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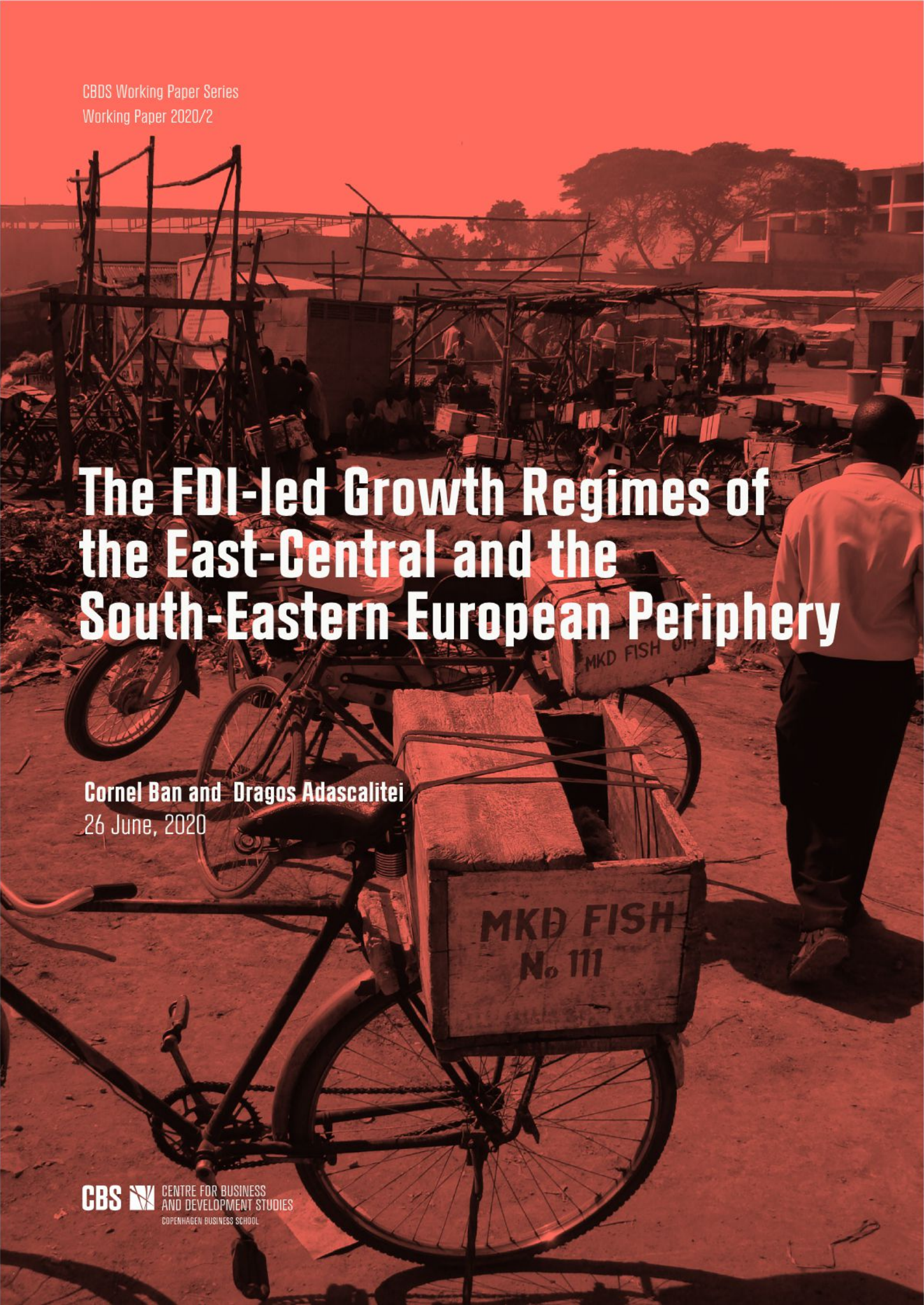

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Cornel Ban and Dragos Adascalitei

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The FDI-led Growth Models of the East-Central and South-Eastern European Periphery

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Abstract

The East-Central European countries that joined the EU in the 2000s are the unsung success of economic development. This paper discusses the consolidation of an export-led growth model in this region by drawing on an alternative school of thought to Varieties of Capitalism: growth regimes. By focusing on three distinct time periods (2000-2008, 2008-2012 and 2012-2019), it shows that despite marginal shifts towards consumption-led growth through personal debt or wage increases, the core of the region's economic model continues to be heavily dependent on exports. Combining IPE and CPE analytical frameworks, we show that the consolidation of the CEE export-led model has both systemic and national roots. Specifically, we argue that growing international competition from Asia in the beginning of 2000s has forced firms in Western economies to seek alternative sources of competitiveness that involved a mix of wage moderation at home and expansion towards the East. The internationalization of Western firms met capital hungry Eastern governments, which were all too happy to use FDI to restore the competitiveness of their outdated SOEs. Backed by a social bloc that involved domestic and foreign capital as well as workers in the tradeable sectors, the export-led growth model took off and generated growth rates well above those in core countries. The 2000s also saw an increase in debt fueled consumption, that partially compensated for the lack of wage growth in the region. The crisis provided an opportunity to put an end to hybridization and to reinforce the export-led component of growth through short-term austerity measures and deeper labor market reforms. These changes consolidated the export-led model that remained in place even amidst political reconfigurations that, at least rhetorically, aimed to fight the economic dependency of the region on FDI. After the crisis ended, however, the closing of the debt-finance consumption channel combined with the German export boom to the rest of the world and local demographic decline to put upwards pressure on wage-financed consumption increases without inflationary or external balance problems. Yet despite historically low spreads in the region's bond markets, this did not count as a full Kaleckian turn, however, with the region's contribution of consumption to GDP growth remaining far below both consumption-led growth regimes and balanced ones.

Keywords: growth models, European periphery, dependent development

1. Export-led and dependent growth in Europe's backstage workshop

In Europe's political economy the East-Central and South-Eastern European (ECSEE) occupy a distinct niche: key enablers of the cost competitiveness of West European-centric global value chains relative to their global (mostly Asian) rivals. The short version of this developmental story is as follows: proximity to West European manufacturing sites at a time of nearshoring and increasingly short just-in-time production cycles (Csevalvay 2019; Piatanesi and Arauzo-Carod 2019; Éltető 2019), combined with China and Korea's entry into formerly privileged European industrial niches to enroll the region into their production networks, local governments' pro-FDI industrial policies and state capacities (Bruszt and Vukov 2017; Medve-Balint and Scepanovic 2019), mostly deregulated labor markets, low corporate tax rates and poor corporate income tax collection (Adascalitei and Guga 2018; Ban 2018; 2020), further strengthened the region's lock on relocation plans of a considerable part of low and medium skilled operations of West European orchestrating firms (Myant 2018). In the process, the CESEE region converged on a growth regime that for all its internal variation was of a solidly export-led kind. In many ways, today most of these economies are to German manufacturing what Mexico is to US-based manufacturing. The only exception is that there is freedom of movement for labor into the markets where the firms orchestrating the global value chains that operate in the region reside.

This paper deploys both IPE (Blyth and Matthijs 2018; Blyth and Schwartz, forthcoming; Farrell and Newman 2014, 2016, 2019) and CPE perspectives (Bacarro and Pontusson 2016; forthcoming) on growth models in order to identify the specific mechanisms that power the FDI-led growth regime and to map out the possibilities for regime change following changes in some of those mechanisms. Our argument is threefold. First, the rise of Asian competition to the European export complex pressured the latter to remain price competitive in manufacturing via wage moderation at home and expansion in the near CESEE abroad, with the former outcome extracted through and/or aided by the relocation of low and medium skill industrial capacity in this region. Furthermore, with financialization, during the 1990s and 2000s American deregulatory and competitive pressure was applied on Europe's bank-based financial system (Goodheart and Schoenmaker 2016), leading the latter to extract higher yields from lending to Southern Europe

(Blyth 2013) and boost revenues from absorbing much of the CESEE financial systems and engaging in risky financial activities there (Drakos et al 2016; Temesvary and Banai 2017; Allen et al 2017).

Second, these international economic and political factors fit neatly with the CPE of the region and particularly its demand for investment and consumption. Thus, the decapitalization of many socialist era SOEs (in part via extremely hawkish monetary policy according to Gabor 2012; 2010) and the scarcity of private local capital crashed investment amidst runaway unemployment and put pressure on the budget deficit and the current account balance. In addition, the brand of neoliberal economics that structured the East European' transition had eviscerated the possibilities of a socially embedded neo-developmentalist path (Ban 2016) that could have balanced the new imperative of global competitiveness with democratic demands for protection against the vagaries of the market mechanism (Bohle and Greskovits 2012). Furthermore, since the domestic capital created by privatizations and regulatory rents was, on the whole, unable to compete internationally, starting with the late 1990s the East Europeans responded to these external dynamics by competing with each other for institutionalizing an economic growth model that relied heavily on FDI. But since this entailed, at least initially, keeping wages low amidst growing disappointment with the results of the transition to capitalism, the FDI-led growth regime replaced wage growth with credit-based consumption facilitated by the privatization of domestic banking systems with West European-owned ones, with bank ownership averaging 80 percent (Grittersova 2017). These banks relied heavily on external financing before the crisis and thanks to lower interest rates and the ease of forex lending households in the region accumulated large debts to purchase homes or consumer durables (Becker and Jäger 2010; Myant et al 2013). In this way, the growth regime was welded together by a social bloc bringing together foreign capital, the domestic capital that benefited from the former's relocation to the region, and workers (especially workers with median incomes from the tradeable sectors).

The combination of export and consumption growth oiled by FDI enabled the region to grow above Asia's already remarkable standards, arrest deindustrialization and gradually increase the value

added of its exports. However, FDI in banking proved to be more of a source of systemic vulnerabilities, from the underfunding of domestic business to acting as a transmission belt for financial shocks in the "mother" countries and, in some cases, to balancing out payments crises and spiraling public debt (Gabor 2010; Bohle and Greskovits 2012; Blyth 2013). As a result, the consumption convergence was arrested and (temporarily) reversed through austerity and structural reforms imposed by the East European version of the Troika in the bailout countries (Hungary, Romania, Latvia) and the competitive pressures that accompanied them in "non-program" countries (Piroska 2017; Toplišek 2019). As a result, as private sector wages began to fall, the CEECs became even more export-reliant, thus cementing the growth regime, except that this time around the credit crunch weakened the social bloc underpinning it in political terms. To top it off, the very openness of the regime became problematic, as it became clear that it cuts both ways: capital from core countries could move Eastwards based on promises of wage moderation but workers from the East could also move Westwards unsatisfied by the consequences of a shrinking wage share that had in turn been caused by the consolidation of the FDI-led growth regime.

The result was growing pressure to increase wages as the bailouts and the recession began to wane (Ban 2019). Indeed, once the recovery cycle kicked in in 2015-2017, governments and firms used the gaping space between slow wage growth and fast productivity growth to push up wages and consumption far above the Eurozone average. This welded back together the supporting social bloc disrupted by the Great Recession, except that this time debt-financed consumption was less important. However, rather than count as regime change, these developments are best interpreted as a mere calibration of the FDI-led growth regime. For all the "nationalist" rhetoric spreading in some CEECs, its fundamentals remain in place and are preset to prevent convergence with "core" Europe and lock in a middle-income trap instead. In short, our paper supports the claim made by Blyth and Schwartz that "unit-level variables may well be brought into play and activated by system-level mechanisms."

2. Analytical framework

2.1. Synthesizing IPE and CPE

Our analytical point of departure is located in IPE territory and is represented by an adaptation of New Interdependence Approach (NIA) to growth regime dynamics (Farrell and Newman 2014, 2016, 2019) and of Macroeconomic Regime Theory (Blyth and Matthijs 2017) at the international level.

The aim of NIA is to emphasize "a systemic account of world politics…where overlapping jurisdictions…emerge from [rule] overlap [to] create new opportunity structures for actors" (Farrell and Newman 2016: 716). In this view, globalization created a world of overlapping rules and novel jurisdictions where policy is no longer bound by the nation state, with control of key institutions at the level of the system being the key source of asymmetric power in political economy. More recently, these authors embedded this approach into a more network analytic perspective at the level of the international system which enables them to focus on its hierarchical nature and specifically on critical nodes of private and public power in the global network-architecture of regulation and access to the financial and informational flows constituting the system. The more central one is in such networks, the higher the returns one receives from the system, something akin to "weaponized interdependence" (Farrell and Newman 2019). In other words, when we dig out the mechanisms of the prevailing growth model in the CEECs, this approach focuses our analytical attention onto the differential rates of return (rates versus dregs) that specific actors get from the deployment of the structural privileges attached to network centrality.

Ideas such as differential gains from globalization or that the fortunes of regions and countries are shaped by wider international relations of control and (inter)dependence should not be seen as the exclusive province of NIA. For almost twenty years, the rich political economy literature on Global Value Chains (GVCs) and Global Production Networks (GPNs) made the case that in open economies the dynamics of manufacturing and tradeable service firms or wages depends on the integration of domestic firms (be it domestically owned or not) into GVCs and the extent to which

the leading firms in the chains/networks extract concessions/rents (Gibbon et al 2008; ; Hamilton and Gereffi 2009). The main implication of the focus on GVCs and GPNs and how they change over time is that local resource endowments, human capital, institutions, geography and economic policy paradigm are no longer the main factors of development.

What distinguishes the NIA approach is that it nudges scholars to identify the state(s) that benefit the most as a result of the GVC/GPN organization and therefore trace not just the economics of its leading firms, but also the international political power of the state in question. Indeed, even the more Polanyian GPN perspective, which takes the political, institutional and territorial determinants of the embeddedness of global production networks seriously (Bair 2005; Coe et al 2008) tends to recoil from focusing on who the ultimate beneficiary states are. Closer to home, the East European growth model is heavily dependent on global value chains organized around West European orchestrating firms, most of them belonging to the German manufacturing complex. Thanks to the capacity of its firms to specialize in activities with ever higher barriers to entry, Germany extracted prime rents from this regime. Moreover, scholarship on the European crisis management disagrees on a lot but not on the fact that Germany is a key player in European economic governance (Matthijs and Blyth 2015; Schelkle 2017; Schoeller 2018). Given this consensus and the fact that Germany is the main direct investor in the region, the crisis management regime cannot be divorced from the interests of German firms enjoying structural power in the European export complex.

Going "down" at the unit level, these external constraints can be modulated by domestic factors. The Bacarro and Pontusson's (2016) supply side and macroeconomically-centric analytical framework identifies the space for multiple growth models based on the relative importance of different components of aggregate demand (such as exports and household consumption) and relations among components of aggregate demand. Their emphasis on exports and external competitiveness builds on the CPE literature of the 80s and 90s but adds a critical Kaleckian layer to it by unearthing the forgotten importance of distributive struggles. By looking at four EU 15 economies (Sweden, Germany, UK and Italy) during the 1990s and 2000s, they found that the

engine of their Fordist model of wage-led growth stalled, with productivity growth no longer feeding into household consumption and investment due to the erosion of strong collective bargaining institutions. As a result, they sought post-Fordist growth regimes to replace the faltering wage-led growth: wage and household debt increases in the UK, export-led growth in Germany based on price elastic goods and a combination of exports of price inelastic goods and consumption growth in Sweden. In contrast, Italy's stagnation is traced to the sluggish growth of both these domains. Each of these post-Fordist growth regimes have distinct drivers. Sweden's balanced growth model was powered by this country's capacity to power through knowledge-intensive, high-value-added exports of goods and services. In contrast, Germany's adjustment was one based on the expansion of low-wage employment in private services. In contrast, consumption-led growth in the United Kingdom and Sweden was powered by labor-market conditions favorable to unskilled (service-sector) workers.

Taken to Eastern Europe's internal economic diversity captured by the existing scholarship (Bohle and Greskovits 2012; Ban 2018), these insights would lead us to expect some variation in how the FDI-led growth regime is domestically articulated based on the structural endowments of these economies: stronger attempts to balance consumption and exports in populous countries with large domestic markets (Poland, Romania), strict emphasis on manufacturing exports in small open economies with a manufacturing tradition/strategy (Czechia, Slovakia, Slovenia, Hungary) and strict emphasis on service exports in small open economies without a manufacturing tradition/strategy (the Baltics, Croatia). However, we do not hold a mechanistic view of how these structural constraints operate and/or path-dependently shape the life of the regime. Instead, as the next section shows, we propose a theory of regime change and stability based on a dynamic view of the economics and politics that regulate it.

2.2. Explaining change and stability

The approaches synthesized above are both pessimistic about the likelihood of regime change while undertheorizing regime calibrations. To explain regime change, Macroeconomic Regime (MRT) Theory focuses on prices shocks. For Blyth and Matthijs (2017), the key driver of the Gestalt

flip from Fordist wage-led regimes – where the policy target was full-employment – to specialized profit-led regimes – where price-stability became the key policy target and the restoration of profits became the key concern of elites – was a Kaleckian stand-off between investors and workers over the effects of inflation on profits and on future investment at the level of the system as a whole. Specifically, the tight coupling of the wage-led regime demanded global compromises securing a stable supply of raw materials, particularly oil at predictable prices. Or, this stability was disrupted by the spread of Fordism, which in turn applied a shock in the "home" of Fordism's tightly coupled production systems. Otherwise put, a growth model changes when its growth driver becomes so internally entrained and externally shocked that it can no longer fine tune its endogenous socio-economic contradictions.

We pursue this hypothesis in the case of the FDI-led growth regime by focusing on the shock of the 2008 crisis and the entrained labor market of the transnationalized manufacturing export sector. Building on research done in economic geography, we expect that this entrainment was represented by the tendency of massive FDI inflows in labor intensive manufacturing of the kind we see in CESEE to deplete the labor surplus, push up wages, decrease the rate of profit and eventually compel firms to look for new spatial fixes to address their search for excess profit opportunities (Freyssenet and Lung 2000; Silver 2003; Pavlinek 2019). Indeed, while the conventional growth regime approach presumes demographic stability, the supply shock represented by the fact that the ECSEE periphery mass emigration reduced between a fifth and a tenth of the workforce (most likely on a permanent basis) is highly consequential from the point of view of the need to calibrate growth regime theory (Atoyan et al 2016). To more directly translate this into the ECSEE context, we suggest that the tight coupling of the region's FDI-led growth model entailed the need for stable prices, stable access to low and medium skilled labor and a stable income policy in which wages grew below or at least in sync with productivity.

3. Forging the FDI-led growth models of ECSEE: The helicopter view

During the 1990s and 2000s the rising Asian competition incentivized German firms to organize production fragmentation and relocate low and middle skill production Eastwards to defend its

competitiveness. This process had a world historical importance for economic development in the ECSEE region. Theory tells that growth in low and middle-income countries is driven either by finance (tax and regulatory havens like Singapore or Latvia) or manufacturing (like China, Mexico and Korea, most of the NMS do the latter). In development economics, Dani Rodrik (2016) found that manufacturing decline in low and middle-income countries is a structural change that has ended up being growth-reducing in these countries. Avoiding premature deindustrialization is important also because as manufacturing shrinks, informality grows and, as a result of the labor force moving into services, the economy-wide productivity figures and, with them, the chances of claims to higher wages being met are set to suffer.

Seen from the helicopter, the ECSEE countries are a resounding success as exporters. When combined with geography and the growing importance of just in time production within European supply chains, this growth model placed the region on a path that avoided the common deindustrialization pathway of other emerging market economies that did not benefit from the unique geopolitical and institutional advantages of East Asia. As Figure 1 shows, by the 2000s, manufacturing value added in GDP stabilized close or above German levels (with the notable exception of the Baltics, where manufacturing petered out in GDP in the same fashion it did in Ukraine or Brazil). The contrast with the traditional US "hinterland" (Latin America) and the fate of manufacturing in former communist countries outside the EU could not be more obvious and underscores the importance of the region's proximity to core European capitalism. Virtually every European Semester and IMF Article IV report indicates that exports of manufactures have been the main drivers of growth for the East-Central European region. This cross regional comparison also begs for the insertion of the NMS in Rodrik's finding that "the sizable shift in global manufacturing activity in recent decades towards East Asia, and China in particular, with both Latin America and sub-Saharan Africa among the developing regions as the losers" (Rodrik 2016: 16).

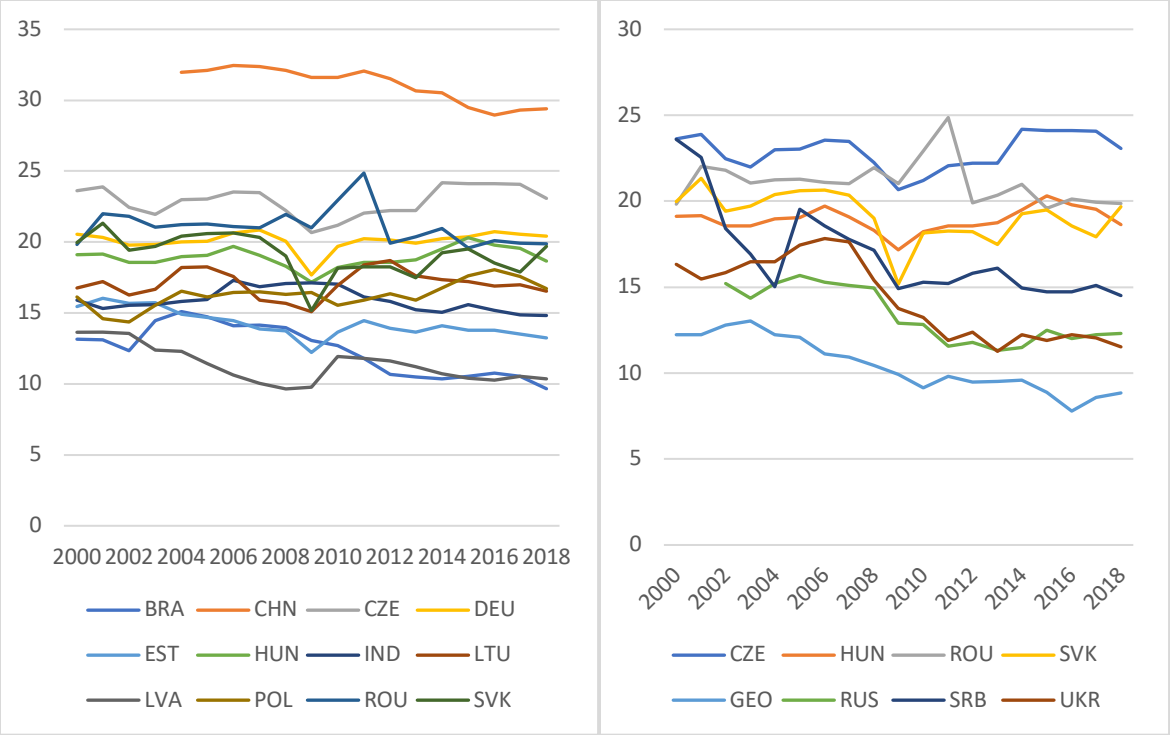

Figure 1. Manufacturing value added as a percentage of GDP (Source: AMECO database)

Critically, this seems to be the case almost everywhere in the region. As Figure 2 shows, reliance on exports is particularly dramatic not only in the region's small open economies (whose export reliance is exceeded in the EU only by Ireland), but also in Poland and Romania, where exports are roughly as big as a share of GDP as Germany's. While in the early 1990s only former Czechoslovakia and Hungary could boast a share of exports in GDP close to Germany, thirty years later they were joined by Poland, Slovenia and Bulgaria in increasing the share of exports in GDP above German levels, in some cases nearly doubling it. By comparison, Katzenstein's OECD small states in world markets seem either mediocre (Austria) or barely defending their laurels (Sweden). Indeed, the small open economies of Slovakia, Hungary, Estonia, Lithuania, Slovenia and the Czech Republic grew to have over 80 percent of GDP from exports (up from less than half in the early 1990s).

Also, while Romania and Poland had a similar share of exports in GDP with Southern Europe in the 1990s, around 2001 Poland broke off to become more export-reliant than Germany today. Around 2002 Romania followed the same path, growing to have a share of exports in GDP that was close to Sweden by and, since the mid 2000s, far outstripping those of Southern Europe and the UK. The

finding challenges the intuitive conjecture that given their large domestic markets, Poland and Romania should be closer to the Southern European/UK consumption-led model rather than to Germany's export-led one. Furthermore, it may point at one of the reasons why manufacturing-based exports in Southern Europe contracted. Also, the shrinking of FDI inflows after 2008 and the plugging of the gaps with EU funds to the tune of three to five percent of GDP (Bohle 2017) was associated with robust export growth, with plateauing effects recorded only as of late.

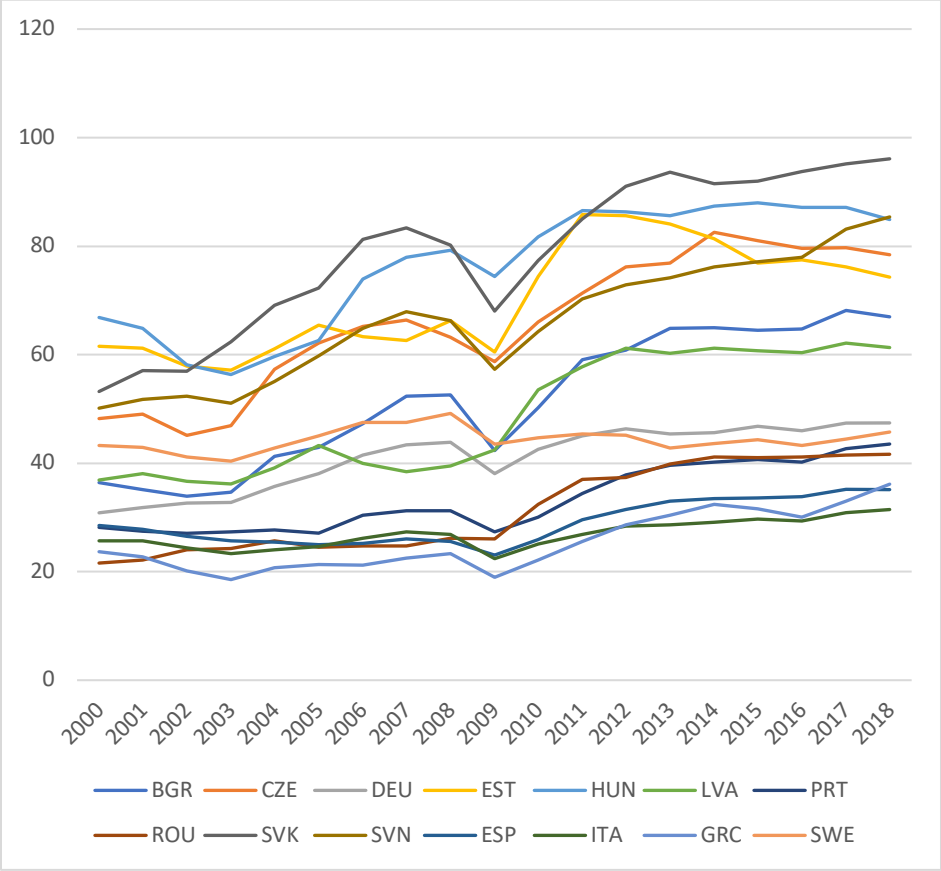

Figure 2. Exports of goods and services as a share of GDP (Source: authors' calculation based on World Bank WDI database)

To make this more concrete, take the example of the geographic restructuring of the European automotive industry (the main export of most CEECs) between 2005 and 2016, a period when average personnel costs per employee were five to eight times higher in Germany than in the CESEE, while wage-adjusted labor productivity was between 40 and 60 percent higher in the CESEE region than in Germany (Eurostat 2019). Combined with 50-70 percent higher tax rates in

Germany, decentralized labor relations, EU-funded infrastructure improvements and a pro-FDI institutional environment, CESEE played a critical role in addressing the declining profitability of Germany's or France's automotive sector (Pavlinek 2019; Adascalitei and Guga 2008).

The 2009-2012 crisis with the attending austerity period contracted European demand and increased surge of demand from extra-EU markets, where exports increased from 23 percent in 1999 to 37 percent in 2015, with finished cars as the main source of German (and generally European) exports. Germany accounts for 42 percent of regional sector production and this relocation made CESEE have automotive-dominated export structures despite not being home to any headquarters. As a result of this shift, imports from outside the EU have been cut to a negligible weight.

In this regard Germany's dominant status is clear and keeping in line with the new economic interdependence hypothesis. In CESEE and Europe as a whole, Germany is the only country with dominant trade relations in the regional automotive network in the sense that it engages in trade with a majority of the member states. Even though France increased its relations of dominance, it does not come close to Germany's position. Since the crisis, both Spain and Italy, the only other countries with their own major auto groups continued to shed relations with two dozen countries. Despite the emergence of CEECs as producer countries since the crisis (their exports of such goods increased between 50 percent in the case of Slovakia and 80 percent in the case of the Czech Republic), Germany remains unchallenged as the top supplier of finished goods. Yet without CESEE the German export performance since the crisis would be harder to imagine: the increase of high value-added finished cars was achieved by increasing imports of parts and components of CESEE origin (Gracia and Paz 2017).

The spatial relocation of Western complex manufacturing towards the East is also evident when analyzing how the region has integrated into automotive GVCs. Figures 3-6 below show that the region has become gradually more integrated into automotive GVCs, with participation peaking in the aftermath of the crisis. Interestingly, integration was cemented through the development of

backward linkages which measure the importance of foreign value added in the export of domestic goods. In other words, not only that the 2000s saw the emergence of ECSEE as the West's backyard workshop that gradually overtook Southern Europe in this regard, but also its establishment as a vital source of demand for Western intermediary goods.

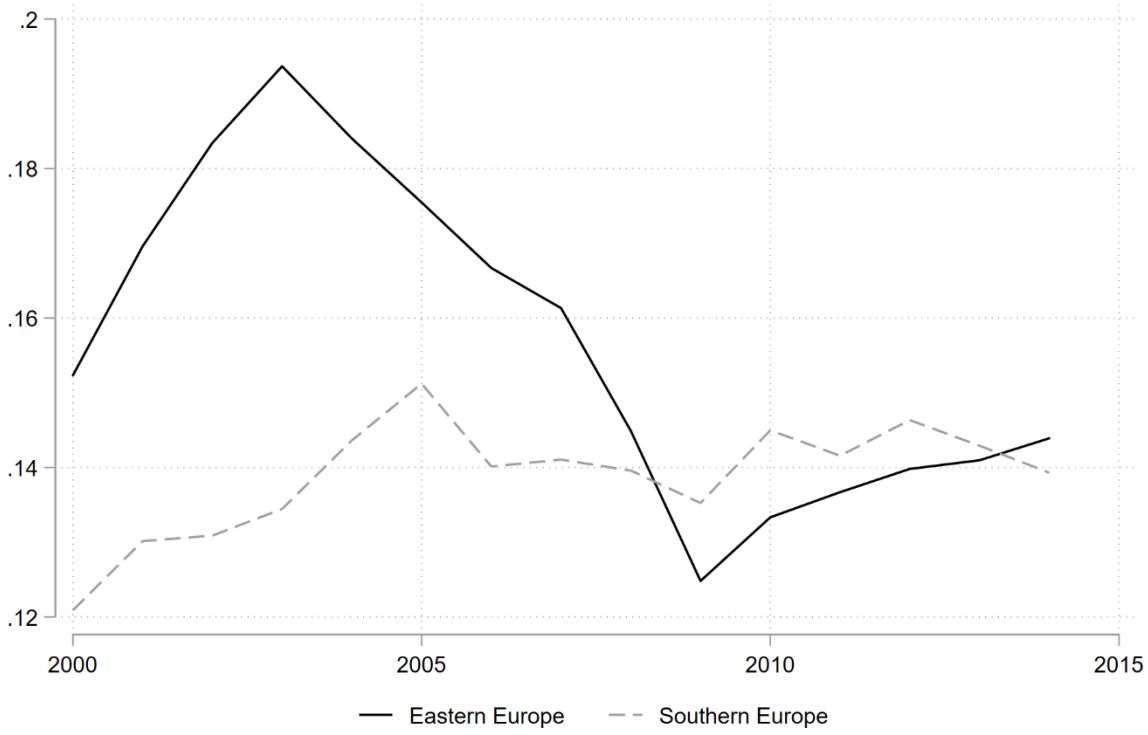

Figure 3. Participation in automotive manufacturing GVCs by region (Source: WIOD dataset)

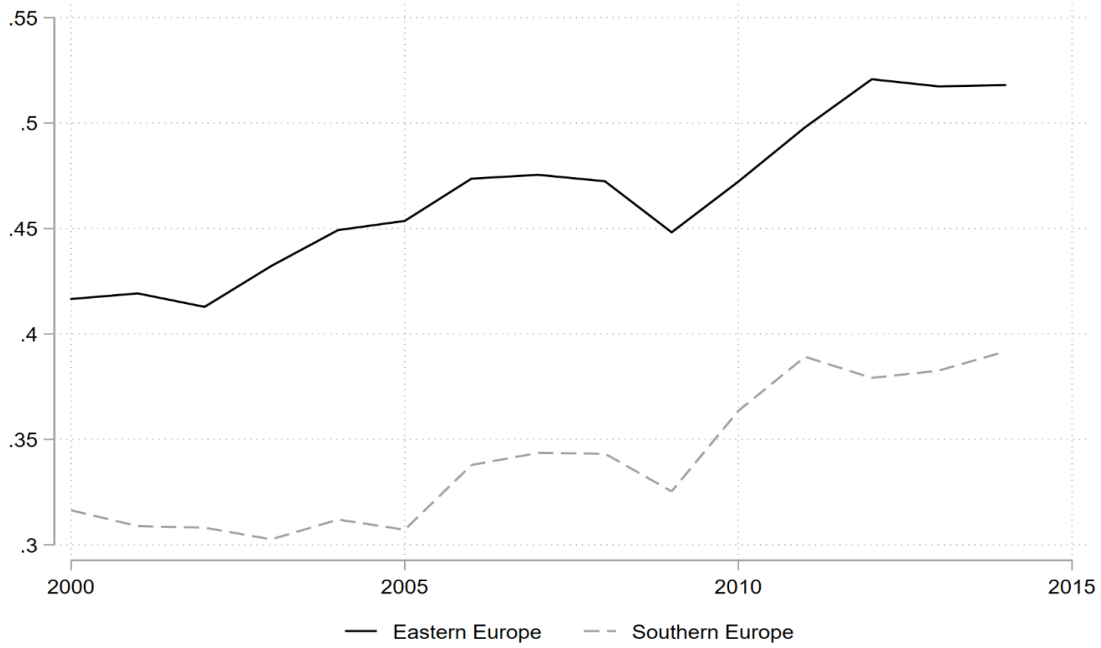

Figure 4. Forward linkages in automotive manufacturing by region (Source: WIOD dataset)

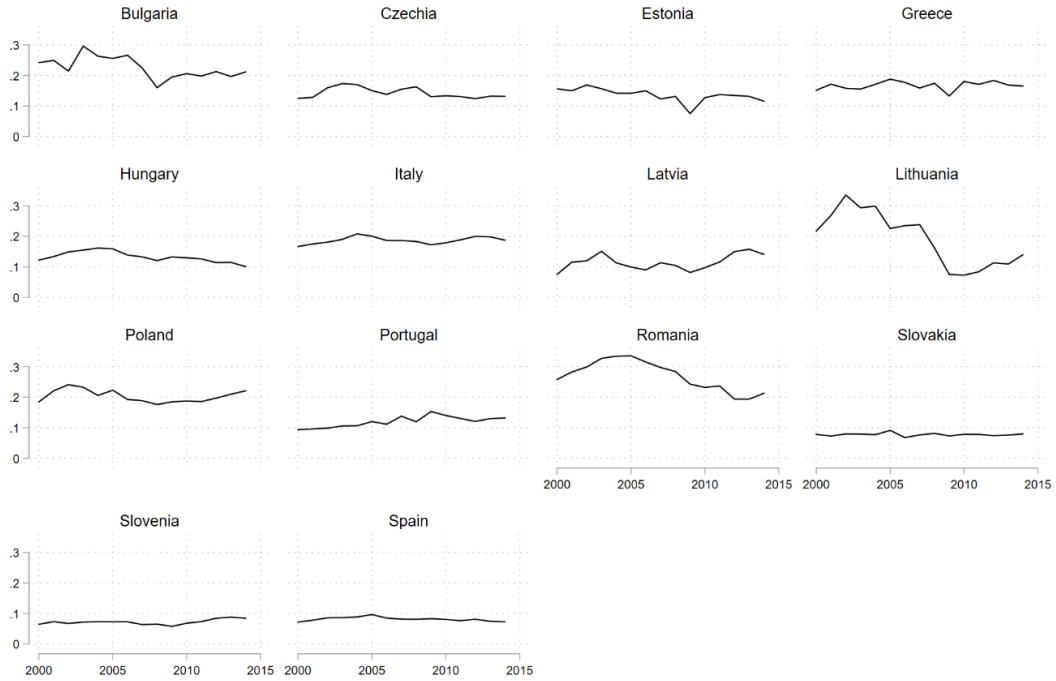

Figure 5. Backward linkages in automotive manufacturing by region (Source: WIOD dataset)

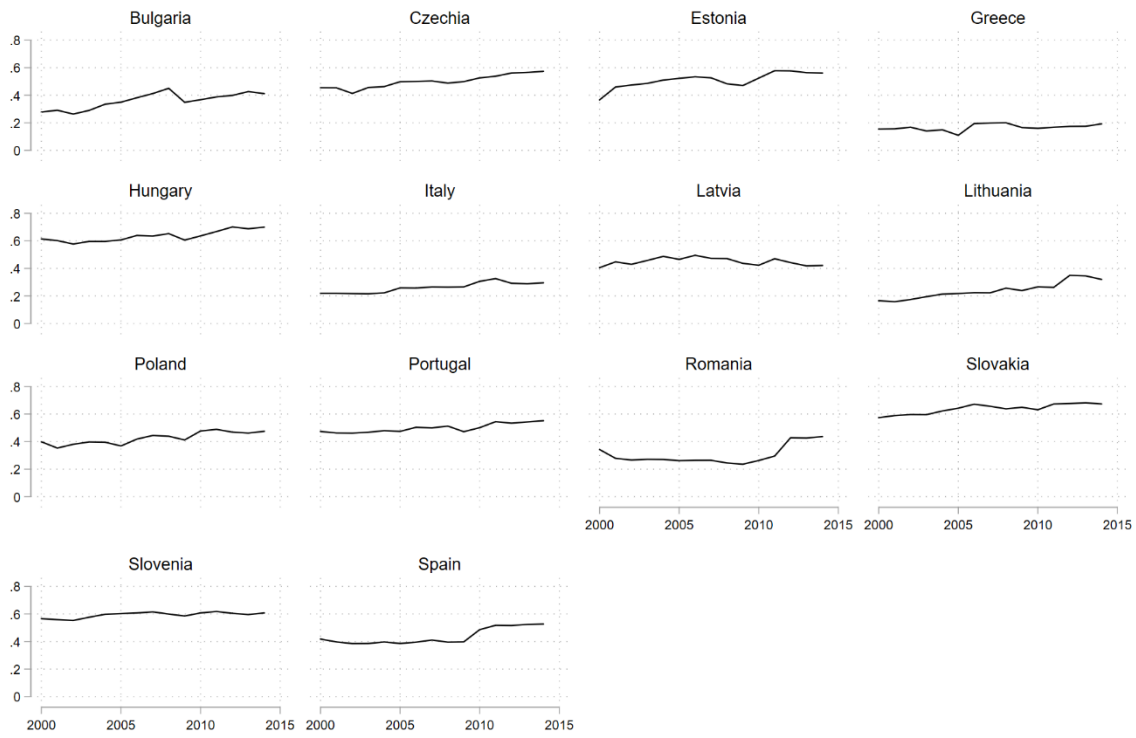

Figure 6. Forward linkages in automotive manufacturing by country (Source: WIOD dataset)

All this did not come with the contraction of consumption. As Table 1 shows, on an annual basis the ECSEE countries had both exports and consumption figures above the EU average, with only two countries (Bulgaria and Estonia) having higher rates of consumption than of exports and Romania and Lithuania recording double the EU average for both exports and consumption growth.

	GDP	Export	Household Consumption
European Union	1.6	4.6	2.5
Bulgaria	3.7	5.9	7.8
Czechia	2.9	8.4	6.4
Estonia	4.0	6.4	8.0
Latvia	3,9	7.3	7.7
Lithuania	4.1	10.0	8.3
Hungary	2.4	8.6	*5.3*
Poland	3.7	8.3	6.2
Portugal	0.7	4.6	2.9
Romania	4.0	9.5	**9.7**
Slovenia	2.4	6	*3.5*
Slovakia	3.9	9.1	8.6
Turkey	5.2	6.4	**9.1**
Serbia	3.3	12.7	5.2

Table 1. GDP, exports and consumption growth rates: 2000-2018 (Source: Eurostat)

As instructive as they can be, helicopter views can be rather misleading for field maps. This is what the growth regime approach in CPE is for and particularly the analytical attention on the ratio of export growth to consumption growth. It is to this aspect that the paper turns to next.

4. Bacaro and Pontusson Go East

Based on the foundational text of the growth regimes literature (Bacarro and Pontusson 2016), we report the annual growth rate of net exports (exports minus imports) and household consumption, weighting each by its contribution to GDP (rather than the cruder measure of share of GDP). This provides a rough measure of the relative importance of net exports and consumption as drivers of growth. The significance of sector-specific growth rates for the economy as a whole depends on the relative size of the sector in question, the ways in which consumption was financed and the extent of external constraints.

The picture that emerges is that the driving factor of growth in the region are exports. Irrespective of the economic cycle, the CEEC's export share in GDP ranges between Germany in Sweden but without ever coming close to Sweden's (let alone the UK's) consumption share. Indeed, none of

these countries, not even the ones with large populations and internal markets (Romania and Poland) come close to being considered consumption-led models. Clearly, their insertion into the Great European Export Complex was unaccompanied by the possibility of extensive and permanent social compensation to labor.

Specifically, during debt-financed consumption (2000-2008) all the ECSEE states did much better than the EU average in terms of both export and consumption increases' contribution to output growth. However, as Figure 7 shows, while some of them were almost exclusively export reliant, others emphasized consumption a bit more. Thus, the Czech, Slovak, Slovenian, Baltic and Hungarian economies were considerably more export-oriented than the more populous countries (0.4 percent a year Romania, Poland), with Hungary and Slovakia's contribution of net exports to GDP close to average Swedish and German yearly levels for the 2004-2007 period recorded by Bacarro and Pontusson (around one percent a year). Slovakia and Hungary were the absolute outliers in terms of the export-led growth, while Romania was the outlier in terms of consumption. Although Romania slightly outdid Poland in terms of exports' contribution to growth, its consumption's contribution to growth was three times as large as Poland's. Indeed, the only countries with a solid balance between consumption and exports were Estonia (a medium and high-end service economy) and Latvia (a financial entrepot).

Yet if we do a back-to-back comparison with Bacarro and Pontusson's cases, even in the more consumption oriented CEECs, the yearly contribution of net exports to GDP growth was far above the "classical" cases of consumption-led growth (UK and Italy). Poland and Romania's 0.4 percent yearly contribution of exports to GDP growth is higher than Italy's best cycles (0.05 and 0.19 respectively) and is far superior to the UK's negative figures, while Czechia, Slovakia and the Baltics average Swedish export performance. Similarly, yearly contribution of consumption to GDP growth met Italian consumption-oriented levels (0.65%) only in the countries pushing the hardest on the consumption pedal (Romania, Lithuania and Bulgaria) while all the others, including Poland, was close to the German average threshold (0.26%). For all the private debt spike, in none of them did the contribution of consumption to annual GDP growth rise to Swedish (1.44 %) or UK (1.67%)

levels. In short, during the 2000-2008 growth years, the CEECs as a whole ranged between Sweden and Germany in terms of their export-consumption relations.

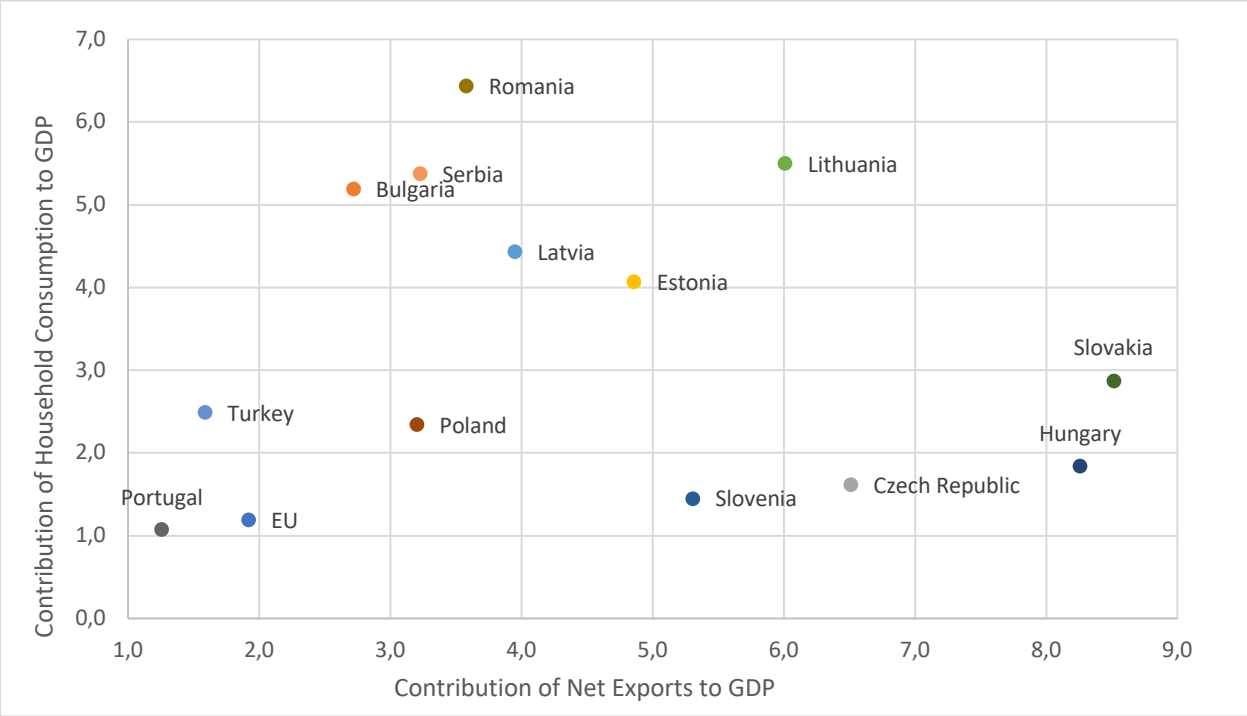

Figure 7. Export-led versus consumption-led growth: 2000-2008.

The dependent status of these economies (Nolke and Vliegenthart 2009) came to the fore during the Great Recession (2008-2012), when definancialization (Gabor 2010) narrowed the possibilities of debt-financed household consumption (Ban and Bohle 2019) and deepened export orientation at the expense of consumption. Overall, the effect was growth of net exports in GDP growth at or above the German pre-2008 levels reported by Bacarro and Pontusson and a contraction of the consumption share below all historical precedents for all recession-hit ECSEE countries.

Indeed, as Figure 8 shows, all ECSEE countries but Poland (who had not gone through a recession) experienced a contraction in the share of consumption in GDP growth below average EU levels. As one would expect, the fall was particularly sharp in the countries under Troika conditionality (Romania, Hungary, Latvia) or close to this average for the rest, (with Estonia and Lithuania voluntarily shading the policies of Latvia, their Baltic neighbor). Even so, yearly growth in Polish consumption during this period was close to the pre-2008 German recession average (0.6%) and

far from Sweden's balanced one (1.46). For all ECSEE countries the number was negative, an unprecedented occurrence in all of Bacarro and Pontusson's cases before 2008. As far as exports are concerned, while in consumption-oriented UK and Italy exports had negative growth as a share of GDP growth, in all ECSEE countries exports the growth rate was positive, ranging from more than double German recession levels in Slovakia and the Czech Republic (around 1.6%) to recession-time Germany ones in Poland and Romania (around 0.6 percent).

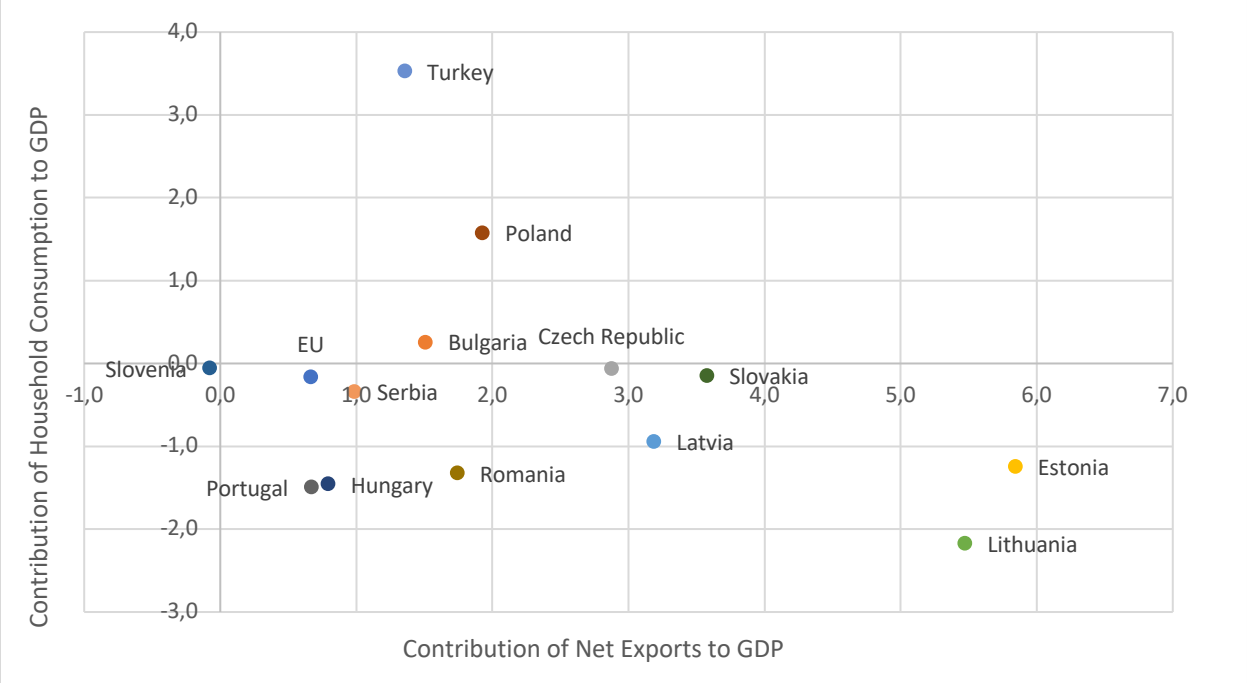

Figure 8. Export-led versus consumption-led growth: 2009-2012

As hypothesized, the FDI-led growth model felt a tweak after both the recession and policy conditionality came to an end because the entrainment of tight labor markets, the demands of the German export boom and the low growth of credit eventually put upwards pressure on wages. As Figure 10 shows, the overall export orientation endogenous to the model deepened: during the recovery cycle (2013-2017), the per annum contribution of exports to GDP growth shot up further still, with above one percent a year growth for almost all countries in the region. Hungary, Slovakia and Slovenia exceeded the pre-2008 German recovery benchmark, with the "laggards" Estonia and Latvia hovering around the typical pre-2008 Swedish average. The tweak was that

consumption recovered strongly in all ECSEE countries, with the strongest growth noted in Romania, Poland, the Baltics and Bulgaria.

Again, when compared to the classical cases from Western Europe, consumption growth did not disrupt the overall balance of the export-led model, as its contribution to GDP growth ranged between pre-2008 Italian recovery levels (in Romania, Poland, Bulgaria and the Baltics) to German ones (in Slovakia, Hungary, Czechia, Slovenia). To sum up, the export share in GDP growth ranged between Germany and Sweden while the consumption share ranged between the low German and Italian levels. Indeed, the figure shows that even at the best of times, not a single ECSEE country had come close to the full-fledged UK consumption-oriented regime or Sweden's balanced one.

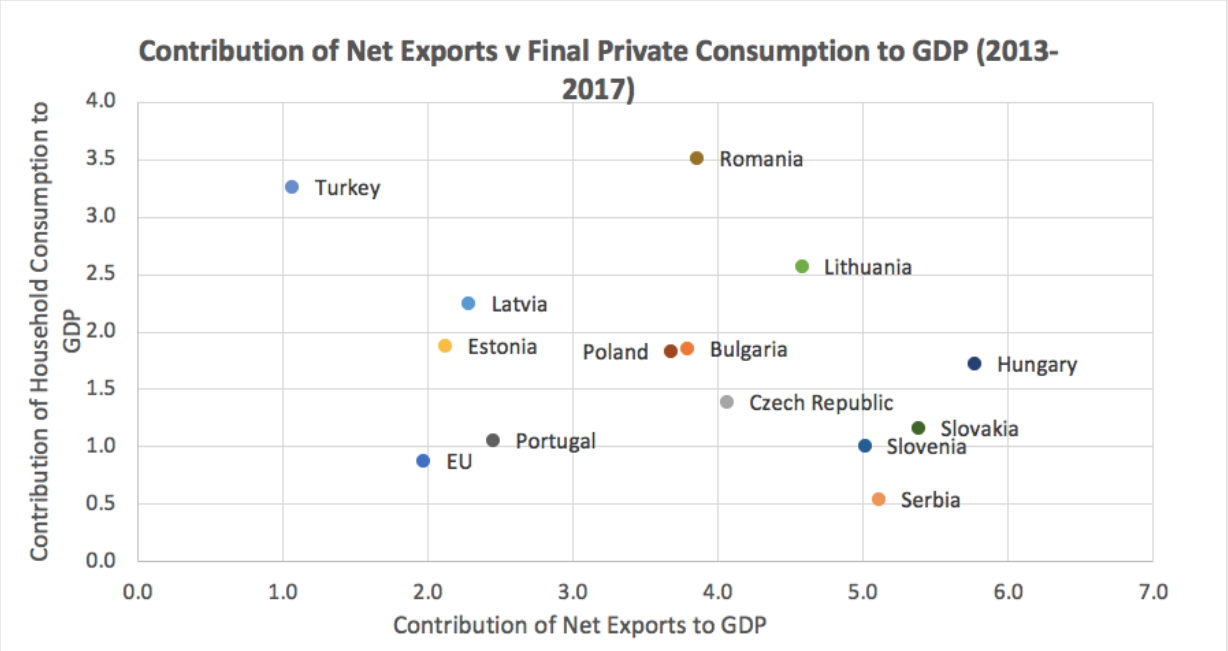

Figure 9. Export-led versus consumption-led growth: 2009-2012

5. Competing on low-to-medium quality?

While FDI was indeed channeled into low and medium skill sectors, at least initially, the conversion of the CEECs as a critical pillar of the European Export Complex could not have been obtained with simple sweatshop tasks and sheer work intensity. The Czech Republic, Hungary and Slovenia are

in the top 20 most complex exporters, ahead of the US, Italy, UK and France (see Figure 10). Romanian and Polish exports are in the same league of complexity as Denmark and the Netherlands. Indeed, China's exports are less complex than most CEEC exports except for Romania whose export complexity profile has grown since 2012 to almost match that of China. This is a drastic change from the early 1990s, when only former Czechoslovakia and Hungary were in the top.[i] Of course, these complex exports are almost entirely produced within FDI-based corporate infrastructures, yet with the exception of Korea and China, the rest of Asia is extremely dependent on FDI as well. As always, the proof is in the pudding of the least complex exporters. Take the case of Romania, a country whose export profile was closer to the Maghreb in 1999 and who, thirty years later, is close to that of Visegrad and the Netherlands. This makes the ECSEE region a kind of unsung developmental success.

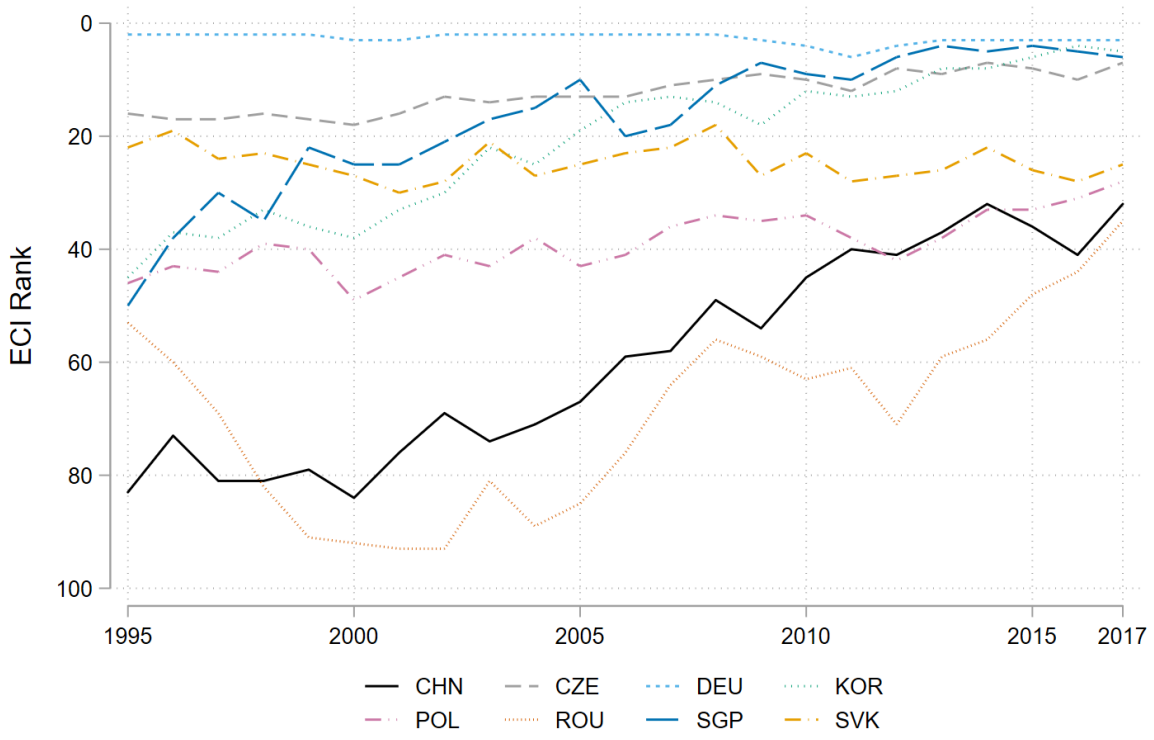

Figure 10. Country complexity rankings between 1995 and 2017 (Source: MIT Economic Atlas)

While "premature deindustrialization" definitively ravaged Latin America and some of the more industrialized parts of the former USSR (Rodrik 2016), it did not affect most of the ECSEE as much.

On average, the dramatic deindustrialisation of the 1990s was arrested (albeit not reversed to 1989 levels) only where one became a dependent market economy (Nokle and Vliegenthart 2009). Thirty years after 1989, the combination between (largely European) industrial investment and the region reclaimed its comparative advantages in medium-skilled segments of manufacturing industries and some high-end services such as ITC and medical. Moreover, when it comes to automotive, the main export of many CEECs, their increasing share in the industry came at the expense of the Southern periphery and more traditional industrial centers such as Belgium and the UK (Gracia and Paz 2017).

Regarding the price elasticity in exports, our estimations in Figure 11 confirm the findings of Bacarro and Pontusson (2016) who show that the German exports have increasingly become price sensitive. Beyond this, they are quite surprising given the consensus in the literature that CEECs specialize in lower value-added niches. Indeed, only two countries (Slovenia and Slovakia) confirm to the hypothesis of price sensitivity in exports, with the size of their coefficients comparable to the German level. The exports of the rest of the countries in the region are *not* price sensitive. This may suggest that other factors (e.g. institutional environment, regulatory quality) account for the price competitiveness of East European exports (Bierut and Kuziemska-Pawlak 2017, Szymczak *et al.* 2019, Kalanta 2019).

Our results should be interpreted with caution as they do not say anything about how exports in different sectors react to exchange rate appreciation. Therefore, the lack of sensitivity of exports to changes in real effective exchange rate (REER) might stem from a disaggregation bias as some goods are more price sensitive than others (Égert and Morales-Zumaquero, 2008). Specifically, firms exporting differentiated goods (ex: complex goods, pharmaceuticals etc.) are more capable to offset costs associated with exchange rate fluctuations by setting prices in their own currency. Furthermore, and central to the CEECs export model, imported intermediary goods can offset the effect of REER appreciation by decreasing production costs. As Figure 5 shows, this is certainly the case with CEECs where the import of intermediary goods from Western markets is a core feature of the export-led growth regime.

The main implication that this finding can have for future research in the comparative growth regime literature is that the price insensitivity of most CEECs exports enabled workers in their tradeable sectors to extract concessions on wages despite low levels of unionization and deregulated labor markets. As the case of Romania's largest exporter (Dacia Renault) suggests (Adascalitei and Guga 2018), given this export profile firm-level unions in the most vulnerable parts of the periphery may project greater leverage than the more general literature in Varieties of Capitalism would lead one to expect. To paraphrase Blyth and Schwartz, it may be that unit-level variables (firm-level labor union activism in large GPN nodes) may well be brought into play and activated by system-level mechanisms (the growth of price insensitive exports).

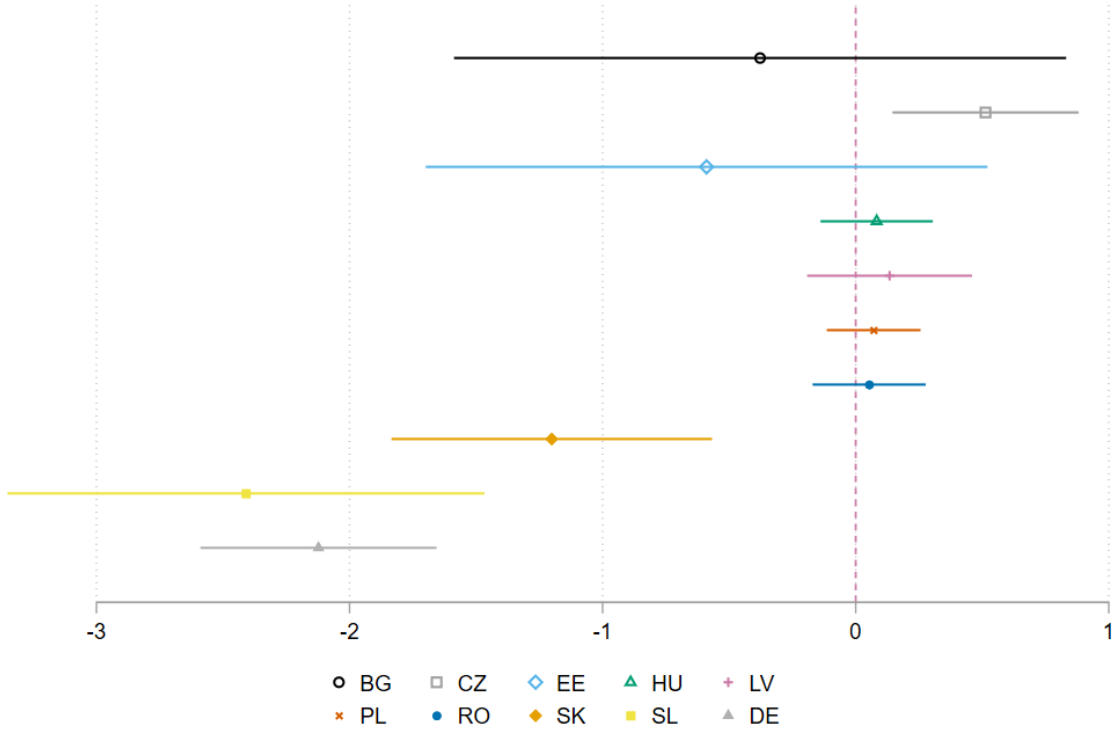

Figure 11. Price elasticity of exports (to changes in REER, quarterly data)

6. A Kaleckian editing of export orientation

As we showed in a previous section, the recovery cycle that kicked in after 2012 was driven by a more balanced mix of exports and domestic consumption, with the latter driven mainly by wage increases into the double digits in most countries (Krajewska and Kapela 2018). Our hypothesis was that the tight coupling of the region's FDI-led growth model entailed stable access to medium-to-highly skilled labor and a stable income policy in which wages grew below or at least in sync with productivity. If instability would characterize these as a result of some shock, then the growth regime would be destabilized.

The evidence suggests that both were somewhat destabilized after 2008. Aging combined with the migration of between ten and twenty percent of the labor force to Western European labor markets to beget a labor supply contraction that destabilized the strong emphasis on the export-led drive (see Figure 12). Firm level surveys indicate that labor shortages in the region are rife and that they are amongst the main factors that limit industrial production (European Commission, 2015). To use the language of Blyth and Schwartz, the "social resource squeeze" and the uneven distribution of material resources across the domestic-international capital frontiers destabilized the profit and export-led vector pushed from the systemic level.

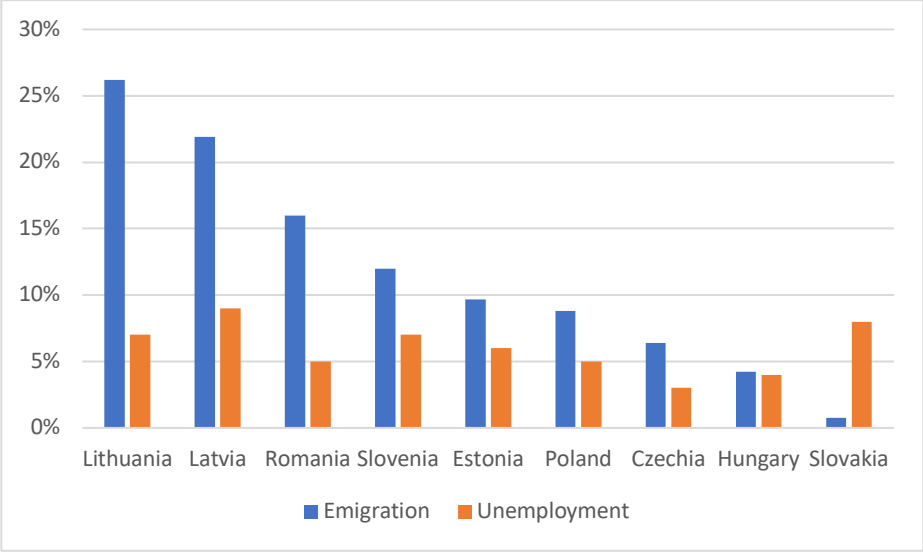

Figure 12. Total Emigration as a Percentage of Working Age Population (2007-2017) and Unemployment Rate in 2017 (Source: Eurostat)

This "social resource squeeze" highlighted and politicized the limits of continuous wage moderation in the region, with both liberal and populist politicians jumping on the bandwagon. This was not surprising: the ECSEE states' wages were clearly undervalued (their actual wages are below the equilibrium wage), regardless of whether they were inside or outside the Euro Area. According to Collignon (2016) "the major dividing line is not between North and South, but between new and old member states in the European Union" with the new member states having a growth regime that systematically undervalued their labor between 1999 and 2015. This left the ECSEE countries with considerable space wage-led activism and all of them used it, leading to the growth of the wage share in GDP (Figure 13). Indeed, with the notable exception of "populist" Hungary, conservative Croatia and, intriguingly, social-democratic Slovenia, where real wages largely stagnated, ECSEE states had real wage increases between 200 and 400 percent higher than the EU average, placing them at the opposite spectrum of the real wage contraction experienced by the Southern member states of the Eurozone. Eurozone membership seems to have had no clear effect, however, with Estonia and Latvia seeing double digit real wage increases and Slovenia experiencing growth around the EU average.

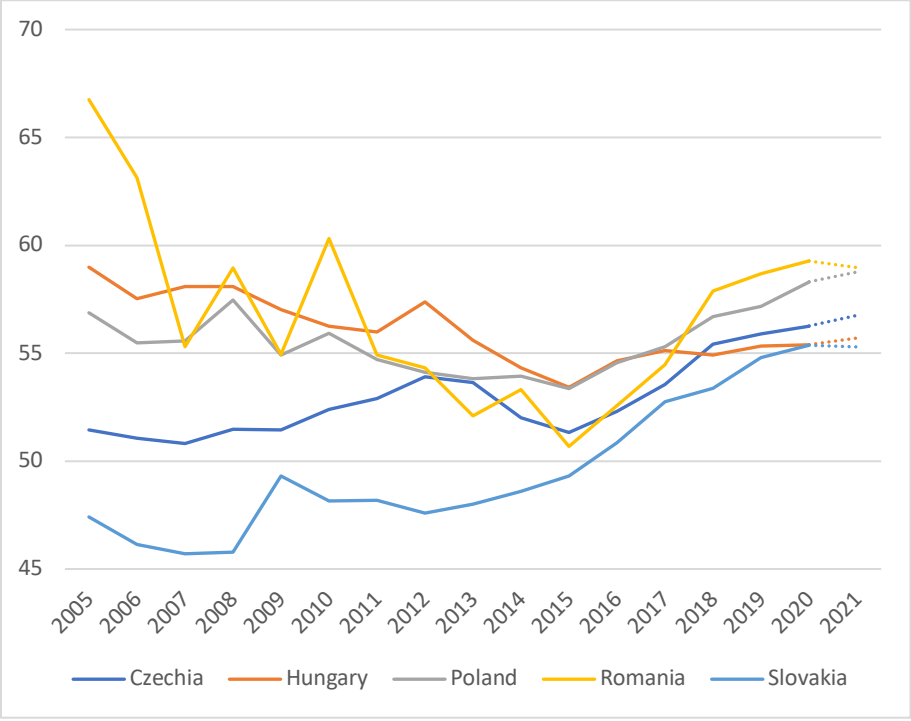

Figure 13. Adjusted Wage Share as percentage of GDP (at factor cost per person employed): 2005 -2021 (Source: AMECO)

Specifically, the wage share grew by almost two percentage points between 2015 and 2017 in the Visegrád countries, with Romania following suit. For example, in Hungary it was only after 2016 that wages began to grow markedly, driven by public sector wages, with a dedicated wage-led policy kicking into place in 2017 as a result of the November 2016 quasi-corporatist Consultative Forum of the Business Sector and the Government (VKF) agreeing on a long-term wage policy: for labor the deal was that real wages would be increased through the channel of the obligatory minimum wage, personal income tax cuts and family tax allowances; for capital, there would be a cut in the social contribution tax they owed. Furthermore, the government spent nearly one percent of GDP on public work programs that made the labor market tighter. To pay for such expenses, sectoral surtaxes levied on equity holders raised between one and two percent of GDP, with the financial transaction duty becoming the most significant source of revenue. The reduction in revenues from personal income taxes roughly matched the size of the extra revenues from surtaxes per annum. Similar policies were adopted in Poland and Romania. This wage-led policy was pursued without indebtedness or risking pro-cyclicality in the budget, with all ECSEE countries cutting their debt to GDP ratio after 2012 and most posting surpluses.

Again, all this needs to be put into perspective. While important, the recovery of consumption did not lead to regime change. Nothing on the scale of the transformation of Western growth regimes from wage-led Fordism to the profit-led heterogeneous and specialized regimes we have had since the 1980s. Price stability is still the key policy target and the restoration of profits via export growth are still the policy targets. Most importantly, however, the contribution of exports to GDP growth exceeded that of consumption, a tendency that suggests that at the region's undervalued wages there can be more space for more consumption without harming export performance. The ECSEE region seems to have half-turned a Kaleckian corner without resorting to a change in growth regime.

6.1. Towards a Kaleckian stand-off?

According to Baccaro and Pontusson, the Kaleckian path to growth should be consumer demand stimulated by real wage increases, deficit spending and income redistribution via both taxation and government expenditure. An increase in the wage share means that real wages increase while labor productivity remains constant.

Our main finding is that after the crisis ECSEE states have used, on average, a quasi-Kaleckian path via real wage increases at constant productivity but with few improvements in terms of taxation and government spending. The consumption boom seems to have been predominantly of the wage-led kind, with minimum wage and public sector increases playing a key role. The CEECs led the wave of wage increases above 2018 levels, with growth rates 2 to 3 times larger than in the average Eurozone member states. Hungary and Croatia proved to be the only countries where internal devaluation was taken very seriously. The result of unilateral minimum and public sector wage increases, this income policy was not reliant on deficit spending or higher debt as a share of GDP. Indeed, all countries cut debt levels as a share of GDP and with the exception of Romania (second highest real wage growth) and Hungary (negative real wage growth), where the budget deficit ran close to 3 percent. They ran deficits close to the EZ average and, increasingly, surpluses.

Of these, Poland, Latvia, Romania, Slovakia and Bulgaria have had the most pronounced Kaleckian "edits" of the growth regime script, as they increased the adjusted wage share, their annual net earnings per worker and hourly pay (see Figures 13, 14, 15). At the other end of the spectrum stands Hungary, where wage increases during the past few years have been insufficient to return to 2009 levels. Still, with hourly labor costs in Greece still far above the highest ECSEE costs (Czechia and Estonia), there is still room for wage appreciation (see Figure 15).

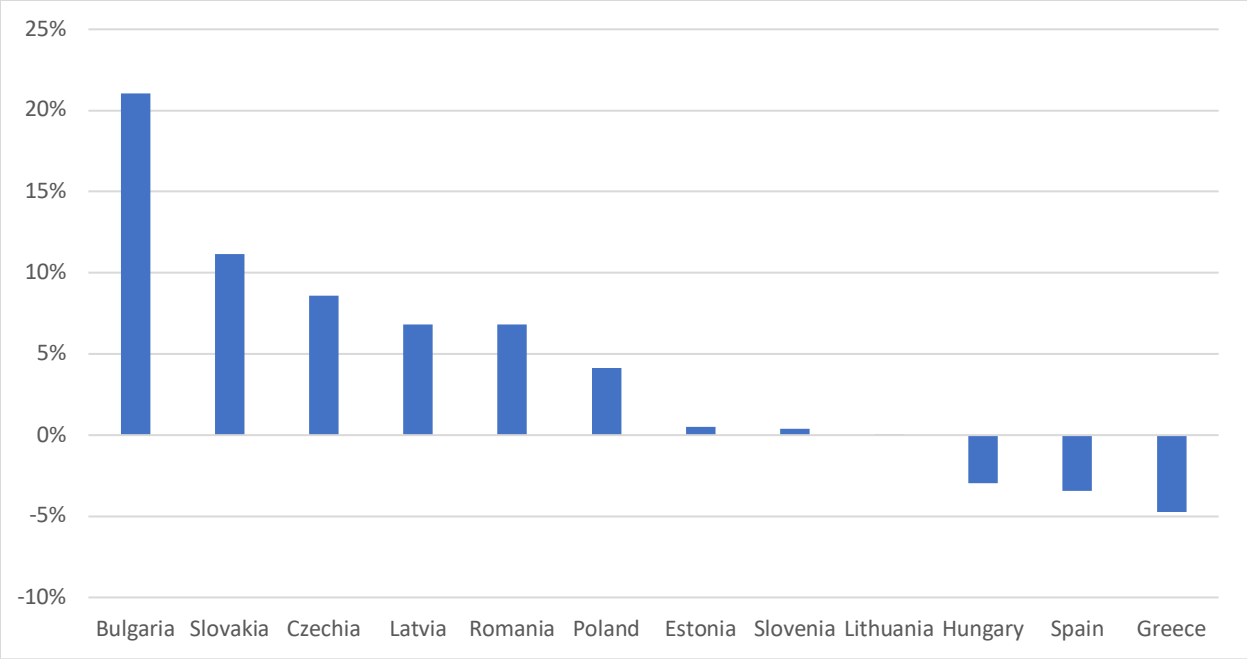

Figure 14. Change in adjusted wage share 2009-2019 (Source: AMECO)

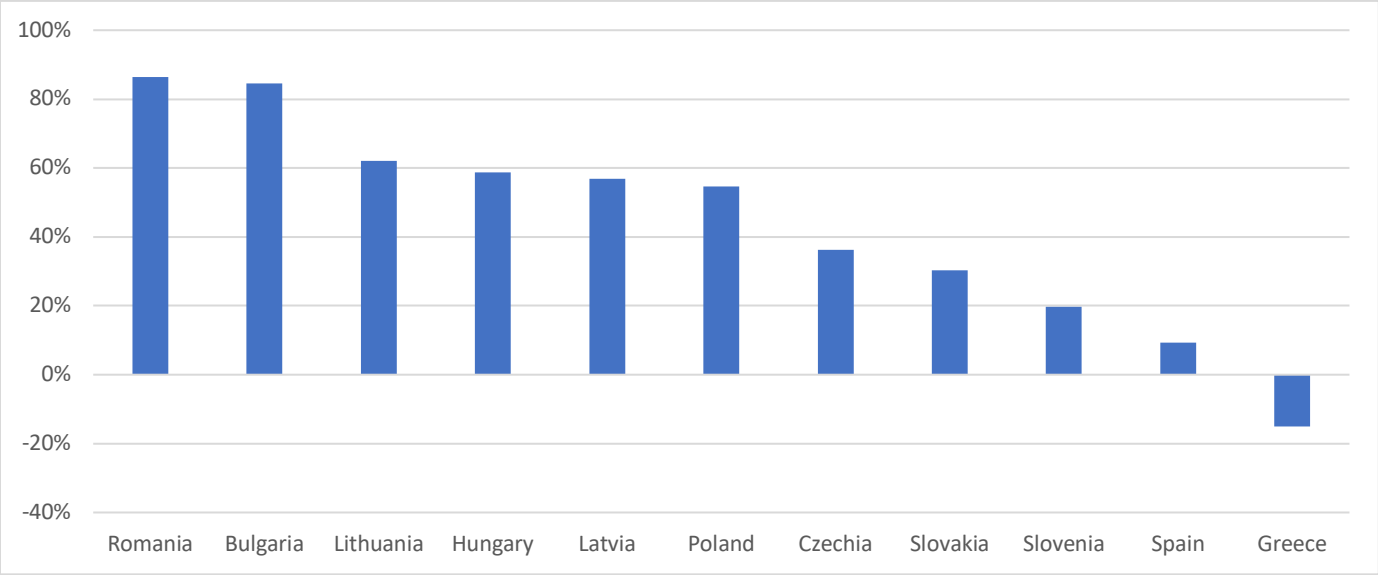

Figure 15. Change in annual net earnings (100% of average worker) 2009-2018 (Source: Eurostat)

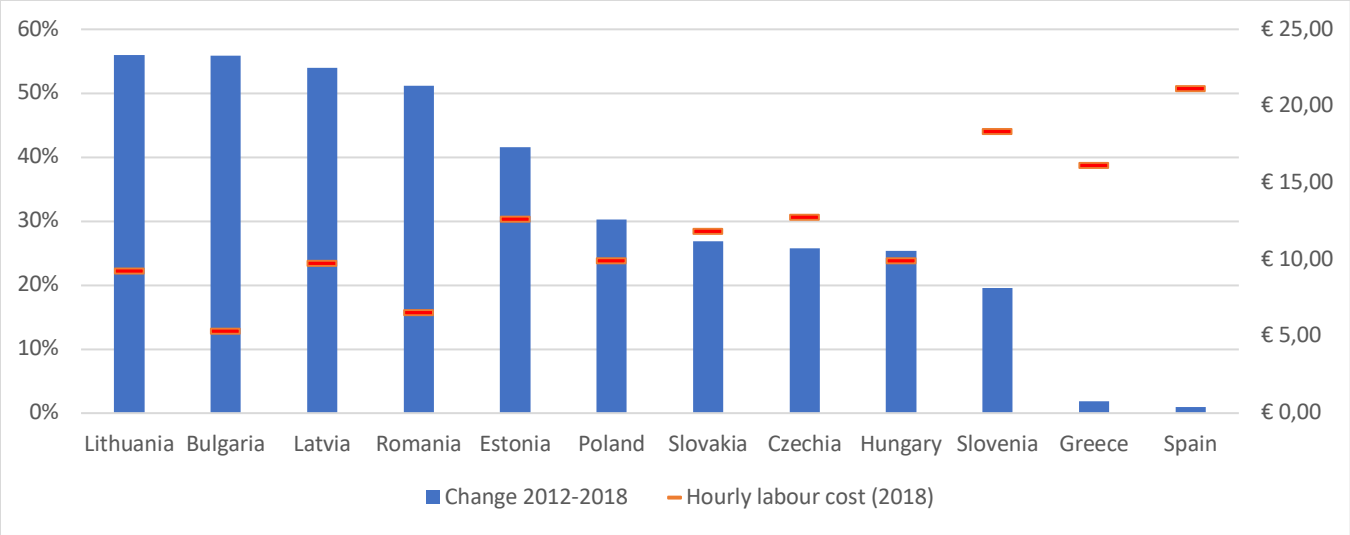

Figure 16. Increase in hourly pay (left axis) and hourly labor costs (right axis) (Source:Eurostat)

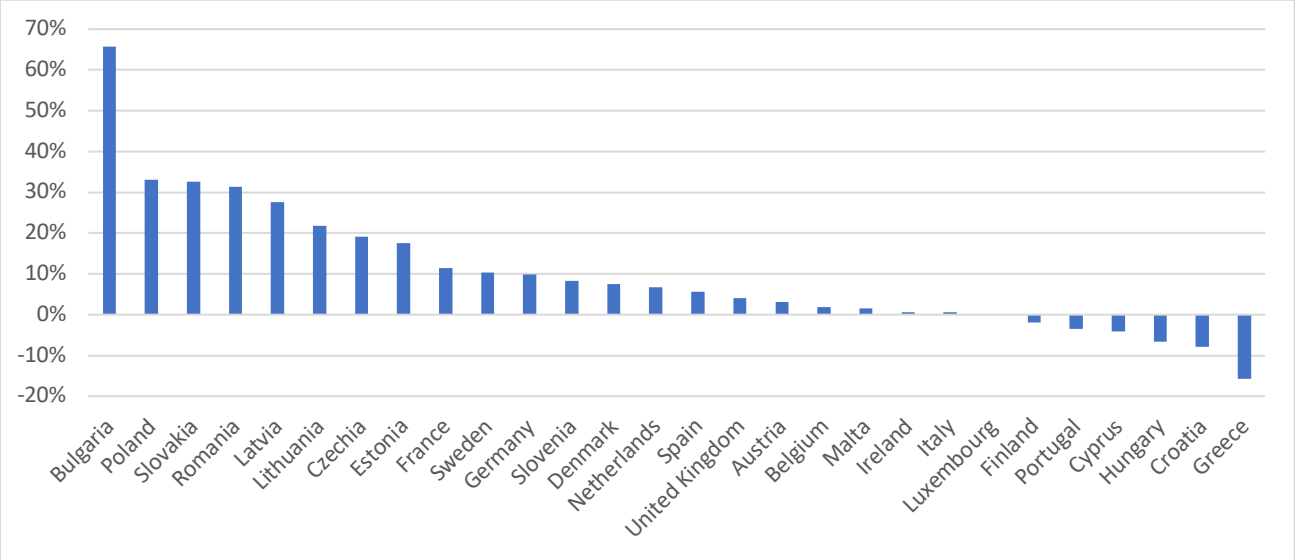

Figure 17. Change in real wages between 2008 and 2018 (Source: Ameco)

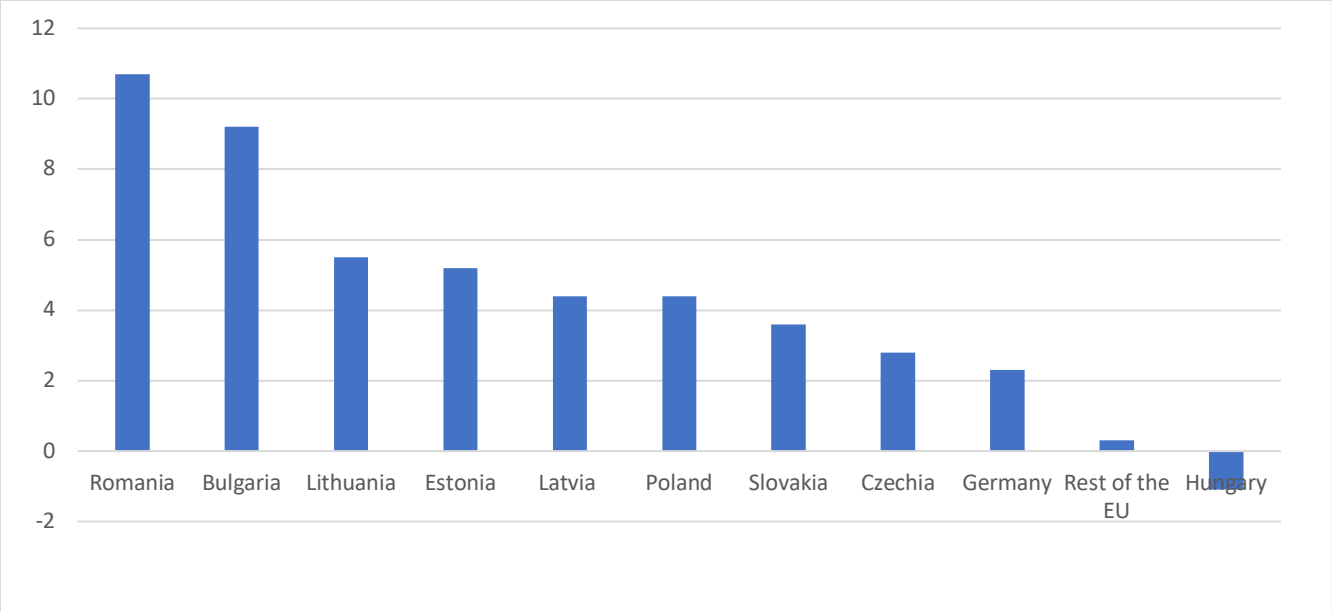

Figure 18. Real minimum wage growth (yearly average 2010-2017)

In contrast to wage increases, social expenditures were cut from already low levels in five ECSEEs (Poland, Slovenia, Hungary, Czechia) and increased in the other five (Romania, Latvia, Bulgaria, Estonia, Slovakia), with no apparent pattern (Figure 20). How about redistribution towards labor via taxation? To increase consumption, governments increase wages in the public sector among other measures (minimum wage increases, labor union laws) and this particular measure can have multiplier effects in the private sector. To do this, they can take on more debt or raise more revenues. All ECSEE countries cut their public debt to GDP ratio and all but Romania, Hungary and Slovenia increased government revenue as a share of GDP, a pattern that suggests that wage increases via the public wage bill are macroeconomically sustainable in most of the region.

However, unlike in the case of Sweden analyzed by Bacarro and Pontusson, it turns out that in the ECSEE's growing export earnings and the wage increases far above Eurozone levels did not boost demand for less skilled labor, shoring up real wages at the lower end of the earnings distribution. As Figure 19 below shows, the income share of the "bottom" ten percent ranged between stagnation and decline, an outcome that we suspect has to do with the underdeveloped welfare

states in the region, with inequality increases during crisis time caused mostly by loss of employment (Brezezinski 2018).

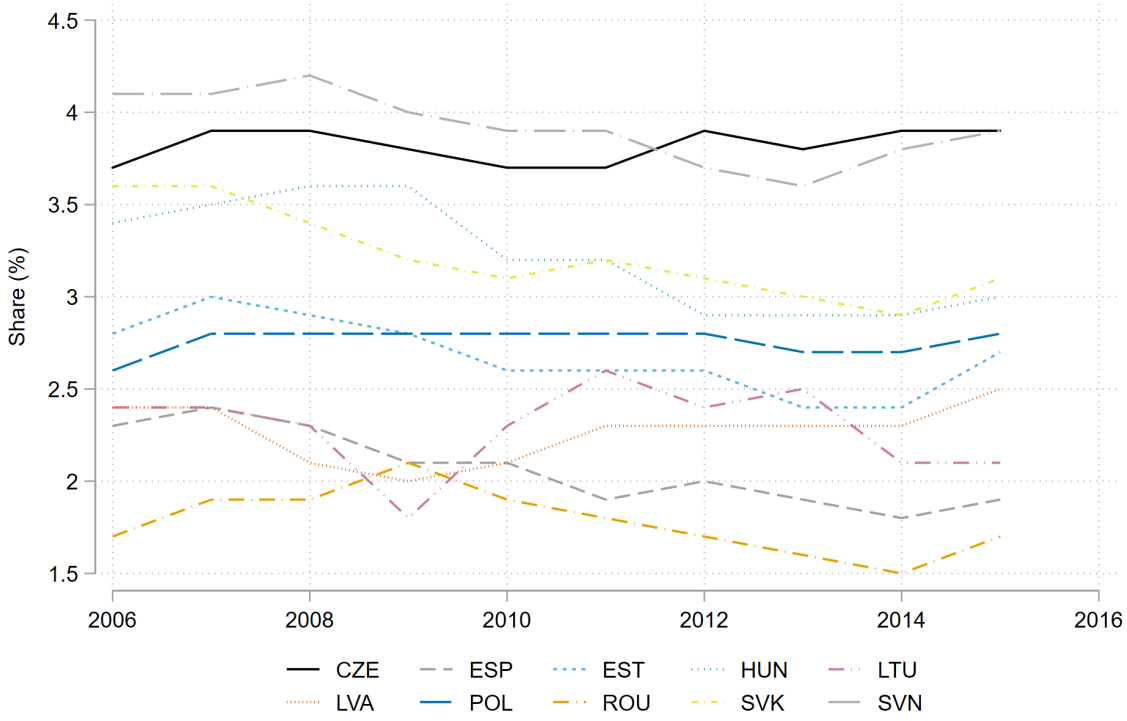

Figure 19. Income share of the lowest ten percent. (Source: World Bank WDI Indicators)

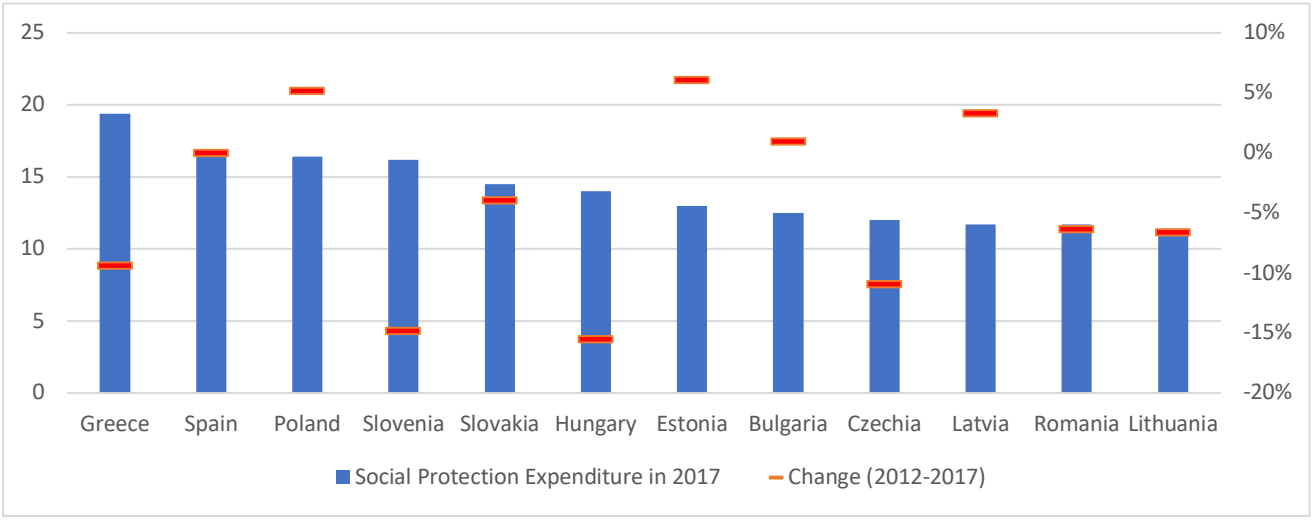

Figure 20. Social protection expenditure and change in social protection expenditure: 2012-2017 (Source: Eurostat)

How stable is a wage-led editing likely to be? For Baccaro and Pontuson, to have long-term growth and no external crises, these wage-led increases in consumption should be accompanied by (a) increases in profits and investment as well as by (b) increases in highly competitive and price inelastic (i.e. high value added, high complexity) exports of goods and tradeable services as a way to forestall a deterioration of the current account balance. If the former condition does not hold, growth will be short term. If the second does not hold there will be a current account crisis and therefore cuts in consumption, output and employment as a way to recover competitiveness. Finally, from a macroeconomic regime perspective, (c) wage-led consumption increases may destabilize the growth regime via inflation spikes.

The figures below show that while wage shares have increased between 2009 and 2018 in most CEECs corporate investments have generally declined while in some countries' profits have also dwindled. Amongst CEE countries, Romania and Slovakia stand out in terms of decline of both investment and profit levels while Poland, Hungary and Iberia are remarkable cases of profit recovery. These are the countries that have also registered amongst the highest increases in wage shares. Does this mean that the wage-led editing of the CEEC regime is doomed?

We performed a simple regression analysis on the data and found a statistically significant and negative correlation between real wage increases and investment. However, when the outliers on wage growth (Bulgaria) and investment (Ireland) were eliminated, the correlation became statistically insignificant at 0.3. Of course, the fall in investment can be attributed to a wide array of factors, from the draining of the labor pool to the disproportionate effects of the crisis on investment flows in the periphery. Yet overall the results are not decisively in favor of the argument that wage-led consumption increases are necessarily doomed by an investment ceiling.

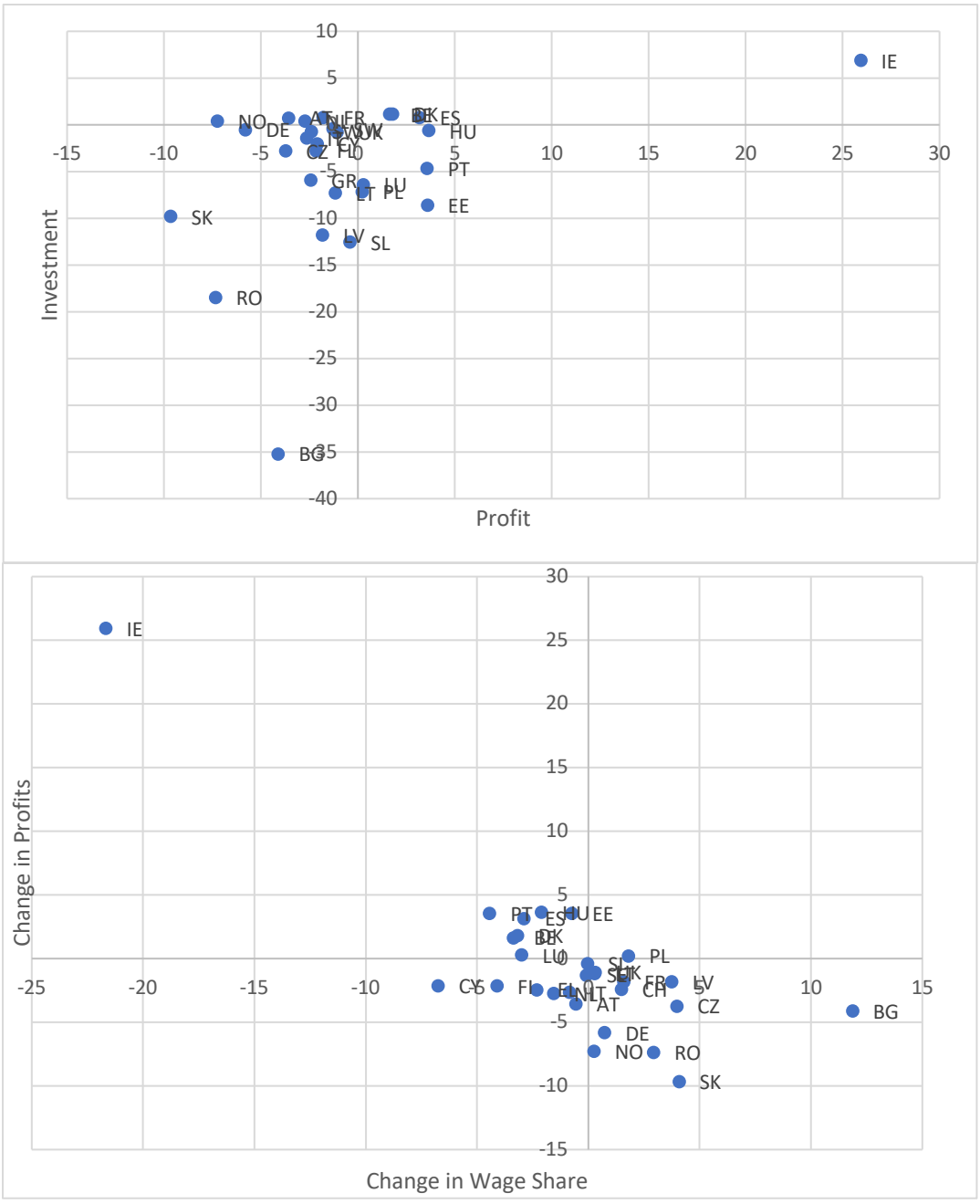

Figure 21. Change in corporate investments and profits: 2008-2018 (upper panel) and change in wage share: 2009-2018 and profits: 2008-2018 (lower panel)

In contrast, there seems to be a profit ceiling limiting the editing of the CEECs growth model: we found a statistically significant and negative relationship between wage increases and profit decreases, which suggests that although the gap between wage adjusted productivity and pay provides more technical room for wage increases, the CEECs may have reached the frontier of

possibilities when it comes to reconciling wage increases with corporate profit maximizing opportunities. The notable exception seems to be the "nationalist" path in Hungary where, for all the rhetoric, there seems to have occurred an exceptional restoration of corporate profits. Given the exceptionally FDI-dominated nature of the Hungarian economy, these must have accrued disproportionately to foreign shareholders. If indeed Hungary was the financially nationalist regime of Central Europe par excellence and the regime there sought to gain political legitimacy by showing the macroeconomic success of Hungary compared to the failure of Southern Europe, when it comes to corporate profits Hungary has gone the Southern European way indeed.

Regarding inflation, the scatterplot below shows that there is no link between inflation and wage growth in Europe (even in Romania, at three percent average inflation, the wage growth was somewhere around 30 percent), with no statistically significant relationship between the two variables. In short, the wage-led editing of the growth model did not have a significant inflation problem overall.

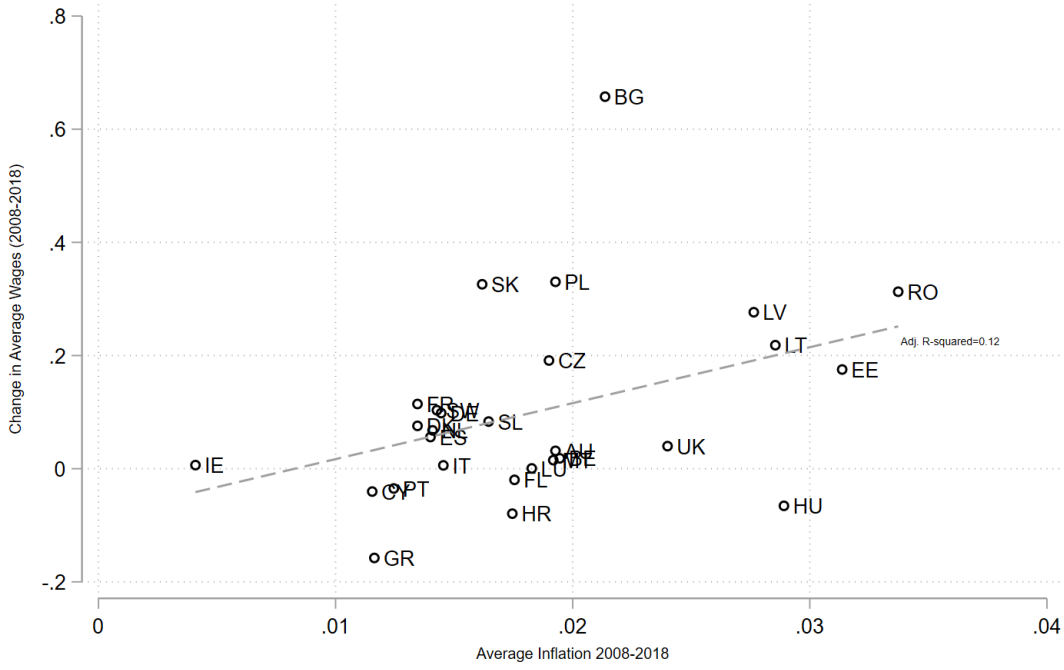

Figure 22. Change in average wages vs. average inflation: 2008-2018

The wage-led consumption did not result in a clear deterioration of the current account. Poor wage growth in Hungary resulted in surpluses, but so did robust wage growth in Czechia Estonia and Slovenia. The largest wage increases and current account surpluses came from Bulgaria, while Romania's strong wage growth came with persistent current account deficits that were nevertheless far from posing refinancing problems (see Table 2 below). To top it off, this incomes policy was not reliant on higher debt as a share of GDP.

	2014	2015	2016	2017	2018
Bulgaria	1.2	0.1	3.2	3.5	5.4
Czechia	0.2	0.2	1.6	1.7	0.3
Estonia	0.7	1.8	1.7	2.7	2
Greece	-0.7	-0.8	-1.7	-1.9	-2.8
Spain	1.7	2	3.2	2.7	1.9
Poland	-2.1	-0.6	-0.5	0.1	-1
Portugal	0.2	0.2	1.1	1.2	0.4
Romania	-0.2	-0.6	-1.4	-2.8	-4.4
Slovenia	5.1	3.8	4.8	6.1	5.7
Slovakia	1.1	-2.1	-2.7	-1.9	-2.6
Hungary	1.2	2.3	4.6	2.3	-0.5
Latvia	-2.3	-0.9	1.4	1	-0.7
Lithuania	3.5	-2.4	-1.1	0.5	0.3

Table 2. Current account balance in peripheral countries

Finally, the ECSEE growth model relies on a labor-productivity gap that far exceeds the EU average. As the figures below show, between 2000 and 2008 wages fell behind productivity throughout the region but while labor compensation in GDP increased slightly in Estonia, Latvia and the Czech Republic, the labor compensation fell dramatically behind productivity, and particularly in Romania (+8 percent productivity per hour and -1.4 wage growth). The internal devaluation of the crisis years (2008-2013) reproduced these patterns but the recovery years (2013-2018) led to wages tracking productivity performance and even exceeding it in Bulgaria and Latvia, with

Romania as the only country where labor was squeezed, with nearly 4.7 percent growth in productivity per hour and negative wage growth of 0.2 percent.

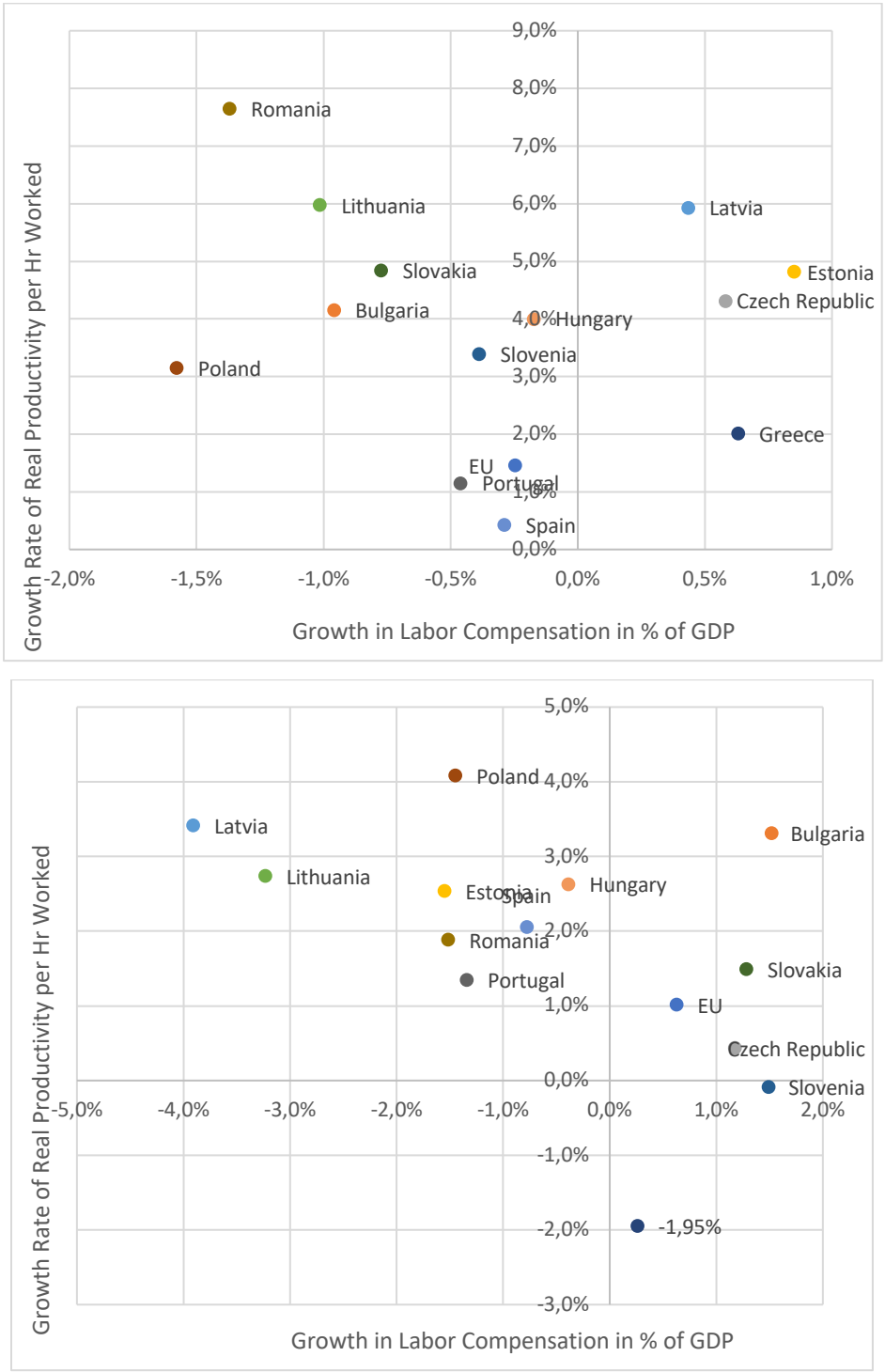

Figure 23. Growth rate of real productivity per hour worked vs. growth in labor compensation in % of GDP: 2000-2008 (upper panel) and 2009-2012 (lower panel)

7. Conclusions

This paper discussed the emergence, consolidation and resilience of a distinct growth regime in Europe: the export-led and dependent growth model in the ECSEE region. Focusing on three distinct business cycles (2000-2008, 2008-2012 and 2012-2019), it shows that despite marginal shifts towards consumption-led growth through personal debt (2000-2008) or wage increases (2012-2019), the core of the region's economic model continues to be heavily and indeed increasingly dependent on exports.

By combining IPE and CPE analytical frameworks, we show that the consolidation of the ECSEE export-led model has both systemic and national roots. Growing international competition from Asia in the beginning of the 2000s forced firms in Western European (and predominantly German) economies to seek alternative sources of competitiveness that involved a mix of wage moderation at home and expansion towards the East. The internationalization of Western firms met capital hungry Eastern economies and states that were all too happy to use FDI to restore the competitiveness of their outdated SOE-dominated sector. Backed by a social bloc that involved domestic and foreign capital as well as workers in the tradeable sectors, the export-led growth model took off and generated growth rates well above those in core countries. The 2000s also saw an increase in debt fueled consumption, that partially compensated for the lack of wage growth in the region.

The crisis proved to be an opportunity to put an end to this hybridization and reinforce the export-led component of growth through short-term austerity measures and deeper labor market reforms. These changes consolidated the export-led model that remained in place even amidst political reconfigurations that, at least rhetorically, aimed to fight the economic dependency of the region on FDI. After the crisis ended, however, the closing of the debt-finance consumption channel combined with the German export boom to the rest of the world and local demographic decline to put upwards pressure on wage-financed consumption increases without inflationary or external balance problems. Yet despite historically low spreads in the region's bond markets, this

did not count as a full Kaleckian turn, as the region's contribution of consumption to GDP growth remained far below both consumption-led growth regimes and balanced ones.

Endnotes

[i] http://atlas.cid.harvard.edu/rankings/1995?country=
http://atlas.cid.harvard.edu/rankings/2017?country=

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