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## Social and economic model of Central European States

**Abstract.** The article covers the problem of special characteristics of the social and economic model in the countries of Central Europe (CE). Despite the lack of academic insight and practical experience in the transition from the command and administration system to the social and economic model based on the principles of free market economy, the states of the region managed to change drastically their development thrust in both socio-economic and political spheres as well as to implement profound structural changes. The formal outcome of the transformation process was the designation of the status of developed countries and their accession to the EU in 2004 and 2007. However, by now the countries of the region are quite distinctively divided into several groups according to their methods and instruments of economic policy that differ more and more significantly from the original “standard pattern”. Everything herein mentioned makes it necessary to study the reasons for both positive and negative emerging major changes in CE. The presently available vast amount of academic publications on social and economic development of these states touch upon many issues, still the coverage of some problem areas is insufficient. It remains pertinent for identifying conditions, under which there appeared a fundamental shift in social and economic models; and analyzing the effectiveness of the influence of the integration factor on the evolution of social and economic models. Consequently, the article attempts to carry out a complex and cross-disciplinary analysis of the interconnection between socio-economic and political development of the CE countries amid participation in the regional association that has reached the utmost level of economic integration.

**Key words.** Central Europe, European Union, EU, Visegrad Group, Poland, Czech Republic, Slovakia, Hungary, social and economic model, foreign direct investment, multinational enterprise, social and economic transformation, labor union, income level, unemployment rate, employment structure, economic structure, migration.

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The commonality of the Visegrad Group countries stems not only from cultural, social, historical but also specific economic characteristics. In the 16th century, during the period of the formation of early capitalist relations in Europe, the regions that were located to the west of the Elbe river and on the territory of which later there formed the modern states of Central Europe, opted for the extensive development path based on further stiffening serfdom. Subsequently, it became one of the major factors of the social and economic lag of the CE region counties behind the leading Western European economies after they gained independence at the beginning of the 20th century. Another feature that is typical mainly for the countries of Central Europe was the socialist pattern of economic development (period of command economy) after the end of the Second World War.

Despite the initial achievements in the economic reconstruction in the post-war period based on the planned economy centrally-controlled methods of national economy regulation and the carry out of industrialization, by the end of the 20th century the states of the region had faced the crisis of the social and economic paradigm and the necessity to find a new social and economic model.

Throughout the 1990s and 2000s the countries of the Visegrad Group had been accelerators for changes in their region. In a rather short period of time they transformed their political systems and socio-economic models. Due to the smart economic policy they managed to shift from the socialist economic pattern to an efficient market economy in a relatively short span of time. Their accession to the European Union (EU) in 2004 is conventionally considered as the culmination of their economic transformation. Apart from the success in the economic transformation, the experience of the Visegrad Group in modernization of social institutions also deserves attention. (Habarta, 2015: 77).

One of the most difficult issues when analyzing economic processes in the region is the typology of the social and economic models of the Visegrad Group countries. Scholarly literature provides a variety of definitions of this term. Nevertheless, everybody agrees that social and economic model presents a set of interdependent elements, describing the economic structure of a country.

The main elements of this mechanism are level of state intervention in the economy, level of economic freedom, the level of business regulation, the dominant cooperate form, the labor relations, the degree of economic freedom of economic agents, the attitude towards entrepreneurship, the sources of investment financing, the degree of development of human resources, the social structure of society, the role of innovations in the economic system, as well as the role of formal and informal rules in the economy.

At the end of the 20th century, when the countries of Central Europe embarked on the path of the search for a new social and economic paradigm, they had in fact to choose among two economic models of the functioning of the state: the liberal market economy (USA, UK) and the coordinated market one (German).

The main features of the liberal market economy inherent in Anglo-Saxon states are a relatively low level of state intervention in economy and a comparatively small size of public sector. In the view of limited public spending on education, healthcare and social security insurance, a high level of society stratification is characteristic of the countries with liberal market economy. The freedom of economic agents is the keystone of this model.

For Central European countries, the coordinated market economy model is closer from the point of view of their mindset, but also in geographical terms. Its most successful and efficient forms had established in Germany and Scandinavian countries during the 20th century.

In comparison with the American and British models, in the continental European variant more attention is paid to social aspects. This explains the enhanced role of the state intervention in the economy.

The most difficult question that experts still fail to give an unambiguous answer to is to which extent the models of the Visegrad Group countries are independent economic mechanisms; i.e. are functioning in accordance with their own unique model or their economic mechanism is a variant of an economic model that has already established in developed countries.

In Russian academic circles the Institute of Economy (RAS) is traditionally engaged in examining particularities of the transformational processes in Central European countries at the turn of the century. Experts from RAS have made an overall analysis of the changes in the social and economic structure of the states of the region. In their scientific papers the IE RAS researchers are assessing critically the results of the transformation and membership in the EU. Summarizing their opinion, it can be presented this way: the states of the region for the sake of EU membership, instead of elaborating independently economic mechanisms, implemented the institutes that had already been created in the EU. They call this pattern “dependent market capitalism”.

The author of the present research holds a different view, considering that a special model, common for all these states is inherent to them. The models of the Visegrad Europe states have common features both with the models of developed countries and those of developing ones. But, the distinguishing features of “the Visegrad model” have not been defined yet (Drynochkin, 2015: 58). It can be explained by the fact that the events which took place after 1991 have led to the appearance of some features, based on which

the states of the Visegrad Europe can be classified in one category (Habarta, 2013: 78).

Unlike Baltic states, where radical neoliberal paradigm prevails, and Slovenia whose economy is characterized by neocorporativism; the countries of the Visegrad Europe are marked by embedded neoliberalism. It consists in search for compromise between the market mechanism, elements of paternalistic state and protectionism.

Two key factors have had a significant impact on the formation of the social and economic model: the desire to become integrated into the EU and the inward investment.

For the sake of the EU membership, the countries of the Visegrad Europe had to adopt political, social and economic institutions that had established in the European Union.

The accession of the Visegrad states to the EU meant that the transformation of the social and economic models and the formation of the market economy model were completed. In spite of the formal ranking in the group of developed countries in accordance with indication of the market principal of the model that is being implemented, the social and economic models of the Visegrad states that are formed, in fact demonstrate various differences from the “perfect” model (Shishelina, Habarta, Drynochkin, 2017: 50). The author of this paper attempts to analyze to what extent these differences are caused by the essence of the “Visegrad” model and to what point they are defined by the disadvantages of implementing West European models.

A distinguishing feature of the social and economic models of the countries under consideration is their orientation towards external resources of economic growth resulting in reorientation of the industrial production from domestic market to the external one. This explains the high level of openness of the economies and their involvement in the world economy; as well as the integration of the industrial sector of the countries of this group in manufacturing chains of multinational corporations, primarily European. Another particularity of the social and economic model is its increasing dependence of the socio-economic development on international economy conditions and trade cycles of the partners in the EU, which is particularly notable during economic crises and financial turbulence of the eurozone countries (Habarta, 2016: 98).

The formation of the market relations in the countries of the region and the processes of privatization were carried out at a faster pace than the formation of the class of private entrepreneurs. That is why modern business elites have emerged on the basis of the technocrats in power, a part of cultured community and successful enterprisers.

There has established a dualism of economy in the Visegrad states. It implies the existence of two types of economic agents that are represented,

on the one hand, by large-scale corporations which are in the hands of foreign multinational corporations and, on the other hand, by low productive national companies. The national capital is presented in the countries of the Visegrad Group predominantly by small and medium-sized enterprises.

Another distinctive characteristic of the social and economic model of the countries under consideration is the submission of their economic development to the interests of multinational corporations. The role of the multinational capital is particularly significant in the export economic sector: industry and services. The main source of capital receipts in the Visegrad countries are foreign investments done by foreign multinational corporations.

At this phase overseas capital has started to play a paramount role in the development of Central European economies. Between 1993 and 2016 the average volume of inward foreign direct investment (FDI) in Visegrad group was 4,7 billion of USD per year (4,5% GDP of the region), with Poland having the highest rate among the countries of the Visegrad Group – 8,9 billion of USD (UNCTAD, 2017).

The volume of inward FDI to the Central European economies have significantly increased after gaining EU membership. Foreign direct investments are mainly concentrated in the so called “Visegrad cluster” that covers the South of Poland, the whole Czech Republic, the North West of Slovakia and the North East of Hungary. However, the issue of the influence of multinational corporations on the efficiency of the engagement of the Visegrad states in the international division of labor remains contradictory.

On the one hand, foreign production location of large-scale multinational corporations on the territory of the countries of the region has contributed to the formation of manufacturing chains in the industrial production, modernization of the secondary sector on the basis of imported technologies, upgrading the structure of merchandise exports and accelerated economic growth.

On the other hand, incorporating national companies in the intracompany system of relations within multinational corporations makes the development of trade relations dependable on their policy. Due to the inflow of FDI, technology transfer took place and, as a result, the average technological level of products has increased. But it had almost no impact on other areas of economy. Links between big enterprises, which are constituent companies of foreign multinational corporations, and national producers are weak.

Thus, Central Eastern economies are put in a subordinate situation to the interests of big multinational corporations. Their dependent nature is reflected in their dependency on the decisions made by multinational capital. There has formed a rather specific structure of corporate management in the countries under consideration. The key decisions are made in the headquarters of big foreign companies; subsequently they are imposed top-down to constituent

companies of multinational corporations located in the region. (Glinkina, 2017: 22). Under the influence of multinational corporations, the Visegrad states specialize in producing sophisticated goods of long-term use engaging skilled and inexpensive labor force.

Another weak point of social and economic models of the countries of the Visegrad Group is the existence of informal institutions, corruption, nepotism when appointing managers and public sector employees on senior posts in public sector and public administration authorities. Despite the formal displacement to the group of developed countries, various problems are inherent in the economies of that region, including low income, relatively high unemployment rate and maladjustments in the structure of employment in comparison with “the old countries of the EU” (Habarta, 2011).

Social and economic development of the countries of the Visegrad Group in 1991-2016, despite all the common features with other developing countries, has a number of differences that allow to delineate them in a separate group.

The structure of the Visegrad economies differs from indicators of developed countries. Share of agriculture sector in GDP in most countries of the region is higher than in developed states and is about 3%, with Hungary having the highest rate — 4.3% and the Czech Republic — the lowest (2.6%). The contribution of services to GDP is also rather small comparing to that of the EU-15; and the regional average is 63%. The high share of industry (about 33%) demonstrates the noncompletion of the transitional stage their economies are at on the way to the postindustrial society (Habarta, 2015: 79).

The employment structure in the Visegrad states also differs from that of the EU-15. The average rate of employment in agriculture among the countries of the region is about 6%, with Poland having the highest rate — 12.6%. About 34% of the population of those countries are engaged in industry. The highest rate was registered in the Czech Republic — 38%. 60% are engaged in services. The highest rate of employed in this sphere was recorded in Hungary — 65%. (The World Bank, 2017).

A weak point of the countries of the Visegrad Group is a rather low-income level that is two times less than average figure for the countries of the EU-28. In 2004 GDP per capita at purchasing power parity (PPP) in the countries of the region was about 61% of the UE-28 — 16 thousand USD. By 2016 the Visegrad states managed to slightly narrow the gap. Regional GDP per capita was about 75% of the UE-28 — more than 30 thousand USD (The World Bank, 2017).

The Visegrad states have similar positions in international ratings. In Visegrad countries the level of human development is very high (average HDI for the region is 0.85). When analyzing constituent elements of this index, it

becomes clear that the average life expectancy at birth in the countries under consideration is 77 years, expected years of schooling – 11.8 years, GNI per capita – 25.1 thousand USD. (The United Nations Development Programme (UNDP), 2017). The social stratification in the countries of the Visegrad Group is not very large (the average Gini ratio for the region is 0.3) (The United Nations Development Programme (UNDP), 2017).

According to the World Bank's report "Doing Business 2017" Visegrad states have gained quite high rankings: Poland – 24th, the Czech Republic – 27th, Slovakia – 33th, Hungary – 41th. This demonstrates a high degree of maturity and competitiveness of the economies of the region (The World Bank, 2017).

According to the methodology set out in the Global Competitiveness Report, published by the World Economic Forum, the Visegrad states are at the stage of transition from economy that is driven by efficiency to the one driven by innovations. This means that in order to boost competitiveness of national economies, the achieved high rates in the system of higher education, effective goods and labor markets and a developed financial market are already not enough. Further increase of competitiveness can be attained only through developing innovations and new technologies and their introduction into national economies. During the past two decades in most countries of the region industrial production was the basis for economic growth. The inflow of foreign capital into the real sectors of economy in addition to cheap and skilled labour force has facilitated the increase of competitiveness and productivity of industrial production. However, in the long term the use of "price-based competition" in combination with low tax burden as an economic growth promoting factor is impossible. The Visegrad countries have already reached their threshold level. Further development of economy and its growth is feasible only provided that there is a transition towards knowledge-based economy founded on the growth of the proportion of knowledge-intensive production in the industrial structure. According to the Global Competitiveness Report, only the Czech Republic has managed to move to the stage of economy driven by innovation (Vorotnikov, Habarta, Dymshic, Lesnaja, Malgin, 2016: 79).

There has formed in the Visegrad states a rather peculiar system of participation in the international knowledge-sharing. On the one hand, the coming of multinational corporations to the countries of the region means a transfer of knowledge, necessary for the launch of their own enterprises; on the other hand, high technology development stays in the home countries. Thus, the access to new technologies is limited. Their transfer happens only within the units of multinational corporations without influencing significantly local innovation centers.

A small amount of R&D spending determines the low level of innovativeness of the economies under consideration. The R&D spending in the Visegrad states is around 1.1% of GDP (The World Bank, 2017); that is twice less than the EU average. In conformity with the Knowledge Economy Index (KEI), which demonstrates the effectiveness of the use of knowledge by a state with a view of economic and social development, the countries of the Visegrad Europe rank 20th and 30th and their indices range from 7.1 to 8.1 points (The World Bank, 2017). The weakness of the countries of the Visegrad Group consists in the underdevelopment of national innovative systems, in the framework of which there exist perception and adaptation of global knowledge for the needs of national economies as well as production of new knowledge and technologies based on it. Another weakness that decreases their Knowledge Economy Index is a not very high level of development of information and communication infrastructure that promotes an effective dissemination and processing of information.

After 2004 the export of young skilled labor force became characteristic of the Visegrad social and economic models. The main reason for the outflow of the labor force were disproportions in social and economic development of these countries in comparison with the “old” EU members (EU-15), which found manifestation in the income level of the population. A high level of unemployment also caused it (Vorotnikov, Habarta, 2016: 126).

The outflow of the labor force had a negative impact on the labor market and employment in the countries of the region (Habarta, 2016: 2, 3, 5). Because of the leaving young skilled labor force there can be noticed its deficit. This affects the modernization potential of the countries; the quality of the labor force is deteriorating, and consequently, the pace of economic growth is slowing down.

Recently the issue of completion of the forming processes of the social and economic models on the base of the liberal model is becoming increasingly relevant. The victory of the conservative-populist forces in the elections in the Visegrad states questions this statement.

The victory of the parties “Law and Justice” in Poland, “Fidesz” in Hungary and “Action of Dissatisfied Citizens” in the Czech Republic demonstrates the disagreement of the majority of the society to continue the former neoliberal policies in the national economy. The above-mentioned political forces challenge the economic achievements of the past 25 years.

The social and economic model that formed during the period of transformation, within the framework of which individualism has turned into an instrument of ideological justification for the economic policy of the new elite and the long-standing values of the society were considered by the political elites a marginal and outdated relic of the past, provokes rejection in the society.

It is ultimately important to overcome in the countries of the Visegrad Group the shortcomings of the neoliberal paradigm, and first of all, of the “cosmopolitan capitalism” that has left out many population groups. The conservative-populist forces that have recently won the elections, declare their desire to get rid of the model of the dependent market capitalism. Their objective is to shift the emphasis of the social and economic development from external factors to the internal ones, and also to eradicate the subordinate status and dependence from the multinational capital. The realization of such ambitious aims is planned to be achieved via reinforcing national and frequently public companies in the economy of the states of the region. Competitive advantages of the national capital are expected to be enhanced by means of increased taxation of foreign banks and large retail chains. Conservative-populist parties are wary of the Brussels bureaucracy and its initiatives. The ideas of further deepening and devolution of rights to supranational bodies within the European association are perceived with great skepticism.

Conservative-populist parties aspire to pay much attention to the social aspects of development of the society. In order to level social disproportions as well as sustain the family policy, more and more considerable resources are redistributed via government budgets.

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Three decades is a very short period of time to state that the Visegrad countries have definitely formed their own unique social and economic model. “Dependent market capitalism” is unlikely to be able to serve for this purpose. The accession of nation-driven conservative forces to power in Budapest, Warsaw and partly in Prague that tend to criticize Brussels’ policy can, besides, demonstrate popular discontent with the development path that had been chosen for Hungary, Poland, Slovakia and the Czech Republic by liberal reformists in the 1990s and the beginning of 2000s. Consequently, legislative changes, which will also affect the major trends of social and economic development, are possible to take place in these countries in the immediate future. They will manifest themselves, in particular, in the formation of social market economy. Nevertheless, at this stage a conclusion can be made that in the foreseeable future the social and economic development of the states of the Visegrad Group will remain dependent on external factors: foreign capital and international market environment. Despite prevailing small and medium enterprises in national economy, large-scale foreign multinational corporations continue to have a paramount influence on the economic development. In this context, export of goods, services and labor will still be the main sources of economic growth.

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## Социально-экономическая модель центральноевропейских стран

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**Аннотация.** Целью статьи является раскрытие специфических характеристик социально-экономических моделей стран Центральной Европы. Несмотря на недостаток академических исследований и практического опыта в области перехода от командно-административной системы к социально-экономической модели, основанной на принципах свободной рыночной экономики, государства региона сумели существенно изменить вектор развития как в социально-экономической, так и в политической сферах, а также провести глубокие структурные преобразования. Формальным итогом трансформационного процесса стало присвоение странам региона статуса развитых экономик и их вступление в ЕС в 2004 и в 2007 гг. Однако к настоящему времени стало заметно, что страны региона достаточно явно разделены на несколько групп по методам и инструментам, используемым ими в своей экономической политике, причем эти методы и инструменты все более и более существенно отличаются от исходных, входящих в т.н. «стандартную модель». Ввиду всего вышеобозначенного необходимо изучить причины значительных положительных и негативных перемен, происходящих в Центральной Европе. Большое число доступных в настоящее время публикаций, посвященных социально-экономическому развитию этих государств, затрагивают множество вопросов, однако ряд областей все ещё недостаточно раскрыты. Однако освящение этих вопросов остается необходимым для выяснения условий, в которых произошел фундаментальный сдвиг в социально-экономических моделях этих стран, и анализа эффективности влияния интеграционного фактора на эволюцию социально-экономических моделей. Следовательно, статья представляет собой попытку кросс-дисциплинарного анализа взаимосвязи между социально-экономическим и политическим развитием центральноевропейских государств с учетом того, что они входят в региональную ассоциацию, в рамках которой был достигнут максимально возможный уровень экономической интеграции.

**Ключевые слова:** Центральная Европа, Европейский союз, ЕС, Вишеградская группа, Польша, Чешская республика, Словакия, Венгрия, социально-экономическая модель, прямые иностранные инвестиции, многонациональное предприятие, социально-экономическая трансформация, профсоюз, уровень дохода, уровень безработицы, структура занятости, структура экономики, миграция.