What kind of capitalism for eastern Europe?

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Deficits are the result of unsustainable processes, says political economist Zoltán Pogátsa in interview with Cristian Ghinea. Merely cutting expenditure leads to general decline: eastern European countries instead need to review the functioning of the state and its subsystems.

Cristian Ghinea: In the course of the conference you mentioned that the economies of Central and Eastern Europe (CEE) – the former communist world – are characterized by low value added [the difference between the value of all the inputs, i.e. raw materials, purchased services, wages etc., and the price at which the product is sold – ed.] and reduced investment in R&D. Do you think these characteristics are the result of conscious decisions taken by policy makers, or was that the inevitable course for our economies to take after 1989?

Zoltán Pogátsa: In my opinion it is more an evolution than an unintended consequence. During the 1990s, decision makers had no fundamental knowledge of capitalism; they assumed that the defining characteristic was private ownership. In which case, all capitalisms would be the same, western and eastern.

CG: And this hope is still here, isn’t it? We are in transition, we first import capital, then technology, and at the end of the road, capitalism will be the same in the East as in the West. These are our expectations?

ZP: The hope is still there, but it is unrealistic. Global capitalism is made up of the global production chains of multinational corporations. These are made up of production phases, some with high value added, some with low value added. Countries and cities compete for high added value phases. But you do not get them without effort. You need a highly educated population to get them. And that means an advanced educational system from kindergarten to PhD level, great research, design schools, languages, psychological skills, infrastructure, social environment, and so on. And then you still have to face the fact that multinationals tend to keep these production phases at home.

CG: Are you suggesting that this trend towards the low value-added economy started as a necessity and is now becoming a trap? Was there any alternative solution by which the
communist economy might have avoided this “low value capitalism” – if that is the right term? Or, to put it more simply: let’s imagine you are Ion Iliescu in 1990s Romania. What would you do?

**ZP:** I call it a “dependent competition state”, since the state is competing to attract more Foreign Direct Investment (FDI), and is dependent on western Europe. But “low value capitalism” is also a suitable expression. Back then, in a way, it was necessary, but now it is a trap, though only if you accept the cultural heritage of the region. In other regions of the world other solutions were possible, for instance in Korea and Japan – an export-driven capitalism with their own multinationals – or import substitution as in Latin America.

**CG:** Let me persist with the Iliescu analogy and the practical options at that time. In a way, Iliescu tried to postpone this economic evolution in Romania: though it is true he sustained jobs, he rejected privatization and continued to subsidize old industries until they were bankrupt. Transnistria makes an interesting comparison: They have retained the Soviet model – in metallurgy especially – but are totally dependent on Russian subsidies. In a way, this is an extreme example of what Iliescu tried: to keep alive heavy industry developed during communism. So, I’m trying to understand your criticism of the current CEE economies from this point of view, to understand what the real policy solutions were at that time.

**ZP:** With the sole exception of Hungary, all the countries in the region attempted some form of privatization through domestic ownership. Only Slovenia succeeded; Croatia is still teetering on the brink. The others, including the Czech Republic, once the sixth most industrialized country in the world, soon realised they had no knowledge of how to run capitalist firms: the technology was out of date, management methods not good enough, there was no knowledge of potential markets for their products and services, and political corruption was rampant. So after 1997, all the countries of the region took the Hungarian road and opted for multinationals.

**Enlightened privatization versus public sector sclerosis**

**CG:** You mention the Slovenian example. In what way was Slovenia different from other CEE countries and what is the alternative to FDI?

**ZP:** Slovenia had a self-management system under Tito. Firms were operating along quasi-capitalist conditions, with a two tier banking system, but owned by the workers. They could export high quality products to the West. Thus, when transition came, they decided that they were good enough to run their own companies. In Slovenia, privatization was carried out internally by preserving the value added of local industries. Consequently they had high employment, high growth, high wages and low inflation. A perfect example is their pharmaceutical sector. They had two pharmaceutical companies. One was sold to a multinational and now produces generic drugs with low value added. The other one was sold to internal investors, produces all types of medicine and hires qualified staff on good wages.

**CG:** But is self-management under communism the only factor explaining the difference? This privatization from the inside – or by insiders – meant in most countries a plundering
of state assets. In Romania’s case, most of the privatizations were not done for the benefit of multinationals but for that of politically well-connected people, who slowly bankrupted factories and then got hold of real estate during the economic boom. All the successful privatizations were related to multinationals – Dacia-Renault for instance.

**ZP:** The Slovenian story is about a lot more than simply self-management. The sense of ownership is also important: it stopped people from giving away their company. They felt it was theirs. They felt they were able to do something. To a considerable degree, this prevented corruption. The Soviet Bloc went from large state firms to large multinationals; Slovenia went from self-managed firms to local private companies. But there was also social consensus: the communists were enlightened; there was no antagonistic political division but a desire for consensus. There was also an ethos that resulted in low levels of corruption. As for the success of privatized multinationals, they were indeed efficient, but only in the short term because they did not continue to develop further.

**CG:** Elsewhere you have been very critical of Slovakia. Is Bratislava a typical example of an “eastern neoliberal” model? What is the difference as you see it? And what, exactly, is the object of your criticism?

**ZP:** Slovakia was dubbed the “Tatra Tiger” because it seemed to have a development model similar to the Asian Tigers or Ireland’s Celtic Tiger. In fact, what happened in Slovakia was a typical reconstruction boom. Vladimir Meciar [three times prime minister of Slovakia between 1990 and 1998 – ed.] tried to privatize internally. He gave away firms to his friends and political cronies. Slovakia was politically isolated because of its nationalism. Therefore Mikulás Dzurinda [prime minister of Slovakia 1998-2006 – ed.] gained an enormously popular mandate and privatized and restructured Slovak companies after 1998 when he took over from Meciar. He sold most of these to multinationals: Peugeot, VW, KIA, US Steel, etc. The workforce was affected in the first years of the restructuring, but people were re-hired once investments had been made. But employment in Slovakia never reached the levels under Dzurinda it had under Meciar.

At the same time, Dzurinda reduced the Slovak public sector to the lowest in Europe by lowering taxes. On the one hand this made Slovakia attractive for investment, on the other it destroyed any chance of future growth. Slovakia has a terrible educational system, bad universities, bad roads, bad hospitals, does nothing for its Roma etc. etc. The prospects for the future diminished as a result of the weakening of the public sector. GDP did grow between 5 per cent and 9 per cent per year, but this is to be expected when non-functioning firms begin to perform again: the so-called rebound effect. Restart the Kosice steel factory and an entire region will start producing again. GDP grows. But this was not reflected in the real wages of Slovaks, which went up one year, down the next year, up again, down again. To sum up: a growth in GDP means profits for investors. The public sector shrank and so did future prospects. In addition, the entire economy became dependent on the western demand that resulted in a fall in growth from 8 per cent to minus 7 per cent from one year to another, when the financial crisis came. This is hardly a wirtschaftswunder: the “Tatra Tiger” was a small cat that had almost been killed but was resuscitated. That’s all.

**CG:** Let’s talk about solutions. You talked about the awful education system in Slovakia:
low R&D investments in the entire region, lack of prestige of eastern degrees, no demand for knowledge. We need more investment in education. On the other hand, a study made by the Romanian office of the World Bank shows that while state investment in education rose more than three times between 1999 and 2007, performance of Romanian students and pupils in comparative international tests decreased over the same period. So basically, during the pre-2008 economic boom, the government flooded the education system – and the health system – with money, but the outcome was worse in terms of quality. The solution seems to be a lot more complex than simply “invest more in education”.

ZP: No one says money alone can solve the efficiency of any system. In fact it is a waste to throw money at a bad system. In most cases, the rise in educational expenditure in the region was correlated with an explosion in the number of students. So you need to look at expenditure per head. But you can also see that the best educational systems in the EU are also the ones that receive the highest amounts of funds, with Scandinavia at the top.

CG: Actually, this is spending per head. The amount spent on each student in foreign currency in 2007 was 480 per cent of the amount spent in 1999.

ZP: You need a review of what this system achieves. But money is necessary in any case. Eurostat figures show that even after tripling spending, Romania still spends on each student only one third of that spent by the most developed countries. In my opinion it would have to spend more to catch up! The global economy needs technical students and laboratories are expensive. Design students also need materials. In addition they need computers, Internet, trips abroad, research and faculty exchanges. All these things cost. I also found that a large number of universities in the region renovated their buildings. Shiny new universities that are not paying their professors properly are not doing research and are not publishing new textbooks for their students.

**Development as cultural issue**

CG: Let’s talk about the economic crisis. Deficit or cuts?

ZP: Neither. Reforms.

CG: But given the fact that these countries do not effectively control their economy, this means state reform. At the same time, you are a supporter of the active – or should I call it “big”? – state. Can one increase the role of the state and at same time reform it? Are there any success stories that offer solutions to the economic crisis in CEE countries?

ZP: What these countries need to do is review the functioning of state subsystems. In fact, they need to start using them, which they have not been doing. Western countries rely on active labour market policies, education, environment and anti-corruption policies, functional legal systems, etc. CEE governments need to kick-start these subsystems. If you only cut expenditure this will lead to a general decline, without analysis beforehand or monitoring after the event. It is unsustainable. A reform should be planned well ahead; impact should be analysed long before and the reform should be negotiated in order to reach a consensus; it should be introduced cautiously and with careful monitoring of its effects. The reform should be corrected if necessary. This is how
it becomes sustainable.

CG: You said earlier that the culture in the region did not allow CEE countries to follow the Japanese or Korean development path. What exactly is that culture? A consensual, rational, policy-oriented (instead of politics-oriented) political system? This requires some social capital, some habit of working together that by and large the region lacks. Is that the “culture” you mentioned?

ZP: The culture of the region is political division, corruption, lack of gradualism, lack of reflexivity, lack of awareness, weak civic participation, clientelism and, I would even add, laziness. Now this is going to turn off half the readership of this conversation, because we do not like to admit these things. Yet I feel they are very much there, hindering our development. We need to create awareness and effect change.

CG: I think the readership will be amazed that you consider these features are valid for the entire region. We in Romania often attribute these features only to ourselves. We have all sorts of positive clichés about our neighbours in the region, for example that the Hungarians are proud, united, hardworking and so on. Why are such features common to us all? If I say that communism is to blame, all manner of new-Left, French-style intellectuals in Romania would call me an obsessed anti-communist. What’s your take on these two issues?

ZP: These characteristics are valid for all the countries of the region because we had no prior experience with democracy and no bottom-up development model. The Ottoman and Austro-Hungarian Empires were just as top-down as communism. These traits of socialization go back much further than communism alone.

Budgetary cuts never work

CG: Romania is at the moment caught in a serious political and social debate over its budget cuts. It is an understatement to say we have no consensual style in politics: we actually practice a very aggressive, attack-oriented one. We have a difficult relation with the IMF and a weak government that pushes for cuts in a constantly critical context. Many Romanians praised the anti-IMF statements of Viktor Orbán. What is your forecast for Romania? Will the cuts have the desired economic effects by stabilizing the currency and the balancing the budget, or they will damage the economy? How is the IMF-Hungary relationship at the moment?

ZP: Cuts always damage economic prospects in the long run. I am completely against cuts in any economy and at any point. Deficits come about as a result of unsustainable processes; you need to be able to tackle those processes, i.e. make reforms rather than implement cuts. Orbán made the right decision in not signing another standby loan deal with the IMF. If you do not need the IMF it is best not to rely on them, since their loans come with heavy conditions.

CG: Is this “never cut” recommendation applicable even to Greece, or generally speaking to countries that have limited possibilities of securing loans? Aren’t you being too extreme in advising against cuts in any economy at any point?
ZP: It is especially relevant for Greece. I spent my summer in Greece, researching the problem. Half of Greece does not pay taxes. The elites of Greece are registered in tax havens. It is not the Greek state that is in crisis: the ratio of debt to GDP in Greece was actually falling before the crisis. Then Greece had to bail out the four largest Greek banks, which had been overexposed in the region. Thus what seems like a crisis of the state is to a very significant degree a crisis of the business sector. Unless Greece is willing to make a real change and get the taxes from the lawyers, the doctors, the shipping-line owners and the banks, the situation will never be stabilized. You can temporarily create the illusion that things are in order through cuts, but it comes back at you in two years’ time and no one will be ready to bail out Greece a second time.

Some good things about Bucharest

CG: Last question: we took a short walk together in the centre of Bucharest and at some point you said that, in comparison with other CEE capitals, Bucharest went through the biggest transformations of the past decade. For people here who are generally unhappy with their city this could sound crazy. What has improved since your previous visit in 2000?

ZP: Bucharest, like any other capital of the region, became the showcase and the playground of the middle class. There is clearly a Romanian middle class now. They are the beneficiaries of transition, such as managers of multinational firms, politicians, mafiosi, small business owners, media people, etc. They operate in the centre of Bucharest as anywhere else in the global centres. Buildings and roads are being repaired, restaurants and cafes opened, luxury cars and SUVs rush by amidst flashy billboards and neon signs. But the transition in Bucharest was bigger than anywhere else in the region, including Prague or Bratislava, which also changed enormously.

Under Nicolae Ceausescu, Bucharest was dark, drab, grey, Balkan, full of potholes, wires, dogs, homeless people and beggars, litter, fog, and depressing, poor-quality reinforced concrete. Now Bucharest has becoming shiny, trendy, flashy, global: great new roads, no more potholes, cultural openness, new cloths, new cars, great restaurants, friendly middle-class people. It is obvious that the former dictator, Ceausescu, could not erase all of the former glory of the Paris of the East. Plenty of buildings were left and have been renovated in the government and business districts. The people of Bucharest have even found ways of integrating the Ceausescu nightmare into the urban landscape. The People’s Palace and the artificial river are now relatively organically liveable. So there is an enormous, positive change. I only wonder if it is not purely a middle-class phenomenon. On my drive home, I saw development in Cluj and Sibiu as well, but in places like Targu-Jiu or the outskirts of Bucharest that same development is missing.

The dialogue arises from a conference on the economic development of Eastern Europe in the context of the Europe2020 strategy, held in Bucharest in October 2010. It was organized by the Romanian Center for European Policies and the German think tank Das progressive Zentrum, with the support of the European Commission Representation in Romania.

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