

Central and Eastern Europe Working Paper 58

***Capital, Labor, and the Prospects
of the European Social Model in the East***

by

Dorothee Bohle

Béla Greskovits

Central European University

Central European University

Political Science Department;

Department of International

Minda de Gunzburg
Center for European Studies
Harvard University

Relations and European Studies;
Committee on Degrees in Social
Studies, Harvard University

ABSTRACT

During the past decade of European economic integration vastly worse standards have emerged in work conditions, industrial relations, and social welfare in Eastern Europe than in the West. Area scholars explain this divide by labor weakness caused by the ideological legacy of communism, and do not problematize the impact of transnational capital. In contrast, this essay argues that the reason why the European social model has not traveled to the East is that its socio-economic foundations, the industrial building blocks of the historical compromise between capital and labor, have not traveled either. In the West, the compromise had been rooted in capital-intensive consumer durables industries, such as car-manufacturing, and their suppliers. These sectors brought together organized and vocal labor with businesses willing to accommodate workers' demands, because for them labor had been less a problem as a cost-factor and more important as factor of demand. However, the main driving force of the eastward expansion of European capital has been the relocation of labor-intensive activities where business relies on sweating masses of workers, whose importance as consumers is marginal, and who are weak in the workplace and the marketplace. With this general conceptualization of how the emerging new European division of labor constrains the social aspects of East European market societies as a background, the essay studies the cases of Hungarian electronics and Slovak car industries in order to better understand how particular features of various leading sectors mediate the general pattern.

I. Introduction

How far has the western economic integration of the ex-socialist economies been accompanied by the eastward extension of the European social model? Recent evidence on workers' situation suggests that social integration has not gone far. Rather, very different working conditions, industrial relations, and levels of welfare characterize the two parts of Europe. In our essay we shall explore the socioeconomic bases of this divide and thus contribute to a better understanding of the prospects for social integration and its politics in a larger European Union (EU).

Earlier literature links the emergence of the European social model to the postwar historical compromise between capital and labor. Some scholars stress the role of labor while some focus on the role of capital in that process. We subscribe to a balanced view and assume that a stable capital-labor accord requires capital willing to accommodate workers' demands as well as labor strong enough to push for, and to maintain businesses' interest in, such a deal. If the European social model could not have emerged without a capital-labor accord, which in turn would have been impossible without accommodating business and strong labor, the task is to identify the conditions under which the interests and capabilities of these actors coincide.

We shall trace some of these conditions to the socioeconomic situation of various business and labor groups. Specifically, we shall argue that business groups' willingness to accommodate labor demands depends on how important labor is to them as a factor of production, and as a factor of demand. In turn, labor strength varies both with workers' location in the production process, and their market situation. Furthermore, rather than distributed randomly, the factors of accommodating business and strong labor are likely to converge in particular major industries and thus turn them into hotbeds of social accords. In specific historical moments industries of the above type can impose the logic of compromise even on sectors where business is less friendly towards workers, and workers less able to fight for their cause.

To briefly summarize our conclusion at the outset, we discover the social bases of the European model, and of the viability of what remained of it in our times, in the dominance of capital and skill-intensive consumer goods and capital goods industries in the production profile of the West European economy. In contrast, labor-intensive export industries have become the leading sectors in the ex-socialist economies integrating into western systems of transnational production. While historically the dominant industrial complexes of the West brought together accommodating capital with strong labor, and have (albeit to a lesser extent) maintained this propensity, most of Eastern Europe's transnationalized industries combine businesses uninterested in, and labor too weak to fight for, their own historical compromise. In the absence of a solid socioeconomic base the European social model will not travel to the East, except perhaps if its extension gets significantly stronger support from Brussels and national governments than it does currently. However, to us, this latter possibility seems unlikely. Rather we predict the persistence of the socioeconomic roots of the social divide that may negatively shape the political prospects of an enlarged EU.

In section 2, we present evidence on the current differences of the social conditions in Europe's East and West. We briefly summarize the main features and origins of the European social model, and comment on recent East Europeanist scholarship that stresses labor weakness as the main factor of the divide. In section 3, we build our own conceptual framework that links business and labor preferences and capabilities for a compromise to industrial attributes. Adapting our general framework to the context of transnational production in section 4 we shall explain why the western integration of East European economies has not been followed by the eastward

extension of the social aspects of the European model. Next, we shall demonstrate how particular features of two major industries mediate the general pattern of the European division of labor, and its societal impact. Section 5 focuses on the electronics industry, and section 6 on car manufacturing, the leading sectors of the Hungarian and the Slovak economies. In section 7 we conclude.

2. The European social divide

East European workers expected that their countries' "return to Europe" would help to bring their work and living standards closer to EU levels. However, these hopes have hardly come true so far. On the contrary, authors of a recent study identify "vastly differing norms in both living and working conditions across the continent," and express concern that this situation poses "serious challenges for Europe's policymakers. A stable and cohesive new Europe requires closing these gaps as effectively and quickly as possible" (Paoli, and Parent-Thirion 2003: 5).¹

While the rate of unemployment was at comparable high levels in Eastern and Western Europe in 1993-1995 – 10.3 percent, and 9.3 percent, respectively –, in 2000-2002 unemployment in the East was almost twice as high as in the West: 12.3 percent versus 6.5 percent (see Table 1 in the Appendix). Once employed, East European workers must work significantly more – usually 43 hours as compared with 37.7 hours per week in 2000-2001 –, often in less secure jobs, than fellow workers in the West. They are also paid much less. In 2000-2001, average gross monthly wages in manufacturing have been around 394 Euros in the East and 1930 Euros in the West (based on EIROnline 2002: Table 7, p. 22, and p. 18). In addition, while Western workers can move and shop around for better work and life conditions in other member states, Eastern workers cannot do the same but remain tied, for the time being, to domestic labor markets. As to the welfare state, its restructuring has for long been on the policy agenda across Europe. However, the reforms that typically result in less generous benefits and narrower entitlements appear to have advanced further in the East than in the West.

The picture is not very different if we consider another important aspect: the shape of organizations and institutions protecting workers and representing labor interests. Union density that in the mid-1980s and early 1990s stood at about 75 percent of all employees in the East, dropped to 47 percent by the mid-1990s, and to 26 percent by 2000. Overall, density decreased by a dramatic 51 percent in this period. In addition, most of the remaining unions are located in the few not yet fully privatized heavy industries (e.g. mining), or public services (e.g. education or railways), while much of the manufacturing sector is virtually union-free. Unionization rates declined in the West as well, from 50 percent in mid-1980s to about 48 percent in the mid-1990s, but there was no further decline by 2000, and the drop over the whole period was a mere 2 percent (World Labour Report 1997-98: 250-4, and EIROnline 2002: Table 1, p. 4). There is a marked divergence in the dominant organizational levels at which labor bargains for wages. In the West the intersectoral, and even more the sectoral level is dominant – in 70 percent of the countries –, whereas in 75 percent of Eastern countries bargaining mainly occurs at the company level (EIROnline 2002: Table 2, p. 10) Given the poor development of the upper tiers of bargaining, and that major business actors are often absent, important issues cannot be discussed with

¹In the following we compare data from ten West European countries, Austria, Belgium, Denmark, Finland, France, Germany, Italy, the Netherlands, Sweden, and the United Kingdom, with evidence on the eight East European countries, which since May 1, 2004, are full members of the EU. These are the Czech Republic, Estonia, Hungary, Latvia, Lithuania, the Slovak Republic, and Slovenia. We refer to the former group "Western Europe" or "the West," and to the latter "Eastern Europe" or "the East." Given our interest in the prospects for the eastward expansion of the European social model, we decided to examine it in the context of its origins, that is Western Europe's rich countries, rather than its periphery, Greece, Ireland, Portugal, and Spain. Luxembourg is left out for lack of sufficient data.

sufficient authority at national tripartite institutions even where they exist (Ost 2000). There is a large difference in the share of workers directly covered by collective bargaining agreements as well: on the average this is 74 percent in the West but only 39 percent in the East (EIROnline 2002: Table 4, p. 13).

Last but not least, when compared with the West, Eastern workers proved no less incapable of organizing contentious collective action than of institutionalizing negotiated labor-management relations. Data controlled for the different sizes of the Western and Eastern labor forces show that over the whole decade of 1993-2002 roughly five times more workers participated in, and four times more workdays were lost due to, strikes in the West than in the East (Table 2 in the Appendix). Furthermore, in the East, there have been hardly any strikes in manufacturing, the sector most thoroughly transformed by foreign direct investment (FDI) and foreign controlled subcontracting networks. A closer look at the dynamics of labor militancy reveals even more striking divergences. Western economies were significantly more strike-prone than the Eastern economies in 1993-1995, when most ex-socialist countries struggled with deep recession. The West-East strike participation ratio was 2:1, and the ratio of lost workdays 2.4:1 in 1993-1995. However the period of recovery in the East seems to have further magnified the West-East gap. In 2000-2002 the West-East strike participation ratio was 35:1, and the ratio of lost workdays 12:1. All in all, East European workers have not been militant in times of economic crisis and even less in times of recovery. Labor protest has almost disappeared by the time when Europe's Eastern periphery became part and parcel of Western transnational systems of production.

To be sure, the above averages cover significant variation on each analyzed dimension both within the West and within the East.² However, while high unemployment, long working hours, lower wages, low union density, the absence of intersectoral or sectoral bargaining, and low strike activity are exceptional phenomena in the West, they are common in the East. That is, notwithstanding the varied national experiences in both parts of Europe, explaining the divergence between the West and the East remains an intellectual challenge of primary importance that should *precede* the study of country variation. To accomplish this task we need to identify the *common factors* that make the West European countries look so similar to each other, and so different from the East European cases (see, for a similar approach, Crowley 2002: 34). Taken together, the above evidence allows us to propose that despite their widely discussed erosion, many of the social aspects of West European capitalism are still alive, and remain attractive, especially from the perspective of the East European newcomers to the EU. To better understand its persistence, it is useful to ask about the circumstances that made the European social model possible in the first place.

2.1. The European social model

In its best period (broadly from the mid-1950 to the mid-1970s), the European social model exhibited “a specific combination of comprehensive welfare systems and strongly institutionalized and politicized forms of industrial relations” (Grahl, and Teague 1997: 20). In a similar vein, Andrew Martin and George Ross write about a “European model of society with broad de-

²For example unemployment is high in Germany and low in Austria, high in Poland and Slovakia but low in Hungary or Slovenia. Similarly, working weeks are longer in the U.K. than in France or Italy, as well as longer in Latvia than in Hungary. There is almost full unionization in the Nordic countries, but the majority of French and British workers are not union members. In the East, union density is higher in Slovenia than in the Baltic States. Finally, while Austrians almost never, and Italians frequently, go on strikes, there are differences in the East as well, e.g. between the more contentious Poles and the quieter Hungarians (Ekiert, and Kubik 1998).

mocratic political participation, collective negotiations between large social forces, protection against risks of illness, accident, aging and the capriciousness of markets, and a commitment to provide employment for all” (1999: 1). Analysts seem to be in agreement concerning the significance of a number of international, historical, and domestic factors for this model.

Internationally, the European social model had been inextricably linked to the American efforts at hegemony and stability in the post-WWII world. It had also been a response to the emergence of the Soviet Union as a world power, and the resulting division of Europe during the Cold War. The model had been enhanced by the post-WWII international regime of “embedded liberalism,” which rested upon the premise that international economic openness was desirable but only to the extent that it did not impede domestic welfare (Ruggie 1982). While the U.S. guaranteed the institutional and financial conditions for expanding free trade, it also propagated the idea that “[c]ooperation among classes would ensure rising real wages and increasing opportunities as well as extensive social welfare benefits, to the mass of the population” (Keohane 1984: 19). At the same time fresh historical experience, the disasters of the interwar period and the war, made an accommodation among the major forces of West European societies both more desirable and more feasible than ever before (Katzenstein 1985: 30, Gourevitch 1986: 168). In the domestic context, then, it was a historical compromise between capital and labor that provided the social foundations for the European model society. *Strong labor movements*, whose strength had not come at the expense of business interests because they could offer business “dedicated consumers, controllable labor forces, wage growth tied to productivity gains, price stability and, in general, a more predictable socioeconomic world,” in exchange for accommodating labor demands, are seen as crucial for the historical compromise (Martin and Ross, 1999: 8)

2.2. Labor weakness in Eastern Europe

In a reverse argument, East Europeanist scholars tend to identify labor *weakness* as the main reason for the inferior work conditions, atomized industrial relations and poor welfare standards in the ex-socialist countries. Stephen Crowley and David Ost, editors of so far the most encompassing and valuable volume on “workers after workers’ states” suggest the weakness of East European labor manifests itself in “low capacity to shape public policy or to win material benefits ... to organize the newly important private sphere, and a general decline of labor’s social and cultural standing” (2001: 219). Ost and Crowley critically review a number of explanations for this situation, which focus on economic conditions, structural factors, the credibility problems and poor resources and skills of trade unions, state strategies and institutional configurations. They discard all these propositions as they view labor as a “weak social and political actor throughout the region, regardless of its diverse economic, political and institutional particularities” (219). Thus Crowley and Ost search for a common feature that could explain labor weakness region-wide, and identify the *ideological legacy of communism* and the resulting problems in labor’s identity as the main shared factor. This is an important suggestion, which is both confirmed by some of our own earlier observations, and other research (Frege 2001).

However, we wonder how much is it still, fifteen years after the collapse of communism, fully convincing to single out the past system’s legacy as the root cause of labor’s misfortunes in the new capitalist political economy. Isn’t it more realistic to think of East European labor in the way Karl Marx thought about late-nineteenth-century Germany, as a society that suffered “not only from the development of capitalist production, but also from the incompleteness of that development ... not only from the living but from the dead” (1977: 91) ? That is, to reverse the Marxian idea, should we not more seriously consider the possibility that alongside “a whole series of inherited evils,” such as the ideological legacy of communism, more “modern evils” arising from the Eastern expansion of transnational capitalism might also contribute to labor weakness in the East? Isn’t it time East Europeanists “brought capital back in” the study of their field?

To be fair, Crowley and Ost are not entirely silent about the impact of Europe's transnational capitalists. Still, they find the surrender of Eastern labor puzzling, especially in contrast to Western Europe, where unions seem to have found some ways of combating the challenge. Hence their conclusion: unlike Western labor, which developed organizational and ideological strength and could preserve it over time, labor in Eastern Europe has "been *created* as a weak actor ... Thus, unions in Eastern Europe confront the new global economy not from an initial position of strength but of weakness" (228).

However, and this is our main critical point, can we really understand the forces of labor and their limits by focusing solely on labor itself? Is it proper to analyze the accumulation or depletion of such forces in complete isolation from their primary social context, namely the multi-level interaction between labor and its main social partner and opponent, capital? Specifically, we miss from the existing literature an analysis of how labor's interest and strength *in relation* to the interest and strength of capital shape the societies in which they interact.³ Given our preference for such an approach, we neither find it helpful to assume that Eastern labor's fate had been sealed, in a single-handed way, by Communism well before the first foreign investor crossed the eastern borders of the EU, nor to consider it evident that capital has the same preferences and power resources in both parts of Europe, and is therefore irrelevant for explaining variation in labor's achievements. Keeping in mind the above, in what follows we shall develop in two steps a logic to explore the social foundations of business preferences and labor strength. We hope our logic also helps to build coherent and micro-founded accounts of the origins and persistence of the capital-labor accord in the West and its absence in the East, as well as hypotheses on the varied prospects in the new ex-socialist EU members to achieve anything similar to the Western historical compromise in future.

3. Industrial structure and the capital-labor accord in an advanced economy before the transnationalization of production

A stable capital-labor accord is *a game it takes two to play*: capital willing to accommodate workers' demands and strong labor capable of both constraining employers' choices and of controlling workers and moderating their demands. Many (though not all) of the factors shaping the preferences and capacities of these actors can be traced to their socioeconomic situation (Gourevitch 1986: 55). Drawing on earlier literature on the subject we identify two features that help us to better understand business propensity to do a deal with workers, and two factors of labor's capacity to press for an accord and enforce its terms. Below we elaborate on these factors and their role in the context of advanced capitalist political economies before the transnationalization of production.

3.1. Factors of accommodating business

The first factor of businesses' willingness to accommodate workers' demands is the importance of labor as a *factor of production* for a particular industry. In his seminal article on the social bases of the second New Deal, Thomas Ferguson contrasts industries that employ mainly robots rather than workers with the opposite type of "industries that rely on masses of un- or semiskilled labor." He suggests that unlike the highly automated businesses, industries of the latter type "could not afford higher social insurance, could not pay higher wages, could not accept a union. Where the workforce was already organized, they could not resist the pressure to attempt to undermine it. And a legislated minimum wage would usually constitute a direct threat to them"

³See Pontusson 1995, for a similar criticism of what he calls "comparative public policy," as opposed to the political economy, of Western societies.

(1984: 49). Ferguson suggests that business groups' willingness to accommodate labor demands declines with labor's growing importance as a factor of production. Businesses in labor-intensive activities more dependent on labor cost for efficiency are likelier to resist workers' pressure for higher wages and better working conditions than capital-intensive producers.

The second factor of business preferences concerning a capital-labor accord is the significance of labor as a *factor of demand* for a specific industry. This aspect was conceptualized, e.g., in studies of the political economy of the Weimar Republic. Writing about the policy and political preferences of various German industries before the Nazi takeover, James Kurth, drawing on David Abraham's work, contrasted the steel and armaments industries pressing hard for protectionism, state procurement and imperialism with the chemical and electrical industries that "had an interest in promoting mass consumption and therefore in supporting social welfare and democratic politics" Consequently, the latter businesses had not been hostile to an alignment with labor (1979: 23, Abraham 1986). Michael Piore and Charles Sabel elaborated on the demand aspect of the expansion of Fordist car industry in the U.S. "Mass production was ... profitable only with markets that were large enough to absorb an enormous output of a single, standardized commodity" (1984: 49). Consequently, "the automobile corporations – foreseeing long-term increases in economies of scale – wanted not just to create a market of a predetermined size, but also to ensure its continual extension" (63). In the long run this shaped their willingness to accept policies that gradually enabled workers to purchase cars and other expensive consumer durables. For our inquiry into the socioeconomic bases of Western Europe's historical compromise it is especially interesting to learn that by the time of Europe's postwar reconstruction politicians and business people referred to Fordism as the blueprint for sustainable development driven by virtuous cycles of mass production and mass consumption reinforcing one another.⁴ All this suggests that workers' importance as a factor of demand enhances business propensity to do a deal with them. Producers of mass consumer goods for whom workers' purchasing power is of significance are likely to be more permissive concerning labor's welfare gains than capital goods or armament producers selling their output mainly to other firms or the state.

3.2. Factors of labor strength

The first aspect of workers' strength, their capacity to organize for collective action, depends on their *location in the production process*. (Shafer 1994, Wright 2000: 962, Silver 2003: 13). As Michael Shafer observes, in line with Mancur Olson's logic, collective action is easier in capital-intensive industries where a few large firms employ concentrated labor forces with specific skills. "Although distributional issues divide them, labor and management have grounds to cooperate" (14). Alternatively, in the above industries it is easier for workers to force employers into a compromise by strikes or other protest. In contrast, "[c]ollective action by firms and workers is unlikely" in labor-intensive industries typically characterized by many small- or medium-size firms, which "draw unskilled workers from mixed communities and employ them in tiny, dispersed sweatshops under the supervision of owners adamantly opposed to labor organization" (ibid.). Yet Beverly Silver highlights another aspect of the industrial bases of workers' collective action capacities. For the vertical integration and the continuous flow of the production process in Fordist auto industry, workers could easily "exploit their position within the complex division of labor...just a militant minority could stop production in an entire plant, so if the plant was a key

⁴In the words of Paul Hoffman (once President of Studebaker) to U.S. senators in the early 1950s, "[w]e take a ton of steel and put it in an automobile and you know how very few people can afford to buy an automobile in Europe. So, if you start this process, raising wages and lowering prices, you get that great expanding market in Europe, and that will take care of this increased production" (quoted by Van der Pijl 1984: 149-150; see also Rupert 1995: esp. Chapter 3).

link in an integrated corporate empire, its occupation could paralyze the corporation” (2003: 47). However, in the textile industry, where “firms were small in size and production was vertically disintegrated, less fixed capital was idled by a strike in a single firm, and the damage done had no significant impact on the industry or the region as a whole” (92-93). In sum, labor strength is inversely related to the labor-intensity, and covaries with the capital-intensity, of technology and production in particular industries.

Last but not least, scholars agree that a second crucial factor of labor’s strength “results directly from tight labor markets” (Wright 2000: 962). Generally low unemployment or the scarcity of specific (e.g. skilled) labor enhances workers’ *market position* and “marketplace bargaining power” (Silver 2003: 13). Clearly, labor can press both harder and with more credibility for a compromise in contexts where unemployment is low, than in situations where obedient new employees can easily substitute for overly demanding workers.⁵ Similarly, the threat of labor militancy is more credible if employers have a hard time to replace militant workers. Overall, industries that use labor intensively, are likelier to tighten labor markets and enhance workers’ market position than sectors using capital-intensive technologies.

3.3. Industries against and for a capital-labor accord

We believe in combination the four discussed factors, a) the importance of labor as a factor of production, b) labor’s significance as a factor of demand, c) labor’s location in the production process, and d) labor’s market position, can offer a fair account of the prospects for a stable compromise between capital and labor, and, as a consequence, of some structural constraints on the social standards of a capitalist democracy. Erik Olin Wright characterized such a “positive” compromise as “a non-zero-sum game between workers and capitalists ... in which both parties can improve their position through various forms of active, mutual cooperation” (2000: 958). Our understanding of the macro-social outcome of the compromise is compatible with Wright’s interpretation. However, in this essay our primary focus is its building blocks at the industry level.

As far as the impact of the above factors is concerned, we agree with Peter Gourevitch that they “do not necessarily converge to define a business situation in the economy: high labor cost may push one way, a desire for strong purchasing power for labor another” (1986: 57). At the same time, as our elaboration so far indicates, these factors are not randomly distributed across the economy but seem to be linked, in a patterned way, to particular industries and turn them into “a multidimensional conspiracy in favor or against” a capital-labor accord (Hirschman 1981: 93).

Specifically, despite the substantial employment opportunities *labor-intensive capital goods industries* (e.g., electrical and electronic parts and components, or basic wood products) might offer, we have three reasons to believe that they are most unlikely to develop a stable capital-labor accord: they rely on labor as the main factor of production, labor demand for their products is insignificant, and labor’s location in their production process does not favor collective action. *Labor-intensive consumer goods industries* (e.g. garment, footwear, plastic toys, or furniture) dependent both on the cost and the purchasing power of workers, who usually do not have strategic location in production but (through the strong employment capacity of these sectors) might be better positioned in the marketplace, exhibit one type of the intermediate cases. Similarly, *capital-intensive capital goods industries* (e.g. heavy machinery, equipment, or basic chemicals) are on the crossroads between support and opposition to a compromise: relatively low

⁵See Pontusson 1992: 24 for another aspect of labor power arising from full employment, that is, the power of unions in relation to the policymaking state bureaucracy.

labor cost and skilled, concentrated workforce push one way, labor's marginal consumer role and the modest employment impact of these industries the other. Assuming that labor cost and workers' location in the production process weigh more in actors' capabilities and strategies than labor purchasing power and overall unemployment, capital-intensive capital goods industries may be more, and labor-intensive consumption goods industries less, in favor of a compromise. Finally, in *capital-intensive consumer goods industries* (e.g. car manufacturing) labor is relatively unimportant as a factor of production, but in advanced societies it became salient as a factor of demand. Furthermore, highly skilled, concentrated labor forces predict strong capacity to organize for collective action. Thus despite their modest employment contribution these industries are likely to be among the vanguards of a stable capital-labor accord (Figure 1).

Figure 1⁶
**Industry attributes and the likely opponents/supporters of a capital-labor accord
in an advanced economy before the transnationalization of production**

Industries Factors	Labor-intensive capital goods	Labor-intensive consumer goods	Capital- intensive capital goods	Capital- intensive consumer goods
Labor as factor of production	-	-	+	+
Labor as factor of demand	-	+	-	+
Labor's location in production	-	-	+	+
Labor's market position	+	+	-	-

This summary suggests that it is not entirely futile to trace the industrial origins of the macro-social historical compromise in post-WWII Western Europe to the industry building blocks of capital-intensive producers of consumer durables, such as cars, refrigerators, washing machines, and TV sets. Given the favorable international and historical preconditions mentioned in section 2, these sectors could indeed bring together coalitions of accommodating business groups with strong organized fractions of labor. To the extent that these industries assumed a leading role in the West European political economies, in coalition with their capital-intensive suppliers of iron & steel, aluminum, rubber, chemicals, plastics, and machinery and equipment, they could also succeed in imposing their logic of higher wages, better work conditions, negotiated management-labor relations, and generous welfare regimes on the rest of the economy where, for structural reasons, business had been less friendly with workers and workers had been less able to fight for their cause. Strong unions, multi-class political parties, and autonomous and capable state bureaucracies had been the actors that transformed the structural potential for compromise to the language of politics and policies. As to the role of unions, in the Fordist work organization the rhythm and content of workers' tasks were dictated by the assembly line, work was standardized, repetitive and did not demand complex skills. In this context unions played a central role in controlling and moderating workers, minimizing their conflicts with the organization of production, and focusing their demands on wages, job security, and consumption. Political parties aggregating the complex demands that arose from the historical compromise, and state bureaucracies translating these demands into concrete policies, played important roles as well. At the

⁶Positive signs denote factors in favor of, and negative signs factors against, a compromise.

same time, it was precisely the balanced, multi-class character of these coalitions that helped states to achieve “a political autonomy that permitted escape from the economic orthodoxies of left and right” (Gourevitch 1986: 162).

The historical accord between West European capital and labor has come under attack in recent decades. A range of structural shifts in production technologies, productivity, growth and employment patterns, and rising unemployment are held responsible for this. The structural shifts are accompanied by changing macroeconomic priorities and an ideological shift towards neoliberalism. One of the most important changes has been the internationalization of production, which significantly increases capital’s power over labor. Internationalization offers capital the exit option, and reduces its loyalty to any state. Undoubtedly, these trends have put the European social model under strain, although the extent to which it indeed has eroded is a debated subject (see, e.g., Grahl and Teague 1997, Garrett 1998, Martin and Ross 1999). How has the opening towards the West European economy shaped the socioeconomic bases of a new historical compromise in Eastern Europe?

4. Why has the European social model not traveled to the East?

To briefly summarize our answer at the outset, the social model has not traveled to the East because its socioeconomic foundations, or in our terms, the industrial building blocks of a capital-labor accord, have not traveled either. Instead, what arrived to the East by the second half of the 1990s were those types of transnationally organized industries and industry fragments that are usually the least hospitable to a capital-labor accord. In this period the ex-socialist economies became dominated by leading sectors, in which most of the factors of business and labor preferences and capacities tend to conspire *against* an accord. Let us explain why and how this could happen.

4.1. Rapid internationalization

During the 1990s the economies of ex-socialist candidate countries to the EU underwent a process of rapid and thorough internationalization on important dimensions: trade, finance, open-market institutions, and foreign direct investment. In 1990-1999 the average yearly growth of exports was 5.7 percent in Western Europe, and even faster, 6.7 percent in the East European countries. Measured by the share of exports in GDP, in 1999 the East European states are far more “open” than the West European countries: this ratio is 54 percent in the East and 40 percent in the West (based on World Development Report 2000/2001: Table 11 pp. 294-5 and Table 13 pp. 298-9).

Financial internationalization in Eastern Europe went much beyond its levels in Western Europe. In the year 2000 the share of the number of foreign banks among all banks had been 53 percent in the East, and reached a degree of foreign penetration that is unprecedented in the West (EBRD Transition Report 2002, country tables. See for the much smaller West European ratios Claessens, Demirgüç-Kunt, and Huizinga 1998). Similarly, by 2000, the ex-socialist candidate countries reached average OECD levels in terms of eight indicators of a market-oriented institutional system.⁷ Last but not least, FDI inflows to the candidate countries over the period of 1989-2000 amounted to \$1181 U.S. per capita, which was about seven times the rate of the Commonwealth of Independent States (based on EBRD Transition Report 2002, Table A.3.9., p. 68). While

⁷These “transition indicators” measure advances in market-based trade and foreign exchange regimes, freedom of domestic prices, small and large scale privatization, enterprise governance, reformed banking systems, and non-bank financial institutions, and competition policy. (EBRD Transition Report 2002)

economic internationalization thus advanced rapidly across the region, some countries, for example Hungary, exhibited extreme cases of foreign influence.⁸

Embedded in the above process of internationalization a major avenue of the ex-socialist economies' return to Europe led through their incorporation into Western transnational systems of production. In the capital-intensive consumer and capital goods industries this proceeded mainly through FDI that implied control of equity. In the labor-intensive industries incorporation occurred mainly through various forms of subcontracting with the implication of non-equity based forms of control. What were the consequences of this emerging cross-European division of labor for labor's importance as factor of production and factor of demand, labor's location in the production process, and its market situation?

4.2. Factors of uninterested business and weak labor

Low labor costs provided one of the main incentives for Western businesses to set up operations in the East. As a consequence, we witness a major eastward expansion and relocation of labor-intensive activities across the entire Western production profile. This process had two intertwining components. On the one hand, Western transnational labor-intensive *industries* – e.g. textiles and apparel, footwear, furniture, consumer and producer electronics – played very large roles in reorganizing production and exports in the East, and emerged, in various periods, as leading sectors in most candidate countries. On the other hand, *within each industry*, notwithstanding their general specialization in capital and skill- versus labor-intensive production, low labor costs attracted firms to relocate to, or expand in, the East their most labor-intensive (often peripheral) activities. In turn, they maintained or expanded their most capital and skill-intensive (often core) processes at home in the West. In general, production and exports became much more labor-intensive in the East over the 1990s (Table 3 in the Appendix). As a consequence, for the emerging transnational business elites, the importance of labor as a factor of production has markedly *increased* both relative to the West, and to the East of, e.g., the 1980s. These new elites included not only Western businessmen, but also members of the East European domestic bourgeoisie who became suppliers and subcontractors in the cross-European industrial networks.

While these elites share a strong interest in keeping labor cost at competitive low levels, their efforts to exploit their workers for as little pay as possible are, in contrast to the West, not tempered by their reliance on labor as an important factor of demand. Precisely because their wages are so low, East European workers *hardly can afford to buy the goods they make* in, or for, Western firms. The handful of Eastern workers, who might have bought a car in the 1990s, purchased them on the second-hand markets of old COMECON makes and of the cheapest imported used Western automobiles. For the overwhelming majority of East European working population the local products of the transnational garment and footwear industries are equally unavailable. Instead they satisfy their needs for pieces of clothing and shoes in semi-legal markets often run by Chinese and Turkish entrepreneurs who sell the cheap and low-quality goods of their home countries. As a consequence, most of Eastern Europe's new transnational consumer goods industries emerged as *export sectors* with a West European destination. However, this is only one part of a more complex problem. The other part is related to the fact, that to the extent that producers of expensive consumer durables, e.g. cars, do sell their products in their poor host countries, they target the managerial, entrepreneurial, and professional upper-middle classes, not workers. However, if the governments try to maintain automakers' interest in local operations by special meas-

⁸In 1999 foreign firms' contribution to Hungarian GDP amounted 49 percent, and their share in corporate equity capital 50 percent. More than half of the firms with more than 250 employees, and 70 out of the 100 top firms (in terms of sales volumes), had been in majority foreign ownership. While 70 percent of total exports came from foreign firms, 30 percent came from four corporations, Opel, IBM, Philips, and Audi.

ures that aim to accelerate the expansion of *this kind* of domestic market, their policies may even put additional burden on low-income social groups.⁹ (We shall return to this problem in our case study of the car industry in the Slovak Republic.)

In the light of the above suggestions, the emerging cross-European systems of production seem to have exported to the East much more the situations in which workers pose a *problem* for businesses – as major factors in production costs – than the contexts in which they become part of the *solution*, factors of demand. How are the two factors of labor strength affected by Eastern Europe’s Western integration ?

Depending on the actual degree to which labor-intensive industries became dominant in the Eastern production profile, their organization poses serious *obstacles to labor’s collective action capabilities*. The multitude of small firms and plants each of which employ relatively small labor forces, handicap both militancy and collective negotiation. But even where production more often proceeds in larger firms and plants, as in the electronics sector, workers rarely enjoy anything comparable to the “locational advantages” they once had in the vertically integrated facilities of Fordist mass production. As to workers’ favorable market position arising from tight labor markets, the labor-intensive sectors indeed contribute more to employment in the East, than the capital-intensive industries. However, the problem is that precisely because of the relatively modest amounts of FDI required by these industries for their operation, and for the resulting minimal sunk costs, they maintain *extremely high degrees of cross-border mobility*. To the extent that labor markets tighten and threaten with increasing wage costs in one country, it is easy for these producers to move to yet lower-wage locations in the region, or to Asia where labor reserves are even more abundant. Thus labor cannot permanently gain from any market position but essentially has a choice between bad jobs or no jobs at all. This way, the chances for a capital-labor accord in the East look bleak on virtually each of the dimensions that we use to predict business willingness and labor strength (Figure 2, appendix).

⁹The automobile industry did not have the same favourable social impact in poor Brazil as it had in Western Europe’s more affluent societies. To the contrary, as Kurth observes, given Brazil’s low per capita incomes in the 1960s-70s, and its “rather thin automobile market...the greatly-increased consumption of automobiles in Brazil required...redistribution to the middle class from the lower classes...through government measures which repressed working class real wages, reduced welfare and public health programs, increased middle-class real salaries, and provided government credit for automobile purchases” (1979: 31). See, on a related though not identical problem, Joseph Stiglitz’s comment on the extreme case Russia. “I did not disagree [with a World Bank economist – DB&BG] that a substantial number of people had been made wealthy enough to cause a traffic jam, or to create a demand for Gucci shoes and other imported luxury items sufficient for certain stores to prosper... But a traffic jam of Mercedes in a country with a per capita income of \$4730 (as it was in 1997) is a sign of a sickness, not health. It is a clear sign of a society that concentrates its wealth among the few, rather than distributing it among the many” (2002: 153-154).

Figure 2¹⁰
**Industry attributes and the likely supporters/opponents of a capital-labor accord
in a less advanced economy after the transnationalization of production**

Industries Factors	Labor-intensive capital goods	Labor-intensive consumer goods	Capital- intensive capital goods	Capital- intensive consumer goods
Labor as factor of production	- (-)	- (-)	+ (-)	+ (-)
Labor as factor of demand	-	+ (-)	-	+ (-)
Labor's location in production	- (-)	-	+	+
Labor's market position	+ (-)	+ (-)	-	-

4.3. Variation in Europe, and within Eastern Europe

A comparison of Figure 2 with Figure 1 reveals, that with a conceptual move from post-war Western Europe to post-communist Eastern Europe, and from a context before transnationalization to the new conditions of transnational production, both the range of industries conspiring for a capital-labor accord, and the intensity of their actors' preferences and capacities radically decline. Conversely, factors opposed to a social compromise greatly gain in strength.¹¹ Therefore, unlike in Western Europe, where industrial structure appeared to *facilitate* the historical compromise, in Eastern Europe it is becoming a serious *constraint* on the eastward extension of the European social model. Finally, neither the international, nor the historical circumstances, which had further enhanced the chances for a social compromise in the post-war West seem to be at work in post-communist East. In the post-Cold War climate the EU has so far been less ready to pay the costs of a long-term stability and convergence than the U.S. had during the Cold War. And while the historical experience of the disasters of the 1930s-1940s could facilitate a reconciliation of interests, and perhaps even solidarity among major societal forces, the collapse of communism contributed to a rather different pattern. At least initially, workers might have shared with their new employers the euphoria over the market and its automatism as the sole guarantor of fast and equitable social progress. Finally, it is not obvious how long the major political parties of the East can retain a *credible* multi-class profile, nor is it clear how far East European state apparatuses, in the absence of the control mechanisms a multi-class accord can provide, can act *autonomously* from business interests.

We devote this essay to the single purpose of revealing the socioeconomic foundations of the European social divide. A full exploration of the variation in the social quality of East European transnational capitalisms, and its structural constraints, goes beyond this task. Nevertheless, to the extent that we are correct in identifying the socioeconomic bases of the divergence *in Europe*, our framework should be no less able to generate plausible propositions on the factors of diversity *within Eastern Europe*. Specifically, if the predominance of capital-intensive consumer

¹⁰Negative signs in parentheses denote strengthening of factors conspiring against and weakening of factors conspiring for a capital-labor compromise, once a transnational industry is set up in a less advanced country.

¹¹See Kurzer 1991 for the impact of relatively mobile versus relatively immobile capital on the prospects of capital-labor compromise in various Western states, Frieden 1988 for similar considerations in five Latin-American countries, and Frieden 1991 for a different theoretical perspective on how capital mobility changes actors' interests.

and capital goods industries indeed helps to explain the persistent superior social quality of West European capitalism, then the East European countries specializing in these activities should also perform somewhat better in social terms than other economies of the region led by labor-intensive key sectors. At a first glimpse, evidence on the candidate countries does not discard the possibility of such a coincidence (Table 3 in the Appendix). In the remaining part of our essay, we will explore the social impact of different leading sectors in Eastern Europe more in detail.

5. Mobile capital and flexible labor in the Hungarian electronics industry¹²

Hungary is Eastern Europe's top producer and exporter in the electrical and electronics industries. In 2001 its exports of computers and accessories, consumer electronics, and telecommunications equipment was \$10 billion U.S. This was three times the exports of Poland, more than the exports of the remaining six Eastern European EU-membership candidates combined, and amounted to 40 percent of the region's total exports in this sector.¹³ At the same time, the electrical and electronics industries represented about one-third of Hungary's total exports, and 40 percent of its manufacturing exports in 2001. These are also Hungary's most dynamic industries: in 1992-2001 the country's total exports tripled, its manufacturing exports quadrupled, while its electrical/electronics exports increased by about eleven times (Table 4, Appendix).

5.1. Foreign and domestic business in alliance

Little wonder that in this "General Electric Country" (this is how some observers nickname Hungary) the perceptions of the health of the entire economy and of the attraction of its policy environment reflect how major actors in the leading sector feel about their own competitive strengths and prospects. The following features further enhance the influence of the leading sector.

It is geographically concentrated in Hungary's most developed Western part, with three bigger cities – Székesfehérvár, Szombathely, and Pécs –, serving as sub-regional hubs. The *Financial Times* counted the Székesfehérvár area among the world's ten most dynamic economic regions in the mid-1990s. A number of large electronics TNCs, such as Mannesmann, Philips, IBM, Kenwood, Samsung, Siemens, and Flextronics, and many smaller firms have set up operations in Western Hungary over the 1990s. Not only did these firms become major producers and exporters – e.g. Philips and IBM have been among Hungary's top five over the 1990s –, but they also played a crucial role in shaping Hungary's fame as a friendly place for foreign companies. In addition, these firms have been major employers offering many thousands of jobs. In the course of the 1990s, each of the Hungarian governments, no matter if conservative or left liberal, offered ample incentives to attract these corporations and to reward them for their services. The incentives included a low corporate tax rate of 18 percent; 100 percent corporate tax relief for ten years, provided that the amount invested exceeded \$12 million U.S. (clearly a modest sum for these firms); exemption from local industry taxes; low-cost real estate offered in the mushroom-

¹²Our case study is primarily based on news, reports, and analyses of *Népszabadság*, Hungary's largest daily, and its archive, accessible online (NOL) at <http://www.nepszabadsag.hu> that extensively covered our subject.

¹³In a global comparison, Hungary's electrical/electronics exports is about one-fifth of Mexico's. Specifically, in exports of telecommunications equipment the country ranked 14th in the world, and of computer equipment 16th; and 6th and 8th in Europe, respectively. For facts and analysis of Eastern Europe's electronics industries see Linden 1998, and Radosevic 2001.

ing industrial/innovation parks; local subsidies for employee training and retraining; a liberal regulation of profit-repatriation; and export-zone benefits.¹⁴

However, not all the powerful actors of the industry are foreign. Central to the emerging electronics production networks has been the entrepreneurship of the large Hungarian firm VIDEOTON, and its CEO and President Gábor Széles.¹⁵ Once the flagship firm of Hungarian electronics that had produced a wide range of branded goods – from consumer durables (such as TV and video sets) to military electronics equipment - for COMECON countries, VIDEOTON had suffered from the collapse of these markets in 1991-1992, and had to fire 6,000 of its workers. In 1996, a managerial team led by Gábor Széles acquired a majority stake in the company, and subsequently reorganized it according to the following simple principle: “Downsize radically, stop developing new products, and focus on labor-intensive manufacturing to serve a hungry crop of multinational investors” (VIDEOTON’s Vice President Ottó Sinkó, cited in Radosevic, and Yoruk 2000: 7). Or, as put by Széles, “Currently there are two types of firms in the world. Some own brand names and sell branded products. Other firms dispose of technology. These latter firms are not known in the consumer markets, consumers hardly meet them. Only the TNCs are informed about their technological capacities and the type of products they are able to produce. VIDEOTON Holding belongs to the latter group of firms that are anonymous in the world market. Nevertheless, over the past years, thanks to investments in new technology VIDEOTON could become a strategic partner of countless well-known TNCs” (NOL February 25, 2002).

Thus, VIDEOTON has been reorganized into a network of more than thirty larger and smaller “projects” in which the firm either serves foreign TNCs as a subcontractor, or as a *labor contractor*. In the latter capacity VIDEOTON leases workers, or production facilities equipped with basic or specialized infrastructure, *and* with workers, to TNCs, and remains the owner of the spaces, and the employer of the labor forces.¹⁶ On the one hand, such services greatly facilitate what TNCs and their foreign suppliers consider the most significant factor of efficient production in Hungary: flexibility. For TNCs, which usually invest relatively modest sums, the fact that they do not need to own the plants and employ workers themselves, means that they can operate at minimal fixed costs, and can react extremely flexibly when facing short-term and long-term market changes. On the other hand, VIDEOTON, and other Hungarian subcontractors, stripped of their own brands and R&D activities, are forced to compete for contracts on the same single basis of flexibility.

Thus, in the Hungarian electronics leading sector following the above predicted logic of labor-intensive export industries, business is pitted against labor that is the crucial factor of production but an insignificant factor of demand, and is also weakened by its location in the production process, and by the labor-market situation detailed below. Ultimately workers have to bear the costs of flexibility primarily in terms of extremely *precarious forms of employment* that closely reflect the rapidly changing market opportunities and the related coming and going of firms and short-term job opportunities across regional borders within, and the national borders of, Hungary.

¹⁴According to Hungarian regulation a firm that supplied export businesses could declare it as operating in an “export zone” irrespective of its concrete geographical location.

¹⁵For a useful case study of VIDEOTON’s development until the late 1990s see Radosevic, and Yoruk 2000.

¹⁶To give an idea of the magnitude of labor contracting, and its significance for VIDEOTON, in 2001-2002 the firm leased about 1600 workers and production spaces to IBM Storage Products. Leasing workers and transporting them daily to the IBM-operated plant earned the firm about 3-4 billion Forints a year, and leasing the facilities an additional 1 billion Forints (Vice President Sinkó, NOL October 25, 2002). These sums roughly equalled VIDEOTON’s profits, and amounted to about 8-10 percent of its turnover.

To enhance flexibility, even big TNCs prefer leasing their workers, as IBM did, or import foreign workers and offer them limited term contracts. IBM Storage Products hired 500 Hungarian-speaking Slovak workers in the year 2000, when it had to fulfill an unplanned peak order from the parent company, and fired them subsequently with the promise that the firm might again count on them in future. Similarly, Phillips contracted for three months (and then easily fired) hundreds of women commuting from South Slovakia, where unemployment was 25-30 percent (NOL July 7, 2001, and July 14). Another widespread method – reportedly practiced, e.g., in SHINWA, Elcoteq (a large subcontractor to Ericsson), and Phillips –, is hiring workers for “probationary periods,” immediately firing them upon the expiration of a production subcontract, and re-hiring them again as “apprentices” when new contracts are in sight. Firms also use this strategy to avoid paying the legal minimum wage. Furthermore, when they can afford to, companies prefer laying off small groups of workers at a time to avoid media attention or conflicts with local labor offices. In addition to precarious employment, foreign and domestic firms operate continuous flow production and try to minimize the related additional costs.¹⁷ Last but not least, although large electronics TNCs pay relatively well, above the minimum wage and sometimes offer their own employees additional benefits, the other side of the coin is that competition forces their Hungarian subcontractors, including VIDEOTON, to push down wages and other work- and wage-related expenses. All in all, we face a situation where particular sectoral attributes conspire for a “conservative” rather than a labor-friendly alliance among the foreign and domestic elements of Hungarian business. Such alliances usually favor “investment-led growth, limited wages, weak unions, limited social insurance, the use of state power to control labor” (Gourevitch 1986: 222). How do such demands reach politicians and policymakers?

For an answer we have to understand that VIDEOTON’s and its President’s power resources give weight and credibility to their claims that everything that harms VIDEOTON also harms the Hungarian national bourgeoisie and, ultimately, the Hungarian economy. These resources are both political and associational. First, by its specialization as a labor-intensive subcontractor and labor contractor, VIDEOTON became the fifth largest Hungarian employer, with 15,000-16,000 workers, almost as many as in the last years of state socialism. Second, personifying many features of what Iván Szelényi and his co-authors termed “managerial capitalism,” Széles, who had been a member of the managerial elite in the previous system, inherited a rich array of skills and network properties (Eyal, Szelényi, and Townsley 1998). Third, being not especially picky in terms of political loyalty, he enriched his inherited political resources with new ones: he started the 1990s as MP of the conservative Hungarian Democratic Forum, and in Fall 2002 there were rumors of his membership on the personal advisory board of Socialist Prime Minister Péter Medgyessy.¹⁸

Finally, the President is also Chair of the National Alliance of Hungarian Industrialists (MGYOSZ), Hungary’s largest business association. MGYOSZ could not have found a better leader who is more representative of its membership, and their interests. Széles epitomizes what the current Hungarian national bourgeoisie is about: inherited managerial and political resources and skills, flexible political loyalties in service of permanent political connectedness, dependence on foreign capital as sub-contractors and labor contractors, and structurally rooted interests against

¹⁷As suggested by Heinz Hermann Thiele, President of Executive Board of Knorr-Bremse, a global producer of brake systems for vehicles, Hungary ought to introduce “more flexible regulation of work organization. For example firms should be allowed to ask for weekend work without paying the usual bonuses, and compensate workers with leisure time over the week, because the task of producing for contract, and to organize work accordingly, cannot easily cope with the rhythm of Saturdays and Sundays” (NOL, October 3, 2003).

¹⁸Neither confirming nor denying the latter information, Széles said “one should not confuse political sympathies with economic policy preferences” (NOL July 7, 2002).

accommodating labor demands. A way to understand how the ensuing preferences may shape politics and policy is to observe Hungarian business leaders “in action”, in the critical context of the years 2001-2003 when many electronics TNCs started to disinvest in Hungary, and to relocate production further East in Europe, or to Asia.

5.2. Disinvestment, its consequences and interpretations

The first shock came when, in 2000, Mannesmann, which produces consumer and car electronics, closed its plant leased from VIDEOTON in Sárbogárd, fired its 850 workers, and relocated its production to China. In 2001, reacting to the emerging crisis in world electrical and electronics markets, General Electric, Elcoteq, and Flextronics followed with layoffs. Elcoteq fired 1,500 workers in response to accumulating losses in producing mobile phones for Ericsson.¹⁹ As a consequence of the price-war between Microsoft and its competitors, Flextronics, which in November 2001 opened two plants in Sárvár and Zalaegerszeg to produce consoles for the video-game Xbox for Microsoft, had to close that product line as early as June 2002. Laying off 1,000 workers, Flextronics shipped its assembly lines to China, which offered, in the words of the firm’s regional director Peter Baumgartner, “more concentrated supply networks, and better opportunities to rapidly collect and assemble the required electronic parts, as well as cheaper labor” (NOL, May 16, 2002). Losing car-manufacturers’ contracts to lower-wage Romanian competitors, VIDEOTON had been the first Hungarian firm to blame the overly high minimum wage for its having to lay off many hundreds of workers from its three cable producing plants in Enying, Veszprém, and Törökszentmiklós, and to close some of these plants later (NOL, November 23, 2001).

While many more layoffs and plant closings followed in the course of 2002, the real blow to the West Hungarian electronics sector came in the summer and fall of 2002, when IBM first closed its slider production in Veszprém, and then also its huge hard disc drive unit in Székesfehérvár.²⁰ In both cases, the IBM units operated in facilities leased from VIDEOTON, and leased large labor forces from the holding. Combined, the two plant closings released 4700 workers, out of which 2,400 had been returned to their “real” employer, Széles Gábor’s corporate empire. Further exacerbating the panic emerging in the course of earlier layoffs, plant closings, and relocations, the IBM decisions and their aftermath revealed a number of important features of Hungary’s leading sector, and its political context.

First, it became clear, that notwithstanding the widely propagated view of electronics as a skill-intensive industry, and of Hungary’s smart strategy of attracting TNCs by its highly skilled labor force, the electronics boom overwhelmingly relied upon masses of low or semi-skilled, mostly female, labor. Neither does the evidence support the hypothesis that employment in transnational high-tech electronics firms results in an upgrading of labor’s skills. Indeed, the recurrent practices of short-term hiring and firing and “apprenticeships” that never yield stable jobs, seem much likelier to destroy workers’ psychological and work capacities. Clearly, finding new jobs for the fired masses, attracted to the Székesfehérvár boom area from thirteen other, often distant, Hungarian counties seemed impossible without re-training. However, as put by József Zimmermann, director of the Labor Office in Székesfehérvár, “given the difficulty of convincing the laid-off semi-skilled workers to participate in retraining programs, the bulk of this crowd is lost, and is likely to face social degradation, long-term unemployment, and the disintegration of their families” (NOL, November 30, 2002).

¹⁹They did the same in Estonia that caused, over the next two years, a 100 percent fall in that country’s electronics exports, and a 10 percent fall in its total exports.

²⁰Although the TNC never confirmed it, Hungarian press claimed to know the reason: IBM sold its loss-making hard disk drive (HDD) branch to Hitachi, and their new joint venture decided to stop producing in Europe entirely.

Second, it is remarkable that despite the massive layoffs there had been no labor protest in 2001-2002. Clearly, given the precariousness of the jobs, the blurred boundaries between “actual” and “real” employers, collective protest did not seem a realistic option. As far as the position of unions is concerned, in late 2001 both László Holly and Gyula Schrenk, secretary and executive of the Federation of VIDEOTON Trade Unions asserted that “the recession, its particular causes notwithstanding, forced unions into backing the holding’s management” (NOL November 23, 2001). Similarly, Tamás Wittich, Vice President of Hungary’s biggest union federation (MSZOSZ), when answering criticism of union passivity against the background of mass layoffs in late 2002, pointed out that sectoral unions, in close cooperation with local labor offices, took a lion’s share in helping affected workers to find new employment. Further, Wittich added that “MSZOSZ initiated talks with e.g. sister organizations in Romania, Bulgaria, and the Ukraine, to see to it that no firm moving to these countries can find employees ready to work for a humiliatingly low pay” (NOL, January 17, 2003).²¹ However, it is also true that in the specific IBM case the unions could reach a settlement between the TNC and its fired workers, according to which generous compensation going beyond the legally set minimum standards had been offered (NOL, November 5, 2002).

Third, precisely as IBM pushed the burden of finding new employment for its fired workers onto their “real” employer VIDEOTON, the holding that declared it impossible to provide thousands of jobs except for a minority of workers at inferior terms heavily relied on damage control measures by the state.²² However, while the local and central government mobilized significant institutional and financial resources to *de facto* back, as “employer of the last resort,” the flexibility and comfort of transnational and national businesses, unemployment in the Székesfehérvár region temporarily has been back at its record levels of the early 1990s.

While the fact of a regional employment crisis was undeniable, its national-level impact was not clear, nor was it evident what these events meant for the Hungarian economy. To begin with, neither nation-wide data nor statements by the authorities reflected any significant deterioration in the general employment situation. Nor have Hungarian exports and, specifically, the export of electrical and electronics industries lost their dynamics. Rather, other firms and industries seem to have compensated for the fallout of NOL. Furthermore, the facts do not confirm the case of a general capital flight either.²³ To the contrary, many big firms, including General Electric, Suzuki, Samsung, Audi, and Electrolux had been in a hurry to affirm their loyalty to, and express satisfaction with, the conditions offered by Hungary, and revealed concrete plans for further grand investment projects. In exchange, the left-liberal government, further blurring the boundaries between national and corporate interests, made public efforts to court TNCs into lobbying jointly with Hungary’s negotiators in Brussels for regulations that could preserve many aspects of their privileged status even after the accession. (Bohle and Husz 2003) Finally, as far as the interpretation of the disinvestment wave is concerned, some academics, policymakers, advisers and even CEOs of major foreign corporations defended the idea that Hungary cannot and should not compete with Chinese, Romanian, or Ukrainian wages and work conditions, and that therefore the

²¹By all means, MSZOSZ refused signing a petition that was proposed in concert by the rest of the (much smaller) unions demanding TNCs to pay back their subsidies in case they relocate production. The reason MSZOSZ leadership mentioned was that in their view this was a sectoral, rather than general, problem.

²²This is ironic especially in the light of the fact that VIDEOTON apparently could not employ its “regained” workers, but signalled at the same time its intention to follow its TNC partners to lower-wage Romania and Bulgaria and to remain, in its newly acquired foreign plants and facilities, their major subcontractor in these countries as well (NOL, August 26, 2002).

²³While there are calculations that show FDI in Hungary declined relative to the neighboring countries, their reliability is questionable given that unlike, e.g., the Czech or the Slovak Republic, Hungary does not add the volumes of reinvested profits to the FDI inflows.

out-migration of low-quality/low-wage activities is not necessarily a negative development. Consequently, rather than getting stuck with an overly labor-intensive export pattern, it would be high time the country started laying the foundations of a human capital-intensive long-term specialization that also would allow the upgrading of the skills and the living and working standards of its population.

However, the leaders of the Hungarian bourgeoisie took a different side in this debate. MGYOSZ and other business associations demanded strong measures to restore the conditions of business trust in Hungary, such as further reductions in the corporate tax rate from 18 to 12 percent, and in the social security contribution paid by employers. Business leaders also continued the criticism of certain policies that they said had greatly contributed to disinvestment. Among these were the previous government's decision to raise the minimum wage to 40,000 Forint in 2001, and 50,000 in 2002, which in the view expressed earlier by VIDEOTON's Vice President Sinkó, "conflicts with market principles, and represents government intervention into natural processes" (NOL, November 23, 2001). Similarly, the President of MGYOSZ passionately criticized the monetary policy of the Hungarian National Bank for the gross overvaluation of the national currency. In late 2002 he went as far as to demand the resignation of Central Bank President Zsigmond Járαι. In fact, relocating TNCs hardly had mentioned the rising minimum wage or the strong local currency as important motives for their decisions. After all, they usually paid higher wages anyway, and used Euros rather than Forints in their contracts with local suppliers. These aspects were much more important for domestic entrepreneurs, whose sub-contracts were set in Euros, but who had to pay wages in the strengthening national currency.

By these demands and criticisms, which also reflected their existential discontent with a coming situation in which the sweat of poorly paid workers would less handily qualify as a winning market strategy, Hungarian business added a strong voice to an emerging alternative political and policy discourse. Also supported by – another group of – academics, policy advisers, and opinion makers, this interpretation viewed disinvestment as symptom of a bigger problem, namely Hungary's general loss of competitive edge and regional leadership in attracting FDI. No matter how difficult had it been to empirically substantiate such claims, their advocates urged the government to regain by radical measures foreign and domestic investors' trust, and to restore Hungary's export-led growth path.²⁴ The case of neighboring Slovakia that by its internationally acclaimed bold tax reforms offered the region's best incentives for TNCs, has been increasingly presented as the positive example Hungary ought to follow.

6. Privileged work at the expense of general welfare: The example of the Slovak car industry

In our second case study we investigate the possibilities of a capital-labor accord in the East European car industry. Since the early 1990s, this sector has attracted an increasing amount of FDI from major Western car manufacturers and their central suppliers (for a general overview see Werner 2003, Havas 2000, van Tulder, and Ruigrok 1998). Five East European states became important car and car parts producers: Slovenia, Poland, the Czech Republic, Slovakia and Hungary. Western investors quickly took over the production facilities in these countries at the beginning of the 1990s, and rapidly started building up new plants. Within a short time, their suppliers followed. Investments in the car industry typically have been among the largest and most important investments in the region.

The rush of Western investors towards Eastern Europe has occurred against the background of saturated Western markets, and increasing competition between the major carmakers.

²⁴The power of the argument was reinforced by a number of really critical phenomena in the Hungarian economy, the analysis of which goes beyond the framework of this essay.

In this context, the “emerging markets” on Europe’s periphery have offered a number of advantages. Given that car density was much lower than in the West, they promised a new outlet for Western cars. Moreover, they provided an opportunity for West European carmakers to reduce their production costs and increase their competitiveness in the West European and global markets.

What is the impact of transnational integration on the pattern of capital-labor relations, and of overall social development in these societies ? These questions can best be answered by an analysis of the Slovak case. More than in any other accession country, Slovakia’s development in the last years has been associated with the car industry, its leading manufacturing and export sector.

6. 1 Investment, markets and exports in the Slovak automotive industry

Slovakia’s first and so far largest investor in the car industry is Volkswagen (VW), which acquired the majority in the state-owned car parts manufacturer Bratislavske Automobilove Zavody (BAZ) in 1991 for 24.6 million Euro (Mikulikova 2002: 47). In 1999, VW acquired an additional production facility in Martin, Central Slovakia. The VW plants together had more than 9,000 employees in 2002. Over the 1990s, VW has invested around 500 million Euro in Slovakia, and it is planning to further expand its investments by at least the same amount (ibid., 48). In January 2003, PSA announced its plan to invest 700 million Euro in Trnava, Slovakia. The plant is expected to have some 3,500 employees in 2006. Honda is planning a 425 Mio Euro investment for assembly, and Hyundai has decided on a major (700 billion Euro) greenfield investment in Zilina. This plant is expected to have an annual production of 200,000 cars and employ 2,400 people by 2007 (RFERL 2003, Reuters, Jan 16, 2004, *Slovak Spectator*, March 2, 2004). In addition to the car manufacturers, their main Western suppliers have established subsidiaries in Slovakia too. The biggest supplier, VW Electrical Systems has 3,500 employees. The share of all automotive employment located in the supplier industry was 45 percent in 2001 (EIROnline 2003). Mainly as a consequence of VW’s engagement in Slovakia, the share of automotive production in total industry rose from 6.25 percent in 1989 to almost 20 percent in 2002 (Vagac 2000, Borgula, and Cziria 2002).

What were the motive for VW’s, and subsequently the other car manufacturer’s investment? Had they been driven by Slovakia’s domestic market potential, the development could not have been more disappointing. Contrary to the expectations of car manufacturers and many experts, the Slovakian car market, similar to other East European auto markets, has developed sluggishly over the last ten years. After an important increase of car sales in 1995, the market stagnated until 2002, with decreasing sales in several years. The ratio of cars per inhabitants was 1:5.2 in 1995, and 1:4 in 2002 (ZAPSR 2003). The comparable figure for Germany is one car per two inhabitants. Sales in relation to the total vehicle stock are considerably lower in Slovakia than in the advanced countries. The average age of the car stock exceeded thirteen years in 2002 (Automotive Industry 2003).

The generally limited market opportunities in the East are due to the “limited purchasing power of the prospective consumers” (van Tulder, and Ruigrok 1998: 2). According to Vagac (2000: 35) a U.S. consumer needs on average 7.7 monthly incomes to buy a new car and fuel for 100.000 km, and a French consumer 12. In contrast, a Slovak has to work 55 months for a new car, a Russian 70 months. All in all, Slovakia’s domestic car market has lagged far behind that

country's car production in the last decade (Table 5 in the Appendix). Slovakian workers, if they buy cars at all, often import used automobiles.²⁵

However, VW's investment in Slovakia was never primarily directed at domestic markets. Rather, it has mainly specialized in the final assembly of high-end, low volume models for re-export to the EU. VW has gradually moved the production of its Golf Syncro and Bora models to Bratislava, started the assembly of Porsche cars and a new VW off-road model. As a result, Slovakia's car industry is highly export-oriented. About 90 percent of VWs production is exported, and by 2000 cars and car components represented almost 27 percent of Slovakia's manufacturing exports (Table 4 in the Appendix).²⁶ Slovakia's car export orientation is very likely to increase further with the planned new investments. Although PSA and Hyundai plan the assembly of small low-end automobiles in Slovakia, most of these cars will not be sold at the domestic market, rather in other Eastern and Western European countries. Taken together, the planned production capacity of the two companies is seven times greater than 2002 total car sales in Slovakia.

Western investors are thus mainly interested in using the locational advantages Slovakia has to offer for restructuring their production chains and increasing their competitiveness in Western markets. It is Slovakia's comparatively cheap and skilled labor force, highly flexible labor market, geographical proximity to EU markets, and its government's willingness to offer generous incentives to foreign investors that have attracted the car manufacturers. The Slovakian automobile sector thus differs substantially from its West European counterparts. Below, we will spell out the consequences on work conditions, wages, labor relations, and social welfare in Slovakia.

6.2. Privileged wages and work conditions

In general, a sharp contrast can be observed between the relatively privileged social conditions at the plant level in the car industry and a degrading social situation in Slovakian society, which is not unrelated to the incentives the Slovak government offers to foreign investors. To put it differently, in contrast to what we have seen in Hungarian electronics, *the car industry does not make its own workers pay the price for Slovakia's transnational integration*. Rather, *the costs are socialized*, and it is Slovakia's poorer social groups who have to bear disproportionate burdens.

In terms of wages and work conditions, the car industry easily provides the best standards to be encountered in Slovakia. Since 1995, the level and growth of this sector's wages has outpaced that of manufacturing as a whole. (Vagac 2000) In 2001, in the core firm VW Slovakia, the average nominal salary was 602 Euro, higher than the sectoral average, and roughly the double of the average national salary. Only the banking sector paid comparable salaries (Mikulikova 2002: 55, EIRonline 2003). In all probability, the sector's high productivity gains rooted in its capital-intensive technology allow trade unions to demand relatively high wages, and employers to pay them. What matters for Slovakia's locational advantage is the gap between the local and the Western wages. This gap remains significant: in 2001, an average VW employee in Germany earned 2896 Euros (Mikulikova 2002), i.e. the Slovak salary was only around one-fifth of the

²⁵In early 1998 this possibility was seriously limited, because the government put a ban on the import of used cars older than six years. In Slovakia's neighboring countries, this form of market protection was requested by the car manufacturers. For the time being we have no evidence that VW requested the import ban. What is clear is that the introduction of the import ban coincided with the real takeoff of car production in Slovakia.

²⁶Worldwide, tiny Slovakia ranked as the seventeenth largest exporter of passenger cars in 2002, ahead of Brazil, South Africa, Poland, and Turkey. International Trade Statistics, <http://www.intracen.org/tradstat/site3-3d/ep781.htm>, accessed on March 11, 2004.

German one.²⁷ When based on wage-adjusted labor productivity and unit labor cost, the East-West divide seems even stronger. Thus, in 1999, “Hungarian and Slovakian workers in the transport equipment manufacturing industry are more than six times as productive as their average EU counterparts on a wage adjusted basis” (Werner 2003: 9). Slovakia’s unit labor costs in the industry are 16.5 percent of the EU average (*ibid.*). As long as real productivity keeps pace with salary increases, Slovakia’s locational advantage in terms of low wage costs will not be threatened.

Work conditions, at least in the core companies, also seem to be much better than in any other industry. Here again, VW stands out with a 35.7-hour working week. This figure is low compared to an average of 42.2 working hours per week for employees in Slovakia, but high compared to the 28.8 working hours per week at VW Germany (Paoli/Parent-Thirion 2003: 49). VW grants pay overtime working hours, rely on teamwork and provide a number of social services for its employees, including subsidized meals, transportation and housing (Mikulikova 2002). On the other hand, VW has introduced a four-shift system, i.e. continuous flow production over seven days a week, and work is experienced as stressful by the workers. The turnover is relatively high (Vagac 2000: 19). In terms of its employment policies, VW seeks flexibility. According to Borgula and Cziria (2003), rather than being hired directly, VW employees initially are hired by an agency, and are considered being on a one-year probationary period before being offered a permanent contract, or rejected. As the firm has expanded over the last decade, workers have been hired rather than fired. VW’s work force is relatively young and well educated: the average age of the workforce is 30-35 years, and more than 70 percent have attended either an apprentice center or a secondary technical school (Mikulikova 2002: 66).

The superior conditions for work and remuneration at the core car manufacturer in Slovakia are the result of a compromise between capital and labor. Trade unions in the automotive industry and at VW Slovakia are indeed strong enough to defend employees’ interests. Unionization in the automotive industry is around 35 percent, and at VW Slovakia it is 65 percent (EIR-Online 2003, Borgula, and Cziria 2003) While these figures are at the lower end in a European context, they stand out positively in comparison to other transnationalized leading sectors in Eastern Europe. Moreover, the management of the lead firm is usually ready to accommodate labor’s demands on the plant level. Marta Mikulikova describes the negotiations between VW Slovakia and the trade unions as tough, but always yielding some results (2002: 73). At the same time, strikes have never occurred in the company.

VW’s willingness to accommodate trade unions’ demands is, however, not generalizable for the whole sector. Borgula and Cziria (2003) describe two approaches: on the one hand the “German way,” where trade unions are considered as partners, and on the other the “American way,” in which trade unions are seen as a complicating factor. VW and some of its major suppliers, such as Delphi and Lear, with unionization rates of 35 percent and 30 percent represent the former approach. Other suppliers, like Johnson Control, or Leoni, have no trade union representation at all. Against this background, it is unclear how far the few lead firms’ superior wages and working conditions are characteristic of the rest of the sector.

Slovakia, in contrast to most other countries of the regions, does have sectoral collective bargaining, although the automotive industry increasingly tends to decentralize wage bargaining (EIROnline 2003, Borgula, and Cziria 2003). VW negotiates both at the level of the company and at the sectoral level, where it is member of the Association of Employers in the Metalworking Industry. The outcomes of company negotiations seem to have some impact on the sectoral negotiations (Mikulikova 2002: 72).

²⁷This ratio is also compatible with more general estimates that Central Eastern European wages in the car industry reach about 25 percent of the Western levels (Wagstyl 2002).

Workers' bargaining power is generally limited by the high unemployment in Slovakia, which stood at 18.5 percent in 2002. The restructuring of the transport equipment industry has contributed to unemployment, yet more jobs were lost in other subsectors than in the car industry. The latter has increased its employment steadily since 1995, but could not compensate for the losses that generally occurred in the transport equipment sector (Vagac 2000, Borgula, and Cziria 2003).

6.3. Socializing the costs of a capital-intensive leading sector

Slovak car industry workers indeed seem to enjoy some of the benefits that come with a capital-intensive leading sector: they have more bargaining power in the workplace, and management is more open towards their demands. However, attracting investments in this industry proves to be very costly to the Slovak society, and especially its poorer social strata. As a rule, no government can any longer attract large sums of FDI without offering generous incentives. "In fact, surveys of international FDI indicate that once investors have decided on a region in which to invest ... they place considerable weight on the investment incentives offered by regional governments – and often play these governments off against each other to extract the most favorable incentives possible. Over the past decade, it has been the central European countries' extensive use of investment incentives that has largely fed the perception that such jurisdictional competition is increasing internationally" (Werner 2003, with reference to Oman 2000). Only a few sectors can systematically play off one government against the other in order to get better incentives. The car industry is among them. The direct financial and/or fiscal "cost per job" of incentives received by investors in the car industry for major investments has risen from \$4,000-\$14,000 U.S. in the early 1980s to sums well above \$100,000 U.S. in the 1990s. Ironically, car manufacturers get similar or better packages in the developing world than in the wealthy developed countries (Oman 2000: 10/80). Lung sees the car industry's bid for socializing the costs of investment as one central element of their strategy of reducing the sunk costs in peripheral markets in which they also have to expand under the pressure of oligopolistic competition. (2000) While some of the incentives, such as the supply of infrastructure, or workforce training also improve the domestic developmental potential, the main problem with the generous subsidy packages is that, especially in low-income countries, they may result in special forms of income redistribution from the lower to the middle class – as we pointed out in section 4. Investment incentives put state budgets under considerable strain. Resources that would be indispensable for the relatively poor East European states to sustain social welfare at some standards, are thus channeled into private hands.

From 1999 the development of the car industry was a policy priority in Slovakia.²⁸ The program for its promotion includes government subsidies for the purchase of land by car investors, coordination of and subsidies for the construction of a thousand new flats in Bratislava, infrastructure support, and yearly financial support of 150 million SKK for programs for the development of the sector. As VW was the only important investor until very recently, first and foremost it was this company that had enjoyed these benefits (Vagac 2000). In addition to the program tailored to the specific needs of the car industry, Slovakia has developed a set of policies which aim at attracting FDI in general. In 2000, a set of financial measures, including the reduction of corporate tax from 40 percent to 29 percent and the introduction of a five-year tax holiday for foreign investors was implemented. In 2001, a Law on Industrial Parks was passed, which allows the government to cover up to 70 percent of the start-up costs in designated areas (EC Commission 2001, 2002).

²⁸We have still to learn about the incentives VW could negotiate with the Slovak government initially, before its first investment.

However, the boldest steps were taken in 2004: Slovakia introduced a flat tax rate, i.e., a single corporate and income tax rate of 19 percent.²⁹ Slovakia's move has led to widespread discussions in its Eastern and Western neighbors about its consequences for the continent-wide competition for FDI (FTD, January 13, 2004). In the case of the Hyundai investment, the move has already paid off. Initially, Hyundai considered four countries as possible locations: Hungary, the Czech Republic, Poland and Slovakia. Earlier this year the former two countries lost out. Poland and Slovakia offered very similar conditions to the investor. Poland plans to introduce the flat tax rate in 2005. The incentives in terms of tax breaks, free land and new infrastructure were comparable as well. However, on top of all these, "Slovakia was prepared to provide 15 percent of the total investment costs in the form of state subsidies" (*Motoring* 2004). Furthermore, Slovakia's lower labor costs and weaker trade unions also counted as attractions relative to Poland (*Slovak Spectator*, March 8, 2004). The Slovak cabinet approved a draft contract with Hyundai which defines its expenditures linked to the project at 216.66 million Euro. Of these, 167.42 million directly go to the investor (*Slovak Spectator*, March 5, 2004). These incentives alone amount to a subsidy of 90,275 Euro per job created. If we assume for a moment that the average salary in the car industry stays stable for the next decade, then it is the Slovak state rather than Hyundai which pays the wages of the plant's initially employed 2,400 workers for the next eleven years.

It is mostly for its effects on FDI that Slovakia's flat tax rate created international attention. The downside of these reforms, namely the strain they put on the budget, and on society, was less frequently discussed. However, for the Slovak policymakers even this impact seemed to be clear well in advance. They estimated that in 2004 the flat tax would reduce the receipts of the budget considerably, by about 20 billion SKK (approximately 480 million Euro). In order to fill the gap, Slovakia increased the excise duty, drastically (by 30-40%) increased energy prices, and introduced a flat 19 percent VAT tax rate. While the flat corporate and income tax rate is one of the lowest, the 19 percent VAT levied on medicines is among the highest in the EU, and the 9 percent increase of VAT paid for basic food substantially raises the cost of living for poor families as well. At the same time, the government foresaw cutting some expenditure that it considered "wasteful." These included, under certain conditions detailed below, a halving of the monthly unemployment benefits to about 163 Euro. Back in October 2003, when asked by *Népszabadság* about his prediction of adverse social consequences, Finance Minister Ivan Miklos, the architect of the package, offered a precise account, and admitted that "just as with any tax reform, the Slovak one will produce losers too. In my view, in Slovakia it will be single tax-payers, childless families, and the unemployed, who will be worse off in the coming year. However, from the unemployed only those individuals will indeed be on the losing side who refuse to search for a new job, or to attend retraining programs, because they will not be eligible for the extra bonus rewarding efforts to acquire the required skills and training" (cited after NOL, October 31, 2003).

6.4. The Roma food riots

The Slovak government did not correctly predict all of the political consequences of its bold policy package. In February 2004, food riots erupted in many, mostly Roma-populated, villages and some smaller towns of Eastern Slovakia.³⁰ For several days Roma groups of different sizes – from a handful to several hundred people – looted small and large food shops and supermarkets, demonstrated against the new social policy, and demanded the resignation of the Minister for Social, Labor, and Family Affairs. The Roma minority, whose size is estimated to be between 1.4 percent and 10 percent of Slovakia's population, has clearly been a loser in the trans-

²⁹In addition, the amount subjected to zero tax-rate was increased to about 160 percent of the yearly minimum wage.

³⁰This was an unprecedented event in Central and Eastern Europe's one-and-a-half decade long post-communist history. (Greskovits 1998)

formation.³¹ Roma unemployment is very high, reaching 50 percent (or even much more in some settlements). Therefore, the social austerity chapter of the government's package affected the Roma with extreme harshness.³² Indeed, many families saw their monthly income dropped by more than half.

The government's reaction to the riots did nothing to alleviate the impression that the welfare cuts were specifically targeting the Roma. The Minister for Social, Labor and Family Affairs, Ludovit Kanik, claimed that "many of those affected by the recent measures have no working habits" (cited after *Slovak Spectator*, February 24, 2004), and said that the new social measures were a tool to motivate people to work rather than to live on state support. Authorities in East Slovakia, however, admitted that they had to turn down most people willing to work, because only an insufficient number of communal work places were available.³³ Slovak Prime Minister Mikuláš Dzurinda insisted that the protests and lootings had nothing to do with the social reforms, but were the instigation of criminal elements, namely loan sharks. A few days after the riots started the government sent, in the largest domestic security operation since 1989, 500 military and 1,500 police forces, including special units, to Eastern Slovakia (See *Slovak Spectator*, March 1, February 25, 24, 23, 2004, Burgermeister 2004). It took several days until these forces, after repeated violent clashes with rioters and demonstrators, sealing a number of rural and urban Roma neighborhoods, and arresting several hundreds Roma, ultimately restored the authorities' control over the region.

Commenting on the riots, Slovak opposition leader Robert Fico suggested: "it would have been better if the billions of SKK spent to attract Peugeot and Hyundai had been used to improve the dire conditions of the Roma masses" (NOL, February 25, 2004). We do not think that VW, Peugeot, and Hyundai are responsible for the hunger revolt of the Slovak Roma. However, social inequality exacerbated by the socialization of the potentially immense costs of building a car-manufacturing leading sector in a less-advanced country are indeed among the major risks of this pattern of development.³⁴

7. Conclusion

Our essay raises the question of the prospects for the European social model in that East. East European workers expected that their countries' "return to Europe" would help to bring their work and living standards and social welfare closer to EU levels. However, empirical evidence suggests that instead of convergence, rather divergent social standards have emerged in the two parts of Europe. Unemployment is persistently higher, working times are longer, and wages are lower in the East than in the West. Eastern labor's collective action capacity is severely constrained by low levels of unionization, and it is much less contentious than its Western counter-

³¹The lower estimate is from EC Commission 2001.

³²Some observers even suspect that the welfare cuts had been specifically targeting the Roma population. "Many Roma have been particularly affected by the changes to the social welfare law, however, due to the provisions cutting support for families with more than four children. These provisions were apparently specifically adopted to reduce welfare payments to Roma" (Hrea 2004).

³³Indirectly, the lack of communal work opportunities has also been confirmed by the Minister for Social, Labor, and Family Affairs, who repeatedly declared that launching such programs is the most important task for every local community council (NOL, February 24, 2004).

³⁴We cannot help being reminded by the apparent logic connecting the revenue and expenditure side of Slovak fiscal reform, of the way Finance Minister, Mario Henrique Simonsen in the 1970s had calculated the impact of income redistribution on Brazil's society, and car industry: "A transfer of income from the richest 20 percent to the poorest 80 percent probably would increase the demand for food, but diminish the demand for automobiles. The result of a sudden redistribution would be merely to generate inflation in the food-producing sector and excess capacity in the car industry" (cited by Kurth 1979: 31).

part. The social divide between East and West indicates to us that – despite recent tendencies of regression – many social aspects of West European capitalism are still alive, but could not take roots in the East.

Historically, the European social model emerged as a compromise between capital, which was willing to accommodate labor demands, and labor, which was strong enough to push for an accord, and maintain capital's interest in it. To better understand the factors of the postwar settlement, we turned to its socioeconomic building blocks. Drawing on earlier writings on how specific production profiles shape the preferences and capacities of social groups, we first identified two factors which can explain the propensity of business to strike a deal with workers. This propensity decreases with the labor-intensity of production, and increases with its orientation towards consumer goods. Moreover, the production profile of specific industries can also account for the likelihood of labor being capable to articulate and organize demands for better working and social standards. Capital-intensive industries, where a few large firms employ concentrated labor forces with specific skills are more conducive for labor's collective action capacity than labor-intensive industries typically characterized by many small or medium size firms. In addition, labor's power is likely to increase in a situation of full employment and decrease under the pressure of unemployment. Finally, the factors that promote accommodating business and strong labor are not distributed randomly, but rather converge in particular major industries and thus turn them into hotbeds of social accords. We identified the leading consumer durables industries as most supportive to the historical compromises that had been at the core of the European social model after WWII.

In contrast, we found the industrial base of Eastern European capitalism conspiring against such a class compromise. As a consequence of Eastern Europe's integration into transnational production, its industrial basis became characterized by highly labor intensive production. Eastern Europe either specializes directly in labor intensive industries, like electronics, apparel, furniture, or attracts those fragments of the capital-intensive industries that require relatively the highest labor input, such as the final assembly of cars, or related supplier activities. For transnational business elites, labor as a factor of production creates more problems in the East than in the West. At the same time, East European workers hardly can afford to buy the products they make in or for Western firms. Most of Eastern Europe's new transnational consumer goods industries developed as export sectors. Thus, the emerging cross-European systems of production are typically exporting to the East situations where labor is a problem. At the same time, labor's collective action capacities are seriously impeded by the attributes of the same industries and the ease at which they can move their production to yet cheaper locations.

While developing our own approach we did not directly engage in a debate with the existing alternative interpretations of the impact of transnational production relocations on labor in the advanced and the less advanced countries. Let us briefly signal our position in that debate. Backers of globalization are optimistic across the board, and assert that outsourcing helps labor by more employment and more growth in the less advanced countries, and at the same time helps advanced country workers to upgrade their skills and improve their work and life conditions in an array of new, innovative activities. Their opponents are pessimistic in both respects: they are worried that global competition brings about a "race to the bottom" of wages, work conditions and labor relations in the West as well as in the rest. A third view has recently been proposed by Beverly Silver (2003), who argues that the impact of capital migration is asymmetrical. In her view relocation weakens labor in advanced countries but creates powerful working classes in the Third World. Our framework implies asymmetrical impact too, but of the opposite kind. As the eastward movement of particular fractions of European capital crushes labor in the East, it temporarily relieves Western workers from the pressure and hostility of the same industries back at home. We did not study the actual impact of the cross-European integration in the West. This will be

one of our future tasks. Given the huge difference between the magnitude of the West European and East European economy, by all means the positive impact in the West (if there is any) should be much more modest and much harder to identify than the negative impact in the East.

We concluded our investigation by spelling out the social consequences of two leading sectors that represent the diversity of Eastern Europe's transnational integration: labor-intensive electronics in Hungary and capital-intensive car industry in Slovakia. The industrial attributes of Hungary's leading sector indeed facilitate a conservative, anti-labor alliance among groups of foreign and domestic capital.³⁵ For Hungary's electronic industry, labor is the crucial factor of production but an insignificant factor of demand. Foreign investors typically seek flexible and cheap labor. In this endeavour they find a willing ally in leading domestic business groups, who offer their service as sub- and labor contractors. The combined power-resources of foreign and domestic business put persistent pressure on the state to keep labor under strict control. Trade unions, intimidated by the threat and experience of job relocation to even cheaper places cannot efficiently challenge the conservative alliance. Thus, it is Hungary's workers who ultimately have to pay the price for this country's transnational integration.

In contrast, Slovakia's leading car industry does not make its own workers pay this price. Workers employed in Slovakia's leading industry enjoy a privileged position. They get better wages, and have relatively decent work conditions, both of which are the result of a limited capital-labor accord. However, attracting capital-intensive investments proves to be very costly to the Slovak society, especially to its poorer social groups. Investors in the car industry require favorable business climate, and extremely generous incentives. Through introduction of a flat tax rate and heavy subsidies for investments, Slovakia has delivered both. To finance related budget losses, it reduced welfare expenditures significantly, a step which has hit the impoverished Roma population so hard that they revolted.

In the critical times of the food riots both Roma groups and Slovakian politicians and opinion makers repeatedly appealed to the EU for help to solve the problems of this socially marginalized minority. This brings us to the last issue we want to briefly touch upon. If the western economic integration of the ex-socialist countries has not helped to build the socioeconomic foundations for the European social model, how likely is it that the EU or its member states provide stronger support for a social Eastern Europe – financially or otherwise? Current evidence seems to indicate that this is unlikely. The EU has been unwilling to grant the East European newcomers the financial support its members get. Moreover, the member states are denying the newcomers the right of labor mobility. In social terms, the new members face - at least a transitional - second class membership. On the one hand, this can be explained by the fact that capital, as argued throughout our essay, is not interested in extending the social model eastwards, as it precisely seeks to make use of the differences between East and West for being more competitive globally. On the other hand, Western labor has come under attack as well. As indicated above, our framework suggests that it actually may profit from the new east-west division of labor. However, Western workers have also been subject to a broader set of fundamental challenges by persistent unemployment, transnationalization of production, and the emergence, if not yet the breakthrough, of new leading sectors, which have threatened the class compromise underlying the European social model. One result of this constellation is that on the eve of European unification, Western labor is using its remaining strength *against* its Eastern counterparts, by forming conservative alliances to restrict their free movement in Europe.

³⁵The term "conservative alliance" of business groups is from Gourevitch 1986.

Appendix

Table 1
Average rate of unemployment in ten current EU member states and eight East Central European membership candidates in 1993-2002

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
EU-10	9,3	9,5	9,2	9,0	8,6	8,0	7,7	6,7	6,2	6,7
ECE-8	9,2	11,0	10,7	11,4	10,3	10,3	11,7	12,7	12,5	11,7

Authors' own calculation based on ILO Labor Statistics accessed at <http://laborsta.ilo.org/cgi-bin/brokerv8.exe>

Table 2
Workers' protest in ten current EU member states and eight East Central European membership candidates in 1993-2002 (1000s, per million labor force)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
	Workers participating in									
	Strikes and lockouts									
EU-10	33,8	22,0	8,6	15,8	6,9	7,5	9,7	7,3	10,4	62,5
ECE-8	11,1	8,9	10,2	1,9	0,6	0,6	1,5	1,3	0,8	0,2
	Workdays lost as a consequence of									
	Strikes and lockouts									
EU-10	37,3	34,4	32,3	27,2	14,3	31,0	14,1	17,4	16,8	60,5
ECE-8	16,7	17,5	9,0	2,9	1,0	1,4	12,5	7,3	0,4	0,1

Authors' own calculation based on ILO Labor Statistics accessed at <http://laborsta.ilo.org/cgi-bin/brokerv8.exe>, and World Development Report 2000/2001.

Table 3
Labor-intensive exports in total manufacturing exports
in eight East Central European membership candidates (%)

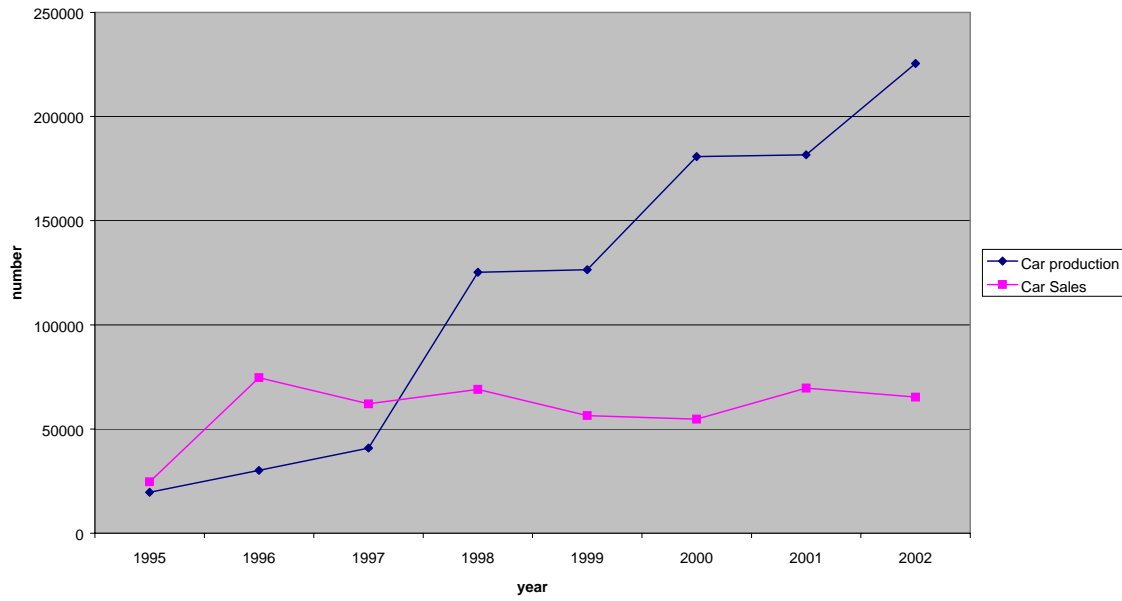
	1994	1997	2000
Group 1			
Estonia		50.6	63.9
Latvia	44.6	58.1	55.0
Hungary	38.0	50.2	53.2
Lithuania	42.5	48.0	53.1
Group 1 average	41.7	51.7	56.3
Group 2			
Poland	38.3	40.7	36.3
Slovenia	32.5	36.9	38.6
Czech R.	23.3	25.3	28.9
Slovak R.	22.5	23.1	25.0
Group 2 average	29.1	31.5	32.2
ECE-8 average	34.5	41.6	44.2

Authors' own calculation based on COMTRADE database of the United Nations Statistics Division. <http://intracen.org/tradestat/sitc3-3d> (Labor-intensive industries' SITC-2 Code: 63, 65, 75, 76, 77, 82, 84, 85)

Table 4
Hungary's export in electrical and electronics industries and
Slovakia's exports of cars and car-parts, in billion \$US

	1994	1997	2000
Hungary			
Manufacturing exports	6.8	14.4	24.2
Electrical and electronics exports	1.2	5.1	10.2
Electrical and electronics exports (%)	18.1	35.3	42.2
Slovakia			
Manufacturing exports	5.4	6.9	10.0
Exports of cars and car parts	0.4	1.1	2.7
Exports of cars and car parts (%)	7.6	15.2	26.8

Authors' own calculation based on COMTRADE database of the United Nations Statistics Division. <http://intracen.org/tradestat/sitc3-3d> (Electrical and electronics industries: SITC-2, 75,76,77, cars and car parts: SITC-2, 71, 78)

Table 5**Car production and sales in Slovakia, 1995-2002**

Source: EIRonline 2003

References

- Abraham, David (1986): *The Collapse of the Weimar Republic. Political Economy and Crisis*. New York and London: Holmes & Meier.
- Automotive industry (2003): "Automotive industry of the Slovak Republic." <http://www.mac.doc.gov/ceebic/countryr/Slovakr/MARKET/AutoindustSloRep.htm>.
- Bohle, Dorothee and Dora Husz (2003): "Whose Europe is it? Paper prepared for the Thematic Network EPOC; Workshop: EU Enlargement and Social Cohesion," Budapest, 7-9 March. <http://www.epoc.uni-bremen.de/publications/pup2003/publications2003.htm>
- Borgula, Juraj and Ludovit Cziria (2003): "Industrial relations in automotive sector." <http://www.eiro.eurofound.eu.int/2003/12/word/sk0308103s.doc>
- Burgermeister, Jane (2004): "Roma Face Starvation in the Slums of Slovakia. *The Guardian*, February 28, 2004.
- Claessens, S., Demirgüç-Kunt, A., and Huizinga, H.(1998): "How does Foreign Entry Affect Domestic Banking Market?" *World Bank Policy Research Paper* (June 1998).
- COMTRADE database of the United Nations Statistics Division. <http://intracen.org/tradestat/site3-3d>
- Crowley, Stephen (2002): "Explaining Labor Quiescence in Post-Communist Europe: Historical Legacies and Comparative Perspective." Harvard University. Center for European Studies Central and Eastern Europe Working Paper No. 55.
- Crowley, Stephen, and David Ost, eds. (2001): *Workers After Workers States. Labor and Politics in Postcommunist Eastern Europe*. Lanham, Boulder, New York, Oxford: Rowman & Littlefield.
- EBRD (2002): *EBRD Transition Report 2002*. London: European Bank for Reconstruction and Development. 2002.
- EC Commission (2001, 2002): "Slovakia. Regular Report on Slovakia's Progress Towards Accession." Brussels. At: <http://europa.eu.int/comm/enlargement/slovakia/#overview>.
- EIROnline (2002): "Industrial relations in the EU Members States and candidate countries. European Industrial Relations Observatory Online." www.eiro.eurofund.eu.int.
- EIROnline (2003): "Industrial Relations in the Automotive Sector." <http://www.eiro.eurofound.eu.int/2003/12/study/tn0312101s.html>
- Ekiert, Grzegorz and Jan Kubik (1998): "Contentious Politics in New Democracies: East Germany, Hungary, Poland, and Slovakia, 1989-1993." *World Politics* 50, 4: 547-581.
- Eyal, Gil, Iván Széleányi, and Eleanor Townsley (1998): *Making Capitalism Without Capitalists. Class Formation and Elite Struggles in Post-Communist Eastern Europe*. London & New York: Verso.
- Ferguson, Thomas (1984): "From Normalcy to New Deal: Industrial Structure, Party Competition, and American Public Policy in the Great Depression." *International Organization* 38. 1 (Winter): 41-94.
- Frege, Carola M. (2001): "Union weakness and post-communist identities in Eastern Europe: evidence from the Hungarian clothing industry." *Industrial Relations Journal* 32:4.
- Frieden, Jeffrey A (1988): "Classes, Sectors, and Foreign Debt in Latin America." *Comparative Politics* (October): 1-20.
- Frieden, Jeffrey A. (1991): "Invested Interests: the Politics of National Economic Policies in a World of Global Finance." *International Organization* 45, 4. Autumn: 425-451.
- Garrett, Geoffrey (1998): *Partisan Politics in the Global Economy*. Cambridge University Press
- Gourevitch, Peter (1986): *Politics in Hard Times*. Ithaca and London: Cornell University Press.
- Grahl, John and Paul Teague (1997): "Is the European Social Model Fragmenting?" *New Political Economy*, 2 3, reprinted in: Pierson, Christopher and Francis G. Castles (2000): *The Welfare State Reader*, Malden MA: Polity Press: 207-233.

- Greskovits, Bela (1998): *The Political Economy of Protest and Patience. East European and Latin American Transformations Compared*. Budapest: Central European University Press 1998.
- Hirschman, Albert O. (1977): "A Generalized Linkage Approach to Development, with Special Reference to Staples." *Economic Development and Cultural Change*. 25. Supplement. *Essays in Honor of Bert Hoselitz*. Chicago: University of Chicago Press: 67-98.
- HREA (Human Rights Education Association) 2004: "Slovakia: Law enforcement degrades into punitive assault on Roma." At: http://www.hrea.org/lists/display_php?headline_id=1107&language_id=1
- Katzenstein, Peter J. (1985): *Small States in World Markets. Industrial Policy in Europe*. Ithaca and London: Cornell University Press.
- Keohane, Robert A. (1984): "The World Political Economy and the Crisis of Embedded Liberalism." John H. Goldthorpe, ed., *Order and Conflict in Contemporary Capitalism. Studies in the Political Economy of Western European Nations*. Oxford: Clarendon Press: 15-38.
- Kurth, James (1979): "The Political Consequences of the Product Cycle: Industrial History and Political Outcomes." *International Organization* 33, 1, Winter: 1-34.
- Kurzer, Paulette (1991): "The Internationalisation of Business and Domestic Class Compromise: A Four Country Study." *West European Politics* 14, 4: 1-24.
- Linden, Greg, "Building Production Networks in Central Europe: The Case of the Electronics Industry." BRIE Working Paper 126. July 1998. <http://brie.berkeley.edu/~briewww/pubs/pubs/wp/wp126.htm>
- Lung, Yannick (2000): "Is the Rise of Emerging Countries As Automobile Producers an Irreversible Phenomen?" *Les Actes du GERPISA* 29, 7-18.
- Martin, Andrew, and George Ross (1999): *The Brave New World of European Labor. European Trade Unions at the Millenium*. New York, Oxford: Berghahn Books.
- Marx, Karl (1977): *Capital. Volume One*. New York, Vintage Books.
- Mikulikova, Marta (2002): "Preserving or Escaping the German Model of Industrial Relations? The Case of Volkswagen and its Subsidiaries in Central Europe." Budapest, Central European University, Department of Political Sciences, M.A. Thesis.
- O'Rourke, Breffni (2003): "Eastern Europe: Region Grows as Manufacturing Point for Auto Industry." At: <http://www.rferl.org/nca/features/2003/08/20082003153918.asp>.
- Oman, Charles (2000): *Policy Competition for Foreign Direct Investment. A Study of Competition among Governments to Attract FDI*. Paris, OECD.
- Ost, David (2000): "Illusory Corporatism in Eastern Europe: Neoliberal Tripartism and Postcommunist Class Identities." *Politics and Society* 28, 4: 503-30.
- Paoli, Pascal and Agnes Parent-Thirion (2003): "Working Conditions in the Acceding and Candidate Countries. Dublin: European Foundation for the Improvement of Living and Working Conditions." At www.eurofound.eu.int.
- Piore, Michael J., and Charles F. Sabel (1984): *The Second Industrial Divide. Possibilities for Prosperity*. Basic Books.
- Pontusson, Jonas (1995): "From Comparative Public Policy to Political Economy. Putting Political Institutions in Their Place and Taking Interests Seriously." *Comparative Political Studies* 28, 1: 117-147
- Pontusson, Jonas (1992): "Introduction: Organizational and Political-Economic Perspectives on Union Politics." Miriam Golden and Jonas Pontusson, eds., *Bargaining for Change. Union Politics in North America and Europe*. Ithaca and London: Cornell University Press: 1-45.
- Radosevic, Slavo (2001): "The Electronics Industry in Central and Eastern Europe: An Emerging Production Location in the Alignment of Networks Perspective." University College London. School of Slavonic & East European Studies. Centre For the Study of Economic

- and Social Change in Europe. Working Paper No. 19. http://www.ssees.ac.uk/publications/working_papers/wp21.pdf
- Radosevic, Slavo, and Deniz Elem Yoruk, "VIDEOTON: The Growth of Enterprise Through Entrepreneurship and Network Alignment. Prepared within the project "The Emerging Industrial Architecture of the Wider Europe; the Co-evolution of Industrial and Political Structures." Mimeo. 2000.
- Ruggie, John G. (1982): "International Regimes, Transactions and Change: Embedded Liberalism in the Postwar Economic Order." *International Organization* 47, 1: 379-416.
- Rupert, Mark (1995): *Producing Hegemony. The Politics of Mass Production and American Class Power*. Cambridge University Press.
- Shafer, Michael D. (1994): *Winners and Losers. How Sectors Shape the Developmental Prospects of States*. Ithaca and London: Cornell University Press. 1994.
- Silver, Beverly J. (2003): *Forces of Labor. Workers' Movement and Globalization Since 1870*. Cambridge University Press 2003.
- Stiglitz, Joseph E. (2002): *Globalization and Its Discontents*. New York, London: W. W. Norton & Company.
- Vagac, L. (2000). "Die Automobilindustrie in der Slowakischen Republik." Manuscript prepared for the Robert Brenner Stiftung.
- Van der Pijl, Kees (1984): *The Making of an Atlantic Ruling Class*. London: Verso.
- Van Tulder, Rob, and Winfried Ruigrok (1998): "European Cross-National Production Networks in the Auto Industry: Eastern Europe as the Low End of European Car Complex." BRIE Working Paper 121, <http://brie.berkeley.edu/~briewww/pubs/pubs/wp/wp121.htm>
- Wagstyl, Stephen (2002): "VW brings Skoda up to world-class speed." *Financial Times* 3. September, 13
- Werner, Robert (2003): "Location, Cheap Labor and Government Incentives: A Case Study of Automotive Investment in Central Europe since 1989." *Chazen Web Journal of International Business*, Spring, 1-29.
- World Development Report (2001/2002)*. Washington DC: The World Bank/Oxford University Press.
- Wright, Erik Olin (2000). "Working-Class Power, Capitalist-Class Interests, and Class Compromise." *The American Journal of Sociology* 105, 4: 957-1002.
- ZAPSR. (Automobile Industry Association of the Slovak Republic) (2003). Studia. <http://www.zapsr.sk/industry1.htm>.

Online Journals

The Slovak Spectator: www.slovakspectator.sk

Reuters: www.reuters.com

Financial Times Deutschland: www.ftd.de

Népszabadság online (NOL): <http://www.nepszabadsag.hu>