Zoltán Ádám:[1]

The power of path dependence? State capacity and autonomy in East Central Europe during transition

Abstract

The paper examines development of state capacities and autonomy in East Central Europe during transition, and attempts to establish a relation between state characteristics and trajectories of economic transformation, especially with regard to privatisation and FDI. The assertion is that the quality of state capacities and the degree of state autonomy, although changing over time, mutually reinforces the formulating of economic policies, and hence in structural transformation. Thus, state characteristics are important determinants of transition outcome, but are themselves affected by structural economic changes.

[1] Paper presented at the conference on "Institutional and Policy Diversity – Its role in Economic Development", Debrecen, Hungary, 3-5, November 2003. Zoltán Ádám is a Research Economist, Kopint Datorg, Budapest, and a PhD student at the University of Debrecen, Faculty of Economics and Business Administration. Email: z.adam@kopdat.hu

1. Introduction

The purpose of this paper is to analyse the impact of state characteristics upon the course of post-communist economic transition. Naturally, such a research question presupposes an approach which considers the role of the state (among other social institutions) significant for economic development (e.g. Stiglitz et al. 1989, Stiglitz and Yusuf 2001, Meier and Stiglitz 2001). Post-communism here entails a complex set of institutional transformations that effects and, at the same time, crucially requires the role of the state. Although this is by no means a unique feature in an era of global product markets and financial transactions, post-communism perhaps exposes the contradiction in its sharpest form: whereas state involvement in economic transactions must be curtailed if market co-ordination is to take over, macro-level management of the transformation requires effective state policies. Therefore, building *capacities* and, as it will be argued, *autonomy* of an increasingly limited state become crucial.

In post-communism, institutions of the ‘global’ (i.e. western-type) market economy were adopted in Eastern Europe. This is a process of market creation (Fligstein 1996) in which foreign direct investment (FDI) plays a critical role. In the particular case of East Central Europe (ECE), this process is advanced and guided by integration of the region into the European Union. Thus, the very definition of ECE for the purposes of this paper is the region that consists of 8 East European states which are to be full members of the EU in 2004. These countries are geographically and economically close enough to Western Europe and considered as the next (semi-) periphery internalised by the EU in its successive expansions from 1973 onwards. However, because of limitations in my research, I will focus only on five of them: the Czech Republic, Hungary, Poland, Slovakia and Slovenia.[2]

The point of departure of this paper is that withdrawal of the post-communist state from economic transactions does not entail its withdrawal from market creation and coordination of transactions. On the contrary: a robust role of the state is a necessary – although not a sufficient – condition for creating western-type market institutions.

As Fligstein (1996) put it, „The organizations, groups, and institutions that comprise the state in a modern capitalist society claim to make and enforce the rules governing economic interaction in a given geographic area. Capitalist firms could not operate without collective sets of rules governing interaction. While most modern discussions of state-building have focused on welfare and warfare, modern capitalist states have been constructed in interaction with the development of their economies, and the governance of economies is part of the core of state-building.”

Indeed, governance of economies has been an integral part of state building in theECE. This paper argues that as a result of a dynamic interaction between transition economic development and state building, ECE states’ autonomy and capacities have increased. Thus, state autonomy vis-à-vis other economic actors, as well as state capacities to formulate and implement policies, have been accumulated because of institutional differentiation (a *differentia specifica* of modern capitalism [Weber 1978]), institutional learning by state organs (Vernon 1971) and the effects of EU integration (Bartlett and Seleny 1998). An important factor of enhancing state autonomy vis-à-vis traditional distributional coalitions (Olson 1982) was the large scale entry of FDI, although under particular circumstances multinational companies (MNCs) may also threaten “state capture.” (Hellmann and Kaufmann 2001)

---

[2] Apart from regrettable limitations in data as well as my knowledge, dramatically different historical trajectories support the differentiation between Central Europe and the Baltic States, and hence exclusion of the latter from this inquiry.

Despite institutional developments, however, characteristics of state-society relations have often proved persistent. Patterns of autonomy and capacity of states have reinforced themselves in economic policies, determining structural economic changes, which in turn affected the state. Thus, although equilibria of state-society relations have been reformulated, resulting in more state autonomy and capacity, the course of economic development has not necessarily followed political deliberation.

First, the paper reviews concepts of state capacity and autonomy in the literature. Second, a discussion of capacity building and autonomy-enhancement by ECE states during transition follows. Third, abstract notions of state capacity and autonomy are tested on the case of privatisation. Fourth, attempted policy shifts on privatisation and FDI in the fundamentally different cases of Hungary and Slovenia are compared. Fifth, conclusions are drawn.

2. Concepts of state capacity and autonomy

States play an instrumental role in formulating, maintaining and reformulating rules of economic transactions. Contrary to widely held assumptions, global capitalism cannot dispense with national states because enforcement of universal rules such as protection of copyrights, and provision of technical infrastructure such as financial markets require effective state institutions (Evans 1997). Indeed, according to empirical evidence, FDI does not enter a particular country unless it is subjected to effective state policies that can locally enforce universal rules of market economies (Bevan et al. 2001). Thus, states need to posses certain capacities to formulate and implement policies and to do so even against powerful social interests; that is, they need a degree of autonomy.

According to Theda Skockpol (1985), state capacity is an ability "to implement official goals, especially over the actual or potential opposition of powerful social groups or in the face of recalcitrant socioeconomic circumstances." However, resistance to powerful opposition rather relates to the concept of state autonomy, defined by Skockpol as the ability to "formulate and pursue goals that are not simply reflective of the demands or interests of social groups, classes, or society."

D. Michael Shafer (1994, pp. 6-7) has defined concepts of state autonomy and capacity slightly differently. In his view, "autonomy is the extent to which the state is not merely an arena for conflict but is distinct from nonstate actors." However, "autonomy is not enough; states must be able to act. But whereas autonomy is always relative [to societal actors], it is useful to think of state capacity as both absolute and relative. Absolute capacity is the extent to which the state has the authority and means to extract and deploy resources: a technocratic, meritocratic, and internally cohesive bureaucracy; and effective monitoring and regulatory capabilities. [However,] state capacity must also be seen in relation to the interests, resources, and capabilities of salient societal actors." Thus, similarly to Skockpol, Shafer mixes capacity and autonomy; in his case, in the notion of 'relative capacity.'

Mancur Olson in his *The Rise and Decline of Nations* (1982) has emphasised the negative role of distributional coalitions that can prevent economic restructuring. The argument – demonstrated by using developed industrial countries' post-war development – is that coalitions between state and private actors can hinder efficient policies. Thus, state capacity is again enhanced by autonomy vis-à-vis societal groups.

An important deviation from this line of reasoning has been presented in Peter Evans' *Embedded Autonomy* (1995). He argues that although 'predatory' Third World states enjoy a substantial degree of autonomy, their capacity to formulate effective development policies are rather limited. The solution is a peculiar type of 'embedded autonomy,' enjoyed by Japanese and Korean state authorities. Policy-making bodies are characterised by professional excellence and a high degree of internal cohesion, whilenevertheless strongly tied to business communities through informal networks. This allows for additional information and policy implementation capacities, essential for the creation of *developmental states*.

Joel Migdal (1988) in turn, has stressed the weakness of Third World states vis-à-vis their concurrent societal groups. He maintained this image of the strong state is stems from western scholarship. But the problem in developing countries is not too much authority but too. Even if a particular state has accumulated sufficient bureaucratic capabilities (the Mexican state, for example), it may still fail to implement policies against the opposition of well-endowed landed classes.

In addition – but referring to a more general notion of the state, including developed countries – Eric A. Nordlinger (1987) has introduced the variable of social support towards the state along with state autonomy. He considers *strong states* as ranking high in scales of both support and autonomy; *responsive states* as being supported but not autonomous; *independent* states as autonomous but lacking support; and *weak states* as neither supported nor autonomous.

Table 1. Nordlinger's classification

	State autonomy	
	+	–
Societal support for the state +	Strong states	Responsive states
–	Independent states	Weak states

Source: Nordlinger (1987)

Both Migdal's and Nordlinger's theories have imminent importance in a post-communist context. It is not difficult to point out that in Russia and other former Soviet republics the underlying problem of economic development has rather been too little rather than too much state. And it is equally plausible to argue that responsiveness and independence of states have been frequently legitimately questioned in post-communist countries. What is important to note, following Migdal and Nordlinger, is that even administratively capable states may lack a sufficient degree of autonomy (and support) to implement policies. While this is far from being a post-communist specialty, East Central European states have to assist the emergence and strengthening of their own 'competitors' for societal power, i.e. private businesses.

3. Dynamics of state capacity and autonomy in ECEs

Having reviewed some concepts on state autonomy and capacity, we can turn to the empirical question of autonomy and capacity of ECE states. As a significant body of literature on state capture has suggested (e.g. Hellman et al. 2000, EBRD 1999), achieving a substantial degree of state autonomy *vis-à-vis* powerful economic elites might be particularly difficult to attain in transition. Evidence on Russia particularly shows that the emergence of private asset-holders and a broadening political franchise can dramatically weaken the state *vis-à-vis* empowered societal actors (Holmes 1997).

Historically, communist states possessed substantial capacities and autonomy in general during state socialism. After all, the system was based on highly centralised economic and political decision making. Planning authorities were considered the elite bodies of state administration, endowed with highly skilled and, roughly speaking, uniformly trained staff. Communist states enjoyed substantial autonomy *vis-à-vis* societal actors as private ownership and autonomous political initiatives were eliminated. East European socialism had been a state-centred modernisation effort, perpetuating a Rostowian take-off by shifting economic resources from agriculture to industry. Similarly in East Asia[3], the state had played a highly instrumental – if extremely oppressive – role up-until about the mid-1960s.

However, as economic growth started declining due to the model's exhaustion,[4] efficiency of state co-ordination rapidly deteriorated. "Reform socialist states," such as Hungary, Poland and Yugoslavia attempted enhancing the role of market co-ordination within the system, resulting in disintegration tendencies (Kornai 1992). In an attempt to improve the standard of living and resist political pressure from dissatisfied societal groups, states introduced welfare systems and kept on subsidising failing industries beyond fiscal capacities.

As a result, Hungary, Poland and Yugoslavia started their transition with a considerable degree of foreign indebtedness, limiting their manoeuvring room in economic policy-making. As this can be understood as a constraint on state capacity, fiscal consolidation should be considered as a channel to enhance it. In addition, social institutions, such as trade unions, employer associations or tripartite negotiations that can mediate between government policy and societal actors may also increase state capacity.

3.1. State capacity and autonomy in early transition

The point of departure in analysing state autonomy and capacity in early transition is policy makers' strategic choice on carrying out stabilisation policies. Whereas Poland introduced tough policy measures – often called 'shock therapy' – at the very beginning of transition, Hungary did not use radical macroeconomic stabilisation up until 1995. On the other hand, at the microeconomic level, the Hungarian transition during the early 1990s was the toughest in the. Czechoslovakia and Slovenia, similarly to Poland, introduced harsh macroeconomic policies, but remained softer than Hungary in hitting particular companies and industries.

A possible explanation is the different political economic features of Hungary. Due to the government's extremely secured parliamentary position[5] and the lack of institutionalised interest representation, Hungarian policy makers were not forced to accommodate particular societal actors' interests. Hungary was the only country in the region in which the first democratic government enjoyed a four-year term parliamentary majority that was never effectively challenged. Also, a reasonably stable party structure emerged right after the first elections. Furthermore, Hungary has a unicameral legislature in which no particular regions, institutions or social groups have privileged representation. Trade unions and employer associations have been traditionally weak and marginalized, and civil society organisations, although large in nominal figures, have not been particularly strong either.

On the other hand, Czechoslovakia, Poland and Slovenia had rather fragile parliamentary majorities at the beginning of the 1990s with substantial changes in the party system and altering governments within the first parliamentary terms. Election systems were based on party lists, and broadly defined coalitions emerged, often characterised with internal conflicts. No confidence votes could prove decisive, as dismissed governments showed in Poland, Slovakia and Slovenia. Furthermore, the dissolution of Czechoslovakia naturally transformed a whole set of state institutions.

Poland and Slovenia have had traditionally strong trade unions and relatively important bi- and tripartite institutions of social bargaining. The Czech Republic, Poland and

---

[3] Cf. Gerschenkron (1962).
[4] Cf. Kornai (1992).
[5] Because of the so called 'constructive no confidence vote,' adapted from the German parliamentary system, the government can only be dismissed if by the same vote a new prime minister is being elected. Moreover, the Hungarian election system is based on individual constituencies in which majority vote prevails, enhancing the position of the strongest party if there is one.

Slovenia have all had bicameral legislatures, with the upper houses consisting of regional representatives; in the Slovenian case accompanied with employer and employee representatives.

Thus, whereas Hungarian economic policy making capacities were constrained by an overstretched budget and a heavy burden of foreign debt, Hungarian policy makers enjoyed a considerable degree of autonomy *vis-à-vis* domestic interest groups. The Czech Republic was probably characterised by a relatively high degree of both autonomy and capacity, as its macroeconomic situation was reasonably good and neither managerial elites nor employees had strong interest representation. In Slovakia, although it had sufficiently good macroeconomic indicators, state capacities were weakened by the vulnerability of new institutions, which reinforced clientelistic policies that constrained state autonomy *vis-à-vis* powerful business groups. In Poland, policy making capacities were enhanced by the IMF's external help that provided room for radical stabilisation measures in January 1990, but state autonomy vis-à-vis companies was constrained by strong employee representation within companies and key sectors. Slovenian economic policy making proved to be extremely capable at the beginning of the 1990s, when macroeconomic stabilisation was implemented and Slovenia emerged from the Yugoslavian economic chaos very successfully. However, microeconomic reforms were less straightforward, and business elites as well as employee representatives remained very powerful, continuing the tradition of Yugoslavian self-management within 'socially owned' enterprises.

In this theoretical framework, successful macroeconomic stabilisation policies are attributed to sophisticated policy making capabilities, able to fine-tune economic factors at the macro-level. This can be relatively easy to do within a certain grace period, i.e., 'window of opportunity' (Leszek Balcerowicz (1995) because the population is more likely to be enthusiastic about political changes at the beginning of transition. Initial stabilisation policies in Poland and Czechoslovakia, for example, provided a competitive advantage for domestic producers by devaluating the zloty and the krone more than their real purchasing power would have justified (Aslund 2002). By doing so, Polish and Czechoslovakian policy makers were buying time for less efficient domestic producers at the cost of the general standard of living. However, in a political economy characterised by relatively strong interest groups and limited scope of autonomous state action, that should hardly be surprising.

Meanwhile in Hungary, in the absence of strong interest representation, harsh microeconomic policies could be implemented, first by hitting less privileged groups. Unemployment was rising most rapidly in backward industrial areas and remote villages, and the hardest-hit were those with low interest representation skills: the less educated, women and in many cases the Roma. Macroeconomic stabilisation, on the other hand, was effectively postponed up until 1995 in an attempt by incumbent governments to sustain popular support for as long as possible. Most probably due to a relatively liberal communist regime since the mid-1970s, the window of opportunity effect was less at work in Hungary than in other ECE countries. At least the so-called taxi driver strike, evoked by rising petrol prices and resulting in spectacular civil disorder in October 1990, could persuade the government about the difficulties of implementing harsh macroeconomic policies.

As the strike was completely unlawful and spontaneous, and not initiated by any established organisation, the importance of institutionalised interest representation became obvious. In seeking this, the centre-right government of 1990-94 was indeed conducting tripartite negotiations with employer associations and trade unions, and established the self-governance of the pension and healthcare funds, controlled by the unions. Nevertheless, a genuine corporatist system did not emerge due mainly to weak social support of employer associations and the unions. Interestingly enough, the institution of tripartite negotiations was weakened by the social-liberal government of 1994-98, which implemented harsh macroeconomic stabilisation measures in 1995. (Greskovits 1998) Thus, economic policy-making remained exclusive *vis-à-vis* societal interest representation, and this has continued in the Hungarian transition ever since.

In contrast, Slovenian economic policy making has been accommodating towards interest representation by trade unions and employee associations. The four large unions and the Chamber of Commerce have always played a crucial role in setting wages, which has been done through peak-level bargaining of the government, employers and employees. Although tripartite negotiations have played a far less pronounced role in the Czech Republic, Poland and Slovakia, fragile parliamentary majorities (in the Czech Republic and Slovakia) and the presence of an upper house (in the Czech Republic and Poland) could still bring about more accommodating policies than in Hungary.

Table 2. State capacity and autonomy in ECE 1: early transition period

	State capacity +	 –
State autonomy +		Hungary
–	Czechoslovakia, Slovenia	Poland (Russia)

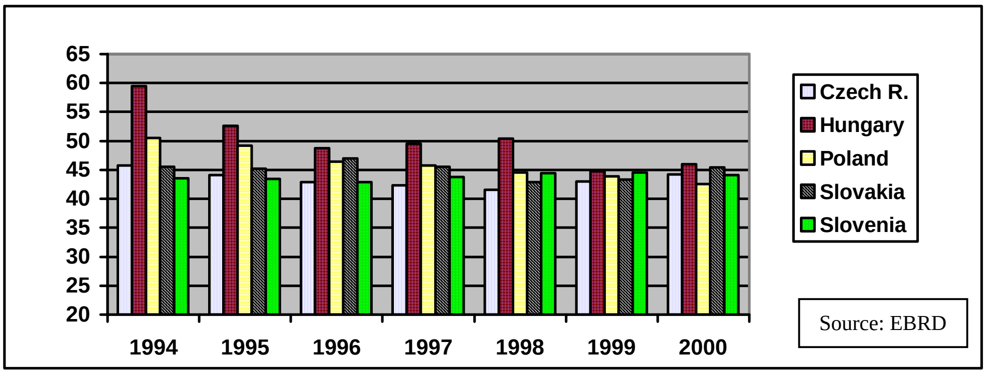
3.2. State capacity and autonomy in advanced transition

We have reason to assume that by the second part of the 1990s, a process of institutional learning by state authorities has taken place in ECE. According to Evans (1987), for example, FDI penetration into manufacturing industries can strengthen state capacities through a learning process that results in more efficient regulatory policies and/or the emergence of state owned companies. Regulations can require increased local content of production aiming at a positive foreign trade balance and intensifying local linkages. In some cases, state owned companies can assist development of domestic manufacturing industries, such as has happened in India, if only as a positive externality of a failing state conglomerate.

However, while confirming the positive impact of institutional learning, one should be suspicious about the viability of these options in ECE. First, in a context of EU accession neither local content requirements nor establishment of state-run national champions are possible options in the long run because of WTO and EU policy regimes. Second, local content requirements have dubious merits in an era of global capital flows and competition in any case (Moran 1998).

Nevertheless, in the particular case of non-EU based foreign investors, local content requirements are imposed by EU regulations, empowering nation states *vis-à-vis* MNCs. State capacities in general were also enhanced by EU integration, through the adoption of international policy standards (Bartlett and Seleny 1998). In consequence, not only capacities but also autonomy of ECE states could be enhanced *vis-à-vis* private economic actors, whether foreign or domestic. In addition, significantly streamlining fiscal policies enabled states to formulate and implement economically more efficient policies.

Figure 1. General government expenditure in per cent of GDP



In most European market economies the state is responsible for financing social activities and institutions to between 40-50% of GDP. Redistribution beyond this in most cases signals overstretched budgets that prevent effective policy making. 'Big' states are usually not particularly 'strong' ones because they have difficulties in relocating resources as their policy preferences change. Therefore, a decreasing degree of redistribution entails reduction of state responsibilities.

Nevertheless, it is another kind of weakness – usually associated with a lack of state autonomy – if a particular state is not able to obtain a sufficient amount of revenues to be redistributed. In most of the 1990s we witnessed falling state capacities *and* limited state autonomy in these terms in many former Soviet republics, Russia included.

Table 3. State capacity and autonomy in ECE 2: advanced transition period

		State capacity +	–
State autonomy	+	ECE countries	
	–		(Russia)

4. Reinforcing patterns of state capacity and autonomy: policies on privatisation

Privatisation has been on agenda since the mid-1980s in developed market economies (Clarke and Pitelis 1993). In addition to concomitant intellectual influence from abroad, reducing state finance had also raised the issue of privatisation in the ECEs. Budget deficits and indebtedness were characteristics of a number of communist countries, such as Bulgaria, Hungary and Poland. Others, like Czechoslovakia and Slovenia, on the other hand, did not suffer from financial imbalances.

4.1. Privatisation in early transition

Although initial financial situations certainly played an important role in choosing privatisation policies, they were by no means the only determinants of policy decisions. For example, while accumulated constraints on state finance certainly played a role in going for revenue maximisation in Hungary, Estonian policy makers, acting similarly, were pursuing national security considerations into first place.

As a policy choice on privatisation, Hungary went for direct sale through competitive bidding, a method that favoured the most affluent bidders when foreign investors were allowed to participate (Mihályi 1998). This policy option was enabled by the weakness of local business elites and the strength of political institutions. In contrast, Slovenian policy makers, facing well established managerial groups and employee associations, and not constrained by external indebtedness and excessive budget deficits, opted for policies favouring employees and managers of ‘socially’ (i.e. publicly) owned companies. Czechoslovakia chose a middle-way, introducing a voucher system as a principal tool for giving away state owned companies: this method meant distribution of state-owned assets among the general population regardless of the individuals’ financial capabilities and association to particular companies, but in real terms entailed little change in actual control over enterprises (Pavlinek 2002). This may reflect an intermediary position of Czechoslovakian state authorities, which, on one hand inherited a stable macroeconomic situation but experienced internal political instability, resulting in a reasonably capable but not entirely autonomous state, somewhat similarly to the Slovenian case. On the other hand, however, Czechoslovakian policy makers faced relatively weak managerial elites and employee representation, just as in Hungary. Finally, as another mixture, Poland employed both voucher and employee buy-out techniques.

In consequence of their privatisation methods, the Czech Republic, Poland, Slovakia and Slovenia have all proved to be much slower and more cautious than Hungary in employing FDI to initiate structural economic changes. Thus, while the first four countries transformed the local population and economic groups into private owners to a greater degree, Hungary did so on a smaller scale. Another important difference in terms of consequences was that whereas privatisation policies based on short term societal interests in the first group of countries resulted in limited efficiency gains, Hungarian exclusionary policies boosted the efficiency of privatised enterprises (EBRD 1999). MNCs rapidly integrated the Hungarian economy into the EU, and Hungarian export performance was enhanced spectacularly. The large-scale presence of FDI in Hungary contributed to swift economic restructuring which was not the case in any of the other countries in that early phase. The secure position of Hungarian policy makers allowed for effective regulatory measures, which were outstanding in the region, e.g., a harsh and actually implemented bankruptcy law (Kornai 2001). Thus, an insulated state could stand up against local economic interest that may have preferred preventing sweeping structural changes.

4.2. Privatisation in advanced transition

Subsequently, however, as the process of institutional learning took place and states became more autonomous *vis-à-vis* local economic elites, other countries of the region also adopted direct sale methods of privatisation and employed large scale FDI from about the mid-1990s. This was a policy shift evoked by economic constraints as well as institutional changes. At the macroeconomic level growing current account deficits threatened the Czech Republic, Poland and Slovakia. At the enterprise level, domestic companies faced increasing external competition, which resulted in their loosing ground in European markets; the case even for the developed Slovenian manufacturing industry (Landesmann 2000). At the same time, state institutions were strengthened over time, and a relatively stable party system emerged, creating increasingly secure parliamentary majorities. This enabled governments to embark upon direct sale methods, preferring well-financed foreign strategic investors in key industries. The result was a proliferation of FDI across the ECEs, with Slovenia still resisting the most.

Table 4. The political economy of privatisation in ECE

	Czech Republic, Slovakia (Poland)	**Slovenia**	**Hungary**
Method of privatisation in early transition	**Citizen voucher**	**Employee voucher (MEBO)**	**Direct sale**
Technique	Give-away redistribution of social property	Give-away redistribution of social property	State-controlled direct sale of social property
Preferred investors	Citizens	Managers, employees	Well-financed, often foreign investors (FDI)
Economic result	Quasi market/state co-ordination, limited efficiency-gain	Market co-ordination, limited efficiency-gain	Market co-ordination, strong efficiency-gain
Method of privatisation in advanced transition	**Direct sale**		
Technique	Direct sale to well-financed foreign OR well-positioned domestic economic actors		
Preferred investors	FDI or domestic investors		
Economic result	Market co-ordination, strong efficiency-gain OR quasi market/state co-ordination, limited efficiency gain		

Furthermore, direct sale methods provided room not only for inviting FDI, but also for building clienteles. As had been the case in the early 1990s in a number of transition countries – among the ECEs perhaps most prominently in Slovakia – governments used decisions on privatisation for supporting privileged business groups. This had always been a minor feature of Hungarian privatisation, but in the period of the 1998-2002 centre-right government the importance of such 'cronyism' increased. Slovenian policy makers had occasionally exhibited similar tendencies, although probably to a lesser degree. Although cronyism is rather costly in terms of microeconomic efficiency and long-term economic growth, it can become attractive even in relatively advanced transition countries.

5. The power of path dependence? Attempted policy shifts in Hungary and Slovenia

Having had diametrically opposite approaches towards privatisation and foreign investment for most of the 1990s, a comparison of recent policies on FDI and privatisation in Hungary and Slovenia may provide interesting lessons. Interestingly, their policy courses altered at the end of the decade: Hungary, the leading FDI recipient until 2000, shifted towards supporting domestic businesses. In turn, Slovenia, perhaps the most anti-FDI oriented country of the ECEs in the 1990s, experimented with pro-FDI policies.

Hungarian officials of the 1998-2002 centre-right government attempted a mild anti-FDI turn. While MNCs and domestic companies had both received state subsidies in a framework of investment promotion, the primary target group was domestic small and medium companies. The government also strengthened some privileged domestic companies by providing exclusive access to funding of highway building and other infrastructure projects. Thus, whereas FDI had dominated most of the 1990s, a revival of domestic companies was attempted for understandable purposes.

The Hungarian government at this stage, controlled by a relatively weakly embedded political right, found itself in a competitive position with its external counterparts rather than with domestic business elites. Moreover, MNCs dominating the Hungarian economy could not be considered as allies, apart from exceptional circumstances[6]. In this situation, the government attempted to enhance its domestic economic hinterland and social basis by providing subsidies to local entrepreneurs. Although the policy prevailed until the centre-right lost the elections in 2002, it cannot be considered a spectacular success. Promoted Hungarian companies did not become technologically advanced 'national champions,' and their efficiency had not improved a lot. Other domestically controlled companies, in turn, which were too big and too internationalised to belong to the governmental clientele even if partly state-owned, such as MOL, OTP and Richter, became outward oriented regional players in their respective industries. This fact not so much demonstrates the limits of state capacity in theECEs but rather in a globalised, WTO-conform world economy.

In contrast to their Hungarian counterparts, Slovenian economic policy makers attempted an opening up towards FDI after their 2000 elections. The centre-left government, enjoying a clear parliamentary majority and even a junior centre-right coalition partner, initiated the privatisation of the two largest state-owned banks, NLB and NKBM. Neither succeeded according to the original plans: NLB was partially privatised allowing only 34% for a strategic investor, while NKBM's privatisation was cancelled under strong political pressure by local elites. Thus, the Slovenian state, whilepossessing a high degree of policy making capacities materialised in remarkably good macroeconomic performance, high wages and enviable human development indices, still lacks the authority to privatise large banks according to its pursues. Thus, the competitive position of state officials and business elites for controlling Slovenian policy making, although shifted in favour of the state, has not changed fundamentally.

In short, state characteristics by and large determined privatisation policies in both countries. Privatisation outcomes, in turn, have effected economic development and hence exercised an important influence on the development of state capacity and autonomy. Consecutive Hungarian governments have accumulated a pool of administrative knowledge and were strengthened *vis-à-vis* MNCs by complying with EU standards. Nevertheless, their capability to influence large foreign owned businesses remained limited and their leverage may have shrunk over time *vis-à-vis* the largest domestic companies. Slovenian policy makers, in turn, although being endowed with excellent administrative skills and able to rely on a very developed economy, to some extent remained captive of local business interests throughout the whole transition.

Privatisation policies in Hungary allowed for very few local economic actors to accumulate large powers to influence economic policy making. Hungarian governments, in consequence, have enjoyed a significant degree of autonomy *vis-à-vis* local business – but less so *vis-à-vis* MNCs. Thus, the course of Hungarian economic development to date has been largely determined by external economic actors. Slovenian privatisation policies, in contrast, strengthened local businesses, but kept MNCs at bay as far as compliance with EU regulations have permitted. As a result, traditional business linkages that have faded away in Hungary mostly remained in place in Slovenia (Dyker and von Tunzelmann 2002, Dyker et al. 2002).

To be sure, economic performance in terms of labour efficiency, export competitiveness and technological complexity of production has been much more impressive in Hungary than in Slovenia (Landesmann 2000). However, it is questionable to what extent MNCs perform or induce local R&D and other high value added functions: Farkas (2000) and Damijan et al. (2001) have both reported limited R&D by FDI and weak technological spillovers from foreign to domestic companies in Hungary and Slovenia respectively. This

[6] MNCs had naturally supported the government in its bid for retaining tax holidays for foreign investors.

may have to do with the fact that MNCs tend to rely on ownership-specific advantages (Dunning 1993) in terms of financial, technological and human resources that are mostly located in their core countries. Therefore, as Blomström and Persson (1983, p. 499) argued, "It is possible that a considerable amount of foreign subsidiaries retards the more fundamental process of local technological development in the host country. (...) Production efficiency may be improved at the expense of basic design and development activity, with the latter being continuously imported from abroad."

6. Conclusions

This paper argued that post-communist ECE states have become more capable and autonomous during transition. However, on one hand, patterns of relations between states and private businesses turned out to be surprisingly persistent, while, on the other one, the capacity to influence large multinational enterprises remained limited, despite the positive impact of EU accession. Therefore, although Olsonian 'distributional coalitions' between states and enterprises in most advanced transition countries had been successfully broken, post-communist states still have a long way to go to reach Evansian 'embedded autonomy'. Nevertheless, according to the evidence considered in this paper, the Migdalian notion of weakness of the state was a feature of the early 1990s and less so during the advanced transition phase.

In sum, states have become more capable through institutional learning and complying with EU rules. Significantly weakened traditional distributional coalitions gave way to institutional differentiation and enhanced administrative capacities. States became more capable to formulate and implement policies and have enjoyed a greater degree of autonomy *vis-à-vis* private businesses, whether local or foreign. However, their capacities to determine the course of economic development are still rather limited.

References

Aslund, Anders. 2002. *Building Capitalism. The Transformation of the Former Soviet Bloc*. Cambridge: Cambridge University Press.

Balcerowicz, Leszek. 1995. *Socialism, capitalism, transformation.* Budapest: CEU Press.

Bartlett, David and Anna Seleny. 1998. “The Political Enforcement of Liberalism: Bargaining, Institutions, and Auto Multinationals in Hungary”. *International Studies Quarterly*. Vol. 42, pp. 319-118.

Bevan, Alan, Saul Estrin and Klaus Meyer. 2001. “Institution Building and the Integration of Eastern Europe in International Production”. One Europe or Several? Working Paper 16/2001.

Blomström, Magnus and Hakan Persson. 1983. “Foreign Investment and Spillover Efficiency in an Underdeveloped Economy: Evidence from the Mexican Manufacturing Industry”. *World Development*. Vol. 11, No. 6, pp. 493-501.

Clarke, Thomas and Christos Pitelis eds. 1993. *The Political Economy of Privatization.* London and New York: Routledge.

Damijan, Joze P., Boris Majcen, Matija Rojec és Mark Knell. 2001. “The Role of FDI, R&D Accumulation and Trade in Transferring Technology to Transition Countries: Evidence from Firm Panel Data for Eight Transition Countries”. *Institute for Economic Research Working Paper* No. 10. Ljubljana.

Dyker, David, Ágnes Nagy, Hedvika Spilek, Peter Stanovnik, Jeffrey Turk and Péter Vince. 2001. "East-West Networks and Their Alignment: Industrial Networks in Hungary and Slovenia". Mimeo.

Dyker, David and Nick von Tunzelmann. 2002. “Network alignment in transition countries: A survey of Hungarian and Slovenian Companies”. Mimeo.

Dunning, John H. 1993. *Multinational Enterprise and the Global Economy*. Wokingham: Addison-Wesley.

EBRD. 1999. *Transition Report*. London: European Bank for Reconstruction and Development.

Evans, Peter B. 1987. “Foreign Capital and the Third World State”. In: Myron Weiner and Samuel P. Huntington eds. *Understanding Political Development*. Prospects Heights, IL: Waveland Press.

Evans, Peter B. 1995. *Embedded Autonomy. States and Industrial Transformation*. Princeton:, NJ: Princeton University Press.

Evans, Peter B. 1997. “The Eclipse of the State? Reflections on Stateness in an Era of Globalization”. *World Politics.* 50, October 1997.

Farkas, Péter. 2000. “The Effects of Foreign Direct Investment on R&D and Innovation in Hungary”. *Institute for World Economics, Hungarian Academy of Sciences Working Papers*, No. 108.

Fligstein, Neil. 1996. “Markets as Politics: A Political-Cultural Approach to Market Institutions”. *American Sociological Review*. Vol. 61, pp. 656-673.

Gerschenkron, Alexander. 1962. *Economic Backwardness in Historical Perspective*. Cambridge, MA: Harvard University Press.

Greskovits, Béla. 1998. *Brothers-in-Arms or Rivals in Politics? Top Politicians and Top Policy Makers in the Hungarian Transformation*. Collegium Budapest Discussion Paper Series No. 55.

Hellman, Joel and Daniel Kaufmann. 2001. „Confronting the Challenge of State Capture in Transition Economies“. *Finance and Development* (A quarterly magazine of the IMF). Vol. 38, No. 3, September 2001.

Hellmann, Joel S., Geraint Jones and Daniel Kaufmann. 2000. *Seize the State, Seize the Day: State Capture, Corruption, and Influence in Transition Economies.* Washington DC: World Bank Policy Research Working Paper No. 2444.

Holmes, Stephen. 1997. “When Less State Means Less Freedom” *Transitions.* Vol. 4, No. 4, September 1997, pp. 66-75.

Kornai, János. 1992. *The Socialist System. The Political Economy of Communism.* Oxford: Clarendon Press.

Kornai, János. 2001. “Hardening the budget constraint: The experiece of the post-socialist countries”. *European Economic Review.* Vol. 45, pp. 1573-1599.

Landesmann, Michael. 2000. "Structural Change in the Transition Economies, 1989-1999". in *Economic Survey of Europe*. 2000 No. 2/3, UN ECE, pp. 95-123.

Meier, Gerald M. and Joseph E. Stiglitz eds..2001. *Frontiers of Development Economics: The Future in Perspective.* Washington DC: The World Bank.

Migdal, Joel. 1988. *Strong Societies and Weak States. State-Society Relations and State Capabilities in the Third World*. Princeton: Princeton University Press.

Mihályi, Péter. 1998. *A magyar privatizáció krónikája: 1989-1997* (Chronicle of the Hungarian Privatisation: 1989-1997). Budapest: Közgazdasági és Jogi Könyvkiadó.

Moran, Theodore H. 1998. *Foreign Direct Investment and Development: The New Policy Agenda for Developing Countries and Economies in Transition.* Washington DC: Institute for International Economics, 1998.

Nordlinger, Eric. 1987. “Taking the State Seriously”. In: Myron Weiner and Samuel P. Huntington eds. *Understanding Political Development*. Prospects Heights, IL: Waveland Press.

Olson, Mancur. 1982. *The Rise and Decline of Nations. Economic Growth, Stagflation, and Social Rigidities*. New Haven: Yale University Press.

Pavlinek, Petr. 2002. “Domestic Privatisation and its Effects on Industrial Enterprises in East-Central Europe: Evidence from the Czech Motor Component Industry”. *Europe-Asia Studies.* Vol. 54, No. 7, pp. 1127-1150.

Shafer, D. Michael. 1994. *Winners and Losers. How Sectors Shape the Developmental Prospects of States.* Ithaka and London: Cornell University Press.

Skocpol, Theda. 1985. “Bringing the State Back in”. In: P. B. Evans, D. Rueschmeyer, and T. Skocpol eds. *Bringing the State Back in*. Cambridge: Cambridge University Press.

Stiglitz, Joseph E et al. 1989. *The economic role of the state.* Oxford: Blackwell.

Stiglitz, Joseph E. and Shahid Yusuf eds.. 2001. *Rethinking the East Asia Miracle*. New York: Oxford University Press.

Vernon, Raymond. 1971. Sovereignty at Bay: The Multinational Spread of U.S. Enterprises. London: Longman.

Weber, Max. 1978. *Economy and Society*. Berkeley and Los Angeles: University of California Press.