposure to imports, are not likely to differ significantly between the regions. One factor that does differ is FDI intensity, which is higher in CEE, particularly in manufacturing and non-tradeable services (most notably, banking and telecommunications). The returns on FDI in CEE are high in comparison with other regions of the globe.[18] Telecommunications, utilities, and finance, typically controlled by foreign investors, enjoy particularly high profits (Chmelař et al. 2016). However, empirical researchers have found that profitability and FDI intensity are associated positively with sectoral wage premiums. The fact that manufacturing, information and communications, and finance and insurance are characterised by the largest wage gaps in CEE groups thus suggests that workers have a limited ability to capture rents in these sectors; these gaps cannot be linked to FDI dependence.

There is much less wage disparity between analysed countries in the more labour-intensive and lower-paid service sectors, such as accommodation and food-service activities, administrative support activities, and wholesale and retail. The fact that the latter sector is among those businesses owned predominantly by foreign investors raises further doubts about the importance of FDI intensity. What seems to matter most is that workers in these sectors in Germany report relatively low incomes, and while the wage penalty in the new member states is still significant, it is narrower than in other sectors. At the same time, however, these differences are not driven by the peculiarities of Germany's sectoral pay structure: the results are still robust if we use a cluster of northwest European countries as our reference point instead of Germany (see Drahokoupil and Piasna 2017).

Interestingly, a broader set of public-sector activities—most notably the education sector—helps drive down wages, and is thus a factor in preserving the wage differences between western and eastern countries. Public-sector wage differentials are typically not investigated in the empirical literature, and many of the factors identified in these studies, such as profitability, are irrelevant to this sector. The wage differentials in this sector are generally attributable to political factors and thus may be indicative of the weakness of labour in CEE countries relative to Western Europe.

Table 4.2 presents a comparison of the wage gaps between the main occupational categories. Statistical significance in this table refers to a comparison with the wage penalty for professionals.[19] Managers suffer from the highest wage gaps in the Visegrád countries and in Slovenia and Croatia. Interestingly, and consistently with our analysis of sectoral differ-

Table 4.2 Differences in net monthly earnings (in euros and adjusted for PPP) relative to Germany, by occupational groups

	DE	*CZ HU PL SK*	*BG RO*	*EE LT LV*	*SI HR*
Managers	0	**−1180**	−1320	−936	**−1196**
Professionals	*0*	*−977*	*−1254*	*−872*	*−832*
Technicians and associate professionals	0	**−754**	−1134	−834	−822
Clerical-support workers	0	**−666**	**−1017**	−605	−761
Service-and-sales workers	0	**−623**	**−952**	−706	−739
Skilled agricultural, forestry, and fishery workers	0	−960	−1401	−1267	−1200
Craft and related trades workers	0	**−761**	−1152	−729	−884
Plant and machine operators and assemblers	0	**−677**	**−1028**	**−489**	−749
Elementary occupations	0	**−506**	**−804**	**−438**	−628

Note: Marginal means estimated from our regression model, adjusted for all control variables. Bold type indicates statistically significant ($p \leq 0.05$) differences from the negative return for professionals. Military occupations are not displayed because of the low numbers of respondents in this category

ences, the wages of workers with lower skills do not differ to such an extent across the analysed countries. This is particularly visible for elementary occupations, which are significantly less undervalued than professionals in most clusters. This pattern is also found for plant and assembly workers, clerical-support workers and services-and-sales workers. There are some differences across country groups, but the overall picture suggests that the relative wage premium for high-skilled workers is higher in Germany, among both manual and clerical occupations.

Conclusions: Wage Differences and Productivity Differentials

It is often argued that wage differences across European countries are the result of differences in labour productivity. However, insofar as they may be useful for assessing the extent to which changes in wages go together with changes in labour productivity, the commonly used indicators—most notably ULCs—do not allow for the computing of equilibrium wage differentials with which to assess the extent of the under- or overvaluation of wages. Moreover, the commonly used measures of productivity—such as value added per unit of labour input—are ill-suited for assessing wage levels as the wage levels themselves contribute to the value added. By addressing the shortcomings of productivity-based measures in this chapter, we have analysed the extent to which differences in the observable productivity-related characteristics of workers and firms—independent of recorded value added—can account for wage differentials. The results suggest that in high-wage countries, the positive wage premium can be attributed to the structural differences between economies: wage premiums diminished once we controlled for productivity-related characteristics. In other words, these differences reflect the better-paying segments—engineers as opposed to care workers—which are prevalent in these countries. In contrast, in most low-wage European countries, controlling for worker and workplace characteristics in fact increases the wage gap. In other words, wage differences are even more significant when we compare similar workers doing similar types of jobs.

Our results thus reveal larger wage gaps than are apparent in the aggregate data. This does not support the productivity-based explanation or the perfect-labour-market-competition model: once we control for productivity-related characteristics, wage gaps actually increase. At the same time, however, we cannot completely discard the role of productivity differences: indeed, apart from differences in the returns on observed characteristics, the residual country (cluster) effects also include differences in returns on unobserved characteristics, which may include other human-capital endowments (e.g., the quality of the education system) as well as other productivity-determining factors (e.g., innovation systems, the quality of a country's infrastructure, and its integration into second tiers of the global production networks). Negative wage premiums can thus be linked to productivity-determining factors that are unrelated to observed worker and workplace characteristics (as suggested by Pereira and Galego 2016). This remains a limitation of our approach, but the results of the aforementioned empirical studies on wage differences strongly suggest that institutional and market power factors, including the role of unions and collective bargaining, are key in accounting for the residuals. Moreover, the capital-stock-productivity method, which takes into account the role of productivity-determining factors other than human capital, also suggests significant wage undervaluation in CEE (Collignon and Esposito 2017).[20] Like our estimates, this method shows that CEE wages are most undervalued in manufacturing (of motor vehicles in particular, according to Collignon and Esposito), as well as in knowledge-intensive services and the public sector.

In theory, negative wage gaps could be linked to differences in labour supplies. More specifically, higher levels of unemployment could put downward pressure on wages in the affected countries. One can find some evidence for this mechanism in data from the 2010 wave of the EWCS, but that seems to have been driven by a spike in the unemployment rate in the Baltic States following the 2008 recession. However, with employment indicators improving substantially in the Baltic States in subsequent years, the weak correlation between unemployment and wage levels has disappeared completely since then (see Myant and Piasna 2014).

One should be cautious in drawing far-reaching conclusions from the magnitudes by which we estimate wages to be under- or overvalued in individual countries. These should be taken only as approximations. As discussed above, survey-based data are likely to be biased and contain measurement errors. Our analysis is also limited by a reliance on net, rather than gross wages. However, these limitations mostly underestimate the extent of wage undervaluation. We suspect the largest distortion in Lithuania, where respondents seem to have over-reported their wage levels. Furthermore, relying on gross, rather than net, wages would increase the wage gap for all CEE countries apart from Hungary.[21] Finally, by adjusting for differences in PPPs, we can compare differences in real wages, but this refinement will also make our estimates of these wage gaps more conservative. Furthermore, the adjustment for purchasing power is absolutely irrelevant from the perspective of companies making decisions about production locations in Europe. For them, wages expressed in nominal exchange rates are more relevant, which supports the argument that there is a greater scope for wage increases than has been identified in our analysis.

The high wage gaps observed in CEE manufacturing and the relatively lower gaps in some non-tradeable services seem to support claims about the importance of low wages as a factor in international competition for markets and FDI. Identifying the factors behind sectoral and occupational variations would require a more systematic assessment, beyond the scope of this chapter, but our results do not support a link between actual exposure to international competition, FDI intensity, and wages. It is more appropriate to conclude that CEE countries have developed a low-cost and low-wage model in general, with relative returns particularly low in higher-skill activities. The negative returns observed in manufacturing are thus common to a larger set of sectors. Importantly, wages in the public sector in CEE are as undervalued as in manufacturing and thus contribute significantly to the wage gap. Moreover, wage gaps in non-tradeable complex services in CEE are as high as in manufacturing. In fact, the magnitude of the wage gap seems to be driven by the relative position of sectors and occupations in the German wage hierarchy. The latter is characterised by low-wage service sectors and higher occupational wage dispersion.

The generalised low-wage model provided a fertile ground to political forces that gave rise to the oligarchic, patronage-state models that characterise Hungary and Poland and to the populist and nativist anti-European politics that can be found across the region. Such political landscape is particularly favourable to the exclusionary patriotism, as discussed in the chapter by Nölke and May. Nevertheless, our analysis suggests a scope for wage increases in CEE countries and recent years have indeed seen substantial growths in real compensations across the region. Further steps towards narrowing the wage gaps are indeed necessary to reduce actual productivity differentials and to enable economic convergence in the EU. The high negative returns in education are particularly worrying in this context. Moreover, persistent cross-national disparities in wage levels, especially for highly skilled workers, strengthen the incentive for human-capital outflow. These risks tend to undermine productivity and the potential for economic growth, and thus may further exacerbate regional divergences. Indeed, sustained convergence with the West requires a steady shift from the low-cost and low-wage model observed in CEE.

Notes

1. The comparison is only provisional, given that wage-adjusted productivity is an inversion of wage share. Differences in the latter might be related to structural differences in the economy, such as capital intensity.
2. Efficiency wage models, for instance, relax the neoclassical assumption that productivity is exogenous and allow for a reverse causation in which higher wages lead to higher productivity by, for instance, inducing greater work effort or better work organisation (Shapiro and Stiglitz 1984).
3. Rents refer to returns in conditions of imperfect competition. The latter might be the result of quasi-monopolies, labour unionisation, or social policies which change workers' external options through, for example, benefit payments.
4. Behr and Pötter (2010) decomposed wage differences between EU countries in different quintiles, using a proportional hazard model to analyse the 2001 European Community Household Panel (ECHP) dataset, which included 13 European countries. Brandolini et al. (2011) analysed the distribution of earnings using the 2007 dataset of the European Union Statistics on Income and Living Conditions (EUSILC).

5. Behr and Pötter (2010) use education, tenure with current employer, and general working experience as measures of skills. Brandolini et al. (2011) relied on education (secondary and university) and worker age. Pereira and Galego (2016) conducted their analysis using education, supervisory responsibility, and being a native worker as explanatory variables.
6. The EWCS has been conducted by Eurofound every five years since 1990. Its samples are representative of persons in employment, both employees and self-employed, working for at least one hour a week, who are 15 years of age or older (16 or older in Spain and the UK). The interviews are conducted face-to-face. Sample sizes, with a few exceptions, are around 1000 workers per country. The response rate for questions on income was 83 per cent.
7. Measurements of educational attainment are based on the ISCED classification (seven groups).
8. Further control variables used in this analysis include occupational groups according to ISCO and 21 economic sectors based on one-digit NACE.
9. The differences between the two means of measurement also include a different sectoral structure (SES does not include agriculture, public administration, defence, or compulsory social security) and different age brackets.
10. Lithuania reported much lower wages in the 2010 wave of the EWCS. In 2015, the response rate in this country was relatively high (90.7 per cent), which makes it unlikely that this factor was the source of this distortion.
11. Response rates lower than 70 per cent were found in Hungary (46.1 per cent), Italy (56.1 per cent), Czechia (59.2 per cent), Poland (60.8 per cent), Greece (61.1 per cent), Portugal (65.1 per cent), Estonia (65.5 per cent), Croatia (67.1 per cent), and Romania (68.4 per cent).
12. See the tax wedge on labour in 2015 in the European Commission's tax and benefits database, based on OECD data, http://europa.eu/economy_finance/db_indicators/tab/
13. The small negative effect in Finland is not statistically significant (i.e., essentially zero).
14. The presence of a significant interaction indicates that the effect of one predictor variable on the independent variable differs when the other predictor variable varies—the latter variable being sectors and occupations in this analysis.
15. We dropped Malta and Cyprus from this analysis.
16. Our regression analysis controls for these differences.
17. Non-significant values should thus be considered as indicating the same wage penalty as manufacturing in the given country cluster.
18. Source: OECD International Direct Investment statistics database.

19. Non-significant values should thus be considered as indicating the same wage penalty as professionals in the given country.
20. The capital-productivity method leads to somewhat more conservative estimates of wage gaps, but these might be related to a reliance on observed differences in value added that reflect differences in wages rather than differences in actual labour productivity. Moreover, as indicated by the significant undervaluation of wages in Ireland and Luxembourg, the results are distorted by the recording of profits in favourable tax jurisdictions (hence the large recorded return on capital stock in these countries).
21. See the tax wedge on labour in 2015 in the European Commission's tax and benefits database, based on OECD data, http://europa.eu/economy_finance/db_indicators/tab/

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CHAPTER 5

The Place of Rent-Seeking and Corruption in Varieties of Capitalism Models

Péter Mihályi and Iván Szelényi

Introduction

The purpose of our contribution to this volume—the fourth in a series of similar chapters[1]—is to renew the discussion of rents, which have been largely neglected by mainstream economists. In our search for a theoretically sound explanation of the phenomenon of "abnormal" or "extra" profits, as they are often labelled in current scholarly discussions, we have turned from Smith and Marx to Ricardo.[2] While the question of inequality was central to the economics of the nineteenth century, twentieth-century economists tended to neglect issues of inequality in incomes and wealth.

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When this theme was brought back to the centre of attention, for instance by Simon Kuznets (1955), it was assumed that economic growth would automatically take care of it; as President Kennedy later famously said: "a rising tide lifts all boats". During the past few years, this topic has received increasing attention, especially in the wake of Thomas Piketty's unconventionally voluminous, but nevertheless hugely successful book *Capital in the Twenty-First Century* (first published in French in August of 2013).

According to Piketty, not only have inequalities increased since the 1970s, capitalism itself has become unequal in a different way: more and more wealth is now inherited. Capitalism has become "patrimonial". In a sense, the system is being re-feudalised before our eyes. Piketty is essentially right, but for the wrong reasons. We can accept his assertion—made in his book and in many other places—that inequalities have been growing for almost half a century, and we share his view that this is a major threat to the legitimacy of the liberal order at both the national and the international levels.[3] We are, however, deeply sceptical about his central explanation, namely that an excessive growth of profits[4] is the fundamental reason for the present inequalities, which have slowed growth and generated popular dissatisfaction over a considerable period.

* * *

The rest of this chapter is structured as follows. In section "Profits Versus Rents", we will discuss "capitalism in general" (without any geographical limitations) in an attempt to bring economic analysis of the Ricardian concept of rent—something different from the category of profit—back into the mainstream. We will argue that this distinction is crucial to an understanding of the growth of inequality and its implications for various models of capitalism. Section "The Role of Rents in Post-Communist Capitalist Societies" will be devoted entirely to a discussion of the role of rent and rent-seeking in "post-communist capitalist countries". Our contribution to the existing literature is a delineation of three periods within the past 25 years. The three phases of rent-seeking are as follows: (i) market capture by political elites; (ii) state capture by oligarchs; (iii) autocratic rulers' capture of oligarchs by means of selective criminalisation and the redistribution of their wealth to loyal new rich. Sections "Consequences of Inequalities" and "Conclusions" will summarise our main points and briefly discuss the most important social consequences of growing inequality, both in advanced capitalist countries and in the post-communist world.

Profits Versus Rents

As is well known, Karl Marx (1867) focused on profit-wage differentials in Volume I of *Capital*. In an attempt to elucidate the concept of exploitation, he proposed a model in which owners of capital were an ever-shrinking minority while a growing number of wage labourers received only the costs of the reproduction of their labour power. Piketty (2013) accepts Marx's conclusion that there is an overarching, secular tendency towards an infinite accumulation of capital, which is concentrated in fewer and fewer hands.

Marx wanted to show that property is not "theft" (Proudhon 1840). He insisted that all market exchanges are exchanges of equivalents. It is not capitalists' personal greed that drives the institutions of exploitation and the extended capitalist reproduction process. Capitalists do pay the full price of their workers' labour power (hence the costs of the reproduction of their labour power), but they keep their employees working beyond the hours necessary to cover these costs and thus appropriate the surplus created during these extra hours of work. In a closed economy, under perfect competition, the individual capitalist has no choice. He has to keep wages at a level which reproduces labour power and he needs the surplus (profit) to reinvest in order to remain competitive with other capitalists. The low wages of the working class and the profit of the capitalists therefore fit into an equilibrium model. As Keynes once said, the capitalists of the late nineteenth century "were allowed to call the best part of the cake theirs, and were theoretically free to consume it, on the tacit underlying condition that they consumed very little of it in practice".[5] "In fact, it was precisely the *inequality* of the distribution of wealth which made possible those vast accumulations of fixed wealth."[6] Hence, under these circumstances, the expanded reproduction process was a "positive-sum game".

Marx thought in this way as well, although he obviously did not use this metaphor. If all profit has to be reinvested, more profit may mean more jobs (which Marx did *not* consider in the mid-nineteenth century) and/or may mean higher wages for workers (a means of generating sufficient aggregate demand). John Roemer, arguably the most distinguished "rational choice neo-Marxist", has noted correctly: "The neo-classical model of the competitive economy is not a bad place for Marxists to start their study of idealised capitalism."[7] While Piketty expressly rejects Marx's version of the *labour theory of value* and the *theory of exploitation* which follows from it, he tends to concur with Marx's twentieth-century followers in assuming that—apart from exceptional periods, when governments intervene into their economies with redistributive policies, or when wars destroy accumulated private wealth—wages remain relatively low all the time, while profits keep increasing. But why does the tendency towards unlimited capital accumulation and increasing inequality matter if capitalists keep reinvesting profits in the production process and thus create more jobs? If expanded reproduction is a positive-sum game for the economy as a whole, what is wrong with it? Marx's original answer to this question—the theory of the declining rate of profit—sounded convincingly in this time, but has proved to be wrong since then. Once we step out of Marx's model, based on the labour theory of value, we cannot dispute that cheap technology such as computers can bring about massive productivity gains, and hence lead to increases in national income. This explains why profits did not decline, the world revolution did not happen, and workers' real incomes have instead increased enormously since Marx's time.[8]

David Ricardo (1817), who lived two generations before Marx, was convinced that the concept of rent was an indispensable explanation for the inequalities he observed. As is well known, he defined rent as "scarcity rent"[9]: an income derived from monopolistic ownership of agricultural land (and mines). He considered rent-seeking to be a negative-sum game. Rents create no new wealth; rather, they reduce economic growth and reallocate incomes from the bottom to the top.[10] This contrast between profits and rents is not at all trivial. Ricardo already noted the lack of clarity around this distinction: "[Rent] is often … confounded with the interest and profit of capital."[11]

While Piketty challenges the ethical bases of observable inequalities of income and wealth, he preserves the framework of the mainstream, neoclassical theory of income distribution which was originally developed by J.B. Clark (1899). Clark thought that wages and profits reflect the marginal product of labour and of capital, respectively. A person's income is determined by his contribution to production—or, more precisely, by the marginal productivity of the "factor of production" to which he contributes. It is truly a zero-sum game, with important consequences: (i) there is no "room" for rents in this model, or (ii) it must be assumed that rents are paid from net profits.

Piketty accepts both propositions, though he does not say so.[12] According to him, the neoclassical model is fundamentally right. When wage earners and capitalists fully share the annual national income between them, there is no injustice or exploitation; both classes get what they deserve.[13] Piketty's line of argumentation allows for only one exception: the compensation of the highest-paid executives of multibillion dollar corporations. He does note that these "super managers" receive more than they deserve, owing to their influence and power in the firms where they are employed. However, for Piketty, this is merely an undesirable, unnecessary, small distortion of the market economy.

Changing and New Forms of Rents

Ricardo believed that agricultural land was lamentably scarce. Its supply is thus inelastic, while demand for food steadily grows. Under these circumstances, landowners receive scarcity rent without producing more or better food—that is, without producing new value. Such rents channel resources away from "productive" investments and cut the real incomes of wage and salary earners. In part, Ricardo proved to be wrong, too. First, he did not consider how much the fertility of land could be increased. Secondly, and more importantly, the price/value of agricultural land declined as the Americas and Australia were incorporated into the emerging capitalist world economy. In fact, there is an abundant supply of uncultivated agricultural land around the globe even in the twenty-first century.[14]

Pareto (1916)[15] and the American sociologist Aage Sorensen (2000) have already broadened Ricardo's notion of rent to include all sorts of real estate and all kinds of monopolies. Stiglitz (2012) also points out that while scarcity rent does not really apply to agricultural land anymore, it certainly applies to residential property and other real estate. In some urban areas around the world, from London and Moscow to Shanghai and Singapore, tremendous wealth is generated merely from the scarcity of highly desirable locations. Today, the demand for housing no longer comes only from those people who live in a given city all the time, but also from the global wealthy who want to have houses in locations like the aforementioned globally attractive cities. Such privately held, consumption-oriented wealth becomes the property of a new urban "aristocracy" which passes these assets down from generation to generation. In the US, the total value of the housing stock was estimated at $26 trillion in 2015, more than the value of all the shares traded on the American stock market.[16] This landownership structure, in which property is concentrated in the hands of the wealthy, is reminiscent of the privileged estates' control of resources during the era of feudalism. Indeed, this concentration is especially intense in the top 1 per cent or even 0.1 per cent of the social hierarchy. However, we would hasten to add that there is a relatively large patrimonial upper-middle class—say the top 10–20 per cent—which also benefits from all this if they happen to inherit property in the aforementioned cities. Moreover, it is worth noting that there is a self-reinforcing mechanism at work here. As the example of London shows in the light of the Panama Papers, the influx of super-rich foreigners drives up property prices, which in turn significantly increases the short-run return on such investments.

But does such rent result only from land or real estate? When we speak of rent-seeking behaviour (as distinct from profit-maximising business investments), we use a broader notion of rent than was customary over the past 50 years.[17] "Max Weber's notion of closure" can be a useful way to conceptualise rent in this broader way. He distinguished "open social relations", where participation is not denied to anyone who wishes to join, from "closed relationships" where the participation of certain persons is prohibited, limited, or subjected to conditions. According to Weber, closed groups manage to monopolise advantages by occupying scarce and desirable positions, or by making desirable goods and services scarce through clientelistic practices—that is, the creation of cartels or monopolies.[18] Today, scarcity rent is one of the explanations for the very high compensation packages offered to the best specialists. Firms—along with universities, hospitals, sport clubs, and so on—compete with their peers for stars. They do not want to lose a legendary CEO,[19] professor, or athlete to a rival, as it could hurt their prestige and possibly their profits. They therefore pay more and more, especially in those countries where excessively progressive income taxes do not counterbalance such incentives. Closure in itself does not guarantee success at the firm level, nor for individual managers, but it is a great advantage *vis-à-vis* those who are excluded from competition.[20]

One of our contributions to the debate on rents is the—in our opinion, justified—introduction of the notion of "solidarity rent". For example, membership in a trade union reduces wage differentials. While nationwide unions tend to fight for the highest level of employment, branch-based unions fight for the highest possible wages for *all* the workers in their branch. In particular, branch unions can push wages in their branches above prevailing market wages, and thus secure rent for their "members". Through the highly sophisticated institution of collective bargaining, unions prevent the use of wage incentives which pay more to the best workers, teachers, or doctors—to the advantage of those who underperform. Arguably, the incomes of those whose jobs are protected by unions or professional associations are composed of two elements: wages or salaries, and rents. In developed democratic societies, one of the main functions of such institutions has been to create conditions for rents. When the power of trade unions was on the rise, solidarity rent helped to reduce inequality. However, in the context of the globalised world economy, their significance has declined,[21] and this in turn has likely contributed to the stagnation of real wages for low-skilled manual workers in the manufacturing sectors of many advanced economies, the US in particular.

Those who collect pensions in a pay-as-you-go system also receive solidarity rent, as do people who are on social welfare and those whose health insurance is paid by taxpayer contributions (as distinct from those who participate in a funded private-pension scheme, or whose healthcare benefits are paid by private insurance policies). Ideally, fiscal transfers always work as mechanisms of solidarity rent—as transfers from the rich to the poor. Even more so: given the logic of the demand side, solidarity rents can be economically beneficial since they can maintain or even boost consumption. This is a strong argument for unemployment benefits, but even conspicuous consumption can increase demand, create higher profits and wages, and hence contribute indirectly to wealth generation.

Aage Sorensen, to whom we have already referred, offered a broad interpretation of rent: "Rents are payments to assets that exceed the competitive price or the price sufficient to cover costs and therefore exceeding what is sufficient to bring about the employment of the asset. The existence of rent depends on the ability of the owner of the asset to control the supply."[22] Sorensen also pointed out that the association of rents with land is not required: "Rent will emerge on all productive assets that are in fixed supply and that actors need to maximise their wealth."[23] If we accept this framework, it follows that ownership of potentially rent-producing assets—such as licences, credentials, and access to loans for starting one's own business—is not restricted to capitalists. Those who do not own profit-generating capital still have the opportunity to accumulate wealth in other forms, such as pensions, as we have already mentioned.[24]

We have now arrived at the central definition of our study. We define rent as the difference between what income would have been in an "open relationship" and what it turns out to have been after the "closing" of such relationships to certain individuals or categories of individuals. In simple algebraic form.

Income from closed relationship – income from open relationship = rent.

It may be difficult to measure all types of rents empirically, but their existence can be demonstrated by means of counterfactual reasoning. What would a closed group's income have been if its members had been competing in open relationships?

Within a well-defined historical-political epoch—say, one lasting 20–30 years, in which average people can make comparisons on their own—rents can be "temporary" or "enduring". An entrepreneur who invents a new technology may collect rent for a while, but eventually his competitors will invest in the same (or a similar) technology and his rent will disappear; the incomes of competing entrepreneurs will be set by the supply-and-demand mechanism. There are many spectacular examples of this: the success of Microsoft's Windows operating system; the rise of cell phones, which toppled copper-cable-based telephone companies from their privileged positions; and the shale revolution of the past decade, which has entirely reshaped the traditional Organization of the Petroleum Exporting Countries (OPEC)-controlled oil industry. Following Sorensen (and also Marshall [1920]), we have identified three enduring sources of rent. First, some of the monopoly rents enjoyed by entrepreneurs are created *naturally*, since increasing returns to scale often make the costs of entering production within a given country prohibitive (e.g., network industries).[25] Governments may create rents by issuing concessions to open mines or licenses to run tobacco and liquor shops. Second, there are *personal* rents on biological endowments, such as individuals' genetic predispositions (e.g., special talents in popular sports or the arts). The third type is resource endowment at the level of firms and countries which exploit mineral wealth,[26] as well as other types of geographical advantages such as access to open sea, sunny beaches, or snowy mountains, and so on.

This rent-based interpretation of the importance of the natural-resource sector can be further generalised. As the Hungarian economist János Kornai (2013) has argued convincingly, in other sectors (such as manufacturing or services), the most important "markets are oligopolistic"—perhaps even more so than in the natural-resource sector. The most efficient firms harness higher-than-average profits through arbitrarily large markups—or, to use our terminology, they exploit a scarcity rent. This is not merely a theoretical possibility. A recent US study (Furman and Orszag 2015) shows that the most profitable 10 per cent of firms have indeed pulled away sharply from the rest. Their return on capital invested has risen from more than three times that of the median firm in the 1990s to eight times. This—as the cited study suggests—is way above any plausible cost of capital and likely to be pure rent.

This increasingly skewed distribution of profits (containing rents) could explain certain types of wage inequalities as well. When an industry includes only a few big companies, they don't have to compete with one another as hard-to-attract employees—and thus can end up paying their workers less than they would if there were true competition (labour-market monopsony). However, the opposite mechanism may work as well. Because of the rent component hidden in these firms' profits, they can afford to pay *all* or *some* of their employees more than the industrial average. There are usually two interrelated factors behind this: pioneering technology[27] and economies of scale arising from the concentration of firms within any given country. In fact, both of these factors play a crucial role in generating revolutionary (or Schumpeterian) innovation. While this generalisation may sound idiosyncratic for many economists trained on neoclassical equilibrium models, it is a commonplace in management science literature that many important industries never have more than three significant competitors.[28] This same school of thought also claims that the shares of the three leading companies in many markets reach a ratio of approximately 4:2:1—that is, there is a significant market share difference even among the top firms. Data from the US Census Bureau also supports this claim. In 2012, the top four US firms' average share of total revenue on a sector-by-sector basis was close to 50 per cent in the IT, telecommunications, and media sector, 40 per cent in retail trade, and almost 40 per cent in the finance and insurance sector.[29]

It is very important to underline that state-created monopolies or oligopolies are not necessarily evil, as they are often justified by other social objectives rather than social equity. For example, there are good and widely accepted reasons why the intellectual-property rights of pharmaceutical companies, individual innovators, and artists are defended by patents and copyrights—"closure" in the Weberian sense. It is not surprising that Aghion et al. (2015) found positive and significant correlations in the US between innovativeness and top-one-per cent income shares. Similarly, it makes a great deal of sense to require state permission for firms to build nuclear power stations, or even simple two-storey houses. It is also in the general interest that physicians have to acquire special occupational licences (e.g., a university diploma) before they can start treating sick people. Other types of regulations (e.g., land-use bylaws in urban areas) can be assessed, if at all, only on a case-by-case basis.

Institutional Consequences of Rent

Rents have at least three institutional consequences. Firstly, certain types and some levels of rent are necessary for social cohesion and innovation in society. Such rents may be seen as "deserved", but on some level they are still "unearned". The major legitimacy claim of market capitalism is meritocracy. At some point, the public will judge rents generated by any means to be "excessive" if those who receive them "do not work for them". Most people accept that some rent is due to drug manufacturers and innovators, but there may be a cap on the amount that is seen as "reasonable", after which point any further rent will be considered "exploitive". The same is true for social benefits. In civilised societies, most people accept that the poor (or disabled) should have some social support (even if it is "unearned"), but at some point it may be judged to be "too much".

Secondly, if individuals' wealth comes increasingly from rent rather than wages or profits earned day after day in a capitalist enterprise, there is little institutional incentive to reinvest such rent. The *nouveau riche* and heirs to fortunes are tempted to waste the rent they have collected—easy come, easy go. Profit-maximising entrepreneurs tend to invest their profits in optimal ways in order to fight off direct competitors. Rent collectors do not face competition; rent can be spent on "conspicuous consumption". *Nouveau riche* entrepreneurs tend to use a chauffeur-driven Mercedes or private plane well before they can afford it. In a best-case scenario, second- and especially third-generation heirs will spend their inheritance on charity; in a worst-case scenario, on conspicuous consumption. The absence of institutional mechanisms which motivate owners of wealth to use it in efficient ways can have devastating social and economic consequences. It can lead to state failure and economic stagnation or even collapse.

Thirdly, and finally, in opposition to Piketty's main line of argumentation, we contend that voters and political activists are chiefly concerned about the *personal inequalities* of income around them. They are thus much less concerned about the concentration of economic wealth and power in the form of publicly traded shares or family-owned companies—that is, the relevant wealth of capitalists in a class-based model. While it is true that sensational formulations—for instance, "48 percent of the world's wealth is owned by 1 percent of the world's population"[30]—can easily catch the attention of the media and, through the media, stick in the memory of social scientists (including Piketty, who often quotes such data), such "facts" do not tend to mobilise ordinary people. People tend to be agitated not because of gaps between business people and wage earners, but rather because of the large variations in employees' wages. Typical cases are when the salaries of doctors, teachers, or police officers are compared to the salaries of bank managers, or celebrated athletes and musicians, or when minimum wages are compared to the minimum cost of living. This is one type of scarcity rent, as we explained above.

Class Reproduction Through the Accumulation of Human and Cultural Capital

The "educational system" is an important terrain of Weberian closure. Given the high cost of education, especially of elite education, the most highly valued education is often inaccessible to youth whose parents cannot afford the often prohibitive costs.

This problem is particularly prevalent in the US. At Ivy League universities, youth from white upper-middle- and upper-class families are overrepresented despite efforts to support the children of less privileged families. One obvious mechanism is strictly achievement-based entrance exams, on which children from more affluent families simply outperform those from average families. It is less obvious, but US colleges' recent efforts to admit students not just on the basis of measurable intelligence, but also on the basis of being "well-rounded" (i.e., having taken ballet classes, performed in plays, founded clubs, volunteered time helping handicapped children, etc.) works in the same direction as well. Whereas there is some randomness in the distribution of intelligence, these sorts of extra-curricular activities tend to be the domain of upper-middle-class, private-school-educated children.[31]

In sum, inheritance is another market-based institution which creates rent for its heirs. This can be inheritance of wealth (including valuable real estate) or social status linked to education at elite universities. This is what Bourdieu and Passeron (1970) called "cultural capital", as distinct from "human capital". Cultural capital does more to reproduce the "patrimonial middle class" or "patrimonial upper class" than to increase the productivity of the graduate. It may cost parents as much as $300,000 or $400,000 to get their children an Ivy League BA or BSc, but that Ivy League degree will likely pass a kind of "noble" status on to their descendants. Employers do not necessarily seek Ivy League graduates because their technical skills are better, but also because hiring such people can add to the prestige of their institutions.

The experience of the US—in many ways the pacesetter for the capitalist economic system—shows that family formation through "assortative mating" further strengthens these tendencies.[32] Since educated men tend to marry educated women more often than they did two generations ago, this inevitably leads to a concentration of income and wealth, which in turn helps these "privileged" parents invest time and money in their children's futures, literally from the day they are born. Children born to families in which both parents (and especially grandparents) hold university degrees outcompete their less privileged peers up and down the educational ladder and later on the job market. This is the main institutional channel through which social inequalities are regenerated and thus patrimonial capitalists are taking more and more ground—and not just the top 1 per cent, as Piketty suggests,[33] but the entire upper-middle class. Three successive cohort studies of 70,000 children born in the UK in 1946, 1958, and 1970 have shown that childhood circumstances—as determined by their parents' social status—profoundly influence life expectancies and lifetime inequalities, despite all the welfare measures introduced by successive British governments since 1946.[34]

There is an additional mechanism of closure in the educational system and that is "credentialing". Education is often conceptualised in terms of human-capital investment. It is usually assumed that human capital invested into education will lead to productivity gains and higher incomes resulting from those productivity gains. Nevertheless, powerful professional associations (such as the American Medical Association and the American Bar Association) can manipulate the supply of occupations under their jurisdiction by promoting licensing examinations, thereby driving up incomes for those occupations by adding a rent component to market-equivalent incomes from work.

* * *

There is no need to list examples demonstrating that the term "rent" is used with different meanings not only in common parlance, but also in scholarly literature. In this section, we have tried to delineate the various types of rents and their characteristics. In the spirit of Ricardo, Weber, and Sorensen, we consider all incomes rents if they stem from ownership of

Table 5.1 Rents extracted in advanced market economies by firms and individuals

		Time horizon		Favourably mostly for	
		Temporary	**Enduring**	**Owners of for-profit firms**	**Ordinary individu-als**
	… without direct state involvement				
1	Innovative technology	x		x	
2	Positional goods and services (e.g., agricultural land[a], real estate, honoraria of art and sport celebrities)		x	x	x
3	Natural monopolies based on economy of scale and scope (e.g., network industries, shopping malls)		x	x	
4	Limits to market entry by professional organizations (e.g., lawyers, doctors)[b]		x		x
5	Cartel agreements	x		x	
	… with direct state involvement				
6	Copyrights and other sorts of protection of intellectual properties (e.g., pharmaceutical industry)	x		x	x
7	Solidarity rent (e.g., collective bargaining, welfare payments)		x		x
8	Limits to market entry through licensing (e.g., medical profession)		x		x
9	State capture (e.g., discriminative law-making, tainted public procurements)	x		x	

[a]First analysed by D. Ricardo
[b]First analysed by A. Smith

any assets, where access to such assets is closed for other economic actors. Our present list comprises nine forms of rent, but it is not exhaustive; depending on the institutional setup of a given country, additional categories could be included (Table 5.1).

The Role of Rents in Post-Communist Capitalist Societies

As we have argued in the preceding sections, there are robust indications that Western capitalism is becoming patrimonial capitalism. We are ready to accept this as a general hypothesis in the post-communist context as well, although it is still unclear whether the children of present-day oligarchs in Russia and China will be able to pass their property rights—including the rights to sell their assets to foreigners and to move their families' financial wealth to foreign countries—on to their children.[35]

As we argued above at length, rent-seeking behaviour has been present in all capitalist market economies, even in the most advanced ones. Centuries ago, high levels of inequality were driven by two forces: (i) in European countries (especially England), the privileged estate was able to convert its feudal privileges into privileged positions in the market; (ii) since appropriate mechanisms of market regulation were not in place, it was possible to create monopolies, or to create cartel-like agreements. A fitting example is the rise of the "robber barons" of the late nineteenth century in the US (Josephson 1934; Folsom 2010). Some of these robber barons came close to "state capture" until the state's elite fought back with anti-trust legislation.[36]

The transition from socialism to capitalism was often driven—or at least coloured—by similar and sometimes more extreme rent-seeking behaviour. During the transition from feudalism to capitalism, there was an intense struggle by old elites to retain their power by converting their formerly privileged positions into economic wealth. Those who suddenly converted from the idea of centrally planned economies to free markets did not always realise that some regulation and planning might be necessary to ensure genuinely free and competitive markets. Similarly, private-property rights were often, and still remain, ambiguous. The conditions of law and order and the separation of powers—especially the separation of politics from the economy—were, and still are, in the process of negotiation. These conditions could not be implemented instantly after the disintegration of socialism. Even a quarter of a century after the transition, these conditions are still debated intensely in many countries. Post-communist capitalism is a curious system, where in many cases (Russia after 2000; Hungary after 2010; and Poland after 2015) "*politics remain in command*" to a large degree, even today. Ironically, Mao correctly defined the essence of socialism with precisely this formulation.

The institutional inertia of the transition was aggravated by a sense of general urgency to convert state property into private wealth as quickly as possible (although this has not been the case in China). In 1991, Boris Yeltsin set the goal of building capitalism in Russia in 500 days. During the early 1990s, political elites and their economic advisers believed that once they could identify owners for formerly state-owned firms, the free market would resolve all their other problems. They did not care about the rights of—or attempt to identify—the original private owners. If the first owner was incompetent or corrupt, market competition would replace him with a competent market actor. Given the specific circumstances, we shall distinguish *three different rent-seeking mechanisms*:

1. Market capture by political elites

This phenomenon can be further broken down into three variants:

(a) *Old communist cadres' use of market mechanisms to turn state property into private wealth*

In the early stages of privatisation, it was often assumed that the former communist elite would convert its political capital into economic wealth.[37] In the eyes of many commentators, post-communist capitalism was simply a "kleptocracy" in which political bosses stole state assets. This undoubtedly occurred regularly in Russia,[38] Ukraine, the Central Asian republics, and—to a certain extent—Bulgaria and Romania, where the circulation of elites was minimal during the first few years. As Hankiss and Staniszkis have articulated, communist elites in Hungary and Poland quickly started trying to convert state-owned enterprises (SOEs) into private firms by using a technique called "spontaneous privatisation".[39] However, these groups lost political power in 1989–1990.[40] As far as we can tell, communist political leaders in Hungary and Poland did not succeed in accumulating substantial wealth prior to 1989. Nevertheless, there is a kernel of truth to Hankiss' and Staniszkis' hypothesis. Some of the post-communist "new rich" in both countries began to accumulate capital before and during the transition, which became a starting point for the wealth they eventually amassed.

(b) *Market capture by new political elites during the privatisation of state property, either for personal enrichment or the recruitment of clients*

When mass privatisation became the official policy of these governments, SOEs were converted into private property either by means of vouchers through sales at competitive auctions. Many workers, ordinary citizens, and their heirs did not know what to do with vouchers and thus sold them to risk-tolerant young investors under market conditions which changed daily. However, as we know from Polányi (1944), markets do not materialise out of thin air; these markets were created and managed by states and political elites, and thus it was inevitable that domestic and foreign investors would confront market management.

During the communist era, private ownership was outlawed, and thus the accumulation of private capital was very limited. For domestic investors to be able to purchase state property, it had to be under-priced. Domestic investors without reliable track records or credit ratings needed government-guaranteed loans. This resulted in the preselection of the investors who could make bids at these auctions; being preselected was inevitably a consequence of personal or political capital. In countries where communist elites survived (like China), or where the new elites monopolised political positions (like Russia, Bulgaria, or Romania), former (or in China, still active) communist cadres had specific advantages.

China is a special case, since its market transition took place under the rule of the Communist Party. According to the Forbes and Hurun lists of Chinese billionaires (see Szelényi 2010) during the first two decades of reform, wealth accumulation was driven mainly "from below". As of the year 2000, virtually all Chinese billionaires had come from humble backgrounds, having begun their careers as rice farmers of bricklayers. Privatisation of large SOEs started around 1997, and there is some evidence that over the past decade or so, some high-level communist cadres and their families have become super-rich.[41] In Russia, Boris Berezovsky and Roman Abramovich are prime examples of people who have acquired substantial wealth mainly due to their *contemporary* personal relationships, rather than *previous* political connections.[42]

However, in giving these "grants" to the new grand bourgeoisie they had appointed, political bosses also anticipated certain kinds of returns. In exchange for Yeltsin's contribution to his advancement as a businessman, Berezovsky supported Yeltsin's 1996 re-election campaign, and when a Communist Party candidate came to represent a real threat to Yeltsin's prospects, Berezovsky also managed to persuade six other oligarchs—the so-called Big Seven, the wealthiest of the wealthy at that time—to support the president. In addition to Berezovsky, the members of the Big Seven included Mikhail Fridman, Vladimir Vinogradov, Mikhail Khodorkovsky, Vladimir Gusinsky, Vladimir Potanin, and Aleksander Smolensky. In 1996, only five years after the collapse of the USSR, the Big Seven claimed that they owned half of Russia.[43]

(c) *Manipulating markets after privatisation for personal enrichment or the recruitment of clients*

The suspicion that political office-holders might use their offices for personal enrichment is still a serious concern. Bálint Magyar (2016), a trained sociologist and a former minister in the Hungarian Socialist-Liberal governing coalition of the 1990s and early 2000s, has characterised Hungary's post-2010, right-wing FIDESZ government as a "*Mafia state*". In his model, Prime Minister Viktor Orbán plays the role of a "godfather". Some scholars assert that government contracts and EU-subsidised programmes are allocated to loyal clients, including family members and members of Orbán's "adopted family".

Arguably, one of the most important mechanisms is the manipulation of public procurements, which, by law, require open competition. Some sectors are particularly susceptible to such manipulation (e.g., road construction, IT services, and commercial advertising paid for by SOEs). By governmental decree, such purchases can be declared to be "emergent", which bypasses complicated competition requirements and gives contracts to clients who are occasionally proxies for government officials. Without competitive bidders, or with reduced numbers of bidders, prices for the services the government contracts can be way above what they would have been in free competition; thus the winners of such bids collect substantial rents over the profits they would have made on real markets.[44] The government can also place limits on the licenses it issues to popular radio stations or television channels, for instance.

As the Yeltsin example illustrates, electoral campaigns need funding from wealthy supporters who finance the campaign directly and indirectly through the media. Such deals could be a source of personal income for political bosses such as President Putin in Russia[45] or Prime Minister Orbán in Hungary. The allocation of tobacco-shop licenses in Hungary was an easy way to reward a significant number of supporters. Prior to this, virtually all Hungarian stores (including grocery stores and gas stations) were allowed to sell tobacco, and a substantial part of their income came from this trade. In 2013, the government created special stores with the exclusive right to sell tobacco, thus transferring "rent" from other stores to the newly licensed tobacco stores. This was not a major source of income; nevertheless, it created a 20-year monopoly for thousands of small shop-keepers, who, according to opposition politicians, were loyal supporters of the government.

Of course, such manipulation of markets is well known in all countries (famous examples include public purchases of military equipment in the US). However, as discussed above, these practices are especially widespread in post-communist economies. This is not only our opinion; it is one of the main reasons why Transparency International has labelled these countries "corrupt". Ironically, the harm done in this way by European Union (EU) money which was meant to help the new (post-communist) member states has outweighed the progress emanating from newly devised transparency mechanisms which were conditions of EU membership.

(d) *State capture by oligarchs*

State capture by business elites is most often seen as a manifestation of rent-seeking and corruption in non-post-communist emergent markets, such North America in the late nineteenth century or Africa in the twentieth and twenty-first centuries. Such rent-seeking behaviour exists in post-communist nations, but it is relatively rare, given the weakness of the propertied bourgeoisie there and its dependence on political elites. As we have already mentioned, those who managed to capture the state in the US in the late nineteenth century were called "robber barons", prime examples of whom include Rockefeller, Vanderbilt, and Gould. In the post-communist world, powerful figures such as these are generally referred to as oligarchs.

The use of the term "oligarchs" is disputed. In this chapter, we apply it to those super-wealthy individuals who have managed to privatise the post-communist state itself. They are not unlike the "boyars" of early tsarist Russia, a class of wealthy individuals who used politics and the state to gain wealth rather than the other way around. It is only in Russia towards the end of the Yeltsin years where we see cases of the latter—that is, state capture by the new wealthy.

As the newly recreated Russian state began to collapse, the largest business conglomerates began to build up their own armed security forces, occasionally with as many as 1000 mercenaries. Indeed, important businessmen needed security forces, since the city of Moscow was ruled by mafia organisations, usually run by Russians or Chechens, and without the protection of one or the other, life was virtually impossible for such business figures. Two such figures, Gusinsky (protected by Russians) and Berezovsky (protected by Chechens), suspected each other of being responsible for assassination attempts and of plotting to frame each other with the help of law enforcement. Finally, in 1996, these two giant oligarchs negotiated an agreement to cooperate, rather than destroy each other.

Berezovsky is the best example of an oligarch. After Yeltsin's 1996 re-election as President, Berezovsky became involved in affairs of state, serving as deputy secretary of the National Security Council in charge of Chechnya. As many of his bodyguards were Chechens, he had working relationships with the Islamist leaders responsible for the Chechen uprising. Even after Berezovsky left this position, he continued to negotiate with Chechen rebels to free hostages. Berezovsky used his business success to gain substantial political power and eventually political office; many commentators assumed he used this office to enrich himself personally.

2. Capture of oligarchs by autocratic rulers

In 2000, Berezovsky and some of the surviving members of the Big Seven (namely, Khodorkovsky and Fridman) supported Vladimir Putin's election campaign, bringing Putin "into the family", to use the language of the mafia. Even so, Putin was no Yeltsin; he wanted to be Peter the Great and refused to be bossed around by "boyars"—that is, oligarchs. Although Berezovsky was elected to the Duma (the Russian legislature) in 1999, he soon clashed with Putin and fled to England. He was later accused of various murders and sentenced to prison in absentia.[46] Berezovsky became public enemy number one for Putin's Russia; it is rumoured that Russian agents made several attempts to murder him in London. He passed away in 2013 in mysterious circumstances. Berezovsky might have been killed by Russian intelligence services; it is also possible that he lost so much of his wealth (mostly to Abramovich) that he was unable to adjust to a more frugal lifestyle and instead committed suicide.

Like Berezovsky, Khodorkovsky was also too politically ambitious for Putin. In early 2003, sensing trouble with Russia's new political boss, Khodorkovsky proposed to merge Yukos with the other major Russian oil company, Sibneft. When Berezovsky was forced to flee Russia, he passed ownership of Sibneft to Roman Abramovich (who was already ranked number two on lists of the wealthiest Russians in 2009), who regarded Berezovsky as his mentor. In 2003, Khodorkovsky was put on trial for corruption and sentenced to prison. He was released in 2013, after which he moved to Switzerland with a small portion of his former wealth. In 1999, he was believed to be worth $500 million; today his assets are estimated to be around $100 million. While Khodorkovsky was "eliminated" by Putin, Abramovich has been a survivor. This may be due to the fact that unlike Berezovsky or Khodorkovsky, he has kept a low profile and assured Putin of his unconditional loyalty. As a reward, he inherited a great deal of property from his former mentor and bitter enemy, Berezovsky.

Excessive rent-seeking threatens the legitimacy of the post-communist regimes and even the institution of private ownership. In response, political elites have launched anti-corruption campaigns. However, it remains to be seen whether such anti-corruption drives will actually reduce rent-seeking, or if they are merely instruments with which to remove political enemies or to reallocate the wealth of oligarchs whose loyalty is in doubt. Khodorkovsky was jailed on charges of corruption, but it was hard not to see political motives behind the struggle between Putin and Khodorkovsky. It is thus possible that these corruption charges were instruments for the *selective criminalisation* of Putin's enemies. Many members of the economic and political elites of the post-communist era are likely to have skeletons in their closets that would also make them vulnerable to such prosecutions.

Executives in such conditions—given the ambiguities of legal regulations and private ownership in post-communist societies—may be even more likely to offer their gratitude (or bribes) to politicians. And even in more established liberal democracies, political elites may be inclined to accept thanks (bribes) for their services. There are many candidates labelled as "corrupt"; the question is, "Who will be selected in the end?"

In 2012, when the Communist Party of China transferred power from President Hu to President Xi, authorities launched a new anti-corruption campaign, promising to catch "tigers and flies". So far, they have caught quite a few flies and some tigers, but those tigers look very much like the political enemies of those in the highest positions of political power.

The first tiger to be subjected to an anti-corruption investigation was Bo Xilai. Bo was the first secretary of the Communist Party of Chongqing, the largest city in the world, and an aspirant for a position on the Standing Committee of the Politburo. He was a Maoism-inspired left-populist politician. He kept speculators out of the urban land market and used the profits from that market to build public housing, schools, and medical facilities (Huang 2011). Although people had to sing songs from the era of the Cultural Revolution, they received better services. Bo Xilai appeared too popular and too dangerous to the Beijing establishment. Although he was not completely innocent, his selection as the first "tiger" may have had more to do with his candidacy for the Standing Committee of the Politburo than with his involvement in corruption. The case against Bo Xilai started with the prosecution of his wife Gu Kailai. Gu was convicted and eventually sentenced to life in prison for the murder of an English business associate, Neil Heywood. She might have been the murderer, but Heywood's body was cremated immediately after his death, preventing an in-depth forensic analysis and hindering the criminal investigation. Nevertheless, in 2012, a court took seven hours to find her guilty and sentence her to life.[47] Eleven months after his wife's trial, Bo was tried on charges of corruption and abuse of power. He was found guilty of having received bribes totalling $3.6 million from two local businessmen. He may very well have taken these bribes, but what is curious is why top party leaders, whose family fortunes count in the billions of dollars, are not also under investigation for the suspicious speed with which their wealth has accumulated.

Selective criminalisation and "capturing" the *nouveau riche* are not exclusively Russian or Chinese phenomena. Some commentators suspect that the Romanian president Klaus Iohannis' anti-corruption drive may also be politically motivated, and there is little doubt that witch-hunts are also widely used in Hungary, especially since 2010. The centre-right government there has accused many former socialist and liberal politicians of corruption. After spending long periods in "pre-trial detention", most of these politicians have been found not guilty by relatively independent courts. The Hungarian government made another interesting case in moving against a "newly rich" businessman for perceived disloyalty. Lajos Simicska, the former treasurer of the party that has ruled Hungary since 2010 (Fidesz) and a winner of many restricted competitions for government contracts, suddenly fell out of favour with the prime minister. By the end of 2014, Simicska was excluded from public-procurement tenders, and all government advertising had been pulled from his media firms. Most recently, even the hunting plot he rented from a state-owned forest farm was taken away from him. As the prime minister put it, "Trees cannot grow into the skies."[48] Unlike Khodorkovsky, Simicska is not in jail, but his business empire is in serious trouble. In 2016, another former Hungarian oligarch, Zsolt Spéder, suffered a similar fate; he had been allowed (or instructed?) to build a financial conglomerate out of a renationalised commercial bank and the 100 per cent-state-owned national post company. While under police investigation, he has been forced to give up his banking empire and his real estate holdings, and will probably lose his media portfolio.

Consequences of Inequalities

Before we move further, let us put the institution of rent in brackets for a moment, as if it did not exist or did not matter to society. As long as wages are on the rise, rent-seeking is a positive-sum game, as we argued at the beginning of our chapter. Neoclassical equilibrium models are all based on this assumption, which was perhaps not very far from reality until recently. Globalisation, however, has radically changed the outcome of the game.[49] While profits have been rising in many sectors of the US, Germany, and other large economies, real wages in those same sectors have been stagnating as a consequence of—inter alia—outsourcing and the growing share of the financial sector. Thus, we agree with Piketty that the wage-profit relationship in advanced Western countries could become a negative-sum game for low-skilled workers and employees, which will in turn fuel populist sentiments against globalisation, migration, the highly educated, and highly paid business executives.

Having said this, we still assert that inequality is only loosely related to economic growth or social stability. In some societies—the US, for instance—high levels of inequality are generally accepted; despite a GINI coefficient over 0.40, the US still enjoys relatively robust growth and a reasonable level of social stability. Other societies (in Scandinavia, for instance) tend not to tolerate inequality, but still produce good growth rates and high levels of social stability.

The current which runs counter to Piketty is that increasing levels of inequality do not necessarily lead to political instability. Important counterexamples can be observed both in Western and post-communist democracies and in post-communist authoritarian regimes. The underprivileged poor are inclined to abstain from voting in elections; this holds for such divergent countries as the US and Hungary, and political elites are fully aware of it. In a vote-maximising strategy, pro-poor policies simply do not pay off. In authoritarian China, where elections are largely ceremonial, inequalities have skyrocketed, but so far the popular response has been mute. Economic growth has been phenomenal there since 1978; this rising tide has lifted the boats of hundreds of millions of people out of poverty, though at very unequal speeds. People may therefore accept more inequality as long as their prospects for a better life seem secure. Martin Whyte (2010) found that inequality was not a major concern for ordinary Chinese citizens; Russians' experiences of the first few years of the twenty-first century were similar.[50]

Furthermore, both everyday experience and academic research show that ordinary people tend to have little understanding of the true (i.e., statistically measured) size of the inequalities in their own countries. With a variety of large, cross-national surveys, Gimpelson and Treisman (2015) demonstrated that what people think they know is often wrong. On their list of 40 countries, the "least correctly informed" people are the citizens of 8 post-communist countries (Ukraine, Hungary, Croatia, Slovakia, Estonia, Poland, Slovenia, and the Czech Republic), while at the top of this list we find two rich welfare states (Norway and Denmark).[51] Moreover, these authors showed that the *perceived level of inequality*—not the actual level—strongly correlates with ideologically motivated demands for redistribution and the reported level of conflict between the rich and the poor.

What seems to annoy people—ordinary people and social scientists alike—is the knowledge *or* the presumption that successful entrepreneurs (and especially the most successful ones) are greedy, dishonest, and corrupt. During the recent financial crisis, the North American media used "Main Street" to represent the interests of everyday people and small-business owners, and "Wall Street" (in the US) or "Bay Street" (in Canada) to symbolise the interests of highly paid managers working for large banks and corporations. In Southern European countries like Bulgaria, Romania, and Greece (or in Latin America), the prevalence of corruption is an important cause of political instability and strikingly low levels of trust in market institutions.

Conclusions

As we have already shown, using the example of Ricardo's failure to "scientifically" predict the rise of scarcity rent for agricultural land, it is inherently impossible to predict the future trends of other types of rents, too. As the last 20 years have exemplified, rents on oil-and-gas extraction can vary enormously and, with them, so do the relative income positions of the workers in these fields. In Central and Eastern Europe, the funds flowing from the EU are the main drivers of the rent-seeking practices of those firms, individuals, local governments, and so on, which are close to centres of political power, where access to EU funds is controlled.

The main implication of the present chapter is that the crucial issue is not the extent of measured inequality (in incomes or wealth). It is possible for a capitalist country with a GINI coefficient of 0.40 to be as economically dynamic and socially cohesive as one with a coefficient of 0.20.

Beyond pre-capitalistic legacies like ethno-racial conflicts, religious cleavages, and gender-based pay gaps, as described in Mihályi and Szelényi (2016b), our key political economy question in this chapter has been whether profit-seeking or rent-seeking is the mechanism which generates inequality in Western-type democracies and in the post-communist states. Our conclusion is that the statistically measured changes in the distribution of wealth at the level of society cannot be explained by the secular rise of profits, as Piketty contends. Since the 1970s, rents have played an increasingly important role.

Our second assertion is that rents are not anomalies in liberal market economies. Strong institutions guarantee their recurrence. Different types of rents exist. Some of them are obviously harmful and deplorable, while others are unavoidable or even indispensable. Hence, our contribution to the current literature is a largely value-neutral reintroduction of the Ricardian concept of rent. At the same time, we have no doubt that rents, rent-seeking behaviour, and increasingly large inequalities of wealth can be destructive. There are two such potentially destructive institutional arrangements: state capture by private businesses and market capture by political elites. These are obviously harmful phenomena; they threaten the legitimacy of both the varieties of capitalism under discussion here—the traditional Western-type and the post-communist model—and undermine their economic efficiency.

Notes

1. See Mihályi and Szelényi (2016a, b, 2017).
2. For example, Summers (2016).
3. It is another—though not unimportant—matter that the epoch between 1910 and 1970, when measured inequalities fell, was far from ideal. This period was burdened with, inter alia, the Great Depression, two world wars, and the Iron Curtain.
4. In Mihályi and Szelényi (2016b), we deal with interpretations of the adjective “excessive” at length. Piketty’s entire argument is based on his alleged discovery that $r > g$, where r is the average growth of profits and g represents the average growth of GDP/capita. We show that the $r > g$ model is a statistical artefact arising from the intermingling of the concepts of profit and rent on the one hand, and capital and wealth on the other.
5. Keynes (1920, 1971), p. 20.
6. *Ibid.*, pp. 18–19. Italics in original.

7. Roemer (1982), p. 196. Using another metaphor, this idealised capitalism is a win-win situation for workers and capitalists.
8. One qualification, however, is justified. Profit-maximising behaviour can reduce wealth at the national level. A classic example is outsourcing (especially in case of off-shore investments of capital gains), which can cut wages and create unemployment at home, though it still creates wealth globally and tends to reduce global inequality.
9. In economic textbooks, this is often called "economic rent".
10. As Ricardo put it, "The rise of rent is always the effect of the increasing wealth of the country, and of the difficulty of providing food for its augmented population. *It is a symptom, but it is never the cause of wealth*" (our emphasis). (*op. cit.*, p. 40.)
11. Ricardo (1817, 2004), p. 34.
12. Another way of formulating our criticism is that Piketty (2013) conflates profits and rents and—as Weil (2015), Stiglitz (2015), and Atkinson (2015) have pointed out, among others—deliberately disregards the differences between capital and wealth. By contrast, Hodgson (2014) argues that the extended definition of capital—which includes cash, bonds, collateralisable assets such as buildings, and intellectual property—has analytical advantages as well.
13. Perhaps this was one of the reasons why his book was so well received in many mainstream macroeconomic departments.
14. According to the FAO's definition, agricultural land covers only 33 per cent of the world's landmass.
15. In *The Mind and Society*, Pareto made an interesting distinction between "speculators" (foxes) and "rentiers" (lions)—that is, between those who seek profits and those who seek rents. A balanced market economy needs both foxes and lions; dynamism and innovation have to be counterbalanced by stability.
16. *The Economist*, 20 August, 2016, pp. 15–17.
17. See, for example, Tullock (1967), Krueger (1974), Buchanan et al. (1980), and Bhagwati (1982).
18. See Weber (1920, 1978), pp. 43–44.
19. Solow (2014) calls supermanagers' rent a "sort of adjunct to capital".
20. On first glance, the Weberian concept of "closed" and "open" relationships looks identical to the proposition in Acemoglu and Robinson (2012), who coined the terms "exclusive" and "inclusive" societies. However, the two are not the same. The American authors—as the title of their book emphasises—analyse the growth process at the level of nations. Weber speaks of "closed" and "open" relationships within a given economy—and this is the right approach, if we are analysing inequalities within a given country. The same can be said about the dual concept of "open and limited

access orders", presented in North et al. (2012). Nevertheless, we strongly agree with their other assertion about the ubiquity of rent in every society, including the most advanced countries.

21. Between 1980 and 2013, average trade-union density in OECD countries fell from 33 per cent to 17 per cent. This decline was uniform across all member countries, with the notable exception of the Scandinavian countries and Iceland. https://stats.oecd.org/Index.aspx?DataSetCode=UN_DEN# accessed on July 10, 2015.
22. *op. cit.*, p. 1536.
23. *op. cit.*, p. 1537.
24. It is noteworthy that in The World Top Income Database, one of the bases of Piketty's book, consumer durables and unfunded defined-benefit pensions are not taken into account.
25. In the context of globalisation, however, the number of companies is growing in every industry worldwide, and thus competition is actually increasing at the international level.
26. For many years, the World Bank has been regularly publishing country time-series under the label *Total natural resources rents (percent of GDP)*, whereby rents are defined as the sum of oil rents, natural gas rents, coal rents (hard and soft), mineral rents, and forest rents.

    See http://data.worldbank.org/indicator/NY.GDP.TOTL.RT.ZS
27. As we explained earlier, this is a temporary advantage.
28. This finding was first demonstrated by the founder of the Boston Consulting Group, Bruce Henderson (1976), then reconfirmed empirically by Reeves et al. (2012), using a much larger data set. Since then, successful companies like General Electric and others have lived according to this maxim. If they cannot be number one or two in an industry, they get out of that market and reinvest their resources elsewhere.
29. See *The Economist*, 26 March 2016.
30. The renowned charity Oxfam (2015) timed the publication of its fresh research for the opening of the Davos economic summit, thereby skilfully capturing headlines at many news outlets. Another sensational formulation of this same report was that the "85 richest people on the planet have the same wealth as the poorest 50 percent (3.5 billion people)".
31. The authors are grateful to Daniel Treisman for this observation.
32. Greenwood et al. (2014).
33. *op. cit.*, pp. 485–486.
34. For example, the meticulously collected data for the 1946 cohort suggest that women born in socially better-off families had a death rate about half that of everyone else born in 1946. Pearson (2016), pp. 301–302.
35. We might add to this list the post-Soviet Central Asian republics, Belorussia, Ukraine, and Hungary—and since 2010, especially (but not exclusively) Romania, Bulgaria, Serbia, Albania, and Macedonia.

36. Theodore Roosevelt's anti-monopoly legislation of the early 1900s is a prime example of regulating rent-seeking.
37. This was the nomenclature-bourgeoisie hypothesis of Erzsébet Szalai (1989), Elemér Hankiss (1990), and Jadwiga Staniszkis (1991).
38. One good example is Victor Chernomyrdin. In the mid1990s, the CIA estimated his net worth at $5 billion, though he claimed to possess only a few million. In 1978, he was already working at the Central Committee of the Communist Party; he later went back and forth between high government posts (deputy minister, minister of the gas industry) and major managerial positions (chairman of Gazprom). He was prime minister of Russia between 1991 and 1998. He passed away in 2010, taking his secrets to his grave. See Szelényi (2010).
39. Voszka (1993).
40. For an excellent comparison of Central European post-communist capitalisms, see Bohle Dorothee and Bela Greskovits (2012). However, it is important to underscore that none of the Central Europeans included on the Forbes billionaires list are known to have been high-ranking officials of the communist party prior to 1989; see Szelényi (2010).
41. There are contradictory assessments of the personal wealth of former prime minister Wen Jiabao and current president Xi Jinping. *The New York Times* reported that the net worth of each man's family may be in the range of $1–2 billion. If there is wealth in the Xi family, most of it was made by the president's daughter, Qi Qiaoqiao, and her husband Deng Jiagui. It is also rumoured that many large, nominally state-owned, firms are led by CEOs who are "princelings", the children of former "revolutionary heroes" (President Xi is one such example). Thus, in reality, these firms are entirely privately owned (Lu Peng, personal communication).
42. Boris Berezovsky (1946–2013) was one of the first and the most prominent founding member of the club of newly emergent oligarchs. In 1983, Berezovsky earned a Ph.D. in mathematics and became the director of one of the laboratories at the Institute of Management of the Soviet Academy of Sciences. There is no definitive indication that Berezovsky was close to high-ranking Soviet party officials. He had good relationship with the young reformers Yegor Gaidar, Anatoly Chubais, and Valentin Yumashev. Yumashev was a journalist who eventually became Yeltsin's chief of staff and the second husband of Tanya (or Tatyana) Yeltsin. However, in the early 1990s, Yumashev was only a ghostwriter for the president. He helped Yeltsin write his 1989 book and helped him with "Notes of a President," published in 1994. It was Yumashev who introduced Berezovsky to Tatyana, who at that time was married to Dyachenko, a commodity trader who later became Berezovsky's business partner at Sibneft. With his newly acquired contacts, Berezovsky managed to take major managerial positions

at—and eventually ownership in—the car-manufacturing firm Avtovaz, the Russian national airline Aeroflot, and the major oil company Sibneft.

43. The Big Seven—Russia's Financial Empires, www.worldbank.org/html/prddr/trans/feb98/bigseven.htm
44. For an empirical study of the situation in Romania, see Pirvu (2015).
45. Vladimir Putin's personal wealth is the subject of wild speculation. Some commentators claim he is the wealthiest man in the world, with a personal net worth of \$40–\$70 billion. Putin's official disclosures suggest that he owns two apartments and one spot at a garage, worth a total of \$119,000. There are also similarly wild and unconfirmed conjectures about the private wealth of Hungary's prime minister, Viktor Orbán. The personal wealth of current political office-holders may be overestimated by political opponents. In any case, smart political bosses do not accumulate wealth in their own names, but rather pass it on to their extended family and friends. Thus, if Putin has indeed managed to accumulate wealth of his own, it may be under the name of his daughter Yekaterina and her husband; it has been reported that the couple holds a \$2.83 billion share of the Silberg Company. Putin's friend, the cellist Sergei Roldugin, is also believed to have acted as his surrogate; Roldugin has reportedly moved billions of dollars into Panama.
46. While no murder charges against him were ever proven in a fair court of law, he was suspected of involvement in the murder of Vlad Listyev, Russia's most successful TV producer, who was killed four years earlier. Listyev supported the privatisation of TV 1 and its sale to Berezovsky, but he advocated fair pricing for advertising time, which clashed with Berezovsky's interests.
47. Without a body or a murder weapon, one would have expected a somewhat longer trial. She confessed, but the usual sentence for murder in China is capital punishment.
48. This metaphor was used at a semi-closed gathering of Fidesz party leaders, as reported in the Hungarian daily *Népszabadság* on 8 September 2014.
49. See Solow (2015), who bluntly acknowledges this.
50. Our recent paper Mihályi and Szelényi (2017) is devoted entirely to the role of rents in the transition process from pre-1989 socialism to the present-day capitalist system.
51. The list was compiled using responses to a questionnaire which asked people to choose the income distribution diagram with the Gini coefficient closest to the correct one for their country in 2009. At the top, 61 per cent of the Norwegian respondents correctly chose the diagram which represented the distribution of their post-tax-and-transfer incomes, while only 5 (!) per cent of the Ukrainian respondents did so.

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CHAPTER 6

The Emergence of the Patronage State in Central Europe: The Case of FDI-Related Policies in Hungary Since 2010

Miklós Szanyi

Introduction

Central Europe's transition from state socialism to capitalism has been marked by the substantial penetration of multinational businesses, especially in the Visegrád (V4) countries.[1] The role of foreign capital in establishing state-of-the-art manufacturing industries and service sectors has been seen as a systemic element with a significant number of historical antecedents in the region, especially in the territories of the former Austro-Hungarian Empire (Szanyi 2003). Another reason for the increasing

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involvement of multinational businesses there has been the unfolding process of globalisation. Markets have become global. Global competitiveness now depends on a suitable combination of traditional comparative (local) advantages and new, company-specific competitive advantages. The latter are most readily made available through the investments of multinational firms. The combination of various competitiveness factors is reflected in the most commonly used foreign direct investment (FDI) theory, the "eclectic paradigm" developed by John H. Dunning (1988, 2001). Nowadays, technologies, large factories, and enormous batch sizes enable firms to build regional centres. Production facilities no longer need to be established in neighbouring countries. First movers of the region, countries which opened up their economies early obtained significant advantages in FDI attraction. It now seems clear that multinational firms have become stable and progressive elements of the V4 economies.

It is therefore somewhat surprising that the strong presence of multinational businesses has become a political issue in the V4 countries, which have had rather successful records of attracting FDI. Political debates on multinational businesses have started and (populist) conservative parties have called for action against their spreading influence. This is most visible in Hungary and Poland. These debates are usually driven by anti-globalist sentiments; intense criticism is articulated, while benefits are neglected. It is possible to conceptualise this trend as an expression of economic patriotism (Clift and Woll 2012; Naczyk 2014). According to this sort of interpretation, (populist) conservative political elites would like to reshuffle the group of winners of the transformation process. However, international competitiveness still depends on the performance of multinational firms; moreover, international institutions continue to safeguard important achievements of liberalisation in world trade and factor flows. Opportunities to enact openly protectionist policies have thus been restricted; such approaches are now more commonly implemented in new, covert forms. The latter practice is reflected in changing state policies towards multinational business in Hungary and Poland. These new policies also mean a departure from the concept of the competition state and a shift towards the patronage state.[2] I argue in this chapter that the kind of economic patriotism which has been applied in Hungary and Poland runs the risk of killing off sources of dynamic economic efficiency by limiting not only global but also local competition.

In the remaining part of this chapter, I will first introduce the concept of economic patriotism as a form of business–polity relationship, highlighting the role of business elites and their networks. I will then provide empirical evidence of changes in Hungary's FDI-related policies to illustrate that such policies can be interpreted as a special form of economic patriotism. In that same section, I will also introduce the results of an empirical survey conducted among multinational firms which have signed strategic-partnership agreements with the Hungarian government. These long-term cooperation agreements were negotiated with a select group of multinational firms working mainly in manufacturing industries. The impact of this bilateral cooperation network will be evaluated in light of restrictive policies against other multinational firms.

Economic Patriotism and Changing Power Relations Among the Elites of CEE

Shifts in FDI-related policies in Hungary and other Central and Eastern Europe (CEE) (especially V4) countries can be discussed from the political-economic point of view. I interpret these changes as modifications of business–polity relationships. I have applied three main strands of this literature in this chapter. The first draws on the evolution of elites during the transition process; the second analyses the role of networks in business–polity relationships; the third approach combines the former two in a broader context and includes suggestions that the emergence of economic patriotism and clashes with the two-decade-long reign of neoliberal economic thought are reflections of a power shift in political and economic elites. In this chapter, I will focus on the Hungarian example to illustrate tendencies which might be applied to Central Europe in general. Even so, more research will be necessary to work out the details of similar processes in other countries.[3]

In order to investigate the Hungarian government's shift from FDI-friendly economic policies to a more low-key—sometimes even hostile—stance, it will be necessary to discuss briefly the starting point. In previous papers, I have argued that the FDI-led economic-development path that Hungary and other CEE countries took in their transition process had historic roots and was reinforced by the urgent need to restructure and modernise in the face of global competition (e.g., Szanyi 2003). However, this latter statement should not necessarily be taken as a given (as if it were an imperative of the globalisation process); it can be conceptualised as a deliberate policy implemented by the leaders of CEE countries in hopes of capturing economic and political power. I believe that in Hungary's case, FDI-led development was *necessitated* by the antecedents of the systemic transition which started in 1990. These determining factors included the need to reform Hungary's planned economy, an unwieldy debt burden which pushed privatisation towards the sales method, severely undercapitalised firms, and a weak domestic bourgeoisie (Szanyi 2003; for a comprehensive description of the Hungarian privatisation process, see Mihályi 2010). Although the background of—and policies related to—the transition differed in other CEE countries, the V4 economies all converged towards a FDI-led development model regardless of such differences. The dependent market economy (DME) model of Nölke and Vliegenthart (2009) conceptualised and criticised this development path. Given this background, I am inclined to separate various CEE policies into two categories: those which were initially intended to help multinational businesses, which soon became dominant in the V4 economies, and those which were later designed to reverse this dominance.

Elites

The CEE transition process was determined by the interplay of local political forces and international consulting institutions, the recommendations of which were informed by neo-liberal assumptions. The aim of shaping social processes so as to encourage the emergence of a local bourgeoisie was an important aspect of the transition process. Liberal notions of ownership conversion and the role of privatisation aggravated the political impact of the process. The selling off of state property was regarded as a crucial element of institution-building mainly because—it was hoped—doing so would reduce the influence of patron–client relationships between managers of state-owned enterprises and politicians, which had survived at various levels (Boycko et al. 1996; Rapaczynski 1996). The liberal model insisted on drastic reductions of the political influence of incumbent managers in order to make the transition process irreversible (Frydman and Rapaczynski 1994). Liberal theorists did not make particularly strong recommendations about the practical implementation of such general concepts—for example, in favour of foreign investors. The actual practice of privatisation thus varied among CEE countries. Even so, privatisation was a key element of the transition process in all of the former state-socialist countries.

Political-economic approaches to the privatisation process soon directed attention to the empirical fact that the influence and economic power of incumbent managers could not be eliminated (Stark 1996; Stark and Bruszt 1998). Nevertheless, fears that the transition process would be reversed proved to be unfounded. Instead, new power networks evolved, which included old and new players in the economy and in the state as well. New types of alliances were set up; new elites were created. While multinational businesses penetrated the transition economies' markets very quickly, local companies and entrepreneurs were slower to adjust (Szanyi 1996). Thus, market power rapidly shifted from local firms to foreign companies. Foreign penetration increased to unusually high levels.

This process of economic restructuring was also reflected in relationships between business and political leaders. Foreign and domestic business leaders organised themselves into various interest groups. Drahokoupil (2008) analysed the impact of the new elite which emerged around foreign-owned companies. He regarded this elite as the ultimate winners of the transition process in CEE, particularly in the V4 countries (and especially in comparison with incumbent technocratic-managerial elites and new entrepreneurs). He called this new elite "foreign investors with their comprador intellectual allies" and claimed that "the domestic comprador forces rather than their foreign allies had…a major role in domestic politics" (p. 361). The rise of this sector was intertwined with the consolidation of the "competition state", the main aim of which was the insertion of the local economy into the structures of global capitalism. It is important to note that the "domestic comprador elite" which is bound to foreign investors need not be a proprietor class.[4] Based on the "strategic-relational state theory", Drahokoupil et al. (2008) argued that the social relations of production, institutions, and ideas constitute "a (strategically selective) environment that provides advantages to some actors and certain strategies over others" (p. 363). If this environment is determined by one or another type of elite, its advantages will flow to actors affiliated with the given ruling elite.

The dominance of one or another elite may or may not be politicised or linked to parties in power. There is support for both notions—that is, for the view that elite dominance is a partisan issue, and for the view that it cuts across party lines. Drahokoupil (2008) argued that political support for the competition state transcended party divisions in CEE. Thus, the connected "comprador elites" might work under the rule of various political parties, though post-crisis experience has shown a more partisan approach towards foreign investors in some CEE economies, most importantly Hungary and Poland. Schoenman (2014), on the other hand, has suggested that types of business–polity connections are a function of political and economic uncertainty and the strength and degree of organisation of networks (lobbying platforms). According to him, all three of the aforementioned elites—incumbent technocrats, local entrepreneurs, and compradors—may or may not act in non-partisan ways in relation to the public, depending on their level of organisation and the amount of political uncertainty facing the ruling parties. According to this approach, the dominance of a certain type of elite may be challenged when there is a shift in the balance between global and local forces. Moreover, Schoenman (2014) found different patterns of business–polity cooperation in the various CEE countries; I will return to this issue later.

Local businesses developed representative organisations, but pre-transition-type links between managers and politicians also persisted. Most local businesses were formed by incumbent managers of pre-transition state-owned enterprises or petty entrepreneurs. One analysis of Hungary's business elite showed that most influential entrepreneurs had some kind of pre-transition career, either as party members, chief or second-line managers of SOEs, or petty entrepreneurs (Laki 2002). It also turned out that local entrepreneurs could not keep pace with the dynamic development, superior technological and market competences, and wealth of multinational competitors (Laki and Szalai 2013). Typically, influential Hungarian entrepreneurs participated in various service businesses (trade, logistics, hotels, business services, gambling, etc.), real-estate development, construction, and banking; far fewer engaged in manufacturing. They maintained good personal relationships with politicians and frequently became officers of various political parties. Thus, the relationships between Hungarian businesses and politicians depended much more on personal linkages than on representative organisations.[5]

Whether this is a temporary or more enduring phenomenon, business and political elites do whatever they can to stabilise their privileged positions. The administrative and corporate functions of the elites are integrated through personal ties, institutional channels, material benefits, and recruiting patterns. There are frequent exchanges of personnel between business, government (state, regional, and local administration), and supporting institutions (consulting firms, development agencies, law offices, etc.). Many persons hold several positions in various areas. Interactions between the state and the business community are usually institutionalised. As a result of important problems of agency, material benefits frequently flow back and forth between government and business, giving way to rent-seeking and corruption. Last but not least, personal careers usually combine positions in various areas of interplay between business and government. The recruitment system gives preference to those with broader professional experience including both business and government positions. While Drahokoupil (2008) provided evidence of the establishment of FDI-based elites in various CEE countries, other authors have described similar processes involving local businesses (Schoenman 2014; Naczyk 2014; Stark and Bruszt 1998; McDermott 2002).

Networks

Elites exercise influence through personal contacts and also by using the communication platforms of business networks. Depending on the focus of their research, authors tend to describe particular sets of business networks. Drahokoupil (2008) highlighted FDI-related networks and emphasised dependence on FDI. Naczyk (2014) concentrated on the Hungarian and Polish governments' sharp turn from policies which supported FDI towards preferences for local businesses, and thus mainly described local business networks and mechanisms of interplay between local business and government. Transparency International Hungary (TIH 2014) drew attention to the fact that after 2010, the then-new Hungarian government curtailed its communication with multinational businesses in an effort to reduce its dependence on FDI. At the same time, it allowed local business-interest groups to exercise more influence on government decisions. I believe that networks and communication platforms are always important channels for exchanges between business leaders and political elites; however, participants may have different access to them over time. The intensity of platforms' usage may also depend on the political climate. If a government needs more support (due to a weakened political position, for instance), they may rely more on networks and supporters.

In his concrete analysis of FDI-related networks, Drahokoupil (2008) provided an interesting comparison of the V4 countries. These networks have been organised by different types of groups. On the state side, regional development agencies and government agencies for the promotion of foreign investment have been most influential, especially in Hungary and the Czech Republic, though less so in Poland and Slovakia. In Slovakia, from 1997 to 2003, the Ministry of Economy and the Governmental Assignee for the Development of the Automotive Industry established themselves as centres representing the interests of FDI-associated elites. Where state institutions are less active, business associations play a major role. In Hungary, the most influential organisations have been the American Chamber of Commerce, the Hungarian European Business Council, the Joint Venture Association, the British Chamber of Commerce in Hungary, and the German-Hungarian Chamber of Industry and Commerce. They are also backed by diplomats at foreign embassies, who have helped establish these powerful lobbying organisations. Membership in such associations is not restricted; thus, they also integrate firms of other national backgrounds, including Hungarian companies. Major international consulting firms also maintain a significant presence in V4 countries and act as hubs for the “comprador service sector”. It is important to emphasise that even more senior positions in the aforementioned firms and organisations are frequently filled by local managers. A similar recruiting pattern of local managers by international firms has been observed in Poland and Slovakia.

In the case of Hungary, two associations have played a major role in shaping institutionalised forms of contact between local business and government—the Hungarian Chamber of Commerce and Industry, an association which represents Hungarian small businesses, and the National Association of Entrepreneurs and Employers, which represents Hungarian big business. Both organisations have supported various governments, though both have been more influential with right-wing governments. This is due to the greater emphasis these governments have traditionally placed on the support of local business. Supporting Hungarian business groups has always been openly declared by governments and implemented by means of various policies throughout the transition process. We may therefore conclude that these two important business organisations have always had partisan linkages to the Hungarian government.

According to Naczyk (2014), local representatives of Poland’s business community have also proved to be partisan, forming various organisations across the political spectrum. The liberal Civic Platform has had close links with PKPP Lewiatan, the country’s largest employers’ association. And although the Polish Chamber of Commerce (which represents small businesses) has not developed strong political ties, on the personal level its leaders have maintained good relationships with the Civic Platform. The Law and Justice (PiS) party, which currently rules Poland, has been linked to the Sobieski Institute, a think tank which organised the “Poland Great Project”, an action plan for supporting Polish local business. Naczyk also provided anecdotal evidence that representative organisations not only lobbied for members’ interests, but also intervened directly in political campaigns.

Schoenman (2014) compared the Polish, Romanian, and Bulgarian experiences with business–polity exchanges. He found that these links were more institutionalised in Poland than in the other two countries, where, even if formal representative organisations existed, they were controlled either by wealthy businesspeople (oligarchs) who used them to lobby for their own business interests or by influential politicians. He also claimed that broad networks (with substantial membership) were less partisan and thus their lobbying efforts were more effective in any political setting than personal-contact-based lobbying. Business–polity networks that engage in broadly representative activities can lobby for "broadly distributed" advantages in exchange for political support. Narrow networks, in which personal contacts play a dominant role, create institutions which confer "selective advantage" and distribute benefits to targeted recipients who are among the supporters of the ruling political party.

Schoenman (2014) states that these two kinds of business–polity network structures work differently when levels of political uncertainty are higher or lower. When political uncertainty is high and politicians need the (material and moral) support of business, relations between government and business elites are marked by broad cooperation and a kind of concerted effort. When narrow networks dominate in conditions of high uncertainty, influential oligarchs may capture the state (as in the pre-Putin era in Russia or Bulgaria). Political uncertainty is usually high in transition economies; even so, there may be periods of lower uncertainty (like in Hungary after 2010 or in Romania in the 1990s). In a low-uncertainty environment, broad business networks may renew their efforts to engage in corporatist cooperation with the state. However, if business is less organised, government representatives may dominate this relationship and confer selective advantage—that is, pick winners. Schoenman calls this patronage, but the term "business capture" (see: Yakovlev 2006) can be also applied to such arrangements.

We may conclude here that the organisational networks of business–polity relationships differ significantly from country to country in CEE. And while business associations have formal institutions in each of these countries, their membership, bargaining power, and levels of embeddedness vary. Multinational business associations are usually strong and well organised in those countries where FDI makes up a significant share of the economy. The characteristics of local business associations are very different and are shaped by local political, economic, and social development factors. They are definitely less effective than associations which represent FDI-based elites, are usually less broad, and are often partisan. In addition to local associations, personal relationships between businesspeople and political leaders may be also important; in some countries, they play a decisive role, paving the way to either business capture (patronage) or state capture.

The Emergence of Economic Patriotism

FDI-associated elites dominated the first two decades of transition in CEE, even in countries with less significant FDI stocks. The neo-liberal model was reinforced by the international consulting community that favoured well-established multinational players over weak local companies, investors, or interest groups. The classical concept of free competition and its general impact on overall well-being determined transition policies with adjustments which favoured local institutions and infrastructure development. Massive transfers of financial capital and knowledge flowed into the CEE region, which contributed significantly to the modernisation process of these countries. The CEE region, and especially the V4 countries, were integrated into the European economic space (the Single European Market), and their level of integration is extraordinarily high. Foreign firms are dominant not only in supplying markets, but also in local production. The share of foreign-owned (mostly multinational) companies is over 50 per cent in a majority of economic sectors—in production, investments, and exports. This high foreign share has been described as excessive by many observers. Szentes (2005–6) wrote about unhealthy asymmetric interdependence; within the framework of the literature on varieties of capitalism, Nölke and Vliegenthart (2009) developed the concept of the "dependent market economy". Even so, CEE economic policies continued to adhere to the neo-liberal orthodoxy until the financial crisis of 2008.

This crisis delivered extraordinary shocks to most developed market economies, which were forced to take rapid crisis management steps of various kinds, steps which did not fit into a neo-liberal framework, but rather a neo-Keynesian one. Many forms of intensified state intervention were applied temporarily (nationalisations, cash transfers to bail out important firms); others remained in place for longer periods (e.g., demand stimulation through increased public spending). Nevertheless, even in the worst days of the crisis, governments refrained from applying "classically" protectionist policy tools like currency devaluation or trade restrictions. This fact reflects the greater level of global economic integration in today's world as compared with the era of the Great Depression, as well as the policy experience which has accumulated since then. Thus, we may conclude that crisis management practice itself continues to be influenced by neo-liberal concepts in many ways. Many of these temporarily applied measures have since been withdrawn.

However, many governments in CEE countries have gone against the grain, refusing to limit increased state economic intervention and instead continuing and even increasing it after the shocks of the crisis eased. The most striking examples are Hungary and Poland. Hungary came into open conflict with the EU by implementing a series of policies that run counter to various EU regulations (mainly competition policies). Poland also took steps intended to strengthen statist policies in the field of state property management, for example. Many of these steps were taken after 2010 by the government dominated by the Civic Platform (Naczyk 2014); the new right-wing populist PiS government merely continued and expanded these policies. Mihályi (2015) highlighted that on certain delicate issues, the social-liberal Hungarian governments of the 2000s also pursued interventionist policies.[6] Thus, the departure from neo-liberal orthodoxy started before the crisis in Hungary as well. These facts suggest that in some CEE countries, politicians have started questioning the dominant neo-liberal policy agenda in general and have increasingly favoured interventionist policies. The tendency can be regarded as a kind of reaction to the far-reaching application of neo-liberal policies which produced significant dependencies in economies which were marked by direct state control at the beginning of the transition process.

Nowadays, increased state intervention is often referred to as "economic patriotism" (Clift and Woll 2012; Naczyk 2014), which Clift and Woll (2012) clearly distinguish from classic "economic nationalism", the roots of which go back to Adam Smith and Friedrich List. The main difference lies in the fact that economic patriotism's toolkit is limited. This means that governments do not revert to explicitly protectionist measures, but use covert tools to discriminate in favour of domestic players, or use liberalisation measures selectively. The aim is to reassert control over open markets. The term itself was first used in 2005 by Dominique de Villepin, the then prime minister of France, who called the defence of local prerogatives in integrated markets "economic patriotism" (Clift and Woll 2012). Clift and Woll also state that the conflicts inherent in pursuing the special political-economic interests of local citizens under conditions of complex economic, legal, and regulatory interdependence started well before the

2008 financial crisis. Lacking exclusive control over large parts of their economic governance and facing intensifying international trade and competition policy regulations, governments "had to become creative with policy strategies".

I use the definition of economic patriotism offered by Clift and Woll (2012, p. 308): "We define economic patriotism as economic choices which seek to discriminate in favour of particular social groups, firms or sectors understood by the decision-makers as insiders because of their territorial status. Economic patriotism entails a form of economic partiality: a desire to shape market outcomes to privilege the position of certain actors. Unlike economic *nation*alism, economic patriotism is agnostic about the precise nature of the unit claimed as *patrie*. It can also refer to supranational or sub-national economic citizenship". An important feature of this approach is that it defines political economic space territorially, rather than by referring to policy content. Thus, it comprises a wide range of state intervention, including the selective application of liberal economic policies (Helleiner and Pickel 2005). The novelty of present-day economic patriotism lies in the fact that unlike old-fashioned economic nationalism and mercantilism, it is a response to the reconfiguration of economic governance and market interdependence. Governments have had to get creative in pursuing traditional economic policy objectives by new means. Today they can transfer their particular objectives from the national to the supranational level. For example, the EU can reinforce liberalisation within the EU for the sake of protection from the outside. On the national and subnational levels, we can distinguish between the defence of existing local production advantages and the creation of such advantages in the process of integrating markets.

Paradoxically, liberalisation, and deregulation may themselves serve to create new types of discrimination (Levy 2006). Deregulation involves not only removing restrictions, but also active reregulation that can be designed to promote particular outcomes. The need for reregulation has provided politicians with new means to continue influencing the economy and produce territorially beneficial outcomes. As Clift and Woll (2012) have written, economic patriotism represents a shift from classic protectionist measures (like barriers to trade) to more indirect measures like discriminative product- and process-standards and state subsidies (as part of an overall industrial policy). Alternatively, such practices may also include selective liberalisation in strategic sectors or the introduction of competition rules that prohibit standards which are common abroad, or other restrictions. These forms of protectionism cannot be easily detected and their use was already spreading in the 1990s, alongside large-scale liberalisation processes (e.g., the terms of WTO negotiations).

CEE Relevance

As demonstrated in the analysis above, the practices that gave rise to the concept of economic patriotism are not new; moreover, they characterise all market economies, including CEE countries. What is really new is the way of selling such ideas more openly, deliberately seeking conflict with the institutions that safeguard the neo-liberal model. Occasionally, other governments have also pursued policies that openly contradict, for instance, the EU's liberal competition policies. Clift and Woll (2012) interpreted these clashes as political messages to the electorate that lacked serious intent. We have seen similar proposals from the Hungarian and, more recently the Polish governments, though on a larger scale. These politicians are aware of the impossibility of implementing such policies under the current EU framework of regulations; even so, they would like to send political messages both to their electorates and to Brussels. Nevertheless, the number of new non-compliant measures could seriously undermine classic market institutions and erode the rule of law in these countries.

The other, more important purpose of economic patriotism is a real reconstruction of power relations. In this sense, the practice of the Hungarian and Polish governments goes beyond the rationale described in the definition above. Evidence from the Hungarian case shows that selective-advantage measures have been applied to favour particular agents. This contrasts with the notion that economic patriots use broadly distributive measures to favour territorially determined groups of actors. The aim of these Hungarian measures is thus not to give general preferences to local citizens, but rather to promote selected clients: in particular, those members of the local elite who might have lost out in the power competition of the transition process. Thus, such policies support only a predetermined part of the local bourgeoisie.

Such aims are more likely to be achieved if the new elite (linked to local business) lacks strong organisations. My earlier analysis showed that local business associations are rather weak in Hungary, especially in comparison to the lobbying platforms of foreign investors. Moreover, the former's leadership has always been determined politically, and thus these organisations have not been able to realise the interests of their members. Weak, politically influenced networks and the strong personal linkages between influential businesspeople and politicians have made Hungary's business elite easy prey for the state. The use of selective-advantage measures does not serve the elite's interest as a whole, but only that of certain selected clients. This practice cannot be regarded an example of economic patriotism; the notion of economic patriotism is rather used as a politically expedient label under which to market the state's predatory practices.

The application of covert protectionism is sometimes justified by referring to the historical (though today not reproducible) success stories of the classic East Asian developmental state. However, an important element of such successes was regulated competition, first on protected internal markets and later on global markets. The patronage-state system, on the other hand, kills market competition altogether. Clients are protected on domestic markets from both unfriendly foreign and domestic competitors. Without competition, however, economic agents focus primarily on maintaining good relationships with their patrons instead of facing the rigours of innovating and modernising their operations. The result will be declining competitiveness, deteriorating product- and service quality, decreasing revenue, and overall impoverishment. The concept of economic patriotism (like economic nationalism and mercantilism) does not negate the role of competition as the driving force in market economies. The political practice of the Hungarian patronage state minimises competition and thus cannot be regarded as a genuine example of economic patriotism.

Empirical Evidence from Hungary

Hungary is a small, relatively open economy, which started its transition from state socialism to a market economy in 1989. Minority foreign ownership, in the form of joint ventures, was legally allowed under communism as early as 1972; a $400 million stock of foreign investments had accumulated by 1989. Moreover, regular contact with world markets and foreign firms made it possible for Hungarian actors to accumulate some network capital which would become an important lever of Hungary's internationalisation process. More significant volumes of FDI started to flow into the country after 1991, when the privatisation process was oriented towards sales to foreign investors. When the privatisation process decelerated towards the end of the 1990s, large-scale greenfield investments increased the annual inflow of FDI to roughly €3–4 billion. Later on, the expansion of existing capacities also gained momentum, as is demonstrated by the increasing share of profits reinvested in operations originally established by means of FDI (Antalóczy et al. 2011).

Traditionally, FDI statistics have been derived from a country's balance-of-payment figures. Such sources became rather problematic around the year 2000, and especially since 2010. FDI-flow figures have become mixed up with the capital flows of "special- purpose entities", and other temporary capital flows. This problem has been recognised internationally (by UNCTAD, for instance) and the related figures have also been rectified by the Hungarian National Bank. However, despite such cleaning procedures, chronologically specific international comparisons continue to be more difficult and less reliable than before (Antalóczy and Sass 2015).

Even so, Hungarian FDI statistics clearly illustrate the outstanding role played by foreign investments. During the years of the transition process, most of the largest multinational companies established a physical presence in Hungary in the form of an affiliated company. The market share of foreign firms has been particularly significant in the automotive- and electronics-manufacturing industries, retail trade, banking and financial services, telecommunications, and the media. These are typically the most globalised businesses. That Hungarian affiliates have been established in these sectors reflects the fact that the Hungarian economy has been successfully integrated into global production networks. I regard this development as a key determinant of Hungary's structural development, technological modernisation, investment activity, and economic growth.

Positive and Negative Impacts: And Criticism—Of the FDI-Led Development Model

Multinational companies' influence on the Hungarian economy can be illustrated by several figures. They have contributed significantly to national investments,[7] creating a massive body of highly productive manufacturing concerns and services. The uneven spread of FDI is also notable. In certain industrial hubs (like Komárom, Győr, Székesfehérvár, and various parts of the greater metropolitan area of Budapest), new industrial districts have been created and old ones renovated. Foreign companies produce 70 per cent of Hungary's manufactured goods and employ 48 per cent of its manufacturing labourers. Their shares of retail trade, banking and financial services, and telecommunications are also exceptionally high. Since foreign firms—especially those in manufacturing—are participants in international value chains, they are export oriented. Over 80 per cent of Hungary's total manufacturing exports are delivered by the foreign-owned sector. In other V4 countries, the participation of foreign ownership is similarly important (Table 6.1).

We can evaluate the significance of multinational businesses in various ways. I take into account the developmental trends of the whole transition period up to the present. Compared to its 1989 starting point, the current economic structure of Hungary is more developed, with a large share of high- and upper-medium-tech manufacturing and a highly efficient service sector. I sincerely doubt these extraordinary changes in its economic structure would have been possible without the vigorous investment activity of foreign firms. It is important to note that global markets are dominated by firms which are also present in Hungary. Entry barriers to global markets are extraordinarily high, and thus penetration can be extremely

Table 6.1 Foreign-owned companies' shares of sales, employment, and gross investments in Hungary (selected economic sectors, per cent)

	2008	*2012*
Sales		
Manufacturing	64.9	69
Energy supply	74.4	67.5
Trade	44.6	45.4
Infocommunication	62.7	67.7
Total non-financial	50.1	53.3
Financial	53.8	70.1
Employment		
Manufacturing	44	47.7
Energy supply	51.5	51.9
Trade	21.5	24
Infocommunication	29.8	37
Total non-financial	23.8	26.1
Financial	46.9	45.1
Gross investments		
Manufacturing	67.8	78.3
Energy supply	61.6	65
Trade	49.4	41.3
Infocommunication	74.2	79
Total non-financial	49.6	55.3

Source: Hungarian Central Statistical Office difficult even for the most innovative small firms. It is true that some Eastern European start-ups have succeeded in becoming global companies, like Hungary's Graphisoft and Prezi and the Estonian firm Skype. However, all these success stories operate in rather small market segments, and many were sold to multinational big businesses when their further expansion into broader markets required large-scale investments. The insertion of the V4 economies into the system of global value chains would hardly have been imaginable without the effective participation of global market players.

On the other hand, the penetration of multinational business has clear drawbacks as well. The significant presence of multinational firms has produced a dual structure in the V4 economies. Foreign firms have relatively low levels of embeddedness in local economies and few contacts with domestic companies. Local suppliers do not usually participate in their value chains, the reasons for which are manifold. Firstly, existing technological-cooperation links in the value chain are not likely to be replaced by new entrants because of the high costs of entry. Secondly, local firms acquire technological capabilities and the financial and logistical capacity for cooperating with global business only gradually. When FDI began to penetrate the V4 economies, local firms were not prepared to cooperate (Antalóczy et al. 2011). Nevertheless, the essential contributions of local firms to global value chains started to increase around the year 2000. As a result of the 2008–2009 crisis and the following recession, cost-cutting considerations became even more important, which pushed multinational firms towards more intensive local sourcing. V4 countries launched support programs in hopes of enabling local firms to cooperate with multinational companies (Kalotay and Sass 2012).

Another important, widely discussed issue is the extent of positive externalities stemming from multinational firms (spillover effects). Most researchers have tried to measure these externalities using various gauges of productivity on the assumption that the aggregate impact of spillovers will increase the productivity of local firms. The results have been mixed and not very convincing. A meta-analysis of the relevant literature suggested that the larger part of these findings supported the idea of a measurable increase in productivity (Iwasaki and Tokunaga 2014). There are methodological and logical explanations for this lack of positive results (Szanyi 2002).

Other critics of the FDI-based development model have drawn attention to systemic problems that might be far more important than its low level of positive impacts. Nölke and Vliegenthart (2009) wrote an important paper in which they tried to describe the CEE economic model (DME model). They emphasised the role of foreign direct investments in shaping the nascent market economies of the V4 countries. They argued that multinational companies' large share of the production and trade of these economies significantly influenced the development of other economic and social subsystems as well. Their effects on national innovation and educational systems were negative, because their operations did not require high-end inputs from these systems. Furthermore, their influence distorted a variety of national policies, since the tax relief granted to multinational companies deprived governments of important financial tools, and because their operations were largely independent of national policies.

There has also been another type of political criticism directed at foreign investments and multinational companies' activities, which populist parties have used in hopes of increasing their levels of support at the polls. Populist sentiments articulated in the Hungarian and Polish mass media have included rants against the "luxury profits" of foreign firms, descriptions of profit transfers as attacks on national property, and claims that the state would be justified in expecting greater tax revenues from foreign firms. Similar statements have served as moral justification, or political and social support, for changes to regulations and tax policies which would burden multinationals. Thus the political expectation that it would be possible to share more of the benefits of global economic integration was encouraged by measures that reached beyond the usual sphere of neoliberal policies and market institutions.

Hostile Actions in Hungary

While the Hungarian government has concentrated on supporting domestic business ventures since 2010, the globally integrated Hungarian economy has continued to rely on the activity of multinational firms. Populist political attacks have targeted selected industries and even companies. Critical arguments (when applied at all) have lost their general character when they are translated into policy measures. The Hungarian government has defined a group of companies that are not to be treated in a friendly manner, while other companies and industries have received further (mostly political) support.[8]

Banks and financial institutions have been repeatedly accused of treating their customers unfairly. They have also been criticised for taking above average profits. Foreign firms used to make up an unusually high proportion of the Hungarian banking sector (80 per cent), which also annoyed the government. Politicians have taken action to change all this. The Hungarian government was one of the first to introduce sector-specific surtaxes (on turnover and on transactions). In addition, banks had to bear much of the cost of converting private debtors' (non-performing) foreign-exchange debt into Hungarian currency. These regulatory changes and new taxes put banks into the red when they were still having problems with recapitalisation after the 2007–2008 financial crisis. The government also accused private pension funds of producing unacceptably low returns. Pensioners' claims were then "secured" by the government when it nationalised the second pillar of the pension system—that is, claims on private pension accounts coming from the compulsory insurance scheme—and rechannelled it into the first pillar of the pension system, that is, the state's pay-as-you-go system. In both cases, most of the affected financial institutions were foreign-owned.

In 2014, the Hungarian state acquired the *Magyar Külkereskedelmi Bank* (MKB)[9] from its German owners. The German parent bank was unwilling to run its Hungarian subsidiary at a loss and sold it to the only serious buyer, the Hungarian state. Its losses, however, had been caused by various changes in the business environment which were initiated by the Hungarian government, and by the process of rescuing private foreign-exchange debtors. Soon thereafter, the government trumpeted the achievement of a 50 per cent share of domestic ownership in the banking sector. Later that year, the Hungarian Postal Service purchased the *Földhitel és Jelzálog Bank* (FHB), increasing domestic ownership of the Hungarian banking sector to over 60 per cent of bank assets.

Retail chains and other trading companies, firms in the telecommunication and energy sectors, and media companies have also been harassed with discriminative regulations, most importantly sector-specific taxes and fees in Hungary. In order to save local businesses from the effects of new taxes, specific selection rules have been applied. In the case of a tax on broadcast advertising, for example, a turnover threshold was fixed at such a high level that only one major foreign-owned firm was affected.[10] A larger number of measures and regulatory changes were implemented over a longer period of time with the stated intention of limiting utility costs. The promise of savings on utility costs was a major promotional tool in the 2010 and 2014 election campaigns. The government had already prohibited rate increases on public utility bills in 2010. Government agencies later reduced these prices significantly, thus eliminating profits in this sector. This measure directly affected the profitability of these businesses; limiting the prices utilities could charge pushed these companies into the red. Owners soon felt compelled to sell their loss-making assets. This is a process of regulatory confiscation: company revenues dry up because of unfavourable changes in market regulations or excessive taxes. Many utility firms were then sold to central or local public agencies, though some of them were compensated quite generously (e.g., the German electric utilities company RWE).[11]

Selective-Advantage Measures: The Strategic-Partnership Program

In order to distinguish formally between favoured firms and those which were discriminated against, the Hungarian government signed a series of strategic agreements with foreign companies. This process started in the summer of 2012, when Hungary's macroeconomic was deteriorating. Its GDP was falling; major business concerns postponed investments. The sluggish activity of large firms could not be counterbalanced by the activity of small and medium-sized enterprises which received state support. The Hungarian government decided to encourage the activities of selected multinational firms by initiating partnerships with them. By September of 2015, 60 such strategic agreements had been signed, 54 of them with foreign-owned companies. These partnerships were concentrated in three major industries: electronics, automotive, and pharmaceutical manufacturing. According to Transparency International Hungary's calculations, the contracts signed by mid-2014 were with firms which represented 18 per cent of Hungary's manufacturing employment and 40 per cent of its manufacturing exports, and thus a significant share of its manufacturing base (TIH 2014).

These agreements were mostly—but not exclusively—initiated by the government. There is a set of conditions which is applied to big multinational businesses (a five-year track record in Hungary, significant contributions to GDP and exports, investments exceeding 5 billion Hungarian forint, at least 1000 employees, an intention to create more jobs for skilled workers, participation in education, and the use of at least 10 per cent locally supplied inputs in production). The content of these agreements was rather uniform. Partners usually declared an intention to cooperate in job creation, training and education, R&D, and the development of a local supplier network, though no concrete cooperative measures were included. In my earlier analysis of FDI-attraction policies, I pointed out that these areas were already important foci in 2004; thus, the Hungarian government did nothing more in these strategic-partnership agreements than reassure selected foreign firms that they would have access to the kinds of cooperation and support which had been nominally extended to all business players before 2010.

Survey Results

Transparency International Hungary (2014) analysed the use of selective policies from the viewpoint of lobbying. The main conclusion of this analysis was that the policies of the Hungarian government increased uncertainty not only in the regulatory environment, but also in the communication channels between business and government. Though earlier regulation designed to control lobbying and corruption was far from perfect, the activities of enforcement agencies were curtailed and laws were lifted (e.g., the law on lobbying), and thus the arbitrariness of decision-making increased. Instead of using official channels, lobbyists engaged in increasingly informal practices. Business representatives used special occasions like football matches and social events to meet influential politicians. Representatives of "bad" and "good" businesses both made use of these informal channels.

TIH's 2014 survey of the practice of these partnership agreements looked back on a period of less than two years. Thus, most interviewees expressed the hope that this new tool would serve to increase the efficiency of their lobbying and communication with the Hungarian government. Some said that signing this sort of agreement was a symbolic gesture on the part of big business as well; companies expressed their goodwill in spite of the government's unfriendly policies. In that early period, interviewees expressed their satisfaction with the fact that these strategic-partnership agreements allowed them to contact mid- and high-level government officials directly, which had not been possible between 2010 and 2012.

In the autumn of 2015, a series of interviews with CEOs of strategic-partner companies was conducted[12] by the Institute of World Economics (IWE). The aim of this survey was to collect first-hand information about the importance and practical application of these partnership agreements. Of the 54 foreign partners who had signed agreements, 12 were approached. All of them worked in manufacturing industries; nine had the necessary qualifications for the program; one was negotiating. Given that TIH (2014) had conducted a similar empirical survey in 2014, I was able to verify the chronological development of these linkages, although the responses to both surveys were anonymous, and thus no comparison of the cohorts could be made.

Most interviewees expected that this new tool would facilitate more efficient communication with the Hungarian government. Even so, they did not expect quick results from their negotiations. Some were most sceptical, asserting that the campaign's PR value was its most important element; they did not expect to receive any kind of concrete benefit. Others reported certain kinds of success, or at least hoped it would have a positive impact on their future public-procurement tenders. Several mentions were made of lobbying in hopes of easing disadvantageous regulations. For example, some respondents felt strange about the government's expectation that they engage in corporate social responsibility activities (sponsoring sport clubs and financing sports-infrastructure development, for instance).

Most firms already seemed to have been engaged in the cooperative activities suggested by these partnership agreements anyway and were unable to report substantial additional government support in these areas. In sum, the 2015 IWE study confirms TIH's major findings of 2014. Most multinational affiliates used these strategic agreements as a communication channel or a platform for lobbying. However, the success of their lobbying efforts did not depend on the conditions or content of these agreements. In fact, most respondents wanted to achieve results in areas that were not covered by these strategic-partnership agreements.

Conclusion

As a result of several factors, intense disillusionment with the liberal competition state started to spread worldwide at the beginning of the new millennium. This process accelerated after the 2008–2009 global economic crisis. Governments, economists, and the general public started to think about curtailing the use of free market logic in economic institutions and policies. In some cases, new ideas and policies were intended to do more than *simply correct the* market failures that became evident during the crisis. For example, unforeseen increases in state assets (e.g., due to massive government bailouts of the financial sector in many countries) were followed by a speedy retreat in most countries, but not in all of them.

In Szanyi (2016a), I described how the Hungarian and Polish governments used increased state ownership to replace important systemic elements of the market economy with statist policies. Such increases in direct state intervention have impaired the rule of law and market competition in these countries. Unfortunately, such policies have a strong demonstration effect: if the state frequently violates the principles of market discipline, such behaviour quickly undermines fundamental institutions like the security of property rights and other areas of the rule of law.

The dual treatment of foreign and domestic firms, or of firms belonging to different economic sectors, goes against the principle of free competition. The application of selective measures further exacerbates this situation. Certain policy measures mean that winners and losers are selected on the basis of political considerations, not economic or social ones. This practice cannot be interpreted as an application of the principle of economic patriotism. Economic patriotism involves a set of measures which distinguish economic agents on a territorial basis, and is thus agnostic and normative. The aim of such measures is similar to the principles of traditional economic nationalism. Temporary protection against large foreign businesses is provided in order to strengthen nascent local industries with the hope of increasing competition on local markets. Local companies' competitiveness is not curtailed. Another important tool is the development of local production inputs (labour, infrastructure, better access to capital), yet what we see in both Poland and Hungary is the frequent use of measures which block all kinds of competition in order to favour politically selected actors.

Of course, cronyism is not absent from more traditional market economies either. The political-business-cycle theory, for example, strongly suggests that serious problems of agency may degrade the effects of economic policies. Also, problematic links between business and government are frequently on display even in the most liberal market economies, including the USA (e.g., see many of President Donald Trump's recent decisions). Even so, in more developed market economies there tends to be a more efficient system of control over political rent-seeking. First, political competition may provide political control in the form of opposition parties. Second, large numbers of civil society institutions and watchdog groups offer a degree of social control over unlawful, fraudulent, or simply unethical policy actions. What we are witnessing in both Poland and Hungary is a deliberate destruction of both these control mechanisms. Such policies make it evident that the main aim of such statist actions is political—and frequently even personal—rent-seeking.

This chapter has discussed in detail one important element of such policies: the dual treatment of multinational companies in Hungary. The various kinds of selective-disadvantage measures taken against multinational businesses in a variety of sectors (mainly, trade and services) have served different rent-seeking purposes. Regulations which required artificially low prices for public utility services served the political interests of the government. Selective taxes on banking, retail trade, and the media were intended to enhance business opportunities for local partisan companies. At the same time, selective-advantage measures were also implemented on behalf of a number of large multinationals—mainly in manufacturing—in order to promote further industrial investment.

Schoenman (2014) offers a possible explanation for such policies. These selective measures can be interpreted as a deliberate attempt to divide the established networks of multinational business in Hungary, and thus weaken their bargaining positions. Political uncertainty (one reason for government collaboration with business supporters) is rather low given the parliamentary supermajority which the current government enjoys. Such policies are thus a move towards a patronage state and business capture, a departure from the competition state. Similar measures have also been introduced in Poland (Kozarzewski and Baltowski 2016). Nevertheless, there is a limit of cronyism and moral hazard also in these countries. Economies cannot be developed in the absence of FDI without significant declines in international competitiveness, and a replacement or substitute for multinational business does not seem technically possible, even in the long run. However, even if such a change could be carried out without a significant drop in economic activity, income generation, or living standards, such an undertaking would also be politically infeasible. And thus FDI will continue to play an important role in the transition economies of Central Europe.

Notes

1. Poland, the Czech Republic, Slovakia, and Hungary.
2. The term *competition state* is taken from Drahokoupil (2008) and refers to liberal state policies which allow global competition to penetrate domestic markets fully. I follow Schoenman (2014) in my use of the term “patronage state”, which refers to the importance of personal business–government linkages in shaping economic policies and a strong, general curtailment of competition on local markets, with the government asserting dominance over business by means of selective-advantage measures (business capture).

3. Some of this work has already been done and published in the literature that I will also cite in this chapter.
4. Drahokoupil (2008) characterises the FDI-related elite—the "comprador service sector"—and its reproduction as follows: "I characterize the domestic actors linked to FDI as the comprador service sector… (It) comprises various groups providing service for foreign investors. It includes local branches of global consulting and legal advisory firms and their local competitors, companies providing other services to foreign investors and officials from FDI-related state bodies. This group is comprador as it is structurally dependent on transnational capital, whose interests it represents. Structurally, this sector is not a bourgeoisie, as it constitutes neither a propertied class nor a professional managerial class….(Its) links to foreign capital can be characterized mainly by the Weberian notions of 'market capacity' and 'income class'….the comprador service sector helps to translate the structural power of transnational capital into tactical forms of power within the states…The structural power of capital is derived from the dependency of the state and society at large on the investment decisions" (pp. 366–7) This type of dependency is also fundamental to Nölke and Vliegenthart's (2009) DME model.
5. The career of Gábor Széles is a good example of this. Until 1990, he was the president of Műszertechnika Coop, a small firm producing electronic devices for the Hungarian market. His firm was one of the two lucky Hungarian companies which formed a winning coalition with the Swedish company Ericsson for a tender to produce electronic switching centres for the Hungarian wired telephone network in 1992—that is, before the appearance of cellular services. Despite this opportunity, Műszertechnika could not establish itself as a significant player in electronics. Széles then lobbied for another, less technology-intensive opportunity; he ended up participating in the privatisation of the large Hungarian bus producer Ikarus. He also acquired the large Hungarian electronics firm Videoton. Neither of these projects turned out to be successful, insofar as these firms' original industrial activities could not be maintained. Today, both companies operate primarily as real-estate development agencies and component producers. Széles used to be a high-ranking official in the MDF (Hungarian Democratic Forum), the larger party in the right-wing coalition which formed Hungary's first post-communist government in 1990. These days, Széles is the owner of a right-wing-oriented media network.
6. The most striking action was the introduction of the "Lex MOL", an amendment to the commercial code which changed corporate-governance regulations so as to help the Hungarian oil company repel a takeover bid by its Austrian competitor ÖMW. These legal changes were passed—barely—with the mutual agreement of the government and the opposition.

7. The other main source of investment financing was EU transfers. Hungarian national sources' share was rather small.
8. Documents related to various government officials' media communications about the ideological differentiation between "good, productive" and "bad, speculative" business have been analysed by Mihályi (2015) and TIH (2014).
9. The *Magyar Külkereskedelmi Bank Rt.* (Hungarian Foreign-Trade Bank Co.) was owned by the Hungarian affiliate of Bayerische Landesbank until 2014.
10. The government explained this measure by suggesting the company was guilty of tax evasion. However, it was never explained whether there was anything illegal about RTL's tax returns; even if there was, why would such irregularities not have been addressed by the appropriate state authority, the tax office?
11. It is of course another question whether today's sales revenues are sufficiently high for the necessary investments. Observers have suggested that public utility companies are still in extremely bad financial condition and do not invest anymore, which may compromise the quality of their services.
12. A full transcript of these interviews was published in Szanyi (2016b).

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CHAPTER 7

Member State Economic Patriotism and EU Law: Legitimate Regulatory Control Through Proportionality?

Márton Varju and Mónika Papp

Introduction

From the perspective of the law governing the European Union (EU) Single Market—which was adopted with the aim of limiting Member States' social and economic policymaking in the interest of market integration—patriotic national economic policies pose a fundamental dilemma. On the one hand, because they pursue considerations specific to a Member State's national economy, such policies run the risk of contradicting the objectives of the Single Market. In particular, they, as well as their introduction, often disregard its core legal prohibition of discrimination against 'non-nationals'. On the other hand, the application of EU law's restrictions must take into account the institutional and social embeddedness of policymaking in the Member States and the fact that national policies are based on the locally generated political mandates of national governments, which bear political responsibility for fulfilling them. Thus, when economic

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policy patriotism comes into conflict with obligations assumed by EU Member States, the courts which scrutinise such policies and test them for compliance with EU law must observe strict boundaries.

According to the law governing the EU Single Market, national policies are usually scrutinised and tested in the context of a court's examination of the proportionality of the legal measures of those Member States which have derogated—in pursuing presumably legitimate general interest objectives—from the obligations arising from the internal market's fundamental freedoms. Proportionality, as a legal principle, imposes far-reaching demands and equally significant restrictions on policymaking, often severely interfering with the ability of national governments to use domestic policies in the service of local socio-economic interests. Both direct and indirect discrimination against 'non-nationals' is prohibited, and policies are expected to exhibit certain qualities, such as the requirement that they be adequately prepared and targeted and meet basic rule of law criteria; Member States may be forced to consider the use of alternative, possibly more burdensome instruments in implementing their policies. Thus the Single Market, as enforced by means of the principle of proportionality, emerges as a largely hostile environment for patriotic national economic policies, which puts pressure on the law when it is used to test national policy choices.

The analysis in this chapter is structured as follows. First, we will introduce the concept of economic patriotism, especially in the context of EU integration, and discuss its general legal implications, particularly for the law governing the EU Single Market. This will be followed by an overview of the specific demands and restrictions which the law—in accordance with the logic of the fundamental freedoms—impose on national policies, with special emphasis on those which follow from the proportionality principle. We will close this chapter with an analysis of certain economic policy developments in Hungary since 2010—a clear example of EU Member State economic patriotism—and their treatment under EU law. Hungary's experiences in defending its policies under EU law in cases brought before the EU Court of Justice illustrate the intensity of the constraints national governments face in attempting to implement economic policies within the Single Market.

Member State Economic Patriotism and the EU Single Market

The term *economic patriotism* refers to national governments implementing economic policies in the national territory which serve the interests of 'one's homeland' (Clift and Woll 2012, p. 308). It is quite natural for governments to act in this way. As a result of their 'spatially limited political mandates', governments develop policies which will, almost by default, be patriotic. Their similarly territorially framed political responsibility to deliver on such mandates is another reason why they prioritise the serving of local interests and meeting local needs in managing the national economy. Generally speaking, national governments have no other political choice than to act in their 'national economic interest'. Domestic economic policies are also shaped by the circumstance that national economies, despite the changes brought about by economic globalisation and regionalisation, continue to be constructed within the confines of the state and to be exposed to socio-economic considerations that are spatially determined (Clift and Woll 2012, pp. 311–312). Governance, overall, also remains state-bound, and policymaking and governance processes continue to be deeply embedded in national institutional and socio-economic contexts (see Clift's contribution to this volume).

For EU Member States, the ability to develop and implement patriotic economic policies is subject to significant institutional legal constraints. These limitations have their origin in these national governments' choice to establish an institutionalised framework of interstate cooperation (the Union) and to pursue shared policy objectives within a framework of common policies determined in most cases by law. The Single Market, which is the Union's central common economic policy, pursues an agenda of integrating its constituent national economies and, since its inception, has been operated according to legal obligations prohibiting national action which contradicts that agenda. Its fundamental economic freedoms and the legislation adopted for their implementation delimit national policymaking directly and intensively; one of its core obligations, for instance, is to prevent Member States from unlawfully differentiating, directly or indirectly—that is, discriminating—between 'nationals' and 'non-nationals', or disadvantaging 'non-nationals' in other ways within a national economy. Scrutinising national policies to ensure that they comply with EU legal obligations usually involves testing them according to the principle of proportionality and imposing further predominantly regulatory demands and limitations. In general terms, their previous political commitments to market integration confine national governments in fulfilling their political mandates.

On this basis, it is quite clear that from the perspective of national governments, membership in the EU and participation in the Single Market are marked by a 'profound if not self-evident contradiction' (Clift and Woll 2012, p. 308). Driven by their political mandates—the expectation that their national policymaking and governance will serve specifically national interests—they continually find their policies and the policy outcomes desired contradicted and thwarted by their long-term (legal) undertakings concretised in the framework of EU policies. Because they operate within the context of local political mandates and seek re-election in national political arenas, they are under constant pressure to disengage from commitments made at the European level and to adopt policy responses that respond to legitimate local interests and needs (Clift 2013, pp. 104–105; see also Weaver 2015, pp. 607–608). Member State governments also face the dilemma that the more constraints they assume within the common policy framework, the more creative they need to be (i.e., the less leeway they will have) in designing and implementing local policies that comply with EU obligations while also satisfying the relevant local interests and needs (Clift and Woll 2012, pp. 311–312).

The local embeddedness of national economic (and other) policies causes particular problems for the enforcement of common EU policies and the legal obligations assumed thereby. It must contend in particular with the diversity of the domestic interests and needs which are addressed within the relevant domestic policy frameworks, as well as the institutional diversity of local economic models and local models of economic governance. These issues have been analysed in detail in the 'varieties of capitalism' discourse, which in the EU context focuses specifically on the ability of EU economic policies—the Single Market in particular—to accommodate the different varieties of Member State economic regimes (see Hancké et al. 2007; Höpner and Schäfer 2007; Bohle and Greskovits 2007, 2012; Farkas 2016). It has been suggested that the most fundamental issues of governing EU market integration cannot be addressed without recognising two fundamental consequences of local diversity: first, that the political mandate to determine the 'ultimate economic model' for local polities lies with the Member States; and, second, that the EU's promotion of a particular 'model of economic structures' among the Member States is subject to strict political and legal limitations (Leino and Saarenheimo 2017, pp. 176 and 183).

The potential for conflict between national policy objectives and the legal obligations assumed as part of EU integration has been discussed in the 'clash of capitalisms' strand of literature. It has been pointed out as a general premise that EU integration reveals not only 'contending conceptions of the internal market' but also 'contending conceptions of capitalism' (see Callaghan and Höpner 2005; Clift 2009; Copeland 2014). It has been argued specifically that for national governments, convergence among the differently institutionalised national markets and the resulting impoverishment of competition between national economies based on their 'existing comparative (institutional) advantages'—as affected by legal harmonisation and the creation under law of a 'level playing field' among national markets—is nearly indefensible as a policy objective and is generally regarded as politically undesirable (Höpner and Schäfer 2010). The institutional incompatibility of Europe's national economies has also been discussed in the context of explaining the political dilemmas faced by national governments in EU integration. Clift has suggested that the EU legal obligations, which limit the means by which the competitiveness of national economies can be maintained within the integrated market, lead national governments to resist systematically developments in market integration (Clift 2009).[1]

With regard to the law governing the Single Market and its impact on the diversity of local varieties of capitalism, it has been asserted that the constraints, challenges, and transformations which the relevant legal obligations may impose on locally developed economic frameworks should not be used to dismantle the different types of capitalism which exist within the EU and to eradicate the 'comparative institutional advantages' which emerge from that variety (Snell 2012, p. 416). Snell has also raised that the controls which EU law imposes on national policymaking are fundamentally limited insofar as they lack the (democratic) legitimacy necessary to induce institutional convergence—that is, to achieve the homogenisation of national market economies (Snell 2012, pp. 433–434). In this connection, Clift has suggested that different local capitalisms are affected in different ways by various developments in EU economic law (Clift 2013, p. 110). On the one hand, the liberal market economies of the Single Market are not threatened by economic liberalisation; they are imperilled by the common institutional developments introduced through positive harmonisation (Snell 2012, pp. 428–429). On the other hand, Europe's coordinated market economies will be threatened by both 'neoliberal positive harmonisation' and negative integration (Snell 2012, pp. 428–429).

From the perspective of EU law's engagement with national policymaking, the nature of the economic patriotism implemented by national governments bears particular relevance. Member States' core legal obligations—such as the prohibition of discrimination on the basis of nationality—will naturally restrict patriotic economic policies which involve discrimination or other practices which disadvantage 'non-nationals'. In contrast, forms of patriotism which advance free trade and open national markets—in the national economic interest—will be compatible with the Single Market. The choice of the form of patriotism depends above all on the characteristics (the particular needs) of the affected economic sector, not on a strict dichotomy based on nationality or other territorial criteria (see Clift's contribution to this volume). In economic sectors that are exposed to cross-border interdependencies, 'conservative' patriotism which favours 'nationals' is more likely to prevail. In other sectors, where the exclusion of foreign capital or non-national competition is not a strategic objective (i.e., the economic presence of non-nationals is in the national economic interest), liberal economic patriotism which promotes open markets is likely to dominate.

When assessing the impact which the law governing the Single Market has on policymaking in EU Member States, it must also be taken into account that there are considerable differences between the Single Market as an idea (a policy ideal) and its actual implementation in specific policy domains and in the various Member States. Although the core principle of non-discrimination on the basis of nationality provides a degree of consistency to market integration, its scope and its intensity depends on—among other things—the nature and coverage of the legal rules adopted for its implementation (e.g., Treaty provisions, implementing directives, facilitating directives, centralised legal regulation in regulations, etc.), the competence area affected and the competences available, the degree of integration achieved—through law—in the specific sector of the national economy, and/or on the quality of Member State compliance with specific rules in specific economic sectors. The frameworks selected for domestic implementation and the implementation practices followed by the national administration are also relevant (see Falkner 2005). Finally, market integration is subject to individual Member States' assessments of the domestic policy opportunities made available by the system of derogations from the fundamental freedoms—in particular, of the general interest grounds which are likely to be accepted as legitimate, or the implementation solutions which will satisfy the requirements of the proportionality principle.

Overall, the Single Market as governed in law is a transnational policy framework which is hostile to economic policy patriotism in the Member States, especially to forms of patriotism which differentiate between 'nationals' and 'non-nationals', either directly or indirectly. The limitations it imposes on Member States may extend to policy implementation frameworks or implementation practices, when substantive policy instruments are nominally neutral and the effects of their economic patriotism (patriotic protectionism) manifest themselves only in the policy implementation phase, which is quite often the case. In the case of non-discriminatory patriotism, national policy efforts may be frustrated by EU legal provisions that determine which policy (general interest) objectives may be pursued legitimately—even though they contravene EU obligations. The actual legal boundaries of Member State economic patriotism, and thus the boundaries between EU and Member State policy action, are most commonly determined in proceedings before the EU Court of Justice and national courts, which investigate Member States' violations of the EU's fundamental freedoms and the justifiability of those national measures which derogate from the obligations assumed under EU law, in which context the principle of proportionality plays the central role.

Testing National Policies for Compliance with EU Law

In the Single Market, national economic policies are subject to legal limitations and restrictions which have the potential to prevent national governments from implementing policies which would fulfil their political mandates. In addition to their fundamental legal obligations, Member States also face burdens arising from the principle of proportionality, which serves as the cornerstone of the legal scrutiny to which they are subjected when national governments are called on to justify policies which come into conflict with their EU legal obligations or affect European market integration. The application of the proportionality principle may involve issuing far-reaching demands and putting stringent limitations on national policymaking which threaten the adoption and the implementation of patriotic national policies which reflect interests and needs which have emerged in a national economy. In order to pass the general legal test, national measures must serve legitimate general interest objectives, be appropriate for securing the attainment of those interests, and not go beyond what is necessary to achieve them.[2] The law specifically requires that there is a genuine and legitimate need for policy intervention,[3] that the implementation of the policy is suitable to achieve the desired objectives and is proportionate—meaning that the benefits generated match the disadvantages caused.[4] In this narrow sense, the law is predicated on the assumption that policymakers will use the least restrictive means possible (Tridimas 2007).[5]

According to relevant judicial practice, proportionality requires that national policymakers' output actually relate to the socio-economic factors which are relevant to their specific policy objectives—that is, their general interest aims—and that the conditions they put on the implementation of such policies also be connected to those factors.[6] Another requirement which affects policy design is the development of implementation measures, which must make it possible to distinguish between the different factual situations which may emerge under the given national policy framework.[7] In a similar vein, EU authorities expect the implementation of national policies to be confined to the problems which were originally identified as necessitating a policy response.[8] National policies which serve purposes different from those originally assigned to them—and could thus give rise to arbitrary abuses of power—are specifically prohibited.[9] In this regard, the principle of proportionality may require a direct, relevant, and visible relationship between the general interest aim pursued and the measure in question.[10] Member States are also prohibited from contradicting the logic of a policy during its implementation, especially when coercive measures are employed.[11]

Further constraints on national policymaking follow from requirements—arising under the proportionality principle—which focus on the quality of the implementation measures, particularly their legal (regulatory) quality. These, along with the aforementioned limitations, considerably reduce the choices available to national governments, especially in how they prioritise policy effectiveness, how they develop policy preparation and implementation practices, and how they calibrate the swiftness, the force, or the modes of their national policy responses. According to the case law of the EU Court of Justice, the legal measures adopted in implementing national policies must be predicated on the assessment of objective and verifiable elements,[12] their scope must be defined with sufficient precision (i.e., their scope can be established by the individuals affected at the outset),[13] and they must be regulated with such precision that individuals are able to determine how their rights and obligations will be affected by such policies.[14] In accordance with the principle of legal certainty, domestic legal measures must be clear, precise, and predictable in their effects, especially where their application may lead to unfavourable consequences for individuals.[15] In particular, they must ensure that the exercise of the rights provided to individuals is qualified by precise conditions, that the conditions for prohibiting or permitting conduct are objectively determined, and that discretion in decision-making during implementation is subjected to precisely regulated objective conditions.[16] Policy implementation at the national level will be deemed disproportionate whenever individual decisions are not supported by sufficient reasons—thus, when effective protection (judicial review) against them is not provided.[17]

Limits on domestic policymaking may be particularly far-reaching when the proportionality principle involves the demand that Member States implement their policies according to the least restrictive means possible. Under this rule, national governments may be instructed to regulate the relevant policy issue (e.g., the risk) directly and in detail and avoid introducing general prohibitions or other generally framed measures which might indiscriminately affect the freedoms of individuals active in the national economy.[18] Member States' discretion can be reduced to a bare minimum when proportionality is interpreted as requiring costly and demanding solutions in national administration and governance, such as instituting new administrative capacities or setting up new administrative frameworks, instead of resorting to the seemingly hard-and-fast solutions of introducing legal prohibitions or setting up frameworks for administrative authorisation.[19] Under the principle of proportionality, national governments may be asked to consider and develop specific alternative modes for the administrative supervision of market operators, which solutions may be more burdensome for national governments, but are less likely to damage the legally protected interests of individuals.[20] The law governing the Single Market often favours policy solutions which are 'market-friendly', solutions that guarantee and safeguard the autonomy and freedom of economic operators.[21]

On a general level, the limitations that follow from the principle of proportionality are neutral in their effects. They do not forbid or interfere directly with patriotic policy choices, either conservative or liberal.[22] Their focus is on the quality of policymaking and implementation in EU Member

States; in particular, they require that a policy's implementation measures meet requirements arising, in general, from the rule of law, such as legal certainty, respect for the rights and legitimate expectations of the individuals affected, and the availability of effective judicial redress and remedies. In principle, these same requirements also bind national governments as a matter of national law. One of the more controversial restrictions imposed on national policymaking is the requirement that policy responses must be linked to legitimate and genuine general interest objectives. The scrutiny to which Member State policy objectives are subjected—and the filtering which is thereby achieved—may in fact exclude national policy objectives which are incompatible with the objective of market integration, such as the disadvantaging of 'non-nationals' in breach of the non-discrimination principle. National governments may feel equally constrained when planned changes in national markets are to be implemented using means that do not conform with standard practices for preparing and executing policies—for instance, the expulsion of 'non-national' incumbents as effectively and quickly as possible. They may also find it problematic when the rationality of their policies, the gaps in national policies, and the means and circumstances of their implementation are assessed from the perspective of the policy conduct which is expected from EU Member States in the context of market integration.

When the complex problems of a national economy require equally complex policy responses, national governments may find the enforcement of the EU's aforementioned legal restrictions especially frustrating. Fulfilling their political mandates may require national policymakers to adopt policies with multiple overlapping, potentially contradictory objectives, to make difficult—often socially and politically controversial—choices of policy priorities, design and implementation, or to sacrifice policy coherence and consistency for the sake of rapid and effective intervention. The markets they target may be complicated and thus in need of policy experimentation and flexibility in governance. In such circumstances, the strict enforcement of the requirements of regulatory clarity, precision, and predictability can saddle national governments with a nearly impossible task. The corollary of the principle of proportionality which requires Member States to adopt solutions that interfere with the fundamental freedoms in the least restrictive manner possible may exclude patriotic policy responses that are not 'market-friendly' or do not aim to maximise the freedoms of economic operators; it may thus interfere with a Member State's choices of appropriate institutional setups for particular local conditions, or demand the recalibration of local, socially and institutionally embedded administrative structures and governance frameworks. This may pose a threat not only to local institutional diversity among Member States, but also to the maintenance of comparative (institutional) advantages in the national economy.

Hungarian Economic Patriotism and Its Limits Under EU Law

Developments in Hungarian economic policy since 2010[23] and their assessment under EU law provide a current and accessible case study for the examination of the aforementioned problems and dilemmas which result from conflicts between Member State economic patriotism and the legal conditions of participation in the EU Single Market. The policies implemented by the Hungarian government which took power in 2010 illustrate the ground which economic patriotism has gained within the integrated EU market,[24] the legal framework of which was confronted—not for the first time[25]—with the efforts of a national government to fulfil its political mandate by shaping its national economy according to what it perceived to be relevant local interests and needs, without regard to its obligations under EU law.[26] When the EU's enforcement mechanisms eventually caught up with these measures, the following patterns of policy development were revealed. First, in certain sectors of the national economy market integration was welcome and the relevant legal obligations were met,[27] while in others, local policies restructured market positions and competitive opportunities in open contravention of the EU's fundamental freedoms.[28] Second, domestic policies (and often the political imperatives behind them) were frequently prioritised over competing considerations, particularly those which followed from the rule of law, which affected the quality of law and administration in policy implementation.[29]

The transformation of the market for tax-free remuneration (non-salary allowances) which public and private employers provide to their workers—which market is now purely national—is a clear example of the type of conservative patriotic policy which the government aimed to implement in the more closed sectors of the national economy. The previously existing market for paper and electronic allowance vouchers was closed in 2011 and the incumbent economic operators, who were 'non-nationals', were expelled from the market without any genuine transitional period.

This measure was implemented by establishing a state monopoly on the paper-voucher market and imposing a 51 per cent tax on the market incumbents, while reserving the tax-free status they previously enjoyed for new market entrant.[30] The new market for electronic vouchers[31] (the *SZÉP*-card) was opened in circumstances which ensured that only 'nationals'—the three large banks domiciled in Hungary[32]—would participate. The new legislative framework imposed restrictive conditions on market entry, such as the requirement that participants' primary establishment and primary place of management be in Hungary.

From the perspective of the incumbents, the partial abolishment of the Hungarian private pension market, which was driven mainly by fiscal policy considerations, entailed similar consequences for their market opportunities. In 2010, the government used legal regulation to force the clients of the private tier of the mandatory pension system to abandon that system and redirect their assets to the public tier. Openly discriminatory legal provisions coerced market participants and their clients (the working population)—without a genuine transitional period—into making the single legal 'choice' available to them, that is, rejoining the public pension system. These discriminatory provisions were withdrawn in 2011, just after the government had finished restructuring this market, in hopes of avoiding legal challenges to this policy.[33]

The government made these changes by adopting a series of measures which altered market conditions. The action they took towards the end of 2010[34] damaged certain participants' market prospects by suspending their clients' insurance payment obligations for a year and offering them the chance to abandon their private insurers and return to the public pension system. The ultimate push came in the form of the subsequently repealed[35] Act 2010: CLIV, which threatened clients who had decided to stay in what remained of the original market with the loss of their entitlements to benefits from the mandatory public pension system starting on 31 January 2011. Even though these legislative measures were framed as an intention to link market developments to the choices made by consumers, it is evident that the deterioration of market circumstances—which led to consumers who were anxious to protect their pension savings to make the only reasonable choice, that is, abandoning the market—was the consequence of the government's intentional use of legal regulation to alter conditions in that market.

The regulation of the retail and wholesale segments of the Hungarian tobacco market is another clear example of a national policy which clearly favoured 'nationals', in this particular case by excluding their market-incumbent competitors. In the retail market, the entry of new economic operators (some of whom also had interests in the wholesale market) and the expulsion of incumbents were achieved—again without instituting a genuine transitional period—by implementing legal measures which not only opened the door to the arbitrary use of public power, but also failed to ensure that the proprietary rights and legitimate expectations of the affected operators would be adequately protected.[36] Although the Hungarian Constitutional Court readily approved these changes by deferring to the government's policy discretion in this matter,[37] the European Court of Human Rights' assessment insisted that these Hungarian measures had failed to comply with basic regulatory requirements derived from Convention rights.[38]

In the wholesale market, a new territorially connected operator endowed with exclusive rights was introduced simply by granting it a concession. The legal preparation and the actual execution of this concession process raised considerable doubts as to whether the selection of the concession holder and the parallel reduction of market opportunities for its competitors were based on objective, transparent, and (from the perspective of the operation of the tobacco market) relevant criteria.[39] As in other economic sectors chosen for restructuring on the basis of patriotic considerations, the implementation of these changes was supported by the adoption of a new tax—the tobacco industry's special tax (healthcare contribution), which placed an additional burden on incumbents and 'nudged' them to reconsider their plans for the Hungarian market.[40]

The rearrangement of the gambling market, where patriotism was used to promote the market position of 'nationals', followed a similar pattern. In the slot machines sector, incumbents were replaced by favoured economic operators from the casino market by means of a series of steps. First, a measure was introduced which—without a genuine transitional period—imposed a new flat-rate tax on slot machines, quintupling the tax on revenues from machines operated in amusement arcades, but not on those in casinos.[41] This was followed by the prohibition—again without a transitional period and without offering compensation—of the operation of slot machines outside of licensed casinos.[42] The position of new entrants was also enhanced in the casino market. Rules on the granting of gambling concessions, which mainly affected the operation of casinos, were modified to include relaxed rules for the so-called trustworthy gambling-service providers, which considerably expanded the government's discretion in selecting favoured concession holders.[43] The online gambling market was also liberalised[44] in a way that secured further market opportunities for the chosen few.

The favouring of domestic retail chains was also central to the Hungarian government's agenda and was pursued by means of numerous regulatory attempts to restructure the domestic food retail sector. The use of fiscal burdens, which in this context were used selectively to give advantages to certain economic operators while disadvantaging their competitors, was again part of the strategy.[45] In 2014, the government introduced an extremely progressive food chain supervision fee which, on the basis of size and the structure of operation, openly distinguished between 'nationals' and 'non-nationals'.[46] Hungarian retail chains were given further support when, during the restructuring of the market for tax-free remuneration vouchers, 'non-national' retail chains were licensed to accept the new state vouchers as legal tender much later than their domestic competitors were.[47] Furthermore, the act which regulated commerce was modified by Act 2014:CXII in order to penalise retail-sector operations with annual net income of 15 billion Hungarian forint or more with a compulsory suspension of their commercial activities if they failed to report profits in two successive years. In the domain of planning law, authorities introduced new, stricter rules for the planning of commercial premises,[48] which were then applied under broad ministerial discretion in procedures which lacked transparency, predominantly to the benefit of Hungarian economic operators.[49]

Patriotism took more complex forms in domestic public service markets, where Hungary had been reluctant to pursue a full liberalisation agenda since the regime change.[50] These changes, which included increased state involvement and a parallel reduction of competition, were supported on generally legitimate policy grounds, such as the strengthening of social cohesion and the intention to respond to a spiralling 'cost-of-living crisis'. The nationalisation of public service providers in the energy markets[51] and the replacing of market operators by state monopolies naturally brought with them the exclusion of 'non-national' incumbents, which had been facing rather grim market prospects in the national market, among others, as a result of direct price regulation by the state which reduced utility prices for end users.[52] In practice, many incumbents returned their licences before they expired; their operations were then sold to the new state monopoly, established in 2015 under the name First National Public Utility Corporation.[53]

Similar developments characterised the restructuring of the market for waste, which coincided with the long-delayed implementation of the Waste Directive.[54] In the waste collection market, the government expelled the incumbents, predominantly foreign-owned economic operators, and renationalised the market by implementing a regulation that limited operating licenses to enterprises which were directly or indirectly controlled by the state or by local councils.[55] The government also introduced price regulation,[56] which affected the market prospects and decisions of incumbents. The waste management market was reorganised by means of a series of public contracts which the national Waste Management Agency[57] signed with a particular group of Hungarian enterprises. These companies were then investigated by the Hungarian Competition Authority on charges of cartel conduct in public procurement, which case was closed in 2015 on the grounds that continuing the investigation was not in the 'public interest'.[58]

When EU law and its enforcement finally caught up with these Hungarian developments, they were confronted with national policies that had been implemented in defiance of core EU objectives. In practice, particular segments of the national economy (or particular aspects of such segments) were, as part of a set of deliberate domestic policies, withdrawn from the European integrated market and restructured on the basis of locally determined interests. The Commission and the EU Court of Justice examined whether the preparation and implementation of these policies satisfied the conditions of EU law (e.g., that of policy rationality) and whether they were adequate and lawful in a broad sense. They focused on whether the basic failures and omissions investigated under the principle of proportionality—such as the inability of the government to link its actions to valid policy objectives, the lack of clarity and certainty in its legal regulation, and the failure to guarantee coherence in its policy actions—would allow these policies to be implemented. Evidently, Hungary had struggled to satisfy the demands of EU law regarding national policymaking. On the basis of the EU Court of Justice's relevant judgements, it is difficult to establish whether Hungary's policies were found wanting as a result of the patriotic objectives that Hungary pursued, or because it failed to stay within the bounds of the policy rationality demanded by the law governing the Single Market.

In the infringement case brought against Hungary over the restructuring of its market for tax-free remuneration vouchers—in which Hungary was accused of (very likely deliberately) failing to meet its EU obligations[59]—the Court faced no difficulties in establishing that the government's regulation of entry into the new electronic vouchers market violated the Services Directive.[60] It held that the government was unable to justify its intervention by pointing to a legitimate general interest ground and also failed to adduce evidence supporting the existence of such a ground.[61] It also ruled that the Hungarian government had not been able to establish that the policy objectives it pursued could justify its breaches of EU law, nor that its objectives were rational and proportionate.[62] The judgement reached similar conclusions about the government's establishment of a new state monopoly in the paper-voucher market. The policy objectives that Hungary invoked were either irrelevant in the context of state interventions in the market, or unsubstantiated, and Hungary was unable to convince the court that there was a rational connection between the operation of this state monopoly and the implementation of the relevant social policy objectives.[63]

The assessment of the Court of Justice in its judgement in *Hervis*—which concerned the steeply progressive retail surtax which the Hungarian government had introduced with the intention of restructuring its domestic retail market by shifting the market positions of 'non-nationals' in favour of those of 'nationals'[64]—concluded similarly. Hungary's justifications for its policy were rejected on the ground that its government had been unable to identify a clear and rational general interest objective served by the tax measure in question.[65]

The judgement in the *Berlington* case, which declared the controversial restructuring of the Hungarian gambling market to be a violation of EU law, was similarly unforgiving, and for the same reasons. It found that the measures Hungary had adopted amounted to the unlawful exclusion of amusement arcades from an important market segment, to the benefit of casino operators.[66] Referring to an earlier Strasbourg ruling concerning the same government policy,[67] it specifically criticised the government's failure to observe the principle of legal certainty and to respect the legitimate expectations of the affected traders when it revoked existing licenses. While the Court did not take a final stance on the issue of whether Hungarian policy was sufficiently coherent and systematic (a concern derived from the proportionality principle), it did point out the connection between the selective reallocation of market opportunities in the slot machines market and the liberalisation of the online gambling market, suggesting that Hungary may be prevented from restricting gambling opportunities in amusement arcades while simultaneously making gambling more accessible to the public in a parallel market segment.

The recent ruling in the *Unibet* case, which concerned the regulation of the conditions under which concessions were granted in the online gambling market—which, as we mentioned earlier, allowed ministers to engage in preferential treatment of the so-called trustworthy operators—was equally condemnatory. Basing its scrutiny on the principle of proportionality, the Court placed particular emphasis on the qualities of the regulatory and administrative environment—specifically whether the regulatory criteria were objective and known in advance 'in such a way as to circumscribe the exercise of the national authorities' discretion so that it is not used arbitrarily'.[68] The context of the public tenders involved in this case meant that the connected principles of transparency and equal treatment were also at issue, which principles demanded the opening up of this tender to competition and the impartial administration of the award procedure, whereby the licensing authority would be prohibited from engaging in 'favouritism or arbitrariness'.[69] The principles of transparency and equal treatment were interpreted as requiring that all the conditions and detailed rules of the award procedure be drawn up in a 'clear, precise and unequivocal manner' so that tenderers can understand their meaning, 'the contracting authority's discretion' is circumscribed, and it can be ascertained whether submitted tenders satisfied the relevant legal criteria.[70] This judgement also relied on the principles of legal certainty and the protection of legitimate expectations which, as enforced in the earlier judgement in *Berlington*, require that the applicable legal rules be clear, precise, and predictable in their effects.[71]

With these principles laid down as the basis for the Court's assessment, the judgement began with a discussion of a fundamental flaw in the discriminatory legal definition of 'trustworthy' operators and criticised Hungary for not explaining—beyond the identification of the general interest aims which could potentially serve as grounds for the relevant local policy—the reasons why it was necessary to introduce such a definition.[72] The Court then ruled that it was unacceptable under EU law for the largely uncontrolled and unregulated discretion of the responsible minister to determine the results of an award process, and for the relevant authorities not to provide tenderers with a precise legal explanation of the 'technical conditions' they needed to fulfil.[73]

Without exception, these rulings revealed that the scrutiny to which national policies are subjected under EU law—particularly in the course of the application of the principle of proportionality by the EU Court of Justice—presents formidable hurdles to national governments which pursue certain forms of economic policy patriotism. Clearly, they are going to be legally prevented from restructuring national markets and redistributing market opportunities to the benefit of 'nationals', even when their own assessments suggest that such changes are desirable. Even though their overall discretion is acknowledged, they are expected to fulfil their political mandates in the national economy in a manner that is compatible with the imperatives of market integration. Crucially, the decisive factor is not so much the patriotism that characterised the local policies at issue or the form of patriotism they implemented, but the presumably interconnected failures of the Hungarian government to observe the largely technical standards which the principle of proportionality imposes on national governance.

Conclusions

For national governments, participation in the EU Single Market presents a rather difficult dilemma. On the one hand, by assuming a legal obligation to guarantee the freedom of movement, they are able to satisfy the 'liberal' objectives of national economic policy which favour open markets and foreign investment. On the other hand, this same obligation prevents them from realising the 'conservative' patriotic objectives of their national economies, which aim to allocate market opportunities by determining who is 'in' and who is 'out', on the basis of some form of territorial connection, for instance. These limitations follow primarily from their core legal obligations to the EU, such as the prohibition of discrimination on the basis of nationality, though the restrictions imposed by the principle of proportionality when national economic policies are scrutinised under EU law can also have a significant impact on the choices of national governments. As these Hungarian examples have shown, the enforcement of the relevant legal requirements may deprive domestic policies of their meaningfulness (effectiveness and responsiveness)—at least, as such terms are understood by national governments constrained by spatially defined political mandates.

Notes

1. The governance of the Single Market is under pressure to address the possibility of local opposition rooted in the political determination that the institutions of local capitalism must be protected, Weaver (2015).
2. Inter alia, para. 42, Case C-262/09, *Meilicke*, EU:C:2011:438.
3. Under EU law, national policies which interfere with the private sphere can be declared—in contravention of a national government's original assessment—as completely unnecessary if the state, in general, seems to have sufficient legal powers at its disposal to address future events and to ensure compliance with the general interest objective in question (para. 11, Case 3/88, *Commission v Italy*, EU:C:1989:606), and when the obligation or restriction imposed is irrelevant to the general interest aim pursued (para. 45, Case C-298/99, *Commission v Italy*, EU:C:2002:194), or when there is no reasonable basis for such intervention (para. 107, Case C-309/99, *Wouters*, EU:C:2002:98).
4. In other words, the restriction introduced in the private (economic) sphere was not excessive; see para. 14, Case C-351/90, *Commission v Luxembourg*, EU:C:1992:266.
5. This latter requirement can be particularly restrictive and burdensome for national policymakers, who must comply *ex ante* in the policy development phase with this *ex post* determined and applied benchmark; see, inter alia, para. 48, Case C-296/12, *Commission v Belgium*, EU:C:2014:24. When a national measure is adequately targeted and precisely regulated, and the discretion made available for decision-making is duly delimited, demands in EU law for alternative national solutions may, however, be more confined; see, for example, para. 53, Case C-503/99, *Commission v Belgium*, EU:C:2002:328.
6. Paras. 54–55, Joined Cases C-197/11 and C-203/11, *Libert*, EU:C:2013:288 A measure is appropriate when it is justified by or corresponds to factual circumstances; paras. 39–40, Case C-451/03, *ADC Servizi,* EU:C:2006:208. A measure must be based on relevant facts, which means that the practical problems listed must be directly connected to the measure; paras. 32 and 36, Case C-514/03, *Commission v Spain*, EU:C:2006:63.
7. Para. 33, Case C-330/03, *CICCP*, EU:C:2006:45.
8. Para. 38, Case C-282/12, *Itelcar*, EU:C:2013:629.
9. Para. 46, Case C-296/12, *Commission v Belgium*, EU:C:2014:24. During their implementation, national policies cannot be justified by just any general interest aim which authorities deem suitable in the given circumstances; see para. 69, Case C-375/12, *Bounaich*, EU:C:2014:138.
10. Para. 32 Case C-260/04, *Commission v Italy*, EU:C:2007:508.

11. Para. 57, Case C-326/12, *van Caster*, EU:C:2014:2269.
12. Para. 37, Case C-282/12, *Itelcar*, EU:C:2013:629.
13. Para. 44, ibid.
14. Paras. 19–20, Case C-54/99, *Eglise de Scientologie*, EU:C:2000:124.
15. Para. 44, Case C-282/12, *Itelcar*, EU:C:2013:629.
16. Paras. 49–52, Case C-503/99, *Commission v Belgium*, EU:C:2002:32. The use of discretion in the implementation of national policy must be based on objective, non-discriminatory conditions known in advance to the persons concerned 'in such a way as to adequately circumscribe the exercise of the national authorities' discretion; para. 57, Joined Cases C-197/11 and C-203/11, *Libert*, EU:C:2013:2888.
17. Para. 40, Case C-282/04, *Commission v the Netherlands*, EU:C:2006:608.
18. See, inter alia, para. 69, Case C-436/00, *X and Y*, EU:C:2002:704.
19. See, inter alia, para. 50, Case C-493/09, *Commission v Portugal*, EU:C:2011:635 and para. 17, Case C-101/94, *Commission v Italy*, EU:C:1996:221.
20. See Case C-299/02, *Commission v the Netherlands*, EU:C:2004:620. See the similar demand in the context of quality regulation in national markets, Case C-351/90, *Commission v Luxembourg*, EU:C:1992:266.
21. See, inter alia, para. 43, Case C-171/02, *Commission v Portugal*, EU:C:2004:270.
22. These limitations can be interpreted as enabling national governments to explain and justify their policies on the basis of the actual facts and providing an opportunity to have them confirmed under EU law despite having a purpose or effect of restricting the fundamental freedoms, Snell (2012, pp. 433–434).
23. Increasing state involvement, which often involved reinstating state ownership in certain aspects of markets or in specific markets, was one of the central policy directions. See, in particular, Act 2011:CXCVI on national assets. See also the measures which protect business information in certain public service markets, such as the 2016 modification of Act 2012:CLIX on postal services (Art. 53(4)) and the modification in that same year of Act 2009:CXXII on the more efficient operation of publicly owned business enterprises (Art. 7/I(1)–(3)).
24. For a general discussion, see Bernitz and Ringe (2010) and the Special Issue of the *Journal of European Public Policy*, 2012.
25. See Krisov et al. (1986, pp. 68, 77, and 87) and Snyder (1993, p. 22).
26. The symbolic triple infringement procedures initiated against Hungary in 2012 (IP-12-24) evinced a realisation at the EU level that Hungary was not afraid of moving away from its EU commitments if doing so was dictated by its interests. Its intention to prioritise domestic interests over EU obligations was made particularly visible in the recent infringement case

concerning the payment of excise duties for the production of ethyl alcohol (*pálinka*) by private individuals; Case C-115/13, *Commission* v. *Hungary*, EU:C:2014:253.

27. Export-oriented sectors and/or sectors exposed to cross-border interdependencies.
28. See the general analysis by Rosamond (2012, pp. 326–328). Hungary's practices fall very much in line with Clift's previously introduced definition of 'economic patriotism' (Clift 2013), according to which individuals and economic operators with considerable connections to local territory are favoured by domestic policies.
29. Economic regulation was—often intentionally—made highly volatile and uncertain, and a number of individual legal measures limited competition and/or favoured certain, predominantly domestic economic operators over others; see OECD Economic Survey (2014, 2016) and Council Recommendation (2014, 2015). Giving nearly unlimited political and policy discretion to the executive in matters related to economic policy was a core development; see the example of the treatment of mergers which were deemed beneficial to the national interest under Art. 24/A of Act 1996:LVII on competition, the powers available under Act 2006:LIII, *infra* note 33, or the powers made available in the planning process for commercial premises, *infra* note 54. Rolling back the possibility of mounting legal challenges to such economic policies was part of the government's toolkit. The suspension of the Constitutional Court's power to review fiscal matters was a huge blow to the principle of legal protection in Hungary (Act 2010:CXIX). The deciding of individual administrative cases through legislation which precluded judicial review was another important regression; see the provisions on the treatment of mergers which were deemed beneficial to the national interest under Art. 24/A of Act 1996:LVII and the provisions of Act 2006:LIII, *infra* note 33. Another issue was the limitation of the availability of legal challenges to protect the rights of individuals. See, for example, Act 2006:LIII, under which public and private investment projects which were declared 'specifically relevant to the national economy' could be exempted by government decree from having to obtain certain otherwise necessary public authorisations and licenses, decrees that cannot be challenged in court.
30. Act 2011:CLV.
31. Act 2011:CLVI, Act 1993:XCVI and Government Regulation 55/2011.
32. Action brought on 10 April 2014 in Case C-179/14, *Commission* v. *Hungary*, O.J. 2014, C 202/12.
33. See ECtHR, *E.B.* (No. 2) v. *Hungary*, Appl. No. 34929/11, judgement of 15 January 2013, which rejected the application but made the criticism

that there was no choice involved for individuals, as was promised in the legislation.

34. Acts 2010:C and CI.
35. Act 2011:CXCIV.
36. Act 2012:CXXIV.
37. Decision 3194/2014 of the Constitutional Court.
38. ECtHR, *Vékony* v. *Hungary*, Appl. No. 65681/13, judgement of 13 January 2015.
39. Act 2014:XCV.
40. Act 2014:XCIV.
41. Act 2011:CXXV.
42. Act 2012:CXLIV. The measure was upheld by the Constitutional Court in Decision IV/03576/2012.
43. Act 2013:CLXXXV.
44. Act 2013:CXXVI.
45. See the aforementioned tobacco industry healthcare contribution, the taxes imposed on operators of slot machines, and the 51 per cent tax on the vouchers market. The media market was also affected by a progressive tax (see the provisions of Act 2014:LXXIV on the so-called advertisement tax).
46. Act 2014:LXXIV. See also the retail surtax investigated in Case C-385/12, *Hervis*, EU:C:2014:47.
47. http://nol.hu/gazdasag/erzsebet_utalvany_utan_szep_kartyat_is_elfogadhat_a_tesco-1315548 (last visited 25 February 2016).
48. Act 2012:CLVII.
49. http://tldr.444.hu/2015/11/30/az-elelmiszerpiacot-akartak-atrendezni-a-plazastoppal (last visited 22 February 2016). The decisions taken by the minister were made public only after a FOI request by investigative journalists.
50. See the 2004 OECD economic survey.
51. Some of Hungary's more general illegal practices in the energy market are addressed in infringement no. 20142271 concerning obligations under the Third Energy Package.
52. Arts. 104(4), 104(4a), 104(4b), 108/A and 109 of Act 2008:XL on natural gas supply, and Arts. 140(4) and 140(5) of Act 2007: LXXXVI on electricity.
53. Regulation 7/2015 of the Ministry for National Development.
54. Directive 2008/98/EC on waste, O.J. 2008, L 312/3. The infringement procedure was closed when Hungary eventually implemented the directive, Order in Case C-310/12, *Commission* v. *Hungary*, EU:C:2013:556.
55. Art. 81 of Act 2012:CLXXXV.
56. See Act 2013:LIV.

57. Act 2012:CLXXXV.
58. Vj/67/2014. See, in particular, Act 2014:XCIX which excluded the applicability of the competition act concerning illegal conduct in public procurement procedures conducted in the years 2012–2013.
59. See paras. 147–174, Case C-179/14, *Commission* v. *Hungary*, EU:C:2016:108.
60. Directive 2006/123/EC on services in the internal market, O.J. 2006, L 376/36.
61. Paras. 46–47, 54–67, 69, 81–88, 89–90, 91, 92–94, 102–107, 116–116, Case C-179/14, *Commission* v. *Hungary*. For example, the interest of sufficient integration into the local economy, the availability of sufficient experience and infrastructure, and the availability of sufficient guarantees to satisfy consumers and creditors.
62. Ibid.
63. SUPRA See Act 2012:CIII. In particular, the interest of realising social policy through State institutions and not the market, and the redistribution (here, more like rechannelling) of incomes to finance social policy aims, such as education.
64. Other progressive indirect taxes which the government introduced were addressed by the Commission under EU State aid law, which made it possible to strike down infringements much more quickly. See Varju and Papp (2016).
65. Paras. 31–44, Case C-385/12, *Hervis*, EU:C:2014:47.
66. See paras. 37–42, 50–64, 67–70, 74–91, 93–100, Case C-98/14, *Berlington*. EU:C:2015:386.
67. *Vékony* v. *Hungary*, Appl. No. 65681/13.
68. Paras. 40–41, Case C-49/16, *Unibet* EU:C:2017:491.
69. Paras. 42 and 46, ibid.
70. Para. 46, ibid.
71. Para. 43, ibid.
72. Paras. 44–45, ibid.
73. Paras. 46–47, ibid.

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CHAPTER 8

Economic Patriotism and Liberalism in Present-Day France: Changing Role of the State in French Economy

Miklós Somai

Introduction

France was known to be a quite centralized state as early as the fifteenth century. The centralization of economic resources became even more acute during the *Great Century* with the rise of absolutism and Colbertism[1] (1589–1715, i.e. from Henri IV to Louis XIV). Since then the French people have kept the tradition of favouring big government and take great pride in their public sector.[2]

From a general and somewhat simplified viewpoint, France has a unique perspective on the role of government. There are two main differences compared with other developed countries' approach. The first one is of a structural nature which, on the basis of the long-standing and steady centralization tradition, led to bodies of permanent and powerful public administrators that were more stable than government members. The second one is enrooted in history and connected to the revolution of 1789,

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the spirit of which had become deeply ingrained in the French interpretation of public service, that is, the permanent search for the right public action for the sake of people's happiness, liberty and fair treatment (Kolm 2010, pp. 690–691).

Although it was a French politician, Domonique de Villepin, Chirac's last prime minister, who—in 2005 and seemingly in line with the then still significant influence of the dirigiste traditions on French macroeconomic policymaking—introduced the notion of 'economic patriotism' by labelling it "*the defence of local prerogatives in integrated markets*", contemporary capitalism in France does not, as this chapter tries to demonstrate, fundamentally differ from that in other developed countries of Europe (Clift and Woll 2012).

Waves of Nationalizations

During the twentieth century, direct economic intervention of the state became stronger in years following great economic and/or social shocks (Chevallier 1979, pp. 17–19). Already in the period after World War I, the creation of mixed public–private companies for the implementation of hydro-energy projects was launched, similar to the 'commercial and industrial public establishments' for running autonomous ports like those in Le Havre, Strasbourg and Bordeaux. But the first big wave of nationalization of the twentieth century was linked to the advent of the Popular Front (1936–1938).

There were three main reasons for the nationalizations. First, during the crisis several companies had asked for financial help and received public aid or loans, which they were unable to repay later. The government swapped these debts for equity in the debtor firms, which led to the establishment of such mixed companies as Air France and SNCF. Second, the international tension of the 1930s urged the Popular Front both to nationalize the existing companies of the arms industry and to create new ones (e.g. three airplane factories). Third, the lessons learnt from the crisis prompted the administration to play a more active role in the regulation of the national economy (see the creation of a national Grain Board and the democratization of the Bank of France[3]).

Following the massive devastation that resulted from World War II, a further increase in the role of the state in the economy became inevitable. As for the origin and justification of the process, two sets of reasons could be distinguished: a political and an economic one. The former was linked to the need for punishment of those who collaborated with the Nazis—a claim laid down in the Resistance's 1943 programme[4]—and resulted in the nationalization of Renault, Havas and Gnome et Rhône. The latter was linked to the immense task of reconstruction: the country had to be put back into operation, rebuilt and modernized, especially in term of infrastructure (e.g. rail, road, energy and pipelines). The takeover of big banks and insurance companies by the state was also justified by the urgent need to channel savings to investments undertaken by the nationalized companies. Following the nationalizations, the number of employees in public sector companies rose to just over 1.1 million, which at that time represented 9.9 per cent of the nationally employed. While the number of public employees stabilized at approximately 1.0–1.1 million in 1980, their share in the total workforce decreased to a mere 6.0 per cent (Chabanas and Vergeau 1996, pp. 1–3).

The third wave of nationalization took place in a period of prolonged economic downturn (stagflation and mass unemployment), originating from oil price shocks and significant changes in the relationship between developed and developing countries (Chevallier 1979, p. 20). As for the magnitude of the crisis in France, it is notable that between 1978 and 1985, approximately one-third of the industrial workforce disappeared (Cohen 2007: 20). Once again, there were both ideological and economic reasons behind nationalizations. The former appeared in the option for taking over 100 per cent of all nationalized firms, against 51 per cent recommended by both Rocard and Delors. The intention was to deprive the country's great dynasties (the remnants of the 200 families) of the base of their economic power, and to push certain foreign multinationals out of France.[5] As for the economic reasons, because of their difficult situation, all five big industrial groups which were nationalized—CGE, Péchiney-Ugine-Kuhlmann, Thomson-Brandt, Rhône-Poulenc and Saint-Gobain—asked for state intervention (Ibid., p. 794).

The Nationalization Act of 11 February 1982 transferred 100 per cent of the shares of the 5 above-mentioned major industrial groups to the state, and 39 registered banks and 2 financial companies (Suez and Paribas) were also included. In the case of three other major banks (BNP, Crédit Lyonnais and Société Générale) indirect state ownerships were converted into direct ones (Légifrance 1982, Article 12). Moreover, the state acquired, through debt to equity swap, at least controlling stake in the two giants in the steel industry (Usinor and Sacilor), as well as in some other companies of high-tech industries—namely, Matra (aerospace/military), Dassault Bréguet (aviation), Roussel-Uclaf (Pharmaceuticals), CII-Honeywell-Bull (IT) and ITT France (Vessilier 1983, pp. 466–467). As some of these high-tech companies were partially foreign-owned, this move, alongside the already mentioned political/ideological motivations, may also have been justified by national security reasons.[6]

As a result of this third wave of nationalization, the number of public companies rose to 3000, representing 23 per cent of GDP, while the number of employees in public sector companies rose to 2.3 million, representing more than 10 per cent of total workforce (Institut National de la Statistique et des Études Économiques, INSEE, the French national statistical office 2016a; Bizaguet 1983, p. 460).

The costs related to the 1982 nationalization programme led to fiscal imbalances. Furthermore, rescuing companies in difficulties and a Keynesian-type demand-stimulation policy—promised by the Socialists before the 1981 elections, but in total asynchrony with the winds of neo-liberalism, deregulation and fiscal austerity blowing in France's main partners—added up in less than two years to a serious deterioration in macroeconomic balances. As a result, the government was forced to make a U-turn in its policy:

- nationalizations were halted;
- the companies in difficulty, instead of being rescued, were dealt with by the Commercial Court; and
- demand-creating economic policy gave way to austerity, based on new priorities like low inflation, low deficit and the adjustment of external balances.

This split in the economic policy—confirmed with the bankruptcy and dismantling of Creusot-Loire, a giant engineering conglomerate with 14,000 qualified workers, the first to be let down by any wing of French government since World war II—deeply undermined the idea that there might be a socialist-type management of industrial crisis, a left-wing social policy or any such thing as a left-wing economic policy in general (Cohen 1993, pp. 797–798).

Twenty Years of (Re)privatization

Three years after the above-mentioned split, the French right-wing government set out to implement an ambitious privatization programme. It was ambitious in two specific ways. First, it was ambitious in its scale, as legal texts, involving 66 companies with a workforce of about 900,000 and worth a quarter of the capitalization of Paris Bourse, covered not only firms taken over by the former Socialist government but also some other ones, nationalized after World War II with broad national agreement. Second, it was ambitious in its desire to create an economic system based on a completely new foundation, that is, promoting the participation of millions of small shareholders, an idea once so dear to De Gaulle (Bauer 1988, pp. 49–50).

But the above-mentioned ambitions could only be partly realized. The process of privatization was very slow and proved to be significant in terms of the size only in the long run (Table 8.1). On the other hand, the basis

Table 8.1 Prolonged French privatization

Who did	*When*	*What*	*How*
Right-wing government	1986–1988	1200 companies – bank/insurance (e.g. SG, Paribas, Suez, CCF), industry (e.g. Saint-Gobain, CGE, Matra) other (Havas, TF1)	Privatization
		Usinor-Sacilor, Charbonnages de France	Reorganization
Left-wing	1988–1993	Elf Aquitaine, Rhône-Poulenc, Crédit local de France	Decrease of state share
		Renault, PTT (split into La Poste and France Télécom)	Change of status
Right-wing	1993–1997	In 1993: 180 firms (BNP, Rhône-Poulenc)	Privatization
		In 1994: 356 firms (Elf Aquitaine, UAP)	Privatization
		In 1995: 180 (Seita, Usinor/Sacilor, Péchiney)	Privatization
Left-wing	1997–2002	Thomson Multimedia, CNP Assurances, Air France, France Télécom	Opening to public
		CIC, GAN, Crédit Lyonnais, Banque Hervet	Privatization
Right-wing	2002–2006	France Télécom, Air France, Motorways	Privatization
		EDF/GDF	Change of status/priv.

Sources: Chabanas and Vergeau (1996, p. 3) and Vie Publique (2013) of popular capitalism could not be made so easily for several reasons. First, the banks were not interested in the propagation of this sort of direct shareholding, as they would rather satisfy such needs of the small investors through SICAVs (i.e. variable capital investment companies, similar to open-ended mutual funds in the US), a saving form which was much cheaper and simpler than shareholding for both banks and individuals. To become an owner in a privatized firm was attractive only temporarily, as shares could be bought at a discount of 5–30 per cent relative to the market price, which guaranteed a comfortable profit if they were resold quickly enough. Second, and this revealed the 'true face' of privatization, nothing was done to give small shareholders any real representation on the board. Despite systematic oversubscription, small shareholders were unable to exert any real influence over the privatized firms' leadership. And the reason behind this can be found in the process of privatization itself.

Market forces did not play a role either as actors or as regulators in the privatized groups. Also, the number of small shareholders did not rise significantly. The government (through the minister of finance) could not only freely decide on the shareholder structure of the firms to be privatized, but could even appoint their board members. Out of the shares, generally, 10 per cent were reserved for the employees, 15 per cent for foreigners, 50 per cent for the public at large and 25 per cent for the 'stable nucleus' consisting of around 10 larger shareholders, the so-called institutional investors who would individually acquire between 0.5 per cent and 5 per cent of the capital (Ibid., p. 53). However, in order to prevent accusations of corruption, the minister of finance tried different combinations of the large investors when preparing 'stable nucleuses'. The top managers and members of boards in the privatized firms were appointed almost exclusively from people belonging to French right-wing politicians' and their friends' and relatives' circles, people of the French establishment, graduated from École des hautes études commerciales de Paris (HEC), École nationale d'administration (ENA) or Polytechnique, the most prestigious and elitist high schools. These people knew each other from college and had already proved their skills in French state bodies (administrative or technical *grands corps*). As the big French companies purchased stakes from each others' capital, even if in relatively broad circles, a complex network of cross-ownership had been established, which, by its mere existence, ruled out any possibility of hostile takeovers. This tradition (of common educational roots and cross-ownership) has been allowing effective coordination and high-level protection of business and political interests since then (Harbula 2007, p. 5).

The process of privatization took so long not only due to the large number of companies to be privatized. Also, throughout the deregulation/privatization of certain sectors (e.g. telecommunication) two different approaches to public services had been competing with each other: the American one based on Anglo-Saxon law and focusing on the quality of products and the Latin-European one based on Roman law. For the French, public services are part of their history, culture and rule of law, connected to the elimination of feudalism, something like a republican value. As for public services, the application of such constitutional principles as *equality*, through tariffs perequation (tariff equalization), enables income redistribution across various social groups and regions.[7]

For the French, public interest in a broad sense, comprising economic, social and territorial cohesion, is the ultimate goal of public services. But with deregulation, this profound interpretation of public services was restricted to an Anglo-Saxon concept of 'universal service', eventually meaning nothing more than an obligation to provide everybody a certain minimum set of services (at a decent cost). Collective utility and related positive externalities are ignored by this new concept of public services. Pushing back the role of the state places limitations on income distribution through tariffs perequation, which has long been a traditional element of French territorial cohesion. Breaking up monopolies and separating network infrastructure from services weaken the position of the historical service provider. While under the pretext of competition, this has opened access for often global market actors to French infrastructure, which had previously been built and was operated using taxpayers' money. The result is that instead of a monopoly market, an oligopol system emerged (Musso 2008, pp. 15–18).

As a result of the privatization process, implemented in different stages all the way up to the global crisis, the weight of state-owned enterprises (SOEs[8]) in the economy has decreased by a great magnitude. Since 1985, their share has shrunk to one-third in fixed capital, one-fourth in employment and one-fifth in Gross Value Added (INSEE 2016b).

The fact that the public sector has been losing ground can also be seen in the decreasing number of SOEs and the people employed by them (Fig. 8.1). Between 1986, the last year before the formal privatization process started, and 2007, the last year before the impact of the global financial crisis was fully felt, the number of SOEs fell to one-fourth and

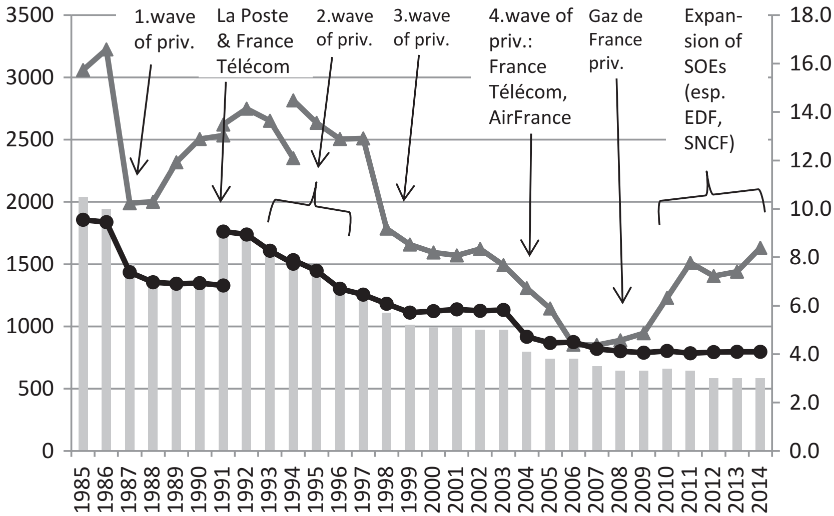

Fig. 8.1 Number of SOEs (triangles, lhs), number of people employed in SOEs (spots, x1000, lhs), and their share in total employment (bars, per cent, rhs). Note: Discontinuities in series for the bars and spots were due to a split in 1991 of PTT, a former government department into two public law corporations (La Poste, France Télécom) which caused an increase of 400,000 or 2 per cent in SOEs employees. Discontinuity for triangles in 1994 was due to a change in methodology. (Source: Own compilation based on INSEE (2016c)

that of the people employed by them to less than one-half. At the same time, the share of SOE employees in total employment fell from 10 to 3.5 per cent. According to répertoire des entreprises contrôlées majoritairement par l'État—a register of SOEs run by INSEE—at the end of 2014, in France there were 1632 companies under state control employing 795,000 people, 85 per cent of which were in transport, energy and sciences. Revenues from privatizations filled up the state treasury with €82 billion in the period 1986–2005, exactly the same value (2500 tonnes) of the French gold reserve in summer 2015 (*Le Figaro* 2015a).

Asset Management

In France, the 2008 global financial crisis cannot be considered a landmark for the role of the state in the economy.[9] There was neither break nor change in the prevailing paradigm. The privatization process had already slowed down before the crisis, and in the life of the biggest SOEs, 2004, the year of the establishment of Agence des participations de l'État (APE), the Government Shareholdings Agency, was more important than 2008.

APE, created in September 2004 by decree under the French Treasury but now belonging to the Ministry of Finance and Economy, engages in long-term investment by boosting the equity capital of companies of strategic importance (i.e. enjoying natural or economic monopoly, or operating in the field of security, defence or nuclear). The aim of APE is to boost their capital structure and development. Revenues generated by APE should be reinvested in wealth management or used to reduce state debt. For APE, four main objectives are identified: to maintain a sufficient level of control in strategic companies; to preserve strong operators able to meet France's basic needs; to help consolidate and develop businesses in sectors driving economic growth; to bail out companies in case of emergency, companies whose failure would otherwise lead to systemic risks (APE 2014).

APE employs slightly over 50 staff and manages a portfolio worth €90 billion (including €60 billion for listed companies alone). The 81 businesses belonging to its portfolio generated annual revenue of €147 billion and employed almost 1.7 million people in 2015. In that year, APE paid dividends worth €3.9 billion into the general budget. APE's portfolio, which contains both direct and indirect shareholdings, is extremely diverse both in terms of the sectors covered (prominently energy, transport, aerospace/defence, automotive, telecom and audio-visual) and the government's stake in the individual companies (Table 8.2).

In addition, the innumerable reports and studies preceding the establishment of APE suggested that the state should create an efficient and transparent framework for the companies in its portfolio, enabling them to develop properly. Most of the proposals—for example, separation of shareholding from other state functions, contractualization of public services and their transformation into concessions, separation of commercial activities (from those under public service obligation) and opening up of SOEs' capital to private investors—were taken into account and put into practice by the government.[10]

Table 8.2 Government's main shareholdings (data y-end 2015)

Main shareholdings (value in €bn for listed companies)		*Annual turnover (€bn)*	*Workforce (1000 people)*	*Government shareholding (per cent)*
Energy	EDF (*17.9*)	75.0	156	84.9
	Engie (ex GDF) (*11.6*)	69.9	155	33.8
Industry	Airbus (*4.4*)	64.5	137	10.9
	Thales (*4.1*)	14.1	62	26.0
	Renault (*4.0*)	45.3	120	20.0
	Safran (*3.9*)	18.1	70	15.4
	Peugeot SA (*1.2*)	54.7	182	13.7
Services	Orange (*5.2*)	40.2	145	23.0
	La Poste	23.0	253	73.7
Transport	SNCF	31.4	259	100
	Air France-KLM (*0.3*)	26.1	96	17.6

Source: APE (2016)

Note: With the exception of Thales and Safran, all these firms feature in the Fortune Global 500 list 2017. (Fortune.com 2017)

There were, however, signs that the socialist government in power after 2012 was trying to maintain and even enhance its influence on some publicly owned companies. Or it would be more accurate to say that the government's action seemed to be a bit contradictory. On the one hand, a law of January 2014 and a decree of August 2014 simplified the life of public companies and made it similar to that of private companies, by, for example, relaxing the rules on the composition of both management and supervisory boards[11].

On the other hand, apart from the remnants of French protectionism present in some out-of-date laws and regulations, a new wave of economic patriotism has arisen and been institutionalized in the form of the establishment of the Ministry for Industrial Renewal in 2012, and especially the adoption of the 'Law Aiming at Recapturing the Real Economy' in early 2014. First, this law made it harder to shut down factories and lay off workers in companies employing over 1000 people in France by slowing down and rendering the process more expensive (Légifrance 2014). Second, through the generalization of the double voting rights in listed companies for those holding their shares for at least two years, it became possible for the state to sell their shares without having to reduce its influence in the given company in order to reduce its debt or finance other investments[12] (*Le Figaro* 2015b).

Saying and doing are, however, two different things. France is part of a world characterized by "*complex economic, legal and regulatory interdependence where large parts of economic governance are no longer exclusively within*" the control of national politicians (Clift and Woll 2012). French politicians pretending "*they can pull all the necessary levers of economic policy to exert control over the national economic future*" simply ignore "*the reconfiguration of economic and political space which the interdependence of markets and multi-levelled economic governance regimes entail*" (see the contributions of Ben Clift to this volume). So, it is no wonder that, for at least the last 10–15 years and despite electoral promises, they could prevent neither the closure of regionally important industrial capacities (e.g. that of the last blast furnace in Lorraine) nor the takeover (and sometimes partial downsizing) of strategic and/or nationally symbolic companies by foreign capital (e.g. the acquisition of Alstom Energy by General Electric and Alstom TGV by Siemens).

Conclusion

In France, the state's involvement in business has long been the legacy enrooted in the French conception of public service, the excellence of which consists of a permanent search for collective, nationwide benefits, for example social, economic and territorial cohesion. However, this does not mean that the way the country's economy functions, or the role the state plays in it, would fundamentally differ from that of other developed countries of Europe.[13]

In the course of the twentieth century, three waves of nationalizations were carried out, partly for ideological reasons (like French industrial voluntarism), partly for the lack of private capital (like in the aftermath of both the Great Depression and World War II). The third wave of nationalizations, however, came up against the reality of worldwide proliferation of the new neoliberal paradigm, which not only caused a radical shift in the political left's vision of French state capitalism, but also triggered a prolonged process of reprivatization. This process has, since the outbreak of the global crisis, been, if not completely reversed, at least significantly slowed down. As a result, state interference in the economy continues to be a dominant feature of French policy. The latter cannot, however, be stigmatized or accused of dirigisme. It is rather a certain degree of economic patriotism that has gained some momentum in today's France, which can mostly be explained by the common educational/cultural roots of the French elite.

It is true that, nowadays, this interference takes the form of direct intervention less than it did in the past. Rather, economic policy goals are met through active management of the holdings carried out by the State Shareholdings Agency, whose primary target is not to generate revenues but to optimize its portfolio in order to boost France's competitiveness. Also, maintaining its influence in strategic sectors remains a key issue for the government. Today this influence often comes indirectly through decentralization, for example, by transferring responsibility for public policy from national to regional and local level of administration.

Notes

1. The royal manufactures developed in France by Colbert can be seen as the first state-owned enterprises (Chevallier 1979, p. 16).
2. It is typical that although people of the French revolution were desperate and upset about unbearably high taxes (especially on peasants), it was not the state but the aristocracy and the clergy, seen as free riders, who they blamed for the country's economic problems (Meisel 2014, pp. 81–82).
3. Following democratization, each shareholder had the right to attend the general assembly of the Bank of France (BoF), and each had only one vote irrespective of the number of shares he/she held (Banque de France 1936). Before the reform, the 200 biggest shareholders (nicknamed *the 200 families*) governed both BoF and the country (Brugvin 2009).
4. In the programme's own words: 'The big and monopolized assets of the economy – i.e. energy sources, treasures of the underground, as well as the large banks, insurances companies – were to return to the Nation' (Andrieu et al. 2014).
5. For example, ITT, having allegedly taken part in the CIA-backed *coup d'état* against the Allende government in Chile on 11 September 1973 (Cohen 1993, p. 793).
6. Protecting strategic sectors is far from being a French specialty. In the US, the 1988 'Exon-Florio' amendment to the 'Defense Production Act' gave the president a broad mandate to limit foreign investments in strategic sectors. Since neither France nor the EU has such a legal instrument, state ownership continues to play an important role in protecting industries, deemed strategic for reasons of national security (*Cour des comptes* 2013, p. 28).
7. There are (or at least used to be) some similarities concerning the use of public utilities as a tool for redistribution in the French conception of pub-

lic services and German conception of municipal utilities. The latter was best represented by the so-called *Stadtwerke* (city utilities), the archetype of the German communal company, owned by the city and offering various type of public services like energy (electricity, gas, and district heat), water, sewage and transport, but also libraries and leisure centres. This solution of pooling different activities made it possible for the service provider to cross-finance the less lucrative sectors (like public transport) from the more profitable ones (e.g. energy and water), and thus to save a significant amount of tax money (Bauby and Similie 2014). According to EU regulation about liberalization of the energy market, this system has been transformed since the late 1990s through privatization and corporatization. But when cross-subsidization ceased, selling profitable services in one sector imposed fare increases in others (Kuhlmann and Fedele 2010).

8. State-owned enterprises are defined as companies in which the public has a majority ownership.
9. It is not a matter of chance that the amount of state aid provided to financial institutions in the EU's biggest economies (i.e. Germany, UK, France, Italy, Spain and the Netherlands) in the context of financial and economic crisis between 2008 and 2014 was, as a share of GDP, the lowest in France (DG Competition 2016). The already mentioned common 'cultural' (i.e. elite network) roots of the bank managers prevented them from exposing their institutions to overly risky transactions, or at least from those transactions that gain too much importance relative to their size (Howarth 2013).
10. For example, by 2015, more than two-thirds of the companies in the state's portfolio (55 out of 81) were already transformed into public limited companies (APE 2016, p. 27).
11. In the wake of these changes, the board members, instead of being appointed from a limited group of senior civil servants, could be appointed from a larger pool of experts which method fit more to companies' interests, because the number of political nominees were reduced substantially. While in 2013 the state still participated in the nomination of 936 administrators, of which 366 represented the state directly, in 2015 these numbers fell to 765 and 272 respectively (APE 2013, p. 7; 2016, p. 17).
12. We refer to economic patriotism in the sense of 'economic choices which seek to discriminate in favour of particular social groups, firms or sectors understood by the decision-makers as insiders because of their territorial status' (Clift and Woll 2012). As already mentioned, five footnotes earlier, there is some similarity between France and Germany. In the case of France, the social groups to be favoured are the French employees, whose interests are to be defended irrespective of the employers' nationality. In our world of globalization, businesses in France do not necessarily need to be loss-making in order to be relocated. It is enough for them to be just

marginally worse in terms of profit margins than their counterparts are somewhere else (in Eastern Europe or Asia). In the case of German cities, the social groups to be favoured are the city dwellers. As fragmentation and privatization of the multipurpose model of German local self-administration have had awkward (unintended) consequences, such as higher prices (and not only for unprofitable services like public transport), declining quality, oligopolistic tendencies—for example, the inexorable rise of the big four (E.ON, Energie Baden-Württemberg AG, Rheinisch-Westfälisches Elektrizitätswerk AG and Vattenfall) in the energy sector—and a general reduction of local council capacity for political steering, a vigorous process of re-municipalization started in German cities in the mid-2000s (Kuhlmann and Fedele 2010; Brandt 2006; Becker 2017), We can deduce that, apart from the differences in tradition and conception of the state (unitary in France and federal in Germany), this new appetite for authorities taking back control over what is considered to be important for the wellbeing of insiders or citizens, either as job holders or consumers, is the same process in both countries. So, if you call it economic patriotism in France, you can call it economic local patriotism in Germany.

13. The value of SOEs to GDP in 2012 was lower than in France in only 6 out of 23 European OECD member countries. Almost all of them happen to be either federal states (like Belgium and Germany) or monarchies (like the UK or Spain), where significant competencies have been devolved to the regions (OECD 2014).

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CHAPTER 9

The Resistance Economy: Iranian Patriotism and Economic Liberalisation

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The Islamic Republic of Iran's position in the global economic system is unique. The experimental model it established after the 1979 Islamic revolution was based on the concept of total independence from foreign influence, including economic independence. The international sanctions imposed on Iran between 2006 and 2010, however, have proven that globalisation has made 'total economic independence' impossible. In recent years, under the stewardship of President Hassan Rouhani, Iranian policies have been characterised by more liberal approaches and attempts to relink the country to the global economy. With a population of 80 million, high levels of human development (as measured by the Human Development Index (HDI)), and a wide range of manufacturing industries, Iran's potential to become the 'last great emerging economy' is significant. Even so, the country still insists on preserving its economic independence.

This chapter will focus on Iran's current liberalisation process, the debates about the threats posed—and opportunities provided—by liberalisation, and the country's mixed approach to inflows of foreign capital.

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The question we want to answer is whether it will be possible for Iran to join the global economy, given the limits of its liberalisation efforts and its strong predisposition to economic patriotism. As Clift has emphasised,[1] economic patriotism itself is a reflection of the contradictions between international market integration and spatially limited political mandates. The concept of the resistance economy is a typical case of the manner in which politicians articulate promises to their citizens about 'control' over economic affairs in a highly interdependent global economy.

Why Iran?

Iran is one of the most promising emerging markets in the Middle East and North Africa (MENA) region,[2] with a relatively young and well-educated population of over 80 million (17th largest globally and 2nd in the MENA) and a Gross Domestic Product (GDP) of $430 billion (29th largest globally and 3rd in the MENA)—or in Purchasing Power Parity (PPP) terms, $1.43 trillion (18th largest globally and 3rd in the MENA). It possesses 10 per cent of the world's proven oil reserves and 16 per cent of the world's natural gas reserves, a diversified manufacturing base, and a relatively well-built physical infrastructure, and it is strategically located for both east-west and north-south trade. After the successful conclusion of Iran's nuclear deal with the P5+1 (the five permanent members of the UN Security Council, plus Germany), the World Bank forecast that Iran's economic growth rate would be 4 per cent or better in both 2016 and 2017. In the coming decade, the country's economy and infrastructure will need an estimated $600–800 billion of investment, which will open up a huge potential market for global financial and business investors (IBP 2016, p. 78).

However, Iran is an Islamic Republic with extensive and mostly negative historic experiences with foreign involvement and a particular sort of political and economic governance, which combines elements of capitalist- and socialist-type systems, but is based primarily on Shi'a interpretations of Islam. The resulting economic policy is characterised by an intensely protectionist impulse to resist any kind of foreign interference and by a cautious tendency towards economic liberalisation, which, especially in relation to the oil-and-gas industry, is a central issue in current Iranian public debates.

Historical Background

By the beginning of the twentieth century, Persia had become a 'semi-colony' as the British and Russian empires expanded; its status was formalised by the 1907 Anglo-Russian convention, which divided the country into British and Russian zones of interest, separated by a neutral zone.[3] The Brits' chief motivation was securing a passage to India and the oil which had recently been discovered in the Gulf. The driving force for the Russians was access to warm-water ports; they also sought to push a weakened Persia out of its historical sphere of influence in Central Asia and gradually to take its place. The political and military intrusions of the British and the Russians into historically Persian fields of interest was coupled with an intensive rush for economic gains, above all in the form of concessions to be provided by the Shah to various foreign businesses.

Russian (later Soviet) and British influence and interference intensified as a result of the Anglo-Persian Treaty of 1919 and the Soviet-Persian Treaty of 1921, but also as a result of trade agreements, investments in industrial development, railways, and—most of all—the oil industry. Germany's push for influence in the Middle East began later, but would cost Reza Pahlavi his throne in 1941, when he was forced to step down in favour of his son, Mohamed Reza Pahlavi.

While Soviet troops were difficult to expel from the country after the end of the Second World War, the 1953 coup d'état which the Central Intelligence Agency (CIA) organised and implemented against the national liberal Prime Minister Mohamed Mosaddeq, who had nationalised Iran's oil companies, signalled the end of British influence and the start of the direct involvement of the US.

The US offered significant support, both diplomatically and militarily, to a policy of regional dominance by Mohamed Reza Pahlavi, partly due to Iran's position and geopolitical assets within its region, and partly due to the perception of a Soviet threat and a desire to contain it. American strategic interests in Iran were also complemented by economic interests. Although many considered the Shah a 'puppet' of the US, this relationship was much more complex, as the Shah also pursued his own interests, both inside Iran (e.g., his consolidation of absolute power and his modernisation programme) and in his foreign policy.

By the late 1970s, however, practically every stratum of Iranian society had been estranged and disillusioned; the Islamic revolution put an end to the monarchy in February of 1979. This revolution, which started as the cooperative effort of several different disillusioned social groups, soon came to be symbolised—and eventually led by—the Ayatollah Ruhollah Khomeini, whose notions of Islamic government and the *velayat-e faqih* ("guardianship of the Islamic jurist") became the basis of the Islamic Republic of Iran.

The Islamic Republic of Iran

The *velayat-e faqih*, Iran's model for Islamic government, is based on the Shiite notion that believers need the guidance of a learned and infallible religious authority who can interpret divine laws for them. Other distinct characteristics of Shiite Islam—the sense of victimisation embodied by Ashura, a yearly commemoration of Hussein's martyrdom; and the *tekiye*, the religious-legal freedom to deny one's beliefs to avoid persecution—manifest themselves in Iran's foreign policy and diplomatic style.

Iran's status as an Islamic Republic was approved by a majority vote during a constitutional referendum in 1979. While the term 'Islamic Republic' was not unprecedented (Pakistan is an Islamic Republic as well), the *velayat-e faqih* is a unique principle which combines divine sovereignty and the sovereignty of people in a republican form dominated by Shiite clergy.

As a model of statecraft, the Islamic Republic of Iran is a modernisation experiment which is uniquely Shiite and Iranian in nature, both in Iran's self-perception and in the perceptions of the world at large. It combines elements of Iranian identity, Shiite Islam, and modernity in the European sense. When a country serves as an experiment in state formation, its aims usually include spreading and defending that experimental model, and the Islamic Republic of Iran is no exception. In its foreign policy—in its relations with the world at large and with its region in particular—its one and only aim is to ensure the survival of its system. In trying to achieve this aim, Iran propagates its "universal" ideology (it considers itself an Islamic Republic, not a Shiite Islamic Republic), seeks allies, and wages wars by proxy—that is, it tends to behave like an empire. On the other hand, in defending its revolutionary model, Iran categorically rejects any kind of foreign interference in its affairs and, in doing so, using both Islamic and Cold War terminology: independence, anti-imperialism, resistance to foreign dominance, and so on.

Article 43 of its Constitution declares 'economic independence' to be a core principle of Iranian politics. In addition to quoting some basic prescriptions of Islam,[4] the Constitution emphasises self-reliance and increases in agricultural and industrial production in order to satisfy public needs and make the country economically self-sufficient and politically independent. It also prioritises the prevention of foreign domination of the country's economy. The most famous example of this rejection is Ayatollah Khomeini's termination and prohibition of all kinds of foreign debt in the Islamic Republic—a position that was rigorously enforced until his death in 1989. The Constitution also mentions the utilisation of science and technology, as well as the training of skilled personnel in accordance with the developmental needs of the country's economy, as important elements of Iran's efforts to achieve economic independence.

Industry in Iran

Iran has a relatively large and diversified industrial sector. Though petrochemicals are still its most important products, automobiles, home and electric appliances, telecommunications equipment, industrial machinery, steel and copper products, paper, rubber products, processed foods, leather goods, and pharmaceuticals are also manufactured in Iran. Several sectors produce technology-intensive goods based on local research and development activity.

In the manufacturing sector, the automobile industry is the most important, producing over one million units per year and employing about 12 per cent of the labour force (directly and indirectly), generating an annual value added of $12 billion and accounting for about 3 per cent of the GDP (Hosseinifar et al. 2016). Between 2000 and 2013, high import duties and a growing middle class created a boom in local car manufacturing. After 2013, however, the stricter sanctions imposed by the international community prevented Iranian companies from importing the parts on which domestic car production relied. As a consequence, local production has decreased and Turkey has replaced Iran as the region's top vehicle manufacturer.

The Iranian car market is dominated by Iran Khodro (IKCO) and SAIPA, both subsidiaries of the state-owned Industrial Development and Renovation Organization. Even though it has made advances of its own, the Iranian automobile sector still depends on imported technologies.[5] Iranian firms have used joint-venture agreements to collaborate with French and German companies, and Asian producers (especially the Chinese) are increasingly significant players in the Iranian automobile market (Alizadeh 2014).

Although Iran is one of the world's largest oil producers, its limited refining capacity makes it heavily dependent on gasoline imports. In 2008–2009, the Iranian government spent over $3 billion to develop the infrastructure which enables vehicles to run on compressed natural gas, and by 2014, the country had become the world leader in vehicles which run on natural gas, with over 3.7 million such cars on the roads (Ashtarian 2015).

Another technology-intensive sector of the economy is pharmaceuticals. There are currently 96 local manufacturers in Iran, producing medicine worth about $2 billion per year (Ashtarian 2015). Local production covers about 92 per cent of the Iranian market; however, several high-quality drugs (for treating diabetes and cancer, for instance) still need to be imported, at a cost of about $1.5 billion (ibid.).

Development Plans

In March of 2005, the Iranian government issued a 20-year economic prospectus (called Vision 2025; Vision 1404 in the original Farsi) that outlined a road map for the country's economic, political, social, and cultural development over the succeeding two decades. This document emphasised: (a) the achievement of fast-paced and sustainable economic growth; (b) the creation of durable employment opportunities; (c) the enhancement of factor productivity; (d) an active presence in regional and international markets; (e) the development of a diverse, knowledge-based economy free of inflation and blessed by food security; and (f) the establishment of a market environment conducive to domestic and international business entrepreneurship (Amuzegar 2009, p. 41).

Vision 2025 suggested that investments totalling $3.7 trillion would be needed by the year 2025 in order to achieve these goals, one-third of which ($1.3 trillion) was to come from foreign sources (Ashtarian 2015). A large share of the overall amount was to support investment in R&D by knowledge-based firms, as well as the commercialisation of research results, with the ambitious target of raising gross domestic expenditure on R&D (GERD) to 4 per cent of GDP by 2025.

The Ahmedinejad administration was relatively indifferent to the implementation of Vision 2025, which, combined with the international sanctions imposed on Iran, made most of that programme's provisions and targets unrealistic—or at least hardly achievable by 2025. Even so, reform of the Iranian economic system, which this development plan also touched on, was unavoidable.

Economic Reforms

The Iranian Revolution created a highly centralised economy in Iran, characterised by state ownership of 70 per cent of the economy, with publicly owned heavy industries (steel, petrochemicals, mining, and machinery) and some private ownership of light industry, construction, agriculture, and the food service industries (Amuzegar 2014). Plans to decentralise the economy and expand private ownership by means of privatisation date back to the 1990s, but this process has been slowed by the nationalist majority in Iran's parliament, which has opposed such decisions for many years (Pesaran 2011).

A 2004 constitutional amendment to Article 44 (which had previously given priority to state ownership of the economy and only a supplementary role to private ownership) authorised a large-scale privatisation of state assets. In the resulting privatisation process, 80 per cent of the state-owned assets in Iranian companies was privatised; 40 per cent of the stock in these companies (with a total share value of $36 billion in 2014) was distributed as "justice shares" which gave ownership to 36 million low-income Iranians; 35 per cent was sold on the Tehran stock exchange; and 5 per cent went to employees, while the other 20 per cent remained in government hands. Overall, around US$80 billion worth of assets have been privatised. However, the efficiency of such privatisation is questionable; with "justice shares" managed by state-owned companies, there is no real private control over these firms. This privatisation campaign was also supposed to involve foreign capital, especially by bringing expatriates' investment capital back to Iran.[6] Foreign investors, however, still need case-by-case government permission to buy privatised assets.

Another major economic change of recent years has been the post-2010 subsidy reform. Price distortion is a major cause of inefficiency in the economy. The Iranian government was spending over US$100 billion annually to subsidise energy and food consumption, which put an almost unbearable burden on the Iranian public budget. To compensate for the effects of reduced subsidies (e.g., rising fuel and food prices), the government now gives grants directly to the poorest strata of Iranian society and spends part of the resultant savings on improving the efficiency of its public utilities.

Sanctions

International sanctions have been part of the Islamic Republic's history ever since the Islamic revolution of 1979. The US imposed sanctions on Iran soon after revolutionary students took hostages at the US embassy in Tehran. These bilateral sanctions, which initially froze Iranian assets in US banks, were gradually expanded over the decades to cover a variety of forms of economic exchanges, especially of scientific and military hardware. The most important legal framework for the US sanctions against Iran is the Iran Sanctions Act, which is a revised version of the Iran and Libya Sanctions Act originally signed on 5 August 1996 (Habibi 2014).

These sanctions against Iran, however, are much more complicated given that the various sanctions which the US had against the Islamic Republic have been augmented by four sets of sanctions endorsed by the UN Security Council between 2006 and 2010 (UNSC Res. 1737/2006, 1747/2007, 1803/2008, 1929/2010). These resolutions—especially the last and most biting one—targeted Iran's nuclear programme by imposing sanctions on the biggest Iranian banks and on exports of oil and gas. Subsequently, the European Union and several other countries introduced similar or even stricter sanctions against Iran. It should also be mentioned that the set of sanctions which several foreign actors have built up against Iran cover areas beyond the nuclear issue—for example, human rights related activities. Thus, the 'nuclear deal' concluded on 14 July 2015 resulted in the suspension only of the nuclear-related sanctions.

Despite the fact that Iran's economy has been suffering from the effects of intensified international sanctions since 2007 (the first set of UNSC sanctions was passed in December of 2006), different industrial sectors have exhibited various levels of instability (Hosseinifar et al. 2016).

One positive outcome of these sanctions, cited by a recent UNESCO study, was that they have accelerated the shift from a resource-based economy to one based on knowledge (Ashtarian 2015). These sanctions have encouraged Iranian companies to innovate; barriers to foreign imports have encouraged knowledge-based enterprises to localise production and have also helped small and medium-sized enterprises develop their businesses. Moreover, Iran's high unemployment rate and its broad pool of qualified labourers have made it possible for firms to recruit trained staff locally.

The Resistance Economy and Iranian Patriotism

The idea of a resistance economy comes from the Occupied Territories/ Palestine, which is, in every aspect of its infrastructure—trade, labour market, and so on—linked to Israel. As Tartir et al. (2012) have recommended, under the current conditions of dependency, Palestine should create an economic agenda based on self-sustainability and socio-economic resistance over and above economic growth.

In the Iranian context, the economy of resistance is a model which promotes growth and dynamism under difficult conditions—such as pressure, sanctions, animosities, and threats—by strengthening Iran's domestic capacities and ruling out isolation (Qorbani 2016).

Iranian Supreme Leader Ayatollah Ali Khamenei introduced the term 'resistance economy' as an Iranian model of modernisation in 2012, but the specification of what he termed as such came in a fatwa issued by him on 19 February 2014.

This 'new economic model' consists of 24 general policy prescriptions, focusing on strategies for strengthening the domestic economy and its resilience. It is interesting to note that in addition to domestic capacity building, food and medicine security, and promoting the consumption of local products—inward-looking priorities which naturally decrease the dependency of the country—its goals also include the improvement of competitiveness and efficiency (e.g., through subsidy reforms), the promotion of a knowledge-based economy, the promotion of foreign investment (mainly for export markets), and more intensive collaboration with regional and international partners (especially neighbours). This model would reduce the vulnerability of the oil and gas sectors by diversifying their sales channels with the participation of strategic investors, increasing value-added exports of products based on oil and gas, and increasing contributions to the National Development Fund from oil-and-gas export revenues.

In many respects, the 'resistance economy' model and its aims resemble the goals of Vision 2025. It includes plans to open up to the global economy, but only to the extent that domestic production will be bolstered by foreign investors and help the national economy boom. In addition, it articulates a desire to create an active and dynamic knowledge-based economy rather than a passive and closed one. It also expresses the intention to make the Iranian economy resistant to internal and external shocks, fluctuations, and damage.

In many respects, the concept of a 'resistance economy' is also similar to 'import-substitution industrialisation' (ISI) strategies. Although the idea of developing domestic industry to reduce foreign dependency was embraced by Alexander Hamilton and Friedrich List in the early nineteenth century, it became popular among developing countries between the 1960s and 1980s.[7] Leftist economists have considered ISI as a possible strategy for delinking developing economies from the world economy which—according to them—is dominated by the advanced Western powers.[8] Due to the asymmetries which characterise all kinds of trade, financial exchanges, or even political relations, any mode of integration into the Western-dominated world system will worsen developing countries' prospects of catching up economically.

The ISI strategy has several potential shortcomings, however. It may create jobs in the short run, but without foreign competition, producers have no incentive to improve their products, and without competitive production and exports, its domestic market will not be enough to create optimal economies of scale. Classical and neo-liberal economists emphasise that countries should specialise based on their comparative advantage, which implies free trade instead of protectionism. Iranians' arguments against 'comparative advantage' and neo-liberal-type participation in the global economy are based on their country's increasing vulnerability, especially in light of the sanctions which have been imposed on it. For Iran, such specialisation would be risky given the possibility of further sanctions.

How to Create a Resistance Economy?

The Iranian government is currently focused on implementing the principles of the 'resistance economy'.[9] To help domestic industries, the government has decided to lower royalty payments it charges domestic iron-ore companies and to raise the tariff on exports of steel. The government has also renegotiated its cooperation agreement with Peugeot, including its production and export targets. Restrictions on food, health, and beauty products were also lifted.

However, the debate over the practice of implementation has been vivid; it has involved numerous different actors representing various interests. In addition to the traditional clash between conservatives and reformists, other stakeholders—consumers, business associations, and other influential organisations involved in the economy, such as the Islamic

Revolutionary Guard Corps and the religious foundations known as *bonyads*—have also taken part in these debates.

The interests of businesspeople and politicians have come into conflict: the business community is generally less convinced about the efficiency of restrictions, which have led to an increase in smuggling (Financial Tribune 2015). On the other hand, as sanctions against Iran have been lifted, international competition has put pressure on domestic producers in many sectors, and thus the debate over protectionism is heating up (Financial Tribune 2015).

In the political-economic discourse of the early 2000s, the 'Chinese model' was frequently mentioned as a potential blueprint by which Iran might open up its economy, step by step. China kept its borders closed until the 1980s, by which time it was self-sufficient in food production, medical care, and education, at which point China opened its borders and started exporting grain and many other products (Koenig 2016). And despite this gradual economic opening-up, China was also able to maintain its specific political system; its economy is so integrated into the global economy that it cannot easily be isolated or sanctioned. On the other hand, North Korea's resistance economy, which is marked by total isolation, differs from South Korea's economic model, which made itself resistant by integrating itself into the global economy by means of a state-led industrialisation model, which eventually made it one of the most competitive and innovative economies in the world.

A counterargument against this type of economic liberalisation, voiced in conservative circles of the Iranian elite, is that the 'ideological' background of the Chinese model is actually disappearing.[10] The 'Communist Party' is communist in name only, while South Korea has a totally Westernised political system.

Conclusion

Iran's current political system is usually considered theocratic, with its strict principles and rules governing every aspect of life, including the economy. In reality, its leadership is extremely pragmatic. The single most important aim of the regime is the maintenance and survival of the 'Iranian model'. This pragmatic approach has manifested itself in the profound economic reforms introduced in Iran over the last decade.

The sanctions imposed on Iran in recent years have had some positive effects on the country, insofar as it has been forced to strengthen its domestic producers and develop its own technological capacity and research-and-development infrastructure. On the other hand, isolation, a lack of export markets, and the scarcity of imported technologies and foreign goods have hindered the proper development of the economy.

Once the remaining sanctions are suspended, Iran may gradually open up and reintegrate itself into the world economy, a process that could make Iran the largest and most dynamic economy in the region. This old Iranian dream may now be fulfilled by the cautious reforms and liberalisation measures of the 'resistance economy' programme. However, as previous attempts to catch up to the West (e.g., in East Asian countries) have shown, a strategy that is based on integration into the global economy will lead to a transformation of the local political-economic structure. In the case of China, core elements of the ruling party's ideology had to be reshaped in order to integrate successfully into the global economy. In Iran's case, its leaders hope to preserve their revolutionary—but at the same time conservative—Islamic ideology, which is the core of the 'Iranian model'.

It remains an open question how far Iran will go in its reintegration and liberalisation efforts. If the country's leaders are ready to let foreign goods and capital in—and with them, foreign influence—such developments will necessarily come into conflict with their treasured principles of independence and self-reliance.

Notes

1. Chapter 2 of this volume.
2. The Middle East and North Africa (MENA) region includes the Arab countries, Israel, Iran, and Turkey.
3. The Cambridge History of Islam, volume 1B, pp. 595–626.
4. For example, the prohibition of inflicting harm or losses upon others, monopoly, hoarding, usury, and other illegitimate and evil practices, as well as the prohibition of extravagance and wastefulness in all matters related to the economy, including consumption, investment, production, distribution, and services.
5. The major foreign partners of the Iranian automobile industry are the French manufacturers Groupe PSA (Peugeot Citroen) and Renault, the Japanese firm Suzuki, and, more recently, the German company Daimler AG.
6. Overseas capital of Iranian origin is estimated at more than $1 trillion, with $200 billion in Dubai alone (IBP 2016, p. 258).

7. See, for example, Hirschmann (1968).
8. See various works by Amin, Cardoso, Emmanuel, and Wallerstein.
9. Ld. pl. http://theiranproject.com/blog/2016/08/23/president-cabinet-focusing-implementing-resistance-economy/
10. See, for example, Xing (1999).

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CHAPTER 10

New Developmental Experiments in Two Emerging Economies: Lessons from Brazil and Egypt

Judit Ricz

Introduction

This chapter is a comparison of the new Brazilian development-oriented experiment and its Egyptian counterpart; I have employed institutional and political-economy approaches while applying the methods of comparative economics. The manner in which Brazil has achieved pro-poor and inclusive growth since the turn of the millennium offers some useful lessons, but recent events there also provide a cautionary tale for other

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emerging and developing countries. At the same time, Egypt's lack of inclusivity helps to explain the political (and economic) turmoil which has affected that nation in recent years.

In this chapter, I will use empirical data to test the theoretical arguments I have made about the viability of the concept of the developmental state (DS) in the twenty-first century (Ricz 2015, 2016b, 2017). In doing so, I have chosen to look at emerging countries outside the East-Asian region, where a test of the DS approach would have been more "trivial". At the same time, I have looked for countries with strong roots in—and significant experience with—the state-led development approach. Brazil seems like a good laboratory for testing the new DS approach, given that it had extensive experience with the old DS approach in the twentieth century and has been regarded as a role model for new developmentalism since the turn of the millennium (see Amann and Barrientos 2016)—though by 2018, it would seem that this attempt has also failed. I have chosen Egypt because it also embarked on a state-led development path in the middle of the last century (the Nasserist period), and even though Egyptian leaders have attempted market-oriented reforms several times, the state has continued to play an outsized role in the economy. Egypt has achieved significant rates of economic growth in recent decades, though Hosni Mubarak's 30-year reign has been characterised as a "non-developmental regime" because it failed in the social front; it did not follow the "growth-with-equity" model of the classic, East-Asian-type developmental states. This failure was undoubtedly confirmed by the revolution of 2011.

The recent political and economic turmoil in both these countries has shed light on the shortcomings and severe deficiencies of their socio-economic achievements, and makes the analysis of their cases even more timely and interesting. Given their volatility, both these cases could be considered "moving targets", which makes my analysis of the most recent developments there more difficult; and though it may encourage speculation about the future of these economies, it limits these case studies to "work-in-progress" status, as daily developments might alter my interpretations of recent processes and affect the likelihood of various scenarios for the future.

This chapter consists of five sections: after this short introduction, I will provide an overview of important traditions within the state-led development approach. The third section is an examination of developmental experiments which have been initiated since the turn of the millennium, while the fourth section is an analysis of recent developments and developing economic-policy trends. The concluding section is a summary of lessons from the Brazilian and Egyptian cases.

The Roots of the State-Led Developmentalist Approach

Brazil and Egypt both have long traditions of state-led developmentalism; since the turn of the millennium, both have initiated processes of thorough reform, though with different foci and intentions, and with significantly differing socio-economic effects. Even though the economic policy cycles of the two countries do not coincide chronologically, they do exhibit some similarities, as illustrated in Table 10.1.

Both countries embarked on a state-led developmental path by the middle of the last century, reacting spontaneously to external and internal changes (and nationalistic feelings). This experiment started earlier and lasted longer in Brazil (1930–1985). Egypt turned towards a state-led developmentalist model (often dubbed Egyptian socialism[1]) after it

Table 10.1 Varieties of economic policies

Period	*Brazil*	*Period*	*Egypt*
1930–1985	The “old” Brazilian developmental state (*Getúlio Vargas, Juscelino Kubitschek—among others*)	1956–70	The “old” Egyptian developmental state (*Gamal Abdel Nasser*)
		1971–81	Open-door policy (infitah), liberalisation (*Anwar Sadat*)
1985–2002	Democratisation and turning to the market (*José Sarney, Fernando Collor de Mello, Itamar Franco, Fernando Henrique Cardoso*)	1981–2011	(Non-)developmental regime of *Hosni Mubarak*
2003–2015	New development-oriented experiment (*Luiz Inácio Lula da Silva, Dilma Rousseff*)		
2016–	Pro-market and pro-business turn (*Michel Temer*)	2011–2014	Political turmoil (SCAF, *Mohamed Morsi*)
		2014–	A new development-oriented experiment (*Abdel Fattah el-Sisi*)

Source: Author’s compilation

achieved independence in 1952, but this programme was adopted only later, during the reign of Gamal Abdel Nasser (1956–1970). The first attempt to open up and liberalise the Egyptian economy—and dismantle its old developmentalist policies—took place under Anwar Sadat, starting in 1971. This was accompanied by an about-face in Egypt's foreign policy orientation; it turned away from the Soviet Union and started a long-lasting strategic relationship with the US and international financial institutions like the International Monetary Fund (IMF) and the World Bank.

In contrast, Brazil maintained the central elements of its old DS approach until the mid-1980s, and it was only after the democratisation process[2] started in 1985 that any important changes were made to its economic-policy design. Even so, Brazil took most of its important steps towards a market-oriented transition only after the 1994 Real Plan and the subsequent economic stabilisation. In addition to these efforts at economic stabilisation, Brazilian authorities introduced structural reforms including elements of the well-known Washington Consensus (such as liberalisation, privatisation, and deregulation), though these policies were implemented in a special "Brazilian manner" and never went as deep as in Chile or Mexico, for example. To paraphrase Kerstenetzky (2014, p. 175), the best term for this era of Brazilian economic policy might be "*state-led governance by the market*".

In general, despite a range of so-called neoliberal reforms and "denationalisations", many areas of the Brazilian and Egyptian economies continued to be characterised by the interventions of their traditionally oversized states up to the end of the twentieth century. Other criticisms of this period in Brazilian economics include selective access to capital, credit, and quality education, as well as the dysfunctionality of the labour market, especially the high and increasing share of the informal sector. Though the results of Brazil's democratisation have been unquestionable, its system of political representation and its unfinished state reform were still the targets of intense criticism, as was its neglect of social issues. The state sector continued to be dominant in Egypt as well: the majority of its jobs were concentrated in the public sector, basic public services were provided by state-owned enterprises, and the government maintained an extensive system of price subsidies for food and oil. It is clear that important institutional and economic-policy legacies of the old DS survived, and have left lasting impacts on the institutional, economic, and social structures of both countries.

New Developmental Experiments After the Turn of the Millennium

2003 was an important milestone in the history of Brazilian economic policy, as the electoral victory of the Workers' Party (*Partido do Trabalhadores*, or PT), led by Luiz Inácio Lula da Silva, inaugurated a new cycle of development-oriented economic policies. The change in political orientation and economic policy was stark: the core of the new model was the strengthening of the role of the state in development, intention of which manifested itself most clearly in a series of active industrial, social, and labour market policies. An intrinsic, overarching pro-poor approach became the trademark of the Lula regime.

Between 2003 and 2010, the Brazilian economy grew by an average of 4.1 per cent a year; the portion of the population living in extreme poverty decreased from 15 per cent to 7 per cent; and inequality decreased as well, as reflected a drop in Brazil's GINI coefficient from 0.6 to 0.53 (WDI 2016). Another sign of the inclusivity of Brazil's growth process since the turn of the millennium is that average wages rose in both the formal and the informal economy as a result of new minimum-wage laws. This led to a significant increase in the wage share of gross domestic product (GDP), from 38 per cent in 2003 to 48 per cent in 2011 (Ipeadata 2016).

Doubts about the sustainability of the new DS regime emerged around 2011, and by 2014 (at the latest) it was clear that this model could not be sustained economically or politically. An economic recession started in the second half of 2014, and was accompanied by a massive corruption scandal involving Petrobras, Brazil's giant national oil corporation, as well as other large companies. Controversy engulfed most of the country's political elite, finally culminating in a political crisis which was "resolved" (at least temporarily) by the impeachment of President Dilma Rousseff. In September of 2016, a new era started under the leadership of President Michel Temer and the Brazilian Democratic Movement Party (PMDB), the policy agenda of which was characterised by a political turn to the right, market-oriented reforms, and austerity measures (the latter implemented in a period of severe economic crisis). This turnaround has culminated in the victory of the far-right candidate Jair Bolsonaro in the 2018 October elections.

In contrast, Egyptian President Hosni Mubarak's reign was not challenged[3] (politically, at least) until 2011; even so, his government implemented some important economic-policy reforms starting in 2004. These neoliberal restructuring measures were intended to decrease state influence in several areas; at the same time, however, they imposed significant burdens on the lower and middle classes while giving disproportionally large advantages to the domestic and foreign capitalist class (especially to certain members of the business community). Nevertheless, these changes were much less significant than Brazil's; they did not constitute a clear shift in economic policy.

Between 2001 and 2010, Egypt achieved significant growth rates; its economy expanded by an average of 4.9 per cent a year, though this figure drops considerably if Egypt's high population growth is taken into account (its per-capita average growth rate was 3 per cent). Within that same period, however, the number of Egyptians living in poverty increased by almost 57 per cent (from 16.7 per cent of the population to 26.3 per cent), meaning more than 12 million people slipped under the national poverty line. Unemployment—already historically high in Egypt—also continued to rise, surpassing 11 per cent in 2005; youth unemployment rates approached 34 per cent (WDI 2016). Meanwhile, the wage share of GDP also decreased after the turn of the millennium, dropping to roughly 25 per cent by 2009 (Morsy et al. 2014, p. 2), which contributed to the growing dissatisfaction of the Egyptian middle classes. Mubarak's *non-developmental regime*—with its low-cost but politically and socially unsustainable strategies—managed to survive until 2011, when it was toppled by a popular revolution, but it has left the country in severe political and economic turmoil and saddled it with significant social costs and other unpleasant consequences.

I argue that looking at economic policies (and their developmental outcomes) since the turn of the millennium makes it possible to establish some important similarities and differences between Brazil and Egypt. I hope this analysis will improve our understanding of the background of these countries' most recent political and economic turmoil, the social forces which drove it, and the reasons behind the failure of their new developmentalist experiments.

The Context of New Developmental Experiments After the Turn of the Millennium

In order to describe the unique features of the new developmentalist experiments which Brazil and Egypt have launched since the turn of the millennium, I have focused on their regional political contexts and the global economic framework. The third significant factor—important legacies of older DS approaches—was presented in the previous section. I am convinced that in order to understand the current role of the state in Brazilian and Egyptian development, one must treat historical evolution as an important variable, given that legacies of the past strongly affect the present—that is, path dependencies prevail.

In Brazil, the regional political context after the turn of the millennium was characterised by a general "turn to the left"; between 1998 and 2015, leftist presidents were elected in 15 Latin American countries. These regimes have varied in the degree to which they have departed from market-oriented economic policies, but all of them have introduced or strengthened redistributive social policies. In this Latin American context, Lula's Brazil is an example of a moderate leftist regime.

In Egypt, and in the wider Middle Eastern and North African (MENA) region, a much more complex political context has emerged as a result of internal military conflicts and the strategic interests of global powers, especially the US. Mubarak's non-developmental regime cannot be understood and analysed without taking into account Egypt's special role and position in the MENA region. It is important to start with Egypt's self-image; Egyptian identity is a very complex phenomenon, perhaps best described using Nasser's concentric-circles approach—Arab first, African second, and finally Muslim (Nasser 1955). This regional political context should also be expanded to include the very specific roles played by the Muslim and Coptic Christian religions, and by the military in Egypt, as well as the rest of the Arab world (N. Rózsa 2015; Csicsmann 2010; Rutherford 2013; Shenker 2016; Ricz 2016b).

The other important element of this specific context was the global economic environment: around the turn of the millennium, important economic factors included the commodity boom and rising demand (mostly in Asia) for commodities; rising demand (mostly in Europe) for tourism; low interest rates; and the overly optimistic business climate of the so-called golden decade (1997–2007). The high growth rates of the US economy and certain emerging markets—mostly in Asia and Africa—acted as the locomotives of the world economy in this period, though this economic boom was also driven by the spread of new information and communication technologies, the intensification of financial globalisation, and the spread of financial intermediation. These favourable factors also contributed to the largely positive economic results which Brazil and Egypt recorded during the first decade after the turn of the millennium.

Social Contracts in Brazil and Egypt at the Turn of the Millennium

In the following section, I have applied the new developmental regime approach (Pempel 1999; Ricz 2016a) and its tripartite structure to analyse changes in the political economies of Brazil and Egypt: (1) social contracts and alliances, (2) institutions and the quality of policymaking, and (3) the developmentalist bias of public policies.

To use the concept of economic patriotism (as described by Ben Clift in the second chapter of this volume), Brazilian and Egyptian social contracts define the *patrie*—that is, those social groups that are considered insiders by the regime. The new and inclusive socio-economic alliance which Lula and the PT assembled represents an important discontinuity with Brazil's previous economic regime. This new social pact brought together a very diverse set of socio-economic groups, mainly by means of its low-inflation regime, but also by using a special mix of public policies (Wylde 2012, p. 177). While the PT maintained the support of traditional national elites and continued to espouse policies which appealed to their other existing constituencies, the inclusion of the poorest members of Brazilian society was a new and unique phenomenon. The poor were induced to support the regime by means of social programmes and compensatory-income schemes, as well as the overall developmental vision of the Lula regime. This new approach to development combined financial stability with economic growth and social justice. Lula was also able to incorporate the middle classes into this new social-economic alliance by demonstrating his managerial capacities at the local level. Organised civil society also contributed to this strong coalition of interests, all of which added up to—by Brazilian standards, at least—an unusually strong (i.e., wide and inclusive) power base for Lula and his regime. Saad-Filho (2007, p. 18) memorably referred to this new social contract as a successful attempt to build up an "alliance of losers", made up of all the interest groups who had suffered the most during the previous neoliberal period—that is, during the 1980s and 1990s.

In stark contrast to the Brazilian story, Egypt in the 2000s was characterised by a struggle to maintain the old social contract, which had been built on the paternalistic promise—or autocratic bargain—of the old DS approach, in which large social-welfare expenditures and extensive public employment schemes served as compensation for limited political rights. Conflicts over this old social contract were already emerging in the early

2000s; more and more signs pointed towards a growing level of social tension and discontent, and while the early protests were limited to the local level, by the election year 2005, protests were already being organised on a national scale (Csicsmann 2017).

Despite average annual economic-growth rates close to 5 per cent in the decade preceding the 2011 revolution, Mubarak's (selective) liberalisation efforts and market-oriented economic-policy reforms produced considerable resentment and tension in a majority of Egyptian society. The benefits of economic growth did not trickle down to the larger part of the society: on the contrary, poverty increased; close to 50 per cent of the Egyptian population is still living on less than two dollars a day (Femise 2013, p. 27). Rising inflation and a series of currency devaluations pushed wage earners into an ever-worsening economic situation, as food products, which are mostly imported, have become more and more expensive. As a consequence, the livelihood of an ever-larger stratum of Egyptian society has been imperilled. In addition, mainly as a result of the privatisation of some large state-owned companies, fewer jobs were created, and thus the already-high unemployment rate rose even further—especially among young people. Finally, the 2011 revolution demonstrated incontrovertibly that the old social contract was broken; a majority of Egyptians has called—and continues to call—for a new one.

The Quality of Policy-Making and Questions of Institutionalisation

The second pillar of this analysis of these new developmental experiments is an examination of changes in the quality of policy-making and the implementation of these new developmental visions. The starting point for an analysis of Brazil's institutions and policy-making is the new constitution which it enacted in 1988. In addition to its extensive social rights agenda, this document implied a democratisation of policy-making and resulted in a set of wide-ranging decentralisation processes and an extension of participatory mechanisms. Decentralisation meant that executive and financial capacity was transferred to local levels, though this was predicated on the setting up of participatory councils which included representatives of various stakeholders. Brazilian policy-making was "pragmatic", insofar as its economic policies were aimed at solving specific problems;

these reforms were bundled together to help them gain political approval, and not imposed as a predefined reform package.

There was a clear ideational shift in the understanding of development, moving away from the old (Brazilian) developmentalist approach, which focused solely on economic growth and neglected distributional issues. The new developmentalist approach grew out of the 1988 Constitution, which guaranteed wide-ranging social rights in hopes of ensuring *all* its citizens a decent life. This new social contract moved Brazil towards more participatory and more consultative policy-making, which would become an inherent feature of the new Brazilian model.

Significant advances have been made in practices of democratic deliberation in public policy formulation, as evidenced by the creation of public consultation councils, dialogue between government and social movements, and participatory budgeting procedures (Kerstenetzky 2014, pp. 186–187). Likewise, the establishment of certain new thematic institutions (such as ministries for social and agrarian development) can be considered institutionalisation efforts which reflect Brazil's new developmentalist bias.

Though it has improved the quality of its policy-making, Brazil still struggles with the 'usual' shortcomings of young democracies. These problems include widespread clientelism and patronage, as well as Brazil's more recent corruption scandals,[4] which suggest that despite the achievements of its numerous anticorruption measures, corrupt officials continue to be firmly entrenched in Brazil's institutional and political system. This has resulted in a lack of accountability and transparency in Brazilian policy-making, which in turn has culminated in the recent political crisis and the rise of a far-right president, as well as one of the world's largest corruption cases.

The tyranny of corruption is a clear linkage to the Egyptian case; however, before discussing this parallel, I would first like to emphasise some distinctive features of the latter. The first important aspect is the lack of a democratisation process in Egypt. The Egyptian political system exhibits a double or layered structure: archaic, patrimonial arrangements coexist with modern power structures (N. Rózsa 2015, p. 64). The autocratic authoritarian political system—generally a military dictatorship—is complemented by (or layered on top of) a democratic institutional system, which is in fact just a tool for maintaining the appearance of a democracy and convincing Western allies of the legitimacy of the system. Although Egypt does have basic democratic institutions, their real significance is negligible. For example, a "state of emergency" was in effect in Egypt for the entirety of Mubarak's 30-year reign (it was lifted only in 2012), and no vice president was named until the outbreak of the revolution.[5]

A typical feature of this (neo-)patrimonal system is that citizens have no or little say in the allocation of the state's (rent-)income, nor in the country's political decision-making or economic policy-making. This regime was able to operate as long as it could provide a "decent life" for its supporters, especially public-sector employees, civil servants and public officials, and some segments of the urban poor, as well as certain private-sector workers. At the same time, however, it ruthlessly (and violently) eliminated all factors and forces which threatened or opposed the regime; systematic political repression was a consistent characteristic of this form of government.[6]

Even so, the relative balance and stability of this system came to end in the 2000s: on the one hand, the redistributional needs of the regime's "silent support base" intensified while state revenues declined—partly due to a drop in external rents resulting from the state's outdated and deteriorating extractive and productive capacities. These tendencies were clearly indicated by the continuous protests, strikes, and demonstrations which took place after the turn of the millennium (see Adly 2013, pp. 210–213). On the other hand, however, the intensification of these workers' protests coincided with the emergence and growth of political-opposition movements, such as the Kefaya (enough!) movement, which was founded in 2004 and was the first organised opposition movement in post-1952 Egypt (N. Rózsa 2015, p. 121). Finally, the Muslim Brotherhood (MB) won 20 per cent of the vote in the 2005 elections. The chronological coincidence of these two processes (the workers' protests and the emergence of organised political-opposition movements) was a major driving force behind the Egyptian revolution and determined its outcome.

The relationship between Egypt's public and private sectors has also been characterised by a dichotomy: while the political and economic elites (big business) are closely intertwined, the public sector has been unable, and perhaps unwilling, to establish close institutional ties with average people in the private sector. While the private sector increased its share of the economy in the 1990s—it accounted for 43 per cent of Egypt's GDP and 30 per cent of its investments in 1983, while by 2001 these percentages had increased to 72 and 66, respectively (Adly 2013, p. 91)—the state did not establish representative organisations and consultative channels, nor did it authorise members of the private sector to organise independently from below. Thus, there was nothing to ensure the efficiency of flows of information, or lobbying channels, or opportunities for advancing interests, as this was not the purpose of the state, neither from a representative nor from a regulatory perspective (for details, see Rutherford 2013, pp. 199–230). Existing public forums and organisations functioned under the authority and dominance of the government, while its institutions remained trapped within the legacies of Nasser's centrally planned economy. The institutionalisation of long-standing informal and personal relationships necessarily led to the perpetuation of clientelistic relationships and the spread of crony capitalism.

In sum, even though the Brazilian and Egyptian cases differ significantly, and Brazil made undeniable improvements to its institutional setting and the quality of its policy-making, the common feature of the two countries' systems was that political ties dominated and often overrode the rule of law, which ultimately resulted in the tyranny of corruption.

Economic Policy Orientation: Developmentalist Biases in Public Policies

The third phase of this analysis is an examination of the developmentalist biases of economic policies. At first sight, there would seem to be a significant difference between Brazil's and Egypt's economic-policy orientations after the turn of the millennium. While Brazil changed meaningfully in turning towards developmentalist and pro-poor economic policies, Egypt was rather selective in introducing market-oriented reforms, many of which exhibited an anti-poor bias.

In Brazil, Lula and the Workers Party were committed to improving the situation of the so-called "forgotten class", that is, the lower strata of the society. At the same time, and not independently of "pink tide" of leftist ideology which was then sweeping the continent, Brazil embarked on a new developmentalist programme in which the state played an important role in promoting social and economic development. And thus a special variety of economic patriotism was in the making.

At the core of this new development-oriented experiment was a special package of policies characterised by the following main elements: (1) tight and conservative monetary policies and a low-inflation regime; (2) complementary microeconomic policies, with an active role for "new-old" industrial policies, and an extensive infrastructural-investment plan to act "as a catalyst for social change" (Wylde 2012, p. 149); (3) active pro-poor social policies; and (4) extensive intervention in the labour market. Taken together, this particular mix of mutually reinforcing economic and social policies facilitated a successful and—compared to previous periods—more stable and inclusive developmental trajectory in the first decade of the twenty-first century in Brazil.

Even though I have argued that the Lula administrations took significant steps towards a more inclusive approach to development, I must also draw attention to important weaknesses and shortcomings, such as unfavourable changes in Brazil's production and export structures, underinvestment in its infrastructure (including a bias towards building luxury sport facilities for hosting mega-events), considerable vulnerability to commodity prices, and a dependence on rising household debt. These contradictions were an inherent part of the new Brazilian developmental model and ultimately contributed to its demise.

In contrast, the Mubarak era in Egypt was essentially characterised by the selective application of free-market principles, which did not improve the well-being of the majority of Egyptian society, nor did an expansion of human rights and political choices make it onto the developmental agenda. We now know that this strategy was not sustainable and led to the Egyptian revolution in 2011, which resulted in Mubarak's removal from power, though it did manage to survive for 30 years. I would argue that it was only temporarily viable within its very specific sociopolitical context, and that the internal and external conditions which supported it changed fundamentally by the mid-2000s at the latest.

When Prime Minister Ahmed Nazif formed a new government in 2004, a new economic team came to power, a group that was much more united and committed to economic liberalisation than any prior cabinet (Rutherford 2013, p. 223). However, the numbers suggest that Egypt implemented a strange combination of inward-looking industrialisation measures and trade liberalisation policies. Even though manufacturing output increased from 12 per cent of GDP in 1980 to almost 20 per cent in 1999, its share of exports remained stable, at around 37 per cent of the total—and as a share of GDP it even decreased[7] (Adly 2013, p. 72).

The implementation of this externally oriented export-promotion plan and export diversification strategy was hampered by a number of (institutional) factors. Most of the new institutions that were set up (which were, in fact, only formalisations of earlier informal, rent-seeking relationships) undermined the effectiveness of both the policy-making process and the capacity of the state to implement the resulting policies.

The economic-policy measures and changes which were implemented in the post-2004 period with the intention of reducing the economic role of the state significantly increased the burdens on the lower and middle classes, while providing disproportionately large advantages for certain circles of the business sector, especially for political loyalists. Without going into detail (for this, see El-Naggar 2009, pp. 36–41), I would mention the following areas in which anti-poor bias was the strongest and most evident: the tax system, competition policy, trade liberalisation (especially tariff reduction), and labour market interventions.

Evidence of the anti-poor (or anti-labour) bias of Egypt's economic policies includes the constantly decreasing wage share of GDP—which dropped from 48 per cent at the end of the 1980s to 29 per cent in 1995 to below 20 per cent by 2007 (El-Naggar 2009, p. 49)—and the increasing proportion of people living in poverty.

It was also in the early 2000s when Hosni Mubarak's son, Gamal Mubarak—along with his close friends, a group of young technocrats—became influential. This new generation of Western-educated technocrats enjoyed good relations with the traditional business elite and took advantage of this fact. Though the flow of information between them has sometimes been interpreted as a significant improvement in the relationship between the public and private sectors, the strengthening of communication and cooperation between them did not take place through formal institutionalised channels, but much more via personal connections (mainly on private mobile phones), which subsequently led to a further intensification of corrupt practices and cronyism. At the same time, there was an important shift in appointment practices: businessmen and other members of the intertwined political and business elites were chosen for leading economic and bureaucratic positions only if they were considered loyal to the existing regime. As a result, the new economic (and political) order which emerged was less market-friendly, in the traditional textbook sense, than big-business-friendly.[8]

In 2009, Transparency International (TI) ranked Egypt 111th out of the 180 countries listed on its corruption-perceptions index, which was a significant decline from its previous position; it was ranked 70th in 2006, and around 60th in the early 2000s (TI 2016a). Problems with corruption changed very little during or following the 2011 evolution, though Egypt's ranking on TI's index improved somewhat (to 94th) after Abdel Fattah al-Sisi came into power in 2014. Even in 2015, according to the latest survey, 50 per cent of the Egyptian respondents had paid a bribe to use public services in the preceding year; in the Middle Eastern region, the situation was worse only in Yemen (TI 2016b).

Brazil has exhibited a similar tendency; its ranking on TI's corruption-perceptions index dropped from 54th in 2003 to 69th in 2010 to 76th in 2016 (TI 2016a). Even so, I would argue that over the last 10–15 years, Brazil, the largest South American country, has implemented significant institutional changes to its judiciary, police, investigative agencies, and prosecutors' offices. Even a few years ago, it would have been unimaginable for members of the political and economic elite to have been sentenced to prison for money laundering or corruption cases, though that has been the result of Operation Car Wash, an investigation of corruption at the national oil company, Petrobras. Even though these events might increase perceptions of corruption, in the medium term or long run they might lead to positive changes. These institutional developments—along with the increasing role of the internet and the use of social media—might also make significant changes in the attitudes of the Brazilian people.

In sum, it is clear that a special variety of capitalism—crony capitalism—has emerged (and been maintained, or even gained strength in recent decades) in Brazil and Egypt. One principle of this variety of capitalism is that the rule of law is dominated by political ties, and, thus, corruption is more likely to be the rule rather than the exception. This is a systemic characteristic of both these regimes.

Post-2010 Troubles and Struggles in Brazil and Egypt

The last seven or eight years have been a very turbulent period, both economically and politically, in Brazil and Egypt. In Brazil, this period of volatility was initiated by changes on the economic front; growth rates began to decelerate in 2011, paving the way to a recession in the second half of 2014, which, along with a wide-ranging corruption scandal, led to a period of political instability which started in 2015 and culminated in the impeachment of Dilma Rousseff in 2016 and the subsequent election victory of Jair Bolsonaro in 2018.

In Egypt, the sequence of change—on the surface, at least—was the other way around: social demonstrations started in January of 2011 and culminated in a revolution which toppled Hosni Mubarak. After a short interlude in which the MB and Mohamed Morsi—the democratically elected president of Egypt—wielded power, social discontent, and upheaval led to another period of instability, which was followed by military intervention.[9] A short-lived transitional government took over, and then, after resigning his military posts, Abdel Fattah al-Sisi was elected and inaugurated as president in June of 2014; he has continued to serve in that capacity since then. This political turmoil was accompanied by very weak and deteriorating economic performance in Egypt, driven mainly by a collapse of incoming tourism and a slowing down of foreign direct investment (FDI), which had severe social consequences. By the autumn of 2016, a shortage of foreign currency, a lack of basic foodstuffs, soaring food prices, and rising inflation were among the important economic challenges which forced Egypt to ask the IMF for a $12 billion loan, which was approved on the 11th of November 2016.

Finally, both countries have "managed" to get onto the front pages of international media under headlines like "heading toward the worst economic crisis since the 1930s". Though there is not sufficient space here for a deep statistical analysis of the current crises, deteriorating tendencies characterise almost every field of these economies. The Brazilian economy has been decelerating since 2011 and was mired in a deep recession for two consecutive years, with growth rates around −3.7 per cent in 2015 and −3.8 per cent in 2016. The Egyptian economy grew at a rate of 4.2 per cent in 2015–2016 and was expected to grow by 3.5 per cent in 2016–2017; though this was well below the planned level of 5 per cent, it is an improvement compared to the 2 per cent growth of the period between 2011 and 2014. In per-capita terms, however, this means that years of stagnation have been followed by average annual economic-growth rates below 2 per cent. Unemployment is on the rise in both countries; Brazil's rate is above 10 per cent, while Egypt's is close to 13 per cent, though as I mentioned earlier, youth unemployment is approximately three times higher. Prices are soaring, with inflation above 10 per cent in both countries, though in some cases it is even higher (e.g., food prices in Egypt). Both countries have increased interest rates to historically high levels in hopes of curbing inflation, though without much success. The budget deficit is increasing and above 10 per cent in both countries, and thus government indebtedness is also on the rise; it was expected to reach 70 per cent of GDP in Brazil by 2016, while it is already above 90 per cent in Egypt. A 40 per cent drop in tourist arrivals and lower-than-expected FDI inflows have also worsened the situation in Egypt, where foreign exchange reserves have dropped to critically low levels. Both countries' currencies have lost more than half of their value over the last year or two, though this was a rather continuous and gradual process in Brazil, while the floating of the Egyptian pound in November 2016—a condition of its IMF agreements—led to a sharp (48 per cent) drop in its value.

These economic difficulties (and political instability) have naturally led to rising social discontent, which is currently near a peak in both countries. Brazilian demonstrations began with unrest related to increases in public transportation fares began in 2013, but then intensified with a series of regular protests against the World Cup and its effects on investment policies. In 2015 and 2016, people protested for and against Dilma Rousseff's government while she faced impeachment proceedings. Soon after Michel Temer's government took power, demonstrations started again, first against the composition and restructuring of the new government; more recently, a growing student movement has been protesting the state's new education model and the so-called PEC 55 (formerly PEC 241) constitutional amendment, which froze government spending at its current level for 20 years. Mass demonstrations erupted again when far-right candidate Jair Bolsonaro was predicted to win the election in 2018 Autumn.

In Egypt, despite the Sisi government's suppression of every social movement (in an even more violent and spectacular way than during the 30-year reign of Hosni Mubarak), protests spring up on regular basis, though they are insufficiently documented (Kandil 2016). In the spring of 2016, demonstrations were sparked by the transfer of two islands to Saudi Arabia; more recently, in the fall of 2016, social unrest was prompted by shortages of food and foreign exchange reserves, as well as increasing poverty and intensifying inequality. Mass protests were announced for the 11th of November, 2016—organised mainly on social media, partly by the marginalised "Ghalaba Movement". However, these demonstrations were thwarted by extensive government intervention (police and security forces intervened even before the announced date) and by the fact that the civil society organisations and political parties involved were divided and hesitant to support these protests, as many suspected the involvement of the MB.

Recent economic problems can be explained at least partially by important changes in the external context of the two countries. The global economic context changed by the time of the global financial crisis, at the latest; lower commodity prices and decreasing demand growth (for primary products, mainly from Asia) have affected both economies. Meanwhile, intensifying security challenges (which have decreased the flow of international tourists) and increasing food prices have imposed significant burdens on Egypt.[10]

These countries' regional political contexts have undergone significant changes as well. In Egypt, the Arab spring and its demonstration effects (spread by means of new- and social media channels) have contributed to a new "enlightenment" of society (especially among the younger generations). Brazil was also affected by the continent-wide political changes which brought the pink tide to an end and resulted in a turn to the political right in a number of Latin American countries.

Due to important internal dynamics and changes in both countries, their prevailing social contracts have broken down. Egypt's clearly unravelled with the revolution in 2011, but Brazil's also fell apart during Dilma Rousseff's term as president. Both countries still await the construction of a new social pact.

It was not until 2014, with Sisi's rise to power, that any new direction in Egyptian economic policy could be identified; in the preceding period, the interim and Morsi governments struggled only to restore the country to governability and to stabilise their political power. "Sisinomics" includes many elements of the old Nasserist developmental approach, but can also be interpreted as a special form of economic patriotism. In contrast, the first Brazilian milestone was 2016, when Temer took power—first on a temporary basis and after September as the inaugurated president—and followed the Rousseff government's ad hoc, discretionary economic-policy (mis-)management with a new economic-policy direction. The second milestone was Bolsonaro's victory with an economic agenda unmistakably dominated by a market-oriented, neoliberal line.

New Economic-Policy Directions in Brazil (2016–) and Egypt (2014–)

Finally, I will turn the focus of this analysis towards the main characteristics of the most recent economic-policy directions in Brazil (2016–) and Egypt (2014–). I am fully aware of the fact that this very short time period (especially in the case of Brazil) will allow me to formulate only preliminary judgements of certain aspects of these policies.

Between 2011 and 2014, first under the interim government of the Supreme Council of the Armed Forces (SCAF) and then during the period in which Mohamed Morsi and the MB ran the government, populist decisions dominated Egypt's economic-policy agenda. As El-Dahshan put it (2016, p. 203), Egypt's economic policy was characterised by "destructive inaction". During Sisi's presidency, this has changed fundamentally, and a much more ambitious and explicit economic-policy package—dubbed "Sisinomics"—has started to unfold.

Sisi's economic programme is reminiscent in many ways of the old, Nasserite programme. First, at least on the rhetorical level, it emphasises social welfare and tackling poverty, with a special focus on housing and education (N. Rózsa 2015, p. 126); second, state-owned, or at least state-led and state-dominated mega-projects are to be the main tools with which to restart economic growth in Egypt; third, it envisions an attempt to mobilise society and the domestic business elite to contribute to a nationalistic developmentalist project. The most prominent mega-project was the construction of the New Suez Canal and other development projects related to it, but other ambitious plans have also been announced, such as a new $45 billion capital project and a $10 billion port-development project with Chinese cooperation and capital.

The new Suez Canal mega-project quickly became Sisinomics' flagship project; it also demonstrated the initial level of social support behind the new regime, as the necessary budget was raised "immediately" by issuing very low-priced, tax-free, high-yield bonds, 82 per cent of which were acquired by private individuals. However, this initial euphoria was soon followed by more critical views, as it soon became clear that the preparation and design of the mega-project was incomplete and overly hasty.

In announcing the *Tahya Masr* ("Long Live Egypt") programme, Sisi turned not only to the people of Egypt for support for his ambitious development plans, but also to the domestic big-capitalist class. He hoped the Egyptian business elite would make donations in support of the realisation of the "Egyptian Dream" (Sisi's version of it, at least) in the form of domestic-development projects. This programme also illustrates the quality of the relationship between the state and the business community in Egypt, in that no serious big businessmen dared to opt out.

A number of initiatives and changes in economic policy (typically issued in the form of presidential decrees) aimed at increasing investor confidence and boosting investment in Egypt; these include the Egyptian Economic Development Conference[11] (EEDC) held in Sharm el-Sheikh in March 2015. Its actual results, however, fell far short of the expectations which preceded it (Esterman 2016).

Egypt's new five-year macro-economic framework and strategy (STRAT_EGY[12]), published during the EEDC, is a kind of revival of the five-year economic plan, a familiar element of the old developmentalist model. The STRAT_EGY is in fact an optimistic medium-term economic plan with two main foci: ensuring macro-economic stability, and restarting and promoting economic growth. In accomplishing these aims, it foresees structural interventions which will improve the investment climate, such as fiscal consolidation measures, reforms of the tax system, and the restructuring of public expenditures (mainly energy-price subsidies and public wages). It also features an export-promotion strategy based primarily on the promotion of FDI, free-trade agreements, and support for a diversification of export production, especially into higher-value-added products.

In addition to its officially proclaimed pro-business stance, Sisinomics has also strengthened the economic role of the Egyptian military, which is traditionally extensive and complex, though not particularly transparent (Abul-Magd 2016). Since August of 2012, the military has taken part in the implementation of 1350 development projects in areas such as the development of transportation infrastructure, education, health, the water supply, and housing (El-Dahshan 2016, p. 213), and also played a central role in major national development projects such as the construction of the new Suez Canal. The social embeddedness of the army is traditionally high in Egypt, and this was well demonstrated in 2014, as the vast majority of Egyptian voters chose Sisi, and thus implicitly voted for the army. And here I would emphasise again that the era of big state development projects and nationalistic approaches has returned, and these, along with the commitment to the developmentalist approach, suggest important parallels with the Nasserist development model.

At the same time, the commitment to a more socially equitable development strategy is largely rhetorical, and in practice, certain anti-poor decisions continue to be made; see, for example, the reduction of the tax rate for the highest income bracket from 30 per cent to 22.5 per cent.[13] To summarise, further action in the area of social justice and inclusion is urgently needed in Egypt, as the events of 2011 and 2013 have shown that Egyptian society has reached the limits of its tolerance. The previous social contract has broken, and no new one has emerged. If Sisi's current economic policies are followed, and more business- and investor-friendly measures are put in place, more compensatory measures will be needed to increase social welfare and improve the situation of the poorest and most vulnerable segments of society. Otherwise, the Egyptian government will not be able to avoid another social upheaval.

Economic support from the Gulf countries (mainly Saudi Arabia) has created economic-policy space for Sisi, which has led to delays in the implementation of economic reforms and even to a suspension of discussions with the IMF. In early 2016, and in the light of new regional political conflicts, the negative tendencies of the Egyptian economy have once again come to a head: soaring food prices and rising inflation, along with further drops in tourist traffic, have led to a severe foreign currency shortage and a significant devaluation of the Egyptian pound. A renewal of talks with the IMF finally became inevitable.

In November of 2016, an agreement between Egypt and the IMF was approved, resulting in a three-year, $12 billion loan which was intended to support the Egyptian government's reform programme, plug its budget gap, and rebalance its currency markets. The central elements of this reform package were subsidy cuts, the introduction of a value-added tax (VAT), and the reduction of bureaucratic hurdles for foreign investors; it also touched on monetary policy issues, such as easing the chronic dollar shortage and reducing inflation to single digits, as well as aims like promoting growth and creating more jobs. One of the first (and most spectacular) moves was the Egyptian central bank's unpegging of the Egyptian pound from the US dollar, which immediately led the pound to lose almost half (48 per cent) of its value. This was followed by a cut in subsidies for fuel. Plans to increase the VAT rate to raise government revenues are currently being debated.

The main differences between the old developmentalist approach and Egypt's new economic-policy suite include the latter's intention to stop subsidising products (such as gasoline or bread) and instead make sure that poor people can survive with a minimum income level and access to education and healthcare. Its success will continue to be in question for the foreseeable future. It is clear, however, that Egypt's public policies have taken a new direction, and might represent a turning point for the country; they will probably also signify the end—or at least a profound modification—of the new patriotic development experiment called Sisinomics.

Brazil's political shift started in 2016, when Michel Temer and his new government took power (on a temporary basis in April of 2016, and officially in September) and continued in 2018 with the rise of Bolsonaro. To understand most recent events there, we have to go back to the end of 2010 and Dilma Rousseff's first term. Economic growth had already started to decelerate, but certain clear and deliberate (though often overlooked) policy choices also date back to the Rousseff government, and thus to the era of the PT and the leftist coalition. Serrano and Melin (2015) called these policies "Brazil's Neoliberal U-Turn", as they were explicitly aimed at reducing the direct role of the state in the Brazilian economy, even though important social policies remained in place.

In Lula's new Brazilian development model, the public sector (including state-owned enterprises (SOEs) and public banks) was clearly the major actor which would stimulate aggregate demand and generate supply-side structural change, mainly by means of investments. At the end of 2010, there was a clear economic-policy shift, an attempt to respond to the intensifying criticism coming from Brazilian corporations, banks, the media, and the conservative opposition, all of whom claimed that the Brazilian state had been intervening too much in the economy. The "ideology" behind the (rather ad hoc) economic-policy decisions which followed was the belief that the state could withdraw from its leading role in the economy, and that the private sector would immediately step in. The government started to offer incentives for private investment, mainly in the form of (unconditional) tax cuts; it also tried to reduce traditionally extremely high interest rates (though this policy was quickly reversed) and oversaw a significant exchange-rate devaluation of the Brazilian real (Serrano and Melin 2015, p. 2).

Even though all economic indicators pointed out the ineffectiveness of this new economic-policy direction, Rousseff's government continued to pursue its market-oriented (or rather, Brazilian-type selective business-friendly) strategy even into her second term, which began in 2015. By then, its primary aim was tackling the unfolding economic crisis, mainly by means of austerity measures such as cuts in public spending, interest-rate hikes, increasing utility prices, and reducing the availability of credit. By 2017, it was clear that these measures had contributed to the worst crisis in Brazil's modern economic history.

This controversial economic-policy turn became much more explicit and obvious in 2016, when the government of Michel Temer came to power. Among its first economic-policy steps[14] was the announcement of a large privatisation programme and a 20-year cap on public spending in the form of a constitutional amendment called PEC 241, or more recently PEC 55; these measures made the direction of Brazil's economic policy obvious. However, further, even more radical plans, such as reforms of the social security system and pensions, indicated the depth of the newly elected Bolsonaro government's commitment to neoliberal policies and to driving the state out of the Brazilian economy; the immense social costs and threats inherent in doing so, however, lay outside the new government's purview.

"Project Growth" is a new and ambitious privatisation plan consisting of 32 infrastructural projects, mainly in the transport, energy, mining, and sanitation sectors, with an expected budget of $24 billion through the year 2018. To attract much-needed private (and foreign) investment, the government implemented several procedural and technical changes, though the possible outcomes of these measures were often debatable (see, for example, the easing and speeding up of environmental-licensing procedures). It is clear, however, that these policies were largely a continuation of Dilma Rousseff's plans: as early as 2012, the Rousseff government had announced its own privatisation programme with an expected budget of $45 billion over five years. The original plans had to be adjusted in several ways in order to offer adequate returns to potential private investors, which led to delays in the implementation of many of these projects; the planned targets were never reached. A second round of privatisations followed, with two peaks, one prior to the 2014 World Cup and another in 2015, preceding the 2016 Summer Olympic Games. Together with some other concession programmes announced in June of 2015, the government envisaged bringing in $25 billion in privatisation income by 2018; this target has not been realised, which might be a warning sign for the prospects of the most recent "Project Growth".

The Brazilian government's new infrastructural programme, the Investment Partnership Programme (PPI), could also be considered a continuation of the Growth and Acceleration Programme (PAC), which was implemented in two phases under Lula and Dilma. The PPI envisaged investments totalling 500 billion Brazilian reals (approximately, $125 billion) in the period from 2016 to 2018 (Amann et al. 2016, p. 6); its principal sectoral focus was oil exploration and production, though it also included some intercity highway developments, which accounted for less than 10 per cent of its planned budget. To highlight the differences between Lula's developmentalist approach and later programmes, I would point out that the first phase of the PAC (2007–2010) allocated almost 40 per cent of its budget to social and urban infrastructure, while in its second phase (between 2011 and 2014, under Dilma) such funding had disappeared almost entirely, with only 0.4 per cent of its total budget earmarked for the development of social and urban infrastructure. The PPI, with its exclusive focus on the energy sector, seems to have continued this trend.

Last but not least, the public-spending cap (approved on the 13th of December 2016) froze most federal expenditures (and the structure thereof) in real terms for the next 20 years, and does so via constitutional amendment, so it cannot be revised for at least 10 years. Most proponents of this extremely divisive measure have highlighted the need to regain market confidence, cut budget deficits, and keep inflation under control to avoid a future debt crisis. However, this spending cap might not be effective, as it does not include the social security system which currently accounts for more than 40 per cent of the government's mandatory expenditures. Perhaps more important is a contributing factor to the mass social protests which were taking place across the country at the time of the writing of this chapter—that is, the fears that this measure will harm the poor, who rely disproportionately on services provided by the government. It will also likely harm Brazil's future economic-growth prospects by freezing expenditures on its already underfunded educational and health systems.

Giant luxury sporting events like the 2016 Olympic Games and the 2014 World Cup have also imposed excessive fiscal burdens on Brazil, especially on the state of Rio de Janeiro. These mega-events not only distorted infrastructural development over the last five or six years, they have also resulted in indebtedness and fiscal problems which are expected to put additional burdens on the populace (especially the poorer strata of society) and its public systems (especially on the educational and health systems, though also on urban infrastructure and other services) for the foreseeable future.

It is clear that even though the backgrounds of their policies differ—in Egypt, as the result of external pressure (from the IMF); in Brazil as the result of a changing internal balance of power and other political transformations—both countries have turned towards a more pro-market or pro-business agenda. However, both their policy programmes have been marked by the dominance of political ties and cosy state-business relationships instead of transparent and equitable rules, which makes it unlikely that these agendas will produce the results expected of them. Recent corruption scandals in Brazil are evidence of this shortcoming, but there have also been similar cases in Egypt (e.g., involving certain major development projects and the ever-growing influence of the military), which have perhaps received less attention from the international media. Critiques of both countries' agendas include their social polarisation and problems with inclusivity, which offers some lessons for developing and emerging countries.

Lessons and Conclusions

This comparative analysis of the Brazilian and Egyptian cases suggests the following conclusions and lessons. First, the end of the twentieth century was marked by substantial changes in the external and internal environments of states with developmental aspirations, and these transformations altered not only the policy space in which these states could manoeuvre, but also the expectations and perceptions of—and decisions taken by—economic actors including states, firms, and individuals, all of whom are subject to the changing pressures applied by the *patrie* in which they operate. I have argued that both Brazil's and Egypt's economic policies and institutional structures exhibit important continuities before and after the turn of the millennium, and that both their developmental experiments were doomed to fail, insofar as they did not manage to react effectively to the emerging challenges of the twenty-first century (see the second chapter of this volume).

Thus, I would assert that the driving forces behind most of the recent political and economic turmoil in both Brazil and Egypt are similar to those which led to the fall of the classic developmental-state paradigm (Ricz 2015). At the same time, I have tried to argue that the more recent troubles in Brazil and Egypt were not the result of unfavourable coincidences, but must be regarded as systemic failures, given that they originate in the very same changes of external and internal context which affected the classic developmental states. I have argued that both Brazil and Egypt remained (to a certain extent) trapped in their old DS models—even though more substantial changes did take place in Brazil, and the continuities were undoubtedly stronger in Egypt. Thus, their current economic, political, and social difficulties can be better understood through the analytical lenses of the DS approach.

Second, on a more practical level, the socio-economic and institutional developmental paths of Brazil and Egypt have varied considerably in recent decades. Brazil's new, socially inclusive, and democratic developmental model[15] was backed by a wide social alliance and resulted in a much more equitable and pro-poor record of development, in contrast to its Egyptian counterpart. These achievements were at least partly the result of democratic values and institutions (e.g., the new Brazilian constitution of 1988). However, Brazil's social progress was accompanied by a deindustrialisation of the economy, a renewed dependency on primary product exports, and a newly emerging dependence on China. Thus, Lula's new developmentalist model was clearly not sustainable—especially not in a less favourable external context, and with the exhaustion of the domestic-demand-led model based on significant increases in private-sector indebtedness.

In contrast, in Egypt, Mubarak's (non-)developmental regime tried to keep its paternalistic promise to society—that is, it tried to satisfy the terms of the autocratic bargain, a familiar aspect of the old DS approach. This effort proved to be unsuccessful as well, if our criteria include Egypt's rising poverty levels and its extremely low (and decreasing) wage share of GDP.

Third, both countries did introduce market-oriented reforms (with different timing and in a rather slow and incomplete manner), but more often than not their implementation took place according to the logic of political ties rather than the rule of law; the result in both countries was the spread of crony capitalism. In recent years, both countries have suffered the tyranny of corruption.

To summarise, I am convinced that the cases of Brazil and Egypt are proof that over the long run, the role and quality of institutions, and the inclusivity of the "growth-with-equity" approach of the classic East-Asian developmental states are important explanatory factors of developmental outcomes and their sustainability. Finally, even though the Brazilian experiment has produced more positive results than the Egyptian case, both countries have failed to "reinvent economic patriotism" (see Clift and Woll 2012) or to take significant steps towards a viable new developmentalist model for the twenty-first century.

Notes

1. I have argued elsewhere (Ricz 2016b, 2017) that the Nasserist developmental experience can be analysed through the lenses of the developmental-state approach; even though it differs somewhat from the classic developmental-state model, it still largely corresponds to the original DS definition formulated by Chalmers Johnson (1982).
2. In fact, the main driving force behind the democratisation process in Brazil was the failure of the old developmentalist model, which was incontrovertibly confirmed by the debt crisis; the military rule thus lost its political legitimacy, which led to important changes in the political, economic, and social spheres.

3. Even though social discontent had been on the rise since the turn of the millennium, it became an organised phenomenon on the national level in the electoral year of 2005.
4. The "Mensalão" (2005–) and "Petrobras" (2014–) scandals are the most-cited cases.
5. On the 29th of January, 2011, amid Mubarak's struggle for political survival, Omar Suleiman was finally appointed to the long-vacant vice presidency, though this did nothing to slow down the protests which culminated in the revolution.
6. With significant ups and downs, however; for example, the electoral year of 2005 and the constitutional amendments of 2007 were interpreted by numerous analysts as the first signs of political liberalisation; the elections of 2010, and the intensification of repression which preceded it, showed how illusory these views were (Csicsmann 2017, p. 94).
7. It is interesting to note that after the opening up of the Egyptian economy in the early 1980s, it was well integrated into the world economy, with exports reaching 33 per cent of GDP and imports reaching 48 per cent; after all the "liberalisation reforms" of the 1990s, exports barely reached 15 per cent of GDP in 1999 and imports 23 per cent. As Henry and Springborg put it (2001, p. 142), Egypt was in fact de-globalising.
8. Numerous examples illustrate how in the absence of the rule of law, transparency, and accountability, political ties and relationships began to dominate Egypt's economic life as early as the 1990s; this trend became "chronically dominant" after 2004 (Adly 2013, p. 96). El-Naggar (2009, p. 46) described the privatisation of the Egyptian American Bank rather spectacularly: it was an "*unholy marriage between the state and business that is characteristic of the current regime*".
9. Morsi and the Muslim Brotherhood have strengthened the Islamist line in policy-making and everyday life (with restrictions on the freedom of assembly and freedom of speech), and this, together with growing economic and social problems, has led to ever-increasing level of discontent among large parts of Egyptian society. A huge demonstration gathered in June of 2013; al-Sisi, backed by the Armed Forces (SCAF), managed to remove Morsi and the Muslim Brotherhood from power. Perceptions and interpretations of these most recent political events are still controversial; they have been called everything from a military coup to a second revolution.
10. While Egypt has traditionally been highly exposed to external factors (such as changes in oil and food prices, tourist traffic, remittances, and regional political changes), the case of Brazil is perhaps even more complex. Brazil can still be considered a relatively closed economy, as its exports-to-GDP ratio is barely 13 per cent. Taking this into account, I have argued elsewhere (Ricz and Nagy 2016) that changes in its external context and

important internal constraints to economic development have both contributed to Brazil's most recent economic crisis.

11. The website of the conference: http://www.egyptthefuture.com/
12. http://www.mof.gov.eg/MOFGallerySource/English/Strategy.pdf
13. There are some initiatives to decrease or tackle social tension, such as the attempt, supported by the World Bank, to create a social net to help the poorest, or the Egyptian Central Bank's initiative to support lending to small and medium-sized enterprises in rural areas; these efforts have produced mixed results, however.
14. It is worth noting that Michel Temer's first political step after Dilma Rousseff was impeached and removed from power in May of 2016 was to assemble a new (at that time, interim) cabinet, which was made up exclusively of elderly white men with rather conservative views. This move attracted intense criticism, as Brazil is a very diverse and mixed country, ethnically and culturally; many social groups did not feel they were represented by an all-white, all-male cabinet for which no one had voted. Many social groups and movements questioned the legitimacy of such a government.
15. This model, which has often been criticised for its active social policies (mainly cash transfers), did not manage to produce transformative changes in Mkandawire's (2007) sense, but led instead to the creation of new (financial) dependencies (Lavinas 2016).

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CHAPTER 11

Conclusion: The Formation of a New *Patrie* in the Multipolar World-System

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Since the end of World War II, Western hegemonic thought and policy-making have been dominated by the idea of market liberalisation; the spirit of the age has been determined by a deep-rooted trust in the superiority of liberal-capitalist ideas, the success of the European project, and—later—the positive consequences of Central European integration. Faith in these ideas had already begun to erode when the global economic crises of 2008 seriously challenged the principles upon which the post-war liberal hegemonic order was built, such as the belief in economic and social convergence between advanced and peripheral countries and trust in the superiority of unfettered market relations. Former global and local class alliances have been shaken, while new contenders who seek alternatives to the liberal ethos have appeared on both the global and local scenes. Even so, differences between national economic policies have widened considerably over the last decade. This is the context in which economic patriotism has become a more popular concept in both advanced Western liberal democracies and in emerging illiberal regimes in the global south and east.

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The purpose of this book is to make a timely contribution to the 'varieties of capitalism' (VoC) literature by identifying post-crises empirical trends in which the scope of 'comparative capitalism' scholarship can be broadened from advanced to peripheral countries. Our authors pose critical questions about the relationship between the ruptures in the post-crises economic recovery and the rise of what Ian Bruff (2014) coined "authoritarian neoliberalism" both in cores of the world-system, such as the US and the UK as well as in peripheral regions, including, Brazil, Egypt, and Eastern Europe. Posing critical questions about the tensions between liberal and authoritarian forms of interventionism, as well as potentially new hybrid forms of 'state-permeated development' as understood by Andreas Nölke et al. (2015), the volume seeks to advance research into a new phase of VoC scholarship in which economic nationalism, authoritarian neoliberalism and various rent-seeking behaviours may come to define not only national economic policies but global economic governance. For the purpose of this reconceptualisation, the volume uses Ben Clift's concept of 'economic patriotism'. The second chapter by Clift explains the core of this idea and serves as a conceptual framework for the following chapters. Although the concept of economic patriotism is nothing new, this volume still amounts to a concerted effort to understand the direction of state intervention after 2008 in both advanced and peripheral countries in order to help broaden the scope of 'comparative capitalism' within VoC tradition.

Economic patriotism is both a general framework for understanding the relationship between structure and agency within the evolution of historical capitalism and also a useful method for analysing more recent developments in the remaking of capitalist social relations at various levels of the global system. In this volume, we have used the concept of economic patriotism to describe a newly forming regulatory regime for global economic governance at the current crossroads of capitalist transformation. The authors presented in this volume have underlined a variety of factors which attest to the novelty and necessity of such analysis: the decline of hegemonic supranational institutions, the changing political and economic landscape in Europe and in the world, the high social costs of the 2008 financial crisis, rising levels of inequality and social polarisation, and disillusionment with the post-communist transition in Central Europe have all played a part.

In the second chapter of this volume, Ben Clift emphasised that economic patriotism is always a political construct which encompasses the structural contradictions and tensions produced by capitalist accumulation. This contradiction is related to question of agency: states regulate market relations, while their capacity is limited by constraints of global economic forces. Economic patriotism is thus not only a political phenomenon; an understanding of its operation requires analyses of sociological, economic, and, in some cases, even global contexts. The theoretical framework of economic patriotism can be traced back to Karl Polányi and his famous model in which states and markets were mutually constitutive factors in the making of historical capitalism (Polányi 1944). The Polanyian model frames these tensions in a historical perspective by highlighting the evolution of capitalism and the interventionist potential of various social classes. These social groups are not always limited to the state framework, but an understanding of the state's role in this systemic transformation remains a crucial scholarly task and is the objective to which this volume is primarily dedicated.

The functions of the state have changed a great deal, and thus economic patriotism manifests itself in several ways; its forms diverge significantly in various states. Economic patriotism is not a simple revival of economic nationalism. As Clift has explained in his chapter, economic patriotism can even be rooted in liberal narratives, and this type of economic governance originates in the post-war era. At the height of the neoliberal era, the state was colonised by private corporate interests, but as the crises of neoliberalism unfolded, a new coalition of capitalist fractions has changed the function of the state.

The crucial element of this concept is that new forms of economic governance have been reconfigured by competing social groups. Intensifying rivalries between international and national capitalist classes have resulted in a return to centralisation and the nationalisation of private assets. The state has become a tool in the hands of domestic capitalist fractions in their struggle with hegemonic groups and corporations. A large part of this competition usually takes place within the framework of the state, where economic governance is a form of intervention used to shape market structures and institutions in numerous ways. One specific feature of contemporary economic patriotism is an ideological need to reassert social control over the economy, a process that corresponds to Polányi's notion of a pendulum swinging towards regulation. Andreas Nölke and Christian May support Clift's thesis by arguing that capitalist development is not a linear process, but rather a series of cyclical shifts punctuated by deep structural crises. This dialectic of crisis and development is so deeply rooted that these authors are led to ask whether the crises produced by the contradictions of capitalist development are the norm—that is, a rule of the system's evolution—or whether such breakdowns are exceptions which could be remedied by economic patriotism.

Clift has also used the concept of the '*patrie*' in his definition of economic patriotism in order to highlight some constraints on the socialisation of the economy. The *patrie* is an economic community of territorially or ethnically defined insiders who make up a newly forming class alliance. The regulatory aspects of economic patriotism favour certain social groups over others, and thus membership in the *patrie*—whether defined by a new or an old existing regime—is a condition of participation in this exclusionary competitive environment. This general framework explains how class alliances of different social interest groups are destabilised and how international class alliances within the hierarchy of fragmented capitalist fractions might reconfigure themselves in their attempts to take advantage of a new hegemonic order. In such interim periods, very different groups and institutions take action and compete in an ongoing struggle for hegemony. Economic patriotism is the form of governance in which such struggles take place, not only within regulatory regimes but also within the informal networks of the broader social system, any analysis of which will require a sociological approach. As Clift himself highlighted with the concept of the '*patrie*' (the analytical unit of economic patriotism), the crucial question in determining the form of the new hegemony is, *Who is in and who is out?*

According to Clift's definition, the concept of the '*patrie*' is more complex than the older concept of economic nationalism would suggest; for instance, a *patrie* can also take the form of a supranational entity, as is the case with the European Union (EU). The concept of *patrie* is very much like what the neo-Gramscian school of international relations has called a regional or international alliance of fractions of capital—for example, that of the transatlantic region. Scholars from this school focus on the intersection of the state, society, and capital in the build-up of hegemony (Van der Pijl 1998; Van Apeldoorn 1999). According to their studies, there is a supranational network of various fractions of capital, the hierarchy of which corresponds to the core–periphery relationships in the EU. Hegemony within Europe has recently been based on the neo-mercantilist or neo-protectionist model of German industrial power. Shifts in cycles of accumulation (as described by Arrighi 1990) have created serious tensions and led to a reconfiguration of the institutions of the EU. As a consequence of this transformation, populist politicians have intensified their attempts to form a new supranational *patrie*. In a sense, emerging populist projects—especially in Central Europe—are among the driving forces behind this transformation into a new *patrie* which is not yet fully in operation, though the tensions around its birth are visible. As Clift has rightly emphasised, economic patriotism does not necessarily entail protectionism or mercantilism. It can take many colourful shapes depending on the historical and geographical contexts of its appearance.

Present-day trends seem to include a revival of regional trade blocks with protectionist tendencies and a reconfiguration of industrial value chains under the direction of financial capital (Gereffi and Korzeniewicz 1994; Gereffi 2014). These are the major global forces shaping new *patries* at both the national and supranational levels. As some of the authors in this volume have argued, such transformations are not new phenomena, as a similar process of multipolarisation characterised the interwar period. As mentioned earlier, the international political system is a hierarchy of structures operating on multiple scales, within which states are still the most important institutions mediating between global economic and political forces and local environments (Gereffi and Evans 1981; Cardoso 1972; Cardoso and Faletto 1979). The function of the state is thus the mediation between external processes of integration and the internal formation of the *patrie*. In a neo-Gramscian analysis, the key instrument in this mediation is the ideology of the hegemon. On the ideological surface, reasserting control over the economy is a popular promise of political rent-seekers, but the original contradiction does not seem to be an easy problem to solve.

The future of capitalism will depend on many factors, and as Nölke and May have predicted, the swinging of Polányi's pendulum might lead us into a new stage of organised capitalist development. These authors disagree with those popular notions which celebrate the economic re-embeddedness of social control as a return to the golden years of Fordism. Nölke and May's prediction is more pessimistic: the next phase of capitalism will be organised, but that does not necessarily mean it will be socially embedded as it was during the Fordist era. Instead, they argue that the nucleus of the next globally organised capitalist system can already be found in the emerging economies of large, powerful countries in the south and east. Nölke and May recommend a critical-institutional, comparative analysis in order to determine what the post-liberal (and disembedded) system of capitalist accumulation might look like in a more organised system. In addition, they argue that the deep crises of liberal capitalism and the subsequent decline of its international political hegemony are far from over, as crises of financialisation are going to continue to accelerate. Interestingly, the successive stages of capitalist development—which shift in opposite directions according to the swings of Polányi's pendulum—are also characterised by a genealogy which stretches across these phases. Financialisation is the cause of the recent structural crises, but it is only one such lineage. It started at the end of the Fordist period and has been evolving since the neoliberal era of the 1970s. Despite the decline of liberalism's institutional hegemony and the rise of new institutional solutions, the financialisation and commodification of social relations do not seem to have been reversed—in fact, these processes seem to have accelerated the transition from the prior stage of capitalist development to the next.

Nölke and May have located the nucleus of the newly forming system of organised capitalism in the global south. They call this organised but nevertheless disembedded form of capitalist relations 'state permeated'. In the model of state-permeated capitalism, the rising political oligarchy is capable of capturing the state and organising the entire social landscape according to its own interests. Such systems are not merely disembedded; they constrain the socialisation of economic forces, and thus their emergence is accompanied by growing inequalities and a rigidly hierarchical social system. As has been argued elsewhere, the driving force behind these highly unequal social conditions is the concentration of power in the financial sector, which has been dominating capitalist fractions and the formation of the new *patrie* in most advanced economies.

These authors, however, warn against early predictions about where this systemic transformation might end up. Many—including well-known scholars from the world-systems tradition, such as Giovanni Arrighi (2007)—believe that China will be the leading force, or in fact the new hegemon in the coming phase of historical capitalism. Nölke and others have made other predictions. While the increasing significance of China's role in the world economy is undeniable, the current process of systemic transformation suggests something more like polarisation—that is, a multipolar international system in which none of the many contenders can achieve a central position (cf. Brenner 2006). Recent financialisation—involving powerful Western banks, institutions, and capitalist classes—has been reminiscent of the crises of the previous systemic phase, but these actors will still play key roles in transforming the system to its newer phase.

Thus, the core of hegemonic power is not simply shifting from west to east or from north to south, but spreading across the world into many emerging national, regional, and supranational blocks. This is the current global framework in which a multiplicity of approaches to economic governance and models of economic patriotism can be and need to be described by means of a comparative approach.

What Nölke and May have highlighted in their analysis is that contrary to apologetic and wishful predictions, transformations of the capitalist social system do not necessarily lead to any balance, and certainly not to equality in the international political system, as core-peripheral relationships have been reproduced by emerging economies. A new type of hierarchy, marked by growing social inequality both within states and on a global scale, seems to be emerging; this combination of increasing social inequality and political oligarchy is characteristic of the state-permeated capitalism in large emerging economies. And despite the fact that Polányi's pendulum might indeed swing back towards an organised form of capitalism, it will likely to be exclusionary and intensely competitive, with devastating consequences for the middle, lower-middle, and working classes who were the beneficiaries of Fordism.

Nölke and May go as far as to predict that capitalism will be remodelled based on the experiences of state-permeated capitalist development. This model is based on the rise of political oligarchies, which is characteristic not only of large emerging economies such as those of Russia and China (the recent history of whose political classes are detailed in Péter Mihályi and Iván Szelényi's chapter), but also of Central Europe. In Central Europe, the formation of the dependent market economy—a concept introduced by Vliegenthart (2010)—has also been the result of financialisation and uneven development along the European periphery. The political context of such dependency is exemplified by the patronage states of Poland and Hungary. Miklós Szanyi has explained the significance of the patronage state in Central and East Europe (CEE) by analysing the changing and controversial role of foreign direct investment (FDI) in the period of economic transition there. Szanyi has highlighted how the exhaustion of the previous FDI-led growth model has led to clientelism, political rent-seeking, and ultimately the emergence of illiberal patronage states in Hungary and Poland. Mihályi and Szelényi have also constructed a comprehensive framework for describing the rise of the illiberal state in Hungary, according to which rent-seeking is a key mechanism by which new political class alliances are reconfigured within the confines of economic patriotism.

Nölke and May, Mihályi and Szelényi, and Szanyi would probably all agree that the patronage states and dependent market economies of Central Europe have not improved their societies' chances of fulfilling their age-old dreams of using a transformational phase of capitalism to catch up to their advanced Western neighbours. Long-standing historical legacies have created path dependencies: their economic model has been imprisoned in a peripheral position and it has been forecast to remain there in the new hierarchical formation as well. This is how core-periphery relationships will not be overcome, but rather reproduced by the multipolarisation of the international political system.

However, the extent to which captivity on the periphery of the world-system is determined by global structural forces is still the subject of academic debate. This is another problem of structure and agency, and as Drahokoupil and Piasna have rightfully argued in their chapter, the highly uneven valuation of labour in Europe—for example, the undervaluation of labour in CEE—is not only a structural phenomenon, but also the historical result of a long series of political struggles. Uneven wage and productivity levels are among the main obstacles to dependent market economies' efforts to catch up to those of Western Europe despite the numerous remarkable achievements the former have made since their economic transition. Drahokoupil and Piasna have applied the dependent-market-economy model in demonstrating that peripheral countries in Europe have specialised in low-value-added manufacturing with bleak prospects for labour. These countries have become deeply integrated into German production networks because world economic forces necessitated deep structural changes to their industrial systems (cf. Becker et al. 2015; Becker 2016; Weissenbacher 2017). The German neo-mercantilist model has dominated the European project, and its economic readjustment will probably shape the future of Europe as well. Market economies in the east are dependent not only because of their openness to external financing, but also because their economies are deeply integrated into the German production system (cf. Gerőcs and Pinkasz 2018). The re-emergence of core–periphery relationships is a matter of interstate ties, but an economy's position in these production networks can determine many aspects of the local social reality, including the system of employment, access to technology, the functioning of the state, and the political struggles around these issues. What many misunderstand about the political developments in CEE today is that political rent-seeking and the rise of the oligarchic, patronage-state model is not simply a reaction against the European project, but the result of this asymmetric integration into the industrial supply chains of Western companies. It comes as no surprise that German industrial capitalists are generally in favour of Viktor Orbán's illiberal state in Hungary (Book 2018).

This is why Drahokoupil and Piasna's analysis of wage and labour relations is a crucial contextualisation of uneven development and peripheral positions in European integration. Wage inequalities and the fragmentation of the labour force do a great deal to determine the political landscape of peripheral countries. Political rent-seeking is thus not a local invention, but more the result of the world economic forces which Germany's mercantile model has transmitted to this peripheral region. Political rent-seeking is already the norm in many parts of the world, not just in CEE, Russia, or China, and we can expect this phenomenon to dominate capitalist competition in Western liberal democracies as well, including those of the EU.

Márton Varju and Mónika Papp have provided a comprehensive analysis of the European regulatory framework to which member states' national regulations must conform. These authors have highlighted Hungary's paradigm shift to economic patriotism within the European legislative environment. According to their account, the state does not simply translate supranational forces into the national sphere; this relationship is dialectical. As a supranational legislative body, the EU does not just limit national regulations; it also provides a larger platform for *patrie* formation. In this context, Varju and Papp have analysed some of the most important national legislative changes, thereby identifying the kinds of capitalist fractions which are struggling over hegemony within the EU, as well as the legislative loopholes which these groups tend to use for their own purposes in their respective national parliaments. In Hungary, trade, industry, finance, and retail are important sectors in which the reassertion of local control over the economy—that is, the formation of a new domestic *patrie*—has been spectacular.

Many questions arise from such comparative analyses of the dialectical relationship between the national and supranational levels on which new forms of *patrie* appear. For instance, how do certain regimes of economic governance form? On what level of this hierarchy of institutions does capital accumulate (at the state level, the regional, or the global level)? Which social classes face the most discrimination in their attempts to join the new global *patrie*? And what are the main differences between the experiences of core and peripheral countries?

Our aim in the second half of this volume was to go beyond a contextualisation of economic patriotism and the formation of a new *patrie* in the West. We also wanted to highlight how global forces are spreading unevenly across different parts of the world with a very diverse set of political and social consequences. The theoretical framework we have employed in these comparative analyses is based on the concept of uneven development embraced by dependency and world-systems scholars—a tradition introduced here in the chapter by Nölke and May. According to the theory of uneven development, the hierarchical nature of the international division of labour reproduces core-periphery relationships. Distinguishing between the core and the periphery is not simply a question of north and south; asymmetric social and economic relations have manifested themselves even within the evolution of Western capitalism, as illustrated by Miklós Somai's comparison of French *dirigisme* and Anglo-Saxon capitalism. Such comparisons have long been the concern of world-systems scholars like Immanuel Wallerstein (1976), who demonstrated that the French system was the product of peripherisation during the era of hegemonic competition in the eighteenth and nineteenth centuries. The *dirigiste* tradition has been dominant in France ever since then; according to Somai, despite its very different institutional background, France has formed a new *patrie* by means of various interventionist practices and corporate activities which are comparable to those of the UK and the US. As Somai has suggested, the history of the *dirigiste* type of patriotism, which in France is dominated by state regulation, might provide a model for the reconfiguration of capitalist fractions in the European context. It was our intention to analyse those forces which are driving the formation of a new *patrie* not only in the West, but also in the large emerging economies of the global south.

Tamás Szigetvári and Erszébet N. Rózsa used the framework of economic patriotism as a model for evaluating Iran's 'resistance economy'. In the Iranian economic model, political hegemony has developed in international isolation and among very dire economic conditions, including international pressure, sanctions, animosity, and threats. These sanctions, however, have done little to counteract the formation of a strong domestic capitalist class and a politically loyal oligarchy; on the contrary, as Szigetvári and Rózsa have demonstrated, they have contributed to a strengthening of the Iranian version of economic patriotism. State strategies in Iran have been aimed at strengthening the domestic capitalist classes in order to improve that country's ability to resist pressure from the West. However, what they call the resistance economy is not specific to Iran. Many countries which have been labelled pariahs by Western policy-makers and scholars have functioned under similar global conditions. Thus, economic patriotism can help create similar forms of 'resistance' to hegemonic pressures by encouraging specific, state-centred interventions. Despite their subordinated and isolated circumstances, these examples do not contradict global capitalist trends, but instead provide evidence that even the most peripheral countries are integral parts of the capitalist world-system.

In many respects, the concept of the 'resistance economy' is similar to the 'import-substitution industrialisation' (ISI) of the late 1950s and 1960s, although the idea of developing domestic industries to reduce foreign dependency was embraced by Latin American dependency scholars as early as the interwar period (Prebisch 1950; Love 1990). The ISI of the Fordist era produced a golden age for many Latin American countries (Hirschman 1968); Judit Ricz analysed Brazil's experience with such policies and compared their consequences to those of Egypt's state developmental approach to the formation of a new *patrie*. Ricz has sought to describe how the experiences of the post-developmental state have affected economic patriotism in these two large southern emerging economies. As she has argued, the driving forces behind most of the recent political and economic turmoil in Brazil and Egypt are similar to those which led to the fall of the classic developmental-state paradigm. The recent troubles in Brazil and Egypt have not been the result of coincidences, but of systemic failures, given that these difficulties originated in the very same changes in the international context which have given rise to economic patriotism. This comparison between Egypt and Brazil suggests more structural similarities than many might expect, and demonstrates how economic patriotism—including various forms of the resistance economy—has developed in response to similar structural forces over the course of capitalism's most recent transformation, despite the geographical or cultural distances between its practitioners.

All the authors in this volume would likely agree that the most recent phase of the history of capitalist development might be best described as an evolving structural crisis of neoliberalism. As Nölke and May have suggested in their chapter, this era of crises did not end in 2009; even deeper structural tensions are expected to arise. The concept of economic patriotism seems to be a useful framework for analysing both the origins of this crisis and its longer-term impact on the evolution of capitalism. Capitalist crises are nothing new, but the way in which we contextualise their systemic appearance can vary significantly. They generally manifest themselves as a shift from one type of social order to another, which impacts every participant in such systemic transformations. If we want to understand how people are affected by them and who the key players in such global social transformations are, the questions we pose in applying the concept of economic patriotism must be focused on the various levels of the system and distinguish core actors from those on the periphery.

How do these players interact within the newly forming global order, and where is this transformation headed? These are the questions our authors have posed in their attempts to establish a precise framework for their analyses. Both their questions and their possible answers can be interpreted from very different angles and thus each of these chapters frames its own contribution to our understanding of the dynamics of capitalist transformation.

This volume is a collection of studies presented at conferences on 'The Role of State in Varieties of Capitalism' (SVOC). This series of conferences was organised by the Institute of World Economics of the Centre for Economic and Regional Studies at the Hungarian Academy of Sciences and the Center for European Neighborhood Studies at Central European University in Budapest. The idea of inviting researchers—especially those from the Central European region—to discuss the role of the state in capitalist development originated with Miklós Szanyi, the director of the Institute of World Economics. Since the start of the first conference in 2015, participants have been trying to document the extent and influence of state capitalism around the globe and to explore its economic implications for various locales. This volume has intended to broaden the scope of 'comparative capitalism' within the VoC tradition and to serve as a forum for exploring the idea of economic patriotism in the present-day capitalist world-system.

The virtue of this volume is that it provides a thorough structural analysis of recent shifts in the global economy and their uneven effects on economic policy-making. This volume encompasses the experiences of both developing peripheral and advanced core countries, and frames them as part of an overall comparison, which we hope will benefit researchers, students, and policy-makers who are interested in the development of global economic governance.

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