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Differentiated European Integration & the Changing Type of Capitalism in the V4 Countries¹

Abstract:

The objective of this paper is to analyze the double-layered diversification of the European integration system represented by the countries of Central and Eastern Europe. Here exemplified by the V4 states (Poland, Hungary, Slovakia and Czech Republic), the region offers a unique laboratory of European integration differentiation. The Visegrad Group positions itself on the outer-core of the European Union hemispheres. At the same time the block itself is internally diversified in various important aspects of integration (conflicting trajectories with Brussels, monetary integration, energy policy, relations with Russia, etc.). Unpacking this intra-V4 diversity will be accompanied by an exploration of the economic and institutional factors possibly affecting it. The political economy perspective allows us to capture the determinants intersecting at the cross-roads of economic and political dimensions. The authors will explore the selected building blocks of the system of differentiation inside the Visegrad Four.

Key words:

Visegrad Group, European differentiated integration, Varieties of capitalism

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1. Introduction

The authors of this paper seek to analyze the double-layered diversification of the European integration system as represented by the countries of Central and Eastern Europe (CEE). Here, the region of the Visegrad Four (V4) states (Poland, Hungary, Slovakia and Czechia), offers a unique laboratory regarding European integration differentiation. The Visegrad Four forms a grouping that is called semi-peripheral and the countries in the group display some similar path-dependencies. The Group positions itself on the outer-core of the European Union hemispheres, as described by Frank Schimmelfennig's (2018) system of differentiation. As such, the V4 states make an interesting case for scientific exploration. At the same time the block itself is internally diversified regarding various important aspects of integration (conflicting trajectories with Brussels, monetary integration, energy policy, relations with Russia, etc.). Unpacking this intra-V4 diversity will be accompanied by an exploration of the socio-economic factors affecting it. The political economy perspective allows us to capture the determinants which intersect at the crossroads of economic and political dimensions.

The second gravity point of this analysis is going to focus on the evolving variety of capitalism performed by the Central European economies. Notably, the term Dependent Market Economy (DME), coined for the V4 countries over a decade ago in order to describe their economic orientation, now seems to be called into question. Significant changes occurred in the political systems and economic policies of the countries due to the so-called illiberal turns (Poland, Hungary) and episodes (Slovakia, Czechia). One of the hypotheses that the authors will verify is that which states that the illiberal tendencies are correlated with their economies becoming emancipated from the "DME trap". The question which then appears is: are the V4 countries following the same path of evolution in terms of institutional order (the variety of capitalism they represent)? The emphasis put on the issue of state agency by the V4 leaders makes the type of capitalism within the V4 apparently more similar to the Coordinated Market Economy (CME) such as Germany, because of allowing more and more state intervention in the economy. On the other hand, less propensity to integrate with the EU rather resembles the UK's extreme case of de-integration. So, does converging more to the British Liberal Market Economy (LME) type mean less inner-core integration?

This paper proceeds as follows: first, the V4 grouping is positioned on the map of various types of capitalism as well as on the map of differentiated integration. For this purpose, the authors reconstruct the main claims found in the literature dedicated to the issue of European differentiated integration and comparative capitalism. Firstly, the V4 countries joined the European Union (EU) in 2004 and a subject of a growing body of literature considers whether they constitute a separate and distinct cluster of economies with some unique features that would allow to qualify them as a (Eastern) pole of integration. Secondly, this specific position of the V4 countries is contextualized in the theories of Varieties of Capitalism (VoC). This leads the present authors thirdly to the presentation of some empirical data explaining the dynamics of institutional parameters of the V4 as a group as well as separate economies. Fourthly, such a comparative analysis is concluded with a summary that highlights the main trends present in the region of Central and Eastern Europe.

2. Theoretical background

2a. Differentiated Integration theory

After the so called “big bang enlargement” (2004), Poland, Hungary, Slovakia and Czechia found themselves in the European Union, which – already at that time – constituted a system of differentiated integration. In fact, their joining the EU club increased the level of differentiation, since one of the most important impulses in the dynamics of differentiation is that of expansion. In general, the story of European integration can be told as a story of its deepening and widening – these two dynamics have founded the mechanics of differentiation so far. Consequently, the progress in integration meant the increase in differentiation over time (Schimmelfenning, Winzen 2019, 2020). However the most recent political and economic developments in the European Union and beyond clearly show that the differentiation gained momentum and its dynamics have accelerated. One of the most important characteristics of the contemporary European integration process requires further exploration in order to advance our understanding of its dynamics and determinants. It is fundamentally important from the point of view of the scholarly explanations as well, as it is furthermore crucially salient from the practical point of view of the real (existing) phenomena, shedding some light on the critical position in which the uniting Europe has found itself.

The political idea of differentiated integration can be tracked back to the famous Tindemans report (1975), whereas as a legal concept it appeared in the Single European Act (1986). The academic debates on the topic find their roots in Dahrendorf’s formulation of *Europe à la carte* (1970s). Already by the 1980s, scholars had identified several variations of differentiated integration and since then the scientific discourse has expanded significantly. From that moment on, many various conceptualizations can be traced in the literature, including flexible integration, multi-speed Europe, Europe as an empire, Europe of variable geometries, concentric circles, hemispheres, etc. (Ferry 2000, De Neve 2007, Riedel 2023), Koelliker 2001). Yet differentiated integration is less studied in comparison with the huge literature on integration as a whole. The reason for it may be that it has been limited by an assumption that differentiated integration would erode over time (Leruth, Lord 2015). It was assumed that member states (and their neighboring regions) would converge over time, and that the same variously applied policies would find their cohesive end.

The concepts used, similar to the standard ones exploited in the differentiated integration literature, range from the *Europe à la Carte* metaphor, through Europe of different speeds, concentric circles and differentiated geometries, up to the diversified hemispheres of integration (Andersen, Sitter 2006). More and more analysts, experts and academics claim that the observed increase in differentiation has reached the limits wherein it carries the potential for disintegration (Riedel 2018). Still, the new member states of Central and Eastern Europe (not only V4 but also other countries that joined in 2004, 2007 and 2013) found themselves at the core of the European integration project. Not all of them decided to enter the inner core (by accepting the common currency, the Euro), and most of the CEE citizens live outside of the

Euro-zone since the countries that decided to join the final stage of EMU are relatively modestly populated, like the Baltic states or Slovenia.

All the above-mentioned examples illustrate that the various semantics of differentiation provide a plethora of complex integration strategies, responding to the challenges of enlargement using variants such as multi-speed (time), variable geometry (space) and an à la carte approach (cf. Stubb 1996: p. 294). The exploration of these semantics always leads to acknowledging the diversity which allows the Union to embrace the flexibility necessary to deal with the strongly varying patterns of integration. The CEE states needed to find their way around the system of differentiated integration. Within the enlargement rounds one can clearly see that different state groupings within European integration were forming, due to the different initial bases from which the member states were starting.

Thus far, both in academic deliberations and in real-life politics, the differentiated integration concepts offered a way out from the dichotomous thinking between full membership and full non-membership. Moreover, nowadays these concepts are treated much more as a solution than a problem. Nevertheless, differentiated integration as a scholarly concept is a relatively new phenomenon in European studies, and wider: international relations, legal studies, political science or economics (Andersen, Sitter 2006, Tekin 2012). It grew alongside the real-life increase in differentiation (opt-outs, exemptions, enhanced cooperation, constructive abstention, special clauses, additional protocols, etc.). In the last two decades, differentiation has been a dominant feature of European integration. It is argued that approximately half of the EU policies are implemented in different ways (Lord, Leruth 2015). Undoubtedly, studying differentiated integration contributes to a better and more refined theoretical and empirical understanding of the European integration process as such. Differentiation in Europe has reached a phase, scale and depth such that it is legitimate to agree to the argument that it is a systematic characteristic of the European integration project as seen in 21st century (Hix 2005). Frank Schimmelfenning, Dirk Leuffen and Berthold Rittberger (2015) even wrote about the system of differentiated integration, in which differentiation is an essential and enduring characteristic of the EU.

2b. Varieties of Capitalism

VoC is the leading approach in the comparative political economy (or comparative capitalism, CC) scholarship of the last 20 years (see e.g. Hall & Soskice, 2001; Lane & Myant, 2007; Hall & Thelen, 2009; Peck & Zhang, 2013). Its two crucial notions are: coordination mechanism - the way in which economic activity is organized (generally choosing between market- or state-oriented coordination) and institutional complementarity - the manner in which different elements (corporate governance, financial system, education & training, industrial relations etc.) of the capitalistic system fit with one another and, as a consequence, create a certain institutional comparative advantage for a given economy. One basic variety of the market economy (here synonymous with "capitalism") is the Liberal Market Economy (LME, typically represented in the literature by e. g. UK, USA, Australia etc.) which is based on a market type of coordination (competition and formal contracts) and has institutional comparative advantage in terms of "radical innovations" (creating new products). Another variety is the Coordinated Market Economy (CME, e. g. Germany, Austria, Japan) which promotes state (or strategic)

coordination (interfirm networks and associations) of the economy and specializes in “incremental innovation” (improving already existing products). The third variety, initially proposed for the Visegrad Four (V4) and later for other Central Eastern European (CEE) countries is the Dependent Market Economy (DME) which relies on attracting Foreign Direct Investment or FDI and being an “assembly platform for semi-standardized industrial goods” (Nölke & Vliegenthaart, 2005) as its institutional comparative advantage. Here, the specific coordination mechanism would come down neither to the state nor to the market, but to the intrafirm hierarchies that prevail within transnational enterprises. As the concept of the DME was created just after the V4 countries’ accession to the European Union, we argue that some of the data supporting its main argument have to be updated. Hence, the first goal of this paper is to rethink the DME eligibility as the region’s distinctive type of capitalism after almost two decades of macroeconomic convergence stemming from EU membership. Another interesting theme is the political dimension and the so-called “illiberal” turns (in Hungary since 2010, in Poland since 2015), or episodes (last decade in Czechia and Slovakia) which the V4 countries have experienced (e.g. Bustikova & Guasti, 2017; Hanley & Vaduchova, 2018). Very often, the “state agency” issue has been underlined by the populist governments and their supporters, which could mean that these once-DME economies would follow the path of a German-like coordinated type of capitalism and the scope of state interventionism in the economy would increase. On the other hand, the V4 countries (especially Poland and Hungary) came to be perceived as stragglers in the European integration process. This rather resembles the case of the UK with Brexit being an extreme case of disintegration, since the CME countries, headed by Germany, are part of the core of integration. Interestingly, the two states that are located at opposite ends in terms of their tendency to integrate with the rest of Europe² are at the same time commonly recognized as internally performing an inverse type of market economy. Thus, the question arises: is there a correlation between institutional convergence towards LME or CME and, analogously, displaying more or less a tendency to integrate? This paper tackles some of these research questions and does so in the comparative manner using mostly data for the V4 economies since their EU accession, and benchmarking their performance with the CME and LME representatives. The goal of the paper is to answer the above-mentioned questions based on the following assumptions: 1) V4 (and possibly most of the CEE) countries cannot be labeled as DMEs anymore because of the unification that occurred due to convergence, 2) the United Kingdom still serves as a typical example of the LME and Germany for the CME type of capitalistic regime.

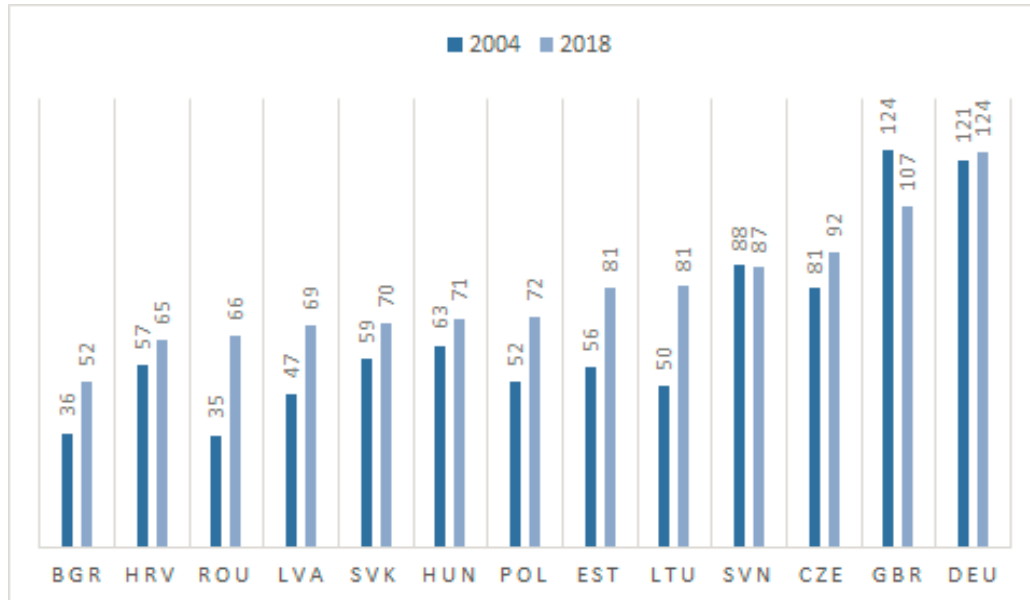
² The Federal Republic of Germany is often understood in the European integration literature as the “inner core” and the United Kingdom became “the outer periphery” after the Brexit agreement came into force.

3. Empirical data review

3a. Macroeconomic convergence and European integration performance

Graph 1.

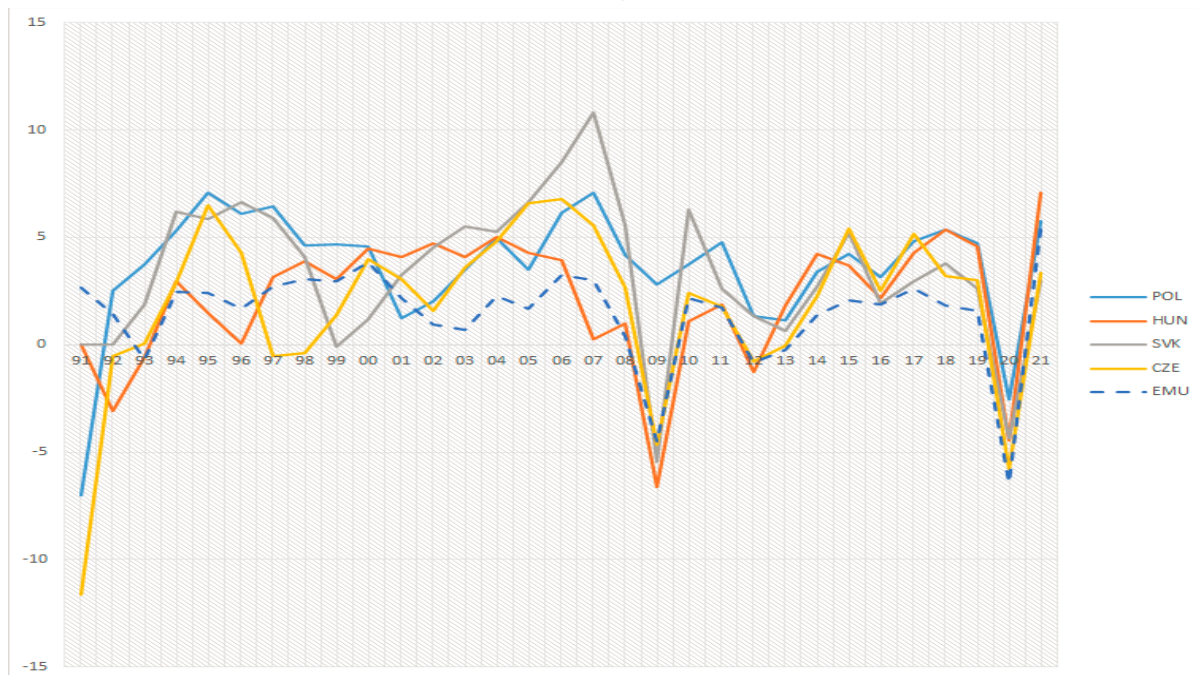
CEE countries, Germany and United Kingdom GDP per capita (PPP) in 2004 and 2019.



Source: authors' calculations based on the World Bank data.

Indeed, CEE countries experienced an intensive convergence in terms of the level of income per person as well as other macroeconomic indicators. Graph 1 shows the “club convergence” (percentage of EU average) for the Gross Domestic Product measured in the purchasing power parity (PPP) on the threshold of accession (2004) and on the eve of the COVID-19 pandemic crises (2019), as well as the same indicator for ideal-typical examples of the LME (United Kingdom) and the CME (Germany). The PPP measure of income serves as an approximation of the standard of living in the given country. Solid improvement can be observed for all the CEE countries with such vivid examples as that of the Romanian economy (over 30 p.p. growth). The CEE countries improved their score by 16,6 p.p. on average in the period, while Germany only did so by 2,6 p.p. The British income level fell from almost 124% of the EU average to 106,6%. Graph 2 depicts another dimension of new and old member states' macroeconomic convergence: the gradual synchronization of observed business cycles which is represented by the annual GDP growth rates. As one can observe, there was no striking similarity before the CEE accession to the EU (in the 1990s the V4 economies experienced a “transition recession”). Significantly, more convergence in this period started to occur after the Great Recession commencing in 2007.

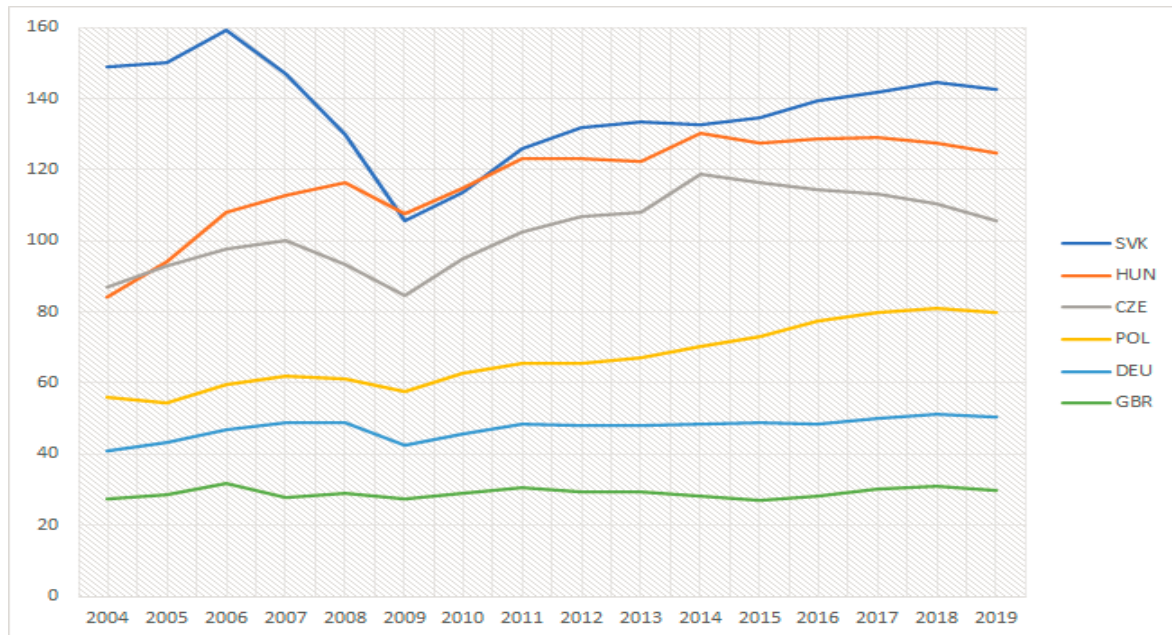
Graph 2.
GDP growth dynamics (annual % change) in the V4 countries and the European Monetary Union (EMU), 1991-2021.



Source: authors' calculations based on World Bank data.

For the purpose of depicting the evolution of the European integration process since the “great enlargement” we use the common indicators published by the European Commission. Intra-EU trade (the sum of exports and imports) of goods and services expressed as the percentage of the nominal GDP is presented in graph 3. The V4 economies are, in terms of this area, some of the best-integrated countries in the EU with Slovakia even being the leader in the ranking for all the member states when looking at the goods trade only (125% of GDP). It also holds the second place when considering aggregated measures (both goods and services) amounting to 142% of GDP which, on the other hand, shows the huge difference between the share of trade in goods and services. Such disparity is nevertheless common for each V4 economy. However, there are some issues concerning such a view of European economic integration. For example, a well-known empirical fact is that the smaller economies tend to trade more (which is reflected in the data on Hungary, Czechia and Slovakia), as well as the fact that some other exogenous factors (the number and size of neighboring economies, the physical length of the border, access to the sea) influence the share of trade volume in the GDP (Alesina *et al.*, 2005; European Commission, 2020). Another issue concerns the methodology behind the indicator. Germany, often described as the primus of integration, shows a deficit in intra-EU trade, largely because of importing vast amounts of sub-components from the CEE and then exporting technologically advanced products overseas (which results in the substantial extra-EU trade surplus). Hence, the typical measures of the scope of economic integration (already mentioned for intra-EU trade levels, but also for “openness” indices - share of imports in the GDP) used in the official documents of the European institutions say little about the true comparative landscape. Moreover, they do not say much about the crucial phenomenon in the European integration process - its differentiation.

Graph 3.
Intra-EU trade of goods and services (as % of GDP) in the V4, Germany and the UK, 2004-2019.



Source: authors' calculations based on Eurostat data.

Differentiated integration (DI) theory tries to embrace the process in a more complex way. Beyond purely economic stock and flow measures it also considers some political and legal dimensions (Leuffen *et al.*, 2012, Schimmelfenning & Winzen, 2020). The essence of the approach is to provide a description of an unequal pace in the increasing integration of different member states but they are selective in the way in which they participate in some core EU policies. Table 1 provides the examples of DI performed by the V4 countries in terms of some selected aspects: adopting the euro currency (case of Slovakia only), belonging to the Schengen area (all countries), joining the European Public Prosecutor's Office (EPPO, in the case of Czechia and Slovakia), participation in the Migrants Allocation Mechanism (MAM, none of the countries), general public support for the EU policies (high in Poland) and the political class's discourse on opting for a one-speed Europe, acceptance of the Recovery and Resilience Facility (RRF) by the European Commission. Each policy has its formal-legal foundations apart from public opinion and political policy measures which are of a non-legal nature, but are also often included in the DI research as a proxy for the “social dimension” of integration. The examples listed relate to the relevant policies, mostly established at the level of primary European law, but a lot of differentiation also takes place in the matter of secondary law derogations (see: Duttile *et. al.* 2017)

Table 1.
Differentiated integration in the EU.

	POL	HUN	CZE	SVK
Eurozone	-	-	-	+
Schengen	+	+	+	+
EPPO	-	-	+	+
MAM	-	-	-	-
RRF	-	-	+	+
Public opinion*	+	-	-	-
Political discourse**	+	+	+	+

Source: own calculations.

*"+ " is given to a country with above-average public support for the EU in the latest Barometer survey (fall 2022).

**"+ " is given to a country where politicians tend to support a one-speed vision of European integration based on the InDivEU database "Government's preferences 2008-2020" country reports.

3b. The changing variety of capitalism in the V4 countries

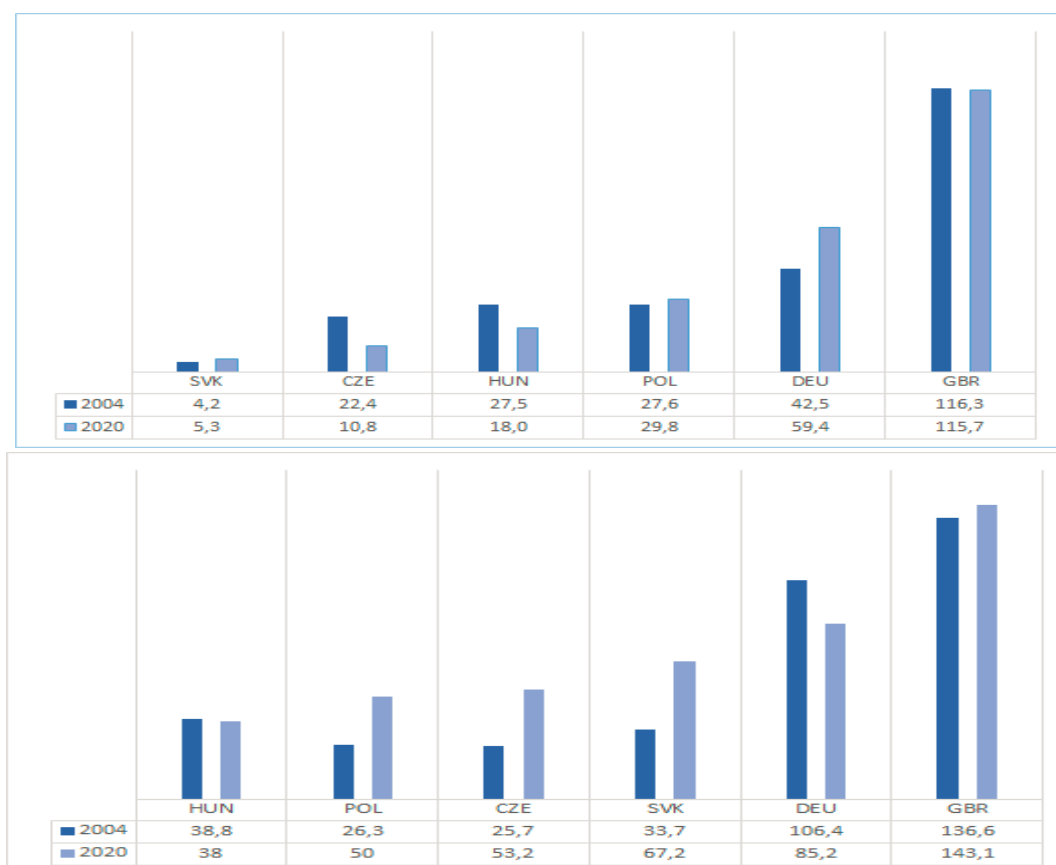
The core feature of the proposed DME type was its outstanding ability to attract Foreign Direct Investment (FDI). Although CEE economies, headed by the V4, are still topping the rankings of countries most often hosting such capital flows, the relative numbers do not prove their distinctiveness in this matter anymore. The inward-to-outward FDI volumes ratios dropped dramatically: in Hungary from 6,4 to 3,2; in Czechia from 17 to 4,1; in Poland from 47 to 9,8 and in 40,3 to 14,3. This, together with the already mentioned economic convergence which is progressing in the EU, leads us to assume an institutional convergence as well. Thus, we review the rest of typical VoC indicators which were used to determine the DME type in the past. The analysis relies on the measures compiled into a "coordination index" in some studies (Hall & Grangerich 2004; Casey, 2009).

Graph 4 shows the irrelevance of the stock market as a way for raising capital for enterprises in the V4 countries. The Czech and Hungarian stock markets capitalization expressed as a share of GDP even fell since the accession to the EU, while the Polish and Slovakian stock markets have increased only symbolically. The role of bank credit, on the other hand, rose substantially in all the V4 economies (apart from Hungary where, technically, it stagnated) and it is now the highest in Slovakia (67,2% of GDP, compared to German 85,2%). Interestingly, in Germany private bank credit for companies fell, while the stock market

capitalization rose in the period, which resonates with some commentators that the German economy has changed recently into the more LME-typical, short-term oriented form of market economy.

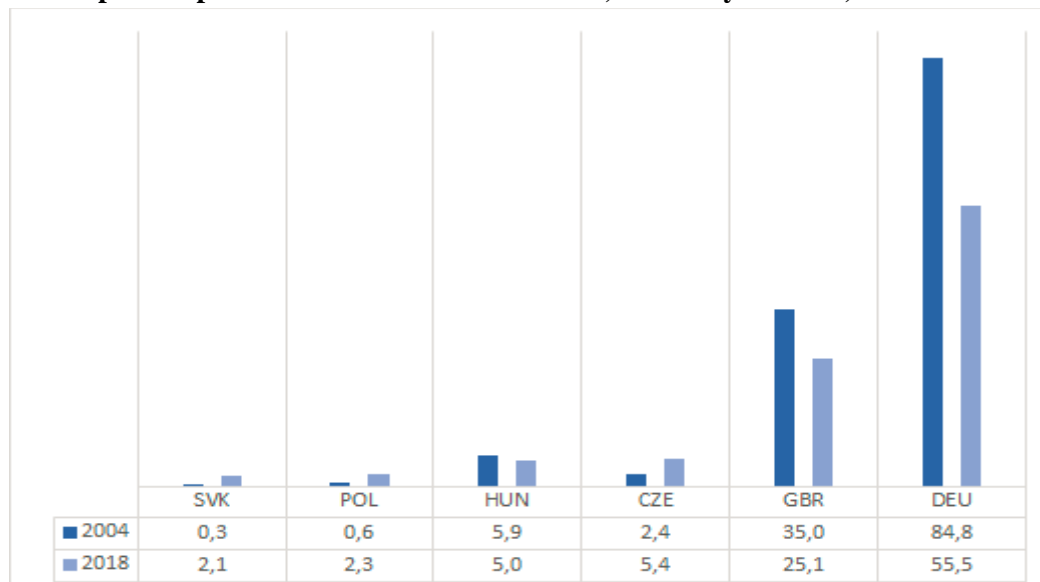
Graph 4.

**Dominant ways of raising capital in the V4 economies, Germany and the UK, 2004 and 2020:
stock market capitalization (% of GDP) - upper panel, bank credit for the private sector
(% of GDP) - bottom panel.**



Another dimension of the standard VoC framework directly concerns the institutional determinants of the emergence of innovation. Here, the two “input” variables will be mentioned. First, public spending on (all kinds of) education has been falling in three of the four Visegrad countries by around 1 p.p. on average and remaining at the same level in Czechia. At the same time, they rose in the UK and Germany. Second, the GDP size-adjusted expenditures on research and development (R&D) improved slightly in the V4 economies, but still remained almost half a per cent lower than that of Germany (3,1% of GDP in 2020). On the “output” side in turn, one can still observe (see: graph 5) relatively poor V4 countries' performance in terms of the number of “triad” (meaning registered in USA, UK or Japan) patents per million inhabitants. Nevertheless, the score has improved in relative terms stemming from both a slight rise in measurements in the V4, as well as some significant fall in the UK and Germany (because of increased global competition).

Graph 5.
Triad patents per million inhabitants in the V4, Germany and UK, 2004 and 2018.



Source: authors' calculations based on OECD (number of patents) and World Bank (population) data.

Table 2 summarizes another area of the VoC analysis - industrial relations. All the countries presented recorded a decline in terms of the unionization level (expressed as number of employees enrolled in a trade union as a percentage of all employees), with the biggest, two-digit drops in Germany (-12,5 p.p.) and Hungary (-10,1 p.p.). The V4 economies' labor markets - where, on average, 10,5% of employees are members of trade unions - are in this case more similar to the German case (17%). The UK tends to have the highest union density within the group, amounting to 23,5% in 2018. Almost each country dropped also in terms of the number of employees whose wage contracts are covered by collective bargaining. The exception is Czechia which improved this measure by nearly 3 p.p. and in 2016 ranked, interestingly, between Germany (outstanding share of 65,8% - 1st place) and the UK (26,3% - 3rd place). This issue also shows some more diversity among the V4 countries. The last parameter concerns the levels of general public spending on social policies as percentage of the economy's output. OECD data suggest that all the countries show moderately stable numbers in the period from 2004 to 2018 and the results range narrowly from 17,2% of GDP in Slovakia (+1,4 p.p. change) to 25,3% in Germany (-0,7 p.p.).

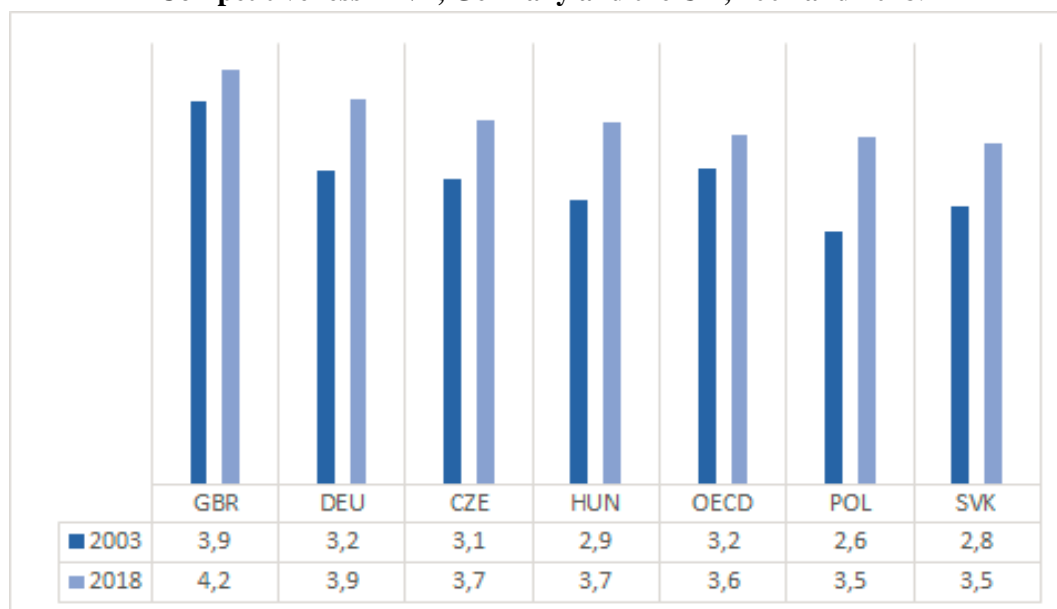
The last, but not the least dimension of the analysis relates to the changing competitiveness of the European economies. Graph 6 presents the composite indicator of the OECD's Product Market Regulation (PMR) published in 2003 and in 2018. After the accession, all the V4 economies recorded an improvement bigger than the average in the OECD in the period (the biggest being in Poland and Hungary). However, in this period, the CEE countries analyzed converged more towards Germany (which also upgraded its score) than to the UK (which has the highest level of competitiveness).

Table 2.
Industrial relations in V4, Germany and the UK.

	Social public spending (% GDP)		Collective bargaining coverage (% employees)		Union density (% employees)	
	2004	2018	2004	2016	2004	2016
CZE	17,8	18,8	43,4	46,3	20,6	10,5
DEU	26	25,3	65,8	56	22,2	17
HUN	21,1	18,8	34,4	22,8	17,2	8,5
POL	21,2	19,8	18,9	17,2	19	12,1
SVK	15,8	17,2	40	24,4	23,7	11,2
GBR	19,3	20,3	34,7	26,3	28,8	23,5

Source: ILO data (unionization and collective bargaining) and OECD (social public spending).

Graph. 6.
Competitiveness in V4, Germany and the UK, 2004 and 2018.



Source: OECD Product Market Regulation (average*).

*The scores have been standardized so that the bigger value means a more competitive economy.

4. Conclusions & discussion

The key question that was approached was whether the V4 countries have followed the same evolution path in terms of the institutional order (variety of capitalism) they represent. And consequently, the issue was whether this evolutionary trajectory influences the position they have taken on the map of differentiated integration.

The first conclusion to be drawn is the statement that the general economic factors correlate positively with the long-term trends of the pro-EU orientation (measured e.g. with the standard trade openness) of the V4 states and their economies. Their income per head converges towards the EU average, and their business cycle is more and more compatible (especially after the economic crisis) with the fluctuations in the Eurozone. The picture becomes more complex when one looks through the lenses of differentiated integration theory. It is the political factors (especially in Poland and Hungary) that put these states on a conflicting path with Brussels, and consequently they position them on the outer-core of the differentiated European integration system. The long trends over three decades which were already observed before the EU accession, accelerated and consolidated after 2004. It is even legitimate to say that the times of crisis acted as some sorts of critical junctures – the periods of economic turmoil bringing more equalization as regards many of the economic parameters in question. However, this growing convergence of the V4 grouping in relation to the EU average is accompanied by some significant divergence inside the Visegrad countries' move towards integrating the “mainstream” of EU policy.

Yet, the assumption of a “hybrid” type of capitalism for the V4 group is to be maintained, basing on the empirical data investigation. Although in most of the areas (competitiveness, ways of raising financial capital) in the process of becoming more and more similar to the CME type continues, other institutions (education and innovation systems) resemble more closely those of the LME. Converging towards the CME may be partially the result of a statistical effect related to the weight of the German economy and the economic governance model it promotes. The CEE economies, being closely inter-connected to the German supply chain, adjust to its dominant features. This type of imitative development has been effective so far in the catch-up strategy of the EU new member states from the CEE region. Nevertheless, it is worth indicating that the middle-income trap literature suggests there will be expected slow-downs as the aspiring economies get closer and closer to the average levels. An important limitation of our analysis is that we focus only on the mechanism of the coordination side, without thoroughly examining the paths of (in)complementarities that these institutions have created in the V4 economies.

Additionally, the Brexit process (the UK's leaving the EU already began in 2016 and continued until 2021) is an important factor in this analysis. Not only was the British economy (and still is, to some extent) an important partner for many of the V4 economies but also the UK's absence from the EU favors the less liberal component in the decision-making process in Brussels. Since the VoC literature indicates that it is London that represents one of the examples of the Liberal Market Economy model, its absence from inside the EU means the lack of an important liberal pole. The only remaining pole of economic governance inside the EU is

represented by the CME model and this could imply its further diffusion among other Member States.

These new findings open a broad path for further investigations to be undertaken in the future. First, the hypotheses generated in the spirit of the middle-income trap literature require systemic verification in the Central and East European setting. So far, most of the studies have been conducted in Asia or South America, with only a few exceptions in Europe. Second, and related, the literature on DME needs to be revisited, since the FDI inflow in relation to the economy's size has been falling gradually since its highest levels after the accession.

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