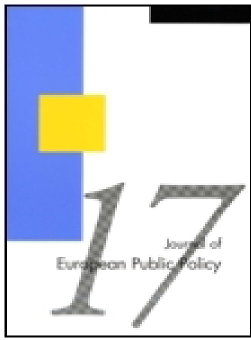

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The role of state in development of socio-economic models in Hungary and Slovakia: the case of industrial policy

Anil Duman and Lucia Kureková

ABSTRACT This contribution systematically evaluates patterns of change in socio-economic models in Hungary and Slovakia, highlighting the role of the state in the process. While the countries share general similarities in their type of capitalism, a closer overview of institutional domains reveals that important differences exist in the character of change and the role of key actors. In terms of the overall reform paths, Slovakia, especially since the late 1990s, is more coherent and overwhelmingly in a liberal direction, while Hungary appears less radical and encompasses a combination of liberal elements and active state involvement. In this contribution we focus on industrial policy and find that Hungary adopted more comprehensive and vertical industrial support geared towards upgrading, foreign-capital openness throughout the economy, and support of the domestic small and medium enterprise sector. Slovakia developed its industry more through regulation than a direct intervention, opened to foreign capital only in late 1990s, and since then eschewed any attempt to nurture domestic capital.

KEY WORDS Capitalism; change; industrial policy; socio-economic model; state.

1. INTRODUCTION

There have been various attempts to apply the Varieties of Capitalism (VoC) concepts to the emerging economies of Central and Eastern Europe (CEE)[1] since the seminal work of Hall and Soskice (2001). While some studies tried to locate the post-socialist countries in the liberal–co-ordinated market economy (LME–CME) continuum (Knell and Srholec 2007; Lane 2005; McMenamin 2004), others highlighted their transitional character (Hancké *et al.* 2007). Another strand emphasized the differences between CEE and the post-Soviet countries (King 2007; Myant and Drahokoupil 2012). Lastly, some scholars found variety within the CEE region, with Slovenia and Estonia as institutional antipodes resembling a CME and LME economy respectively (Buchen 2007; Feldman 2007).

There are also studies pointing out the ineptness of the VoC classification in capturing the characteristics and developments of the socio-economic models of the

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transition economies: these countries are faced with the paramount influence of transnational factors and their institutional set-up is to a large extent unstable and unconsolidated (Bohle and Greskovits 2009; Nölke and Vliegenthart 2009). Moving beyond the VoC categories, Bohle and Greskovits (2007) propose that there are divergent paths towards neoliberalism – neoliberal (Baltic countries), embedded neoliberal (Visegrad) and neocorporatist (Slovenia) – whereby external influences are shaped by an interplay of structural and institutional factors, past legacies and their perceptions by the political élite. Adopting the VoC's analytical concepts most rigorously, Nölke and Vliegenhart (2009) argue that a distinct capitalist model, namely 'dependent market economy' (DME), has emerged in these countries. This model is particularly characterized by a high degree of reliance on foreign capital and export-led growth. The Visegrad countries that are deemed exemplary cases of DMEs share a 'new' institutional complementarity built on skilled but cheap labour and the provision of technological knowledge and capital via foreign firms. They thus possess a comparative advantage in the assembly and production of complex manufacturing durables.

This contribution illustrates the role of state in shaping socio-economic models in two CEE economies – Hungary and Slovakia – by comparing their development trajectories in the two decades following regime change. Hungary and Slovakia are classified as belonging to a similar variety of capitalism in the more encompassing typologies of post-socialist capitalism (Bohle and Greskovits 2007; Myant and Drahokoupil 2011; Nölke and Vliegenthart 2009;). They both adopted a path of foreign-dependent export-led growth that, in contrast to the Baltic states, was more 'embedded' through the provision of relatively generous incentive packages to foreign investors and social protection to domestic electorate, but unlike Slovenia lacked more genuine co-ordination between social partners. Our motivation for choosing these cases is driven by the goal of highlighting the different paths taken in spite of similar international financial institutions (IFIs) and transnational (private foreign capital) influences. These differences can be attributed to the countries' distinct economic positions at the onset of the transition, especially the external debt and the degree of openness, as well to the process of nation-making in Slovakia.

We complement the existing research by placing greater attention on the role of state in shaping the socio-economic models, providing historically detailed and country-specific accounts in a comparative perspective (cf. Nölke and Vliegenhart 2009: 673). To this end, the contribution provides rich empirical evidence that maps the dynamics of change in the last 20 years along six institutional domains: corporate governance; financial systems; skill formation and vocational training; employment and industrial relations; welfare state; and industrial policy. Through a brief but systematic overview of these domains, the contribution lays out differences in the socio-economic models in the two countries as found in 2010. In order to demonstrate more clearly the details of state activism and relative importance of different actors, we select industrial policy as an exemplary institutional domain and examine the variation across two countries and over time.

In terms of the overall reform paths, Slovakia, especially since its turning point in 1998, embarked on a more coherent and overwhelmingly liberal direction. In contrast, Hungarian reforms appear less radical and encompass a combination of liberal elements and active state involvement in most institutional domains. The differential goals set by the governing parties at the beginning of the transition constrained or enabled by socialist legacies (i.e., market openness, foreign debt, welfare state), political context (i.e., nation-building, minorities) and the role of institutional veto players (i.e., constitutional court) have been important factors that contributed to different paths of change and state activism. Therefore, even if Hungary and Slovakia can still be classified broadly as 'dependent market economies' or 'embedded neoliberals', there are significant differences between them in their adaptation and implementation of industrial policy, which significantly affects their capacity for maintaining their existing socio-economic models.

In the institutional area of industrial policy we find that Hungary adopted a more comprehensive and vertical industrial policy geared towards upgrading, and introduced relatively early schemes aimed at the development of domestic small and medium enterprises (SME) without necessarily disfavouring foreign firms. The Slovakian state was initially more subject to pressures from local business groups and adopted a foreigner-friendly approach only after the turning point in 1998, when the pro-reform coalition replaced illiberal Mečiar government. It developed its industry more through regulation than a direct intervention, abstaining from any attempt to nurture a domestic bourgeoisie. Hungarian governments managed to pursue an outward-looking policy from the start of the transition, unlike Slovakia, which could not resist the domestic business élites and pursued an outward-looking policy only from late 1990s. The initial choices enabled Hungary to enjoy a first-mover advantage, and later on these choices put the countries in significantly different positions with different capacities and possibilities for industrial policy.

Section 2 discusses each institutional domain in conjunction with the main features and broad underlying factors of the socio-economic models in both countries. In Section 3, industrial policy is evaluated by examining the key external and internal actors' impact as well as firm responses to the policy decisions. Section 4 concludes.

2. CHARACTERISTICS OF NATIONAL MODELS AND FIVE INSTITUTIONAL DOMAINS

The institutional starting points of Hungary and Slovakia were very different at the outset of their post-communist transition. Liberalization in Hungary already began at the end of 1960s when the country introduced elements of market competition, and prior to 1989 it established a handful of institutions that allowed it to progress very quickly at initial phases of transition. Greater openness of the Hungarian economy also meant that the country entered transition with high foreign debt. This is one of the key reasons for opening up the

banking and manufacturing sectors very early on to foreign investors. Hungary was rewarded for its reform progress and pro-foreign attitudes with record high inflows of foreign direct investment (FDI). However, the country ran into severe fiscal problems and had to implement an austerity package, known as the Bokros package, in the mid-1990s. This is generally viewed as a turning point in the character of its model owing to its major effect on tripartatism and Hungary's welfare state.

Hungarian politics has been characterized by strong polarization of its polity and society, which has affected the depth and stability of the institutional reforms and led to policy oscillations. Contrary to the developments in Hungary, the socialist regime in Czechoslovakia became even more stringent politically after the 1968 Prague Spring, and the economic realm remained oriented towards the Council for Mutual Economic Assistance (COMECON) until the regime's collapse. After the Czechoslovak split in 1993, Slovakia took on a nation-building path under the leadership of Vladimir Mečiar signified by an anti-foreign stance and attempts to build a national business élite. The low initial foreign debt limited foreign influence on the government, and it postponed most of the reforms until after the political power shifted in 1998 to pro-integration and pro-Western government led by Mikulas Dzurinda. While the labour unions were marginalized in Hungary and did not play a significant role in instigating change, the Slovakian turning point was brought about with the support of unions for a mixed broad left–right coalition. Two pro-reform governments that took power from the end of 1990s significantly reshaped the Slovak socio-economic model.

The changes in Hungary and Slovakia over the last two decades were fundamental in both countries but they took a more gradual pace in the former and a much faster and deeper form in the latter. While both systems were fragile and heavily dependent on foreign investments at the end of the last decade, the Hungarian system overall appeared to be relatively solidaristic and characterized by a powerful and active state. The Slovak path was typified by a more dramatic withdrawal of the state, especially from the welfare system where extensive redistributive liberalization took place. There was also a rhetorical and an actual shift towards a regulatory state. The variation in timing as well as the type and extent of changes carried out in different institutional areas are summarized in Tables 1 and 2, and the key changes are discussed in the following sub-sections.[2]

2.1. Financial system and corporate governance

Two important processes marked the development of financial markets in transition economies: development of financial systems through bank restructuring and privatization; and the liberalization of capital accounts. In both countries the financial system is bank-based and investment capital has been generated primarily through the inflow of FDI. The national stock markets were opened up at the beginning of transition but the corporate governance standards in Hungary and Slovakia were formalized only in the early 2000s.

Table 1 Institutional design and change (2009): Hungary

	Typology	*Major changes*	*Timing*
Financial systems	Bank-based	Restructuring and privatization of state-owned banks. Several changes to the regulatory and supervisory structures resulting in streamlining and integrating supervisory structures in the National Bank.	1995–1998
Corporate governance	Insider-dominated	Introduction of CG Code which became binding for listed companies in 2004. Monistic company board structure (Anglo Saxon style) allowed since the 2006 Company Law amendment.	2004, 2008
Industrial relations	Conflictarian Dominant bargaining level: company Recognition of unions: Limited role owing to fragmentation which has been used to weaken and play off the unions	Tripartite and Labour Market Law (part of the same Labour Code) 1992 – established dualism; bargaining function to labour unions, consultative function to work councils; weaker position of unions compared to the Code of 1968; 2001 – established greater flexibility and gave more powers to work councils; transposed nine EU directives; 2002 - Labour Code amended after the social–liberal coalition won the elections and repealed several elements, i.e., changing the system of interest reconciliation (New Interest Reconciliation Council), repealing the amendment on work-council powers.	1992 2001 2002

(*Continued*)

Table 1 Continued

	Typology	*Major changes*	*Timing*
Education and skill creation	State-/school-based	Systemic and substantive reforms of vocational education and training very early on in transition and in mid-2000s: • substantive changes in National Core Curricula on all educational levels; • training levy and Vocational Education Fund; • Regional Training Centres; • National Council for Vocational Education; Progressive methodology introduced to devise study programmes based on labour market needs (2008).	1993 2005–2008 1993, 1996, 2005
Welfare: pension system	Weakly privatized	1997–1998 – Major two-pillar pension system introduced 1998–2002 – Gradual implementation that was legislated was slowed down, changes to indexation. 2006–2010 – Reform continued, new measures introduced in the course of the 2009 economic crisis. 1994 – introduction of voluntary pillar.	1997–1998

Welfare: labour market policies	Welfare-workfare welfare system	1992–1993 – First major significant downward adjustment to UB. 2000–2001 – Eligibility eased but lowered duration of benefits, work availability requirement introduced; greater emphasis given to Labour Office tasks (job search assistance, career management, brokerage services). 2005–2006 – Conceptual remodelling of the system, activation logic fully introduced, replacement rates for UB lowered, contribution period requirement increased.	1992–1993 2000–2001 2005–2006
Welfare: healthcare system	State-controlled healthcare	Mid-1990s – privatization of primary care and drug sector, rationalization of in-patient care. 2006–2008 – Reform introduced more competition but preserved the control function of state, greater financial participation of patients while keeping solidarity of the system and universal (but controlled) assess.	1995–1997 2006–2008
Industrial policy	Active state	1988 – Act on the Investment of Foreigners – opening to foreign capital. 1993 – Industrial export processing zones. 2000 – 2003 – Szechenyi Plan and its followers. 2001–2003 – Wage regulation.	1988 1993 2000–2003

Source: Authors.

Table 2 Institutional design and change (2009): Slovakia

	Typology	*Major changes*	*Timing*
Financial systems	Bank-based	Restructuring and privatization of state-owned banks. Several changes to the regulatory and supervisory structures resulting in streamlining and integrating supervisory structures in the National Bank.	2000–2002
Corporate governance	Insider-dominated	Introduction of CG Code which became binding for listed companies in 2002–2003.	2002–2003, 2008
Industrial relations	'Corporatist' (relative to Hungary but not Western style corporatism) Dominant bargaining level: Industry and company Recognition of unions: Yes, relevant partners in legislation discussions and in tripartite dialogue.	Tripartite Law and Labour Market Law: 1997 – Repulsion of Tripartite. 1999 – Tripartite re-established. 2001 – Labour Code amendment reduced flexibility and increased power of labour unions. 2003 – Over 200 amendments substantially changed the Labour Code towards more flexibility, unions' role weakened. 2007 – Increased security, power of labour unions and decreased flexibility.	1999–2001 2003–2004 2007
Education and skill creation	State-/school-based	Vocational Education Reform: Transformed curricula in secondary vocational and technical training education.	2007–2009
Welfare: pension system	Strongly privatized	2003–2004 – Parametric reform. 2004–2005 – Second pillar introduced. 2006–2008 – Changes to several rules of the second pillar. 1996 – Third voluntary private pillar introduced.	2004–2005

Welfare: labour market policies	Workfare welfare state	1992 – First major significant downward adjustment to UB. 1996 – Act on Employment – institutional changes to provision of services, more emphasis on disadvantaged groups 1999 – 2001 – further downward adjustment to UB levels and eligibility; the concept of 'subjective' reasons for becoming unemployed introduced. 2003–2004 – Act on Social Assistance and Subsistence, Act on Social Insurance, Act on Employment Services – major overhaul of the labour market policies set-up.	1992 1999–2001 2003–2003
Welfare: healthcare system	State-regulated healthcare with market elements	Mid-1990s – Privatization of primary care and drug sector. 1999–2002 – Rationalization. 2002–2004 – Change of legal personalities of healthcare providers to introduce market and competitive elements, hospital rationalization and restructuring, transformation of legal status of healthcare insurance companies to profit-making institutions. Reform shifted the role of the state to one of regulator, introduced more competition in each healthcare sector market segment. 2006–2010 – Several elements of the reform reversed or unfinished.	Mid-1990s. 2002–2004 2006–2010
Industrial policy	From protectionist paternalism to regulatory state.	1997–1998 – Beginning of support for the automotive sector. 1999 – Opening to FDI. 2000 – SARIO established (Investment agency). 2001 – Law on Industrial parks, aggressive investment incentive. 2004 – Flat tax reform.	1999–2001

Source: Authors.

The Hungarian government made a conscious decision to privatize the banks to strategic investors, and in 1995 six large Hungarian banks were sold to foreigners. By the end of 1990s, 70 per cent of the banking system was under foreign ownership, mainly of European Union (EU) origin. Such early privatization to foreigners encouraged further FDI inflows to Hungary, as the investors were able to find branches of domestic banks in the country (Szapary 2001). Hungarian regulation also allowed foreign banks to set up new branches (EBRD 1998). In Slovakia, during most of the 1990s, bank regulation was intertwined closely with state enterprise restructuring and state-owned banks were utilized as tools of support for large state-owned enterprises. Restructuring of the banking sector in Slovakia started only in late 1990s and was Slovakia's first major reform of the Dzurinda government. In the autumn of 1999, the government, being the last among the Visegrad countries, began to recapitalize and restructure the state banking sector in preparation for privatization. By 2007, the Slovak banking system was dominated by private commercial banks, which constituted nearly 88 per cent of the financial sector assets (IMF 2007).

While corporate governance in both countries is insider-dominated, several differences can be observed in the process through which corporate governance (CG) regulations emerged. First, in spite of later privatization and acceptance of foreign ownership, Slovakia adopted formal corporate governance regulation earlier than Hungary. The second round of amendments of the CG Codes took place in 2008 in both countries and it had been explicitly related to the need to respond to new EU regulation. Second, in Hungary the process of corporate governance reform was solely in the hands of Budapest Stock Exchange, while in Slovakia a handful of different actors were involved, including non-governmental actors and associations. Third, while the Hungarian CG rules provide for a one-tier board system, in Slovakia only a two-tier board is allowed. However, the actual governance issues in foreign-controlled companies are decided by headquarters abroad (Nölke and Vliegenhart 2009), which limits the states' capacity to regulate their activities.

2.2. Industrial relations, and vocational education and training

Industrial relations in Central and Eastern Europe can be characterized as acquiescent, employer-oriented and with a strong position for governments. The position of social partners seems to be relatively more established in Slovakia than in Hungary, but the actual powers of unions has been subject to frequent legislative changes at the will of governments in power (Stein 2001). Hungarian industrial relations have suffered from fragmentation owing to its dual system – work councils at the company level and trade unions at the sectoral level. Additionally, there are multiple organizations and representations on both the unions' and the employers' sides. Hence, despite the early legislation on social partnership, the Hungarian tripartite system is practically ineffective. This allowed governments to play the social partners off each other and even

take over some of the typical union issues such as minimum wage and public sector salary increases (Fazekas 2004). The weak position of industrial actors in Hungary enabled the state to stand firm against the domestic pressures from the beginning of transition and make more autonomous policy choices.

The Slovak system of industrial relations has been more concentrated with centralized representation, both on the side of the unions and the employers. Although there have been fluctuations in Slovak industrial relations in line with the ideological orientation of the governments in power, the existence of tripartite institutions was largely preserved. The comparatively more institutionalized and effective industrial relations system in Slovakia forced the government to opt for an inward-looking economic policy in the early 1990s, though this was largely abandoned later on, partly owing to the diminishing strength of labour. The most fundamental reform of the labour law, which includes industrial relations legislation, was carried out in 2003. It was heavily opposed by the unions and supported by the employers' associations, as well as the chambers of commerce representing mainly foreign companies. In addition to significantly increasing the flexibility of the labour market, the reform also restricted the coercive character of the labour law and reduced labour union power (Jurajda and Maternova 2004).

In spite of the fragmented industrial relations in Hungary, reforms of vocational education and training were introduced early on in the transition which led to a greater involvement of the social partners in the skill-formation system. The Vocational Training Act of 1993 and the Chamber Act of 1994 provided a legal framework for shifting the responsibility for practical training back to industry and re-introducing apprenticeships. The social partners had an advisory role in the development of vocational training policies and the distribution of funds for practical training (OECD 1999). The first co-ordinated attempt at curricular reform of vocational training in Slovakia came much later in 2009 with the adoption of the Vocational Education Act. Until this reform, employers and unions had limited influence over the development of educational and training curricula, with the exception of the leading sectors – i.e., automotive or financial services (Vantuch 2007). Therefore, the established industrial relations system in Slovakia did not translate into co-ordination and co-operation among the social partners on some of the institutions that can generate benefits in the long run.

2.3. Welfare systems

A big share of the variation among the Visegrad countries comes from their welfare systems which have served as compensating mechanisms, especially during the 1990s. Social policies, together with public education and healthcare, have been used as tools of economic restructuring and to provide a skilled and healthy labour force (Greskovits 2010). Welfare systems carried important legacies from the socialist and pre-socialist periods, but over the last two decades important changes took place in all core policy segments.

Hungary and Slovakia inherited highly redistributive pay-as-you-go pension systems from the socialist regime. Pension privatization was an area where the countries received significant technical help and pressure from the international financial institutions. All countries in CEE gradually introduced parametric or systemic reforms to their pension systems that, however, differed in timing and scope. In 1997–98 Hungary was the first CEE economy to undertake a systemic reform towards a three-pillar pension but opted instead for a weakly privatized system. Slovakia followed suit only in 2005, though it did so with the highest allocation of resources to the second (private) pension pillar among the new accession states (Wagner 2005).

A comprehensive reform of the healthcare system came on the agenda relatively late in the transition. A major restructuring of the system took place in Slovakia between 2002 and 2004 and aimed at changing its incentives and basic functioning principles. While keeping solidarity and universal coverage, the reform introduced more competition into each market segment, as well as greater individual responsibility for health and health expenses (Pazitny *et al.* 2006). In the autumn of 2006, the Hungarian healthcare reform laws were passed, in many aspects modelled according to the Slovak example. The reform turned out to be highly controversial and led to the breakdown of the government in 2008 (Mihalyi *et al.* 2009).

Unemployment and other non-employment benefits – early retirement, disability pensions and social assistance – served as important tools to help the society to adjust to the market transition (Vanhuysse 2006). All the countries in the CEE region adopted comprehensive regulations encompassing the provision of income support for the unemployed almost immediately after the regime change. Both Hungary and Slovakia concentrated on unemployment benefit schemes and their re-calibration for most of the 1990s, while active labour market policies entered the agenda more substantively around the time of their EU accession. They were designed in line with the Western activation principles, emphasizing better institutional quality and improvements to the scope of job search advice and placement (OECD 2007). Over time the unemployment benefit systems in both countries underwent a series of amendments resulting in tightened access or shortened duration. These were decreased most dramatically at the beginning of the transition and then again in the early 2000s. In Slovakia, labour market legislation and the structure of social benefits underwent the most comprehensive changes in the 2002–2006 period and ended up being one of the most restrictive unemployment benefit systems in Organization for Economic Co-operation and Development (OECD). Overall, Slovak social assistance has gone through substantive redistributive liberalization and weakened solidarity, achieved by regulatory tightening (Bodnarova 2006). In Hungary the system remained more generous and family allowance schemes provide an additional sizeable form of income support.

A careful analysis of the successful and failed reforms across the welfare system areas highlights the role of domestic veto players and electoral politics. In Hungary, the Constitutional Court played a crucial intervening role in

halting the planned liberalization or increased privatization of education and the healthcare systems (Mihalyi *et al.* 2009). Moreover, party polarization in Hungary resulted in preservation of the system since each succeeding government revoked the previous liberalization attempts. Generally, the Slovak Court has played a less powerful role in shaping policy trajectories and outcomes. Also the reform path initiated by the two liberal governments in Slovakia between 1998 and 2006 was maintained by their socialist successor.

3. INDUSTRIAL POLICY

In this section we focus on industrial policy to demonstrate more clearly the features of state activism and the different choices made in the two countries. We define industrial policy as a set of policies aimed at affecting particular industries to achieve the outcomes which are perceived by the state as efficient for the economy as a whole (Chang 2006). Industrial policy comprises government interventions directed towards enterprises, industries or sectors and aimed at influencing the industrial structure (Budzinki 2004). There is a distinction between general (horizontal) and selective (vertical) industrial policy, as the former targets all sectors and interventions are applied across the board, while the latter is about promoting specific sectors and industries. In practice, the distinction between them becomes much blurred. Some of the policies that are technically horizontal can end up having differential effects across sectors. For instance, energy or training subsidies can be given to all firms, but in fact energy or skill-intensive firms would benefit disproportionately from such support. Nevertheless, the distinction is still useful because the degree of verticalness or horizontalness helps to explain the governments' overall development strategy.

Hungary and Slovakia diverged in both the timing and character of their industrial policies. This occurred despite similar external pressures stemming from the process of EU accession or IFI policy advising in the early period of transition. First, the level of state aid in Hungary was significantly higher than in Slovakia, especially during the 1990s. Budget subsidies as a share of gross domestic product (GDP) declined in Slovakia from 4 per cent to 2 per cent between 1992 and 1998, while in Hungary they remained between 5 per cent and 6 per cent (EBRD 2005). Second, although their subsidy levels converged in the early 2000s, the structure of state aid differed substantially. Hungary targeted its manufacturing industry, while Slovakia preferred regional state aid which has a horizontal character (European Commission 2009a). The third difference exists in the SME sector size – in 2008 over 56,000 enterprises were present in Hungary with less than 249 employees, while only 8,000 existed in Slovakia (European Commission 2009b). In sum, Hungary took a more active and vertically oriented approach to industrial policy. The following sub-sections highlight the underlying political, social and structural reasons for these differences.

3.1. Major external actors

The external actors that were influential over policy-making in the two countries were similar. The International Monetary Fund (IMF) and World Bank had significant leverage at the beginning of the transition period and promoted a mainstream approach to industrial policy. These organizations support only horizontal, generic or sector-neutral industrial policy and adamantly oppose changing relative sectoral prices through vertical intervention. For them, optimum industrial upgrading and development are expected to emerge automatically as the government plays a role in supporting the market by getting the prices right and building the correct institutional set up (Wade 2010). This understanding was supported to differing degrees by domestic policy-makers, as the above-presented data (and the discussion in the next sub-section) demonstrate. Although external openness in both trade and capital accounts were seen as the sources of innovation and industrial restructuring. and any form of state interventionism or market protectionism was labelled as unproductive and inefficient, each country intervened actively into the process of restructuring. After a very short initial period following a hands-off approach that conformed to neoliberal expectations, massive efforts to actively soften the adverse effects of the transition were launched, including intervention in firm restructuring and the mode of privatizing large state-owned enterprises which were, in effect, sectorally specific (Török 2007; cf. Hanley *et al.* 2002; King and Sznajder 2006).

The most important external actor in the transition process was the European Union, which implicitly holds a slightly different view on the issue of industrial policy. EU rules bring several tools typically used as industrial policy under its purview. With the aim of securing fair competition across the single market, the EU regulates and controls state aid. While new member states only had to comply with these rules after accession, they were encouraged in the late 1990s to establish state aid-monitoring authorities and adopt EU-compliant state aid legislation (Mogyorosiova 2006). The promotion of agriculture, promotion of backward areas (i.e., regional development) and important projects of common European interest represent exceptions to the state aid surveillance. Hence, while after accession Hungary and Slovakia both became more limited in their options regarding, for example, free economic zones and other FDI incentives, the resources available through EU structural funds and the ability to direct investments into underdeveloped areas offered multiple tools for continued support of selected sectors or regions. In a way, through the need to prepare operational programmes and plans to channel the available funds, industrial policy has become even more formalized.

Recently the EU prescriptions for industrial policy heavily emphasize the importance of innovation, knowledge and research and development (R&D). The R&D focus is an indication of a shift towards horizontal measures, but in practice the member states still support certain sectors, such as manufacturing, more heavily. Indeed, in 2009 over 60 per cent of all state aid accrued to the

manufacturing sector, excluding crisis measures (European Commission 2009a). In sum, although there have been external constraints on the extent and form of industrial support since the beginning of the transition, the exact policy was determined by each country's preferences and domestic resources.

3.2. Government policies

Immediately after the regime change, the transition countries maintained a liberal approach to industrial policy since the major structural changes were expected to take place through markets. The governments were initially hesitant to use (or proclaim that they use) vertical interventions, partly owing to the association of the term with the old regime, but nevertheless enacted several specific measures very early on. Both countries allocated sizable resources to support enterprises in the 1990s. These were primarily foreign-owned or domestic firms in preparation for privatization in Hungary and big companies in state controlled sectors in Slovakia. Importantly, both the Hungarian and Slovak governments used privatization decisions as a tool for economic intervention via the allocation of property rights (Hanley *et al.* 2002; Miklos n.d.).

Hungary's industrial policy is characterized by extreme openness towards foreign capital throughout the post-communist period. This is partly owing to the economic reforms preceding the change of the regime. In 1984 it passed a Law on Enterprise Councils which introduced a self-management system in large- and medium-sized enterprises and increased the role of managers rather than state officials. In 1988 it adopted an Act on Investment of Foreigners which set the stage for early FDI entry. Hungary offered considerable incentives to foreign investors and was also the first country to involve foreigners in privatization. Likewise, Hungary very early on allowed Export Processing Zones (EPZs), which offered simplified customs regulations and duty-free imports, investment incentives and government support. These succeeded in attracting a range of green-field investments that fostered modernization of the Hungarian economy. In respect of domestic enterprises, what first appeared as a marked *laissez-faire* approach soon took on a more strategic course of crisis management. Launching the 'Dirty Dozen' consolidation package in 1994, the Hungarian government decided that active involvement was required to prevent the collapse of a handful of manufacturing firms that were crucial for employment generation and exports (Török 2007).

Furthermore, as the efforts to attract FDI continued, in 2000 the conservative Orban government introduced the Szechenyi plan, which was a medium-term development plan for SMEs. The plan, amounting to 3.5 per cent of Hungarian GDP (HUF434 billion), aimed to improve competitiveness by supporting infrastructure, real estate, tourism, R&D and subcontractor networks. Local and regional governments, as well as firms, could participate in projects co-funded by the central government with their own developmental plans (Doliak and Kollarova 2002; Török 2007). The programme had two successors: Szechenyi Programme for Enterprise Development and 'Smart Hungary'.

The former offered preferential credit, mainly to domestic companies, while the latter established tax credits in accordance with the EU rules and gave firms the option of creating tax exempt financial reserves for later investment. The Joint Research Centres schemes offered R&D capacities to companies like Audi and Nokia. Another innovative element of SME support consisted of the 'simplified corporate tax' introduced in 2003, which unified different taxes for companies generating turnover below a certain threshold (Török 2007).

Slovakia entered its transition with a particularly unfavourable industrial structure consisting of armaments production and heavy industry – steel, iron and some chemical production. By the mid-2000s, the industrial profile of the country had changed profoundly, and the country has become one of the leading car producers and exporters in the world (on a per capita basis). The industrial policy of Slovakia can be divided into two distinct phases.

Until 1998 the government's policy concentrated on the preservation of national champions in the energy and steel sectors at the expense of SMEs. While the official rhetoric acknowledged the unfavourable economic structure, there were no moves towards changing it (Beblavy 2000). After the separation of Czechoslovakia the policy was characterized by hold-ups, especially in the large-scale privatization process, increased concentration of government power, and favouring the management of state-owned enterprises (SOEs) or other previously determined interested parties (Miklos n.d.). The decision to support large domestic firms and to close off privatization to foreign investors was related to the nation-building efforts after the separation of Czechoslovakia and the ambition to create and support domestic capital. The implicit industrial policy consisted primarily of subsidized energy prices, since energy sector ownership and distribution were kept in state hands (Doliak and Kollarova 2002). Additionally, cartel regulation and merger control enforcement were applied in a manner supportive of greater domestic market power when it was considered beneficial for the export competitiveness of a Slovak company (Török 2007). Major resources were used to develop the energy infrastructure, such as finishing the Mochovce nuclear power plant and investing in the Gabcikovo damn. State loan guarantees to big enterprises were another tool that was used to sustain big domestic employers (Beblavy 2000). The loan guarantees offered to SOEs, in effect, postponed rather than promoted firm restructuring.

Slovakia offered foreign investment incentives for a very brief period in the early 1990s, attracting investors to automotive industry, but then stopped giving them until the late 1990s. The form of privatization through vouchers, the attitude of Mečiar's government towards foreign investment, and political instability, led to low foreign investment levels. An example of the anti-foreign attitude was the 1995 Act on Ensuring State Interests in Privatizing Strategically Important State-Owned Companies, which excluded monopolies from privatization and implicitly discriminated against foreign participation.

Yet a major shift in the Slovakian industrial policy occurred in the late Mečiar government. As the production and exports of one single company – VW Bratislava – rose to significant levels, there was a swing in its production strategy to

which the government responded with its own supportive steps. In 1997, a position of plenipotentiary for the development of automotive sector was established, followed by a governmental decree in 1998 which approved tax incentives to the company (Jakubiak *et al.* 2008). From 1998 onwards, with the change in the governing forces, a further shift in industrial policy ensued. In the early 2000s the country introduced an aggressive investment incentive scheme and opened up privatization to foreigners in order to catch up with its regional neighbours. The 2001 law on industrial parks allowed the government to cover up to 70 per cent of designated investment costs in certain areas (Bohle and Greskovits 2006). Seeking to further distance the country from 'Mečiarism', accelerate the delayed restructuring and the EU accession processes, and to make the country more attractive to foreign investors, the government implemented sweeping reforms across different areas, such as business, environment, labour market, and tax policy. A flat tax rate (19 per cent) was adopted in 2004, which earned the country international attention and became an important element for a positive international image and investor recognition (*ibid.*). While industrial policy became more general in its emphasis on the creation of a favourable business and investment environment, the projects that gained major government support concentrated on the automotive and, later, electronics industries. A policy supporting domestic SMEs or R&D schemes of the sort introduced in Hungary did not surface.

The industrial policy choices of the Hungarian and Slovakian governments might appear similar overall, but, as described above, there are important distinctions between them, especially in the timing, level and type of support provided to foreign and domestic firms. While Hungary combined aggressive incentive schemes to foreign investments with state aid to SMEs at a much earlier stage, Slovakia was not only late in welcoming foreign capital but also did not extend industrial support to domestic capital formation in the later phases. These government choices reflect the power balance between the domestic élite and political actors, and are not fully determined by the structural constraints brought on by their transition experience and status in the world division of labour.

3.3. Responses and actions of multinational corporations (MNCs)

The benefits of industrial policy accruing to domestic and multinational firms in Hungary and Slovakia also differ. Hungary started the transition with large-scale privatizations aimed at decreasing state ownership rapidly. The government gave considerable privileges to foreign investors, including monopoly rights and market protection at the beginning of the transition, and promoted green-field investment projects (Antaloczy and Sass 2001). However, there was no explicit bias toward either domestic or foreign firms, as the investment promotion schemes were based on performance. Any company, domestic or foreign, was eligible to receive tax exemptions and other support. Moreover, while foreign buy-outs were concentrated in certain sectors (i.e., manufacturing

and export-oriented sectors), those companies in which foreign interest was low were given out under preferential terms to domestic owners, often outside the management–employee buy-out frameworks (Hanley *et al.* 2002). Thus, foreign investors were favoured at the expense of domestic investors in Hungary only in the first half of the 1990s.

In Slovakia, as part of the attempt to create a domestic business class, competition laws included exemptions for domestic firms that have an existing or potential market power. That said, the government's approach was still in line with horizontal measures and domestic investors were favoured through implicit methods. After the separation of Czechoslovakia, privatization decisions were erratic, but there were attempts to support management–employee buy-outs (Brzica 1998). Owing to the lack of necessary capital for restructuring and technological upgrading, most of the companies had to undergo a second round of ownership change or faced bankruptcy. After 1998, Slovakian industrial policy became much more outward oriented and multinationals started to enjoy tax exemptions and other forms of support.

A combination of the above described policy efforts and favourable skill endowments in the region made Hungary and Slovakia home to important investors in complex manufacturing industries with a measurable rate of upgrading (Pavlinek *et al.* 2009). However, as foreign-owned companies have become the key drivers of export-led economic development and growth, it can be argued that both countries are dependent on the strategic interests of multinational firms. Individual foreign firms control large shares of output, employment and exports in these countries.

Alongside EU accession, the attraction and retention of foreign companies served as important reform anchors for both countries. In this way the MNCs had an indirect effect on the discussed reforms. The period between 2000 and 2004 was characterized by a cut-throat competition to attract green-field investments between Visegrad countries. MNCs responded strongly to the offered investment incentives, since otherwise these countries are similar structurally and skillwise (Greskovits 2010). Transnational firms in CEE generally do not recreate their domestic institutional set-ups (Bluhm 2007). Rather, they use the CEE institutional context to complement what they were missing at home (Bohle and Greskovits 2009). Therefore, MNCs did not try to interfere in the domestic industrial policy-making in either country unless it conflicted with their interests. The state aid to SMEs and other forms of support to domestic capital were not opposed by MNCs as long as the governments did not decrease active or passive assistance to the foreign firms.

4. CONCLUSION

Hungary and Slovakia are widely seen as having a similar type of socio-economic regime with high reliance on foreign capital and a mixed approach to social policy. However, significant differences exist between them, especially in the role of key actors who set the direction and magnitude of change in

the main institutional domains. In Hungary, reforms took a more gradual path with heavy involvement of the state, particularly in education and training, the welfare system and industrial policy. In contrast, in Slovakia the governments have taken a liberal stance and assumed a regulatory role in almost all institutional areas, especially since late 1990s. The most similar patterns are observed in finance and corporate governance, as both countries continue to have bank-based and insider-dominated systems.

Given that the transition led to low international competitiveness, booming unemployment and other socioeconomic difficulties, an active industrial policy became essential for recovery and establishing a viable private sector. Although the imperative of industrial restructuring and technological upgrading held for both countries from the outset of the transition, only Hungarian governments managed to pursue an active and comprehensive industrial policy continuously from the beginning. Instead of accepting a minimal state and relying solely on markets, in Hungary the state shaped the socio-economic model into a more mixed type. While early attempts at liberalization and massive privatization allowed foreign capital to become a crucial player, the state continued to hold a strong hand through the incentives and subsidies it provides to large investments. Moreover, it actually put more effort and resources into assisting SMEs in their industrial upgrading. Lastly, the socio-economic consequences of industrial restructuring were partly compensated by the social policies, since Hungary maintained relatively large public programmes in pensions, healthcare, labour market and family policies.

We find that the differences in the role of state and the extent of interventionism in the two countries illuminate our understanding of the developments in their socio-economic models. While the type of change that materialized in the two countries is by all accounts transformative, it was more gradual in Hungary and more radical in Slovakia. The Slovak socio-economic configuration in 2010 also appeared to be more coherent than the Hungarian one, but the long-term sustainability of the models in both countries is questionable. This is partly owing to their heavy reliance on foreign-owned firms and the degree to which foreign influence permeates across institutional areas. However, the analysis also revealed the importance of factors such as pre-1989 legacies (the level of foreign debt and market openness), domestic political context (nation building process, political polarization), and the role of institutional veto players (i.e., Hungarian Constitutional Court) in setting boundaries of the types of change and the resulting socio-economic configurations. Moreover, our account also highlighted that the manner in which Hungary and Slovakia were inserted into the international system was a matter of political choice and active state agency.

Since we emphasize the country specific conditions for industrial policy formation, our results would not necessarily apply to the other CEE transition countries. Similar analysis underlining the interplay of macro, meso and micro factors in shaping socio-economic trajectories of other DMEs could be

developed for the remaining Visegrad countries – Poland and the Czech Republic – in future research.

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NOTES

1 Central and Eastern Europe includes the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia and Slovenia.
2 A detailed reform database can be downloaded from the ICaTSEM website: http://icatsem.u-bordeaux4.fr/

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