What kind of capitalism is emerging in Eastern Europe? Varieties of Capitalism in Estonia and Slovenia

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Draft

1 Introduction

The collapse of the communist planning system in Central and Eastern Europe (CEE) raised the issue, how to manage the transition to a market economy. Only later interest was expanded into the question, what kind of capitalism is emerging in former socialist countries (eg. Wagener 1996, Lane 2000)? Previous attempts to identify a type of capitalism in CEE can roughly be put into two groups. On the one hand authors have tried to find analogies to existing western market economies (Chavance/Magnin 2000, Cernat 2002), however with an idiosyncratic character due to lack of structured theoretical underpinnings. On the other hand studies were limited to particular sectors, as ownership (Stark 1996), corporate governance (Neumann/Egan 1999) or organizational structure within old networks (Staniszkis 1990, Martin 2002), mainly dealing with deviations from western best practice. This account, although far from being exhaustive, reveals the main deficit of previous attempts: decisive determinants of a capitalist system are left out. From this it follows that a structured approach of comparative capitalism is needed to identify a type of capitalism in CEE. The Eastern European transitional experience brought about a shift of interest in the area of comparative economic systems, which until then had mostly been occupied with the comparison of capitalism and socialism. The fact that most of the objects of study had vanished in the beginning of the 1990s led, among other factors, to a reorientation towards the distinction of various forms of capitalism. The most recent and influential approach in the area of comparative capitalism is the Varieties of Capitalism (VoC) approach by Peter Hall and David Soskice (2001). VoC distinguishes two distinct systems of capitalism, Liberal Market Economies (LME) and Coordinated Market Economies (CME). It identifies institutional

1 I am indebted to Frank Bönker and Hans-Jürgen Wagener for recurrent fruitful discussions and advice while preparing this paper. All remaining deficiencies are mine.
complementarities between different sub-systems of an economy. The predominant modes of coordination of national models of production are examined. It is a useful heuristics to be applied to transition economies, thereby answering the question, what kind of capitalism is emerging in Eastern Europe?, in a structured and comparable way. The present paper is based on a study, which compares Estonia and Slovenia in the sphere of industrial relation with regards to VoC (Feldmann 2002). Feldmann comes to the conclusion that in the realm of industrial relations Estonia can be described in terms of an LME, whereas Slovenia can be regarded as a CME. This result serves as hypothesis, which shall be tested by studying complementary areas of VoC, namely corporate governance, social security, inter-firm relations and vocational training. VoC has so far exclusively dealt with mature capitalist systems, which means that by applying its framework to Estonia and Slovenia, further applicability of the approach can be assessed.

The remainder of the paper is organized as follows: Section 2 briefly introduces the VoC approach as the tool of analysis. In Section 3 the determining sections of both economies are studied in the following manner. After identifying which indicators should be examined, first peculiarities in the respective area resulting from the socialist past, and corresponding reform measures are described. Then the now existing institutions are inspected to identify complementary relations.

The final part concludes.

2 The Varieties of Capitalism approach

The VoC literature stands in a long tradition of comparative capitalism. The origin reaches back as far as Andrew Shonfield’s “Modern Capitalism” in 1965. In the 1970s the phenomenon of rising inflation and unemployment (“stagflation”) in the industrialized economies triggered the literature on neo-corporatism which deals with macro-issues like the scope of wage-bargaining (Schmitter/Lehmbruch 1979). On the micro-level neo-institutionalism looks at the institutional setting with regard to the finance sector and the role of the state (Hollingsworth et al. 1994). At about the same time another strand of literature emerged which Hall (1999) dubs Organization of Production. It distinguishes various modes of coordination of work processes in firms (Chandler 1990, Lazonick 1991).

For a more comprehensive overview, see Hall (1999).
The VoC approach, which has been developed throughout the 1990s, draws mostly on neo-corporatism and neo-institutionalism, but in contrast to them it was developed further in essentially three respects (Ebbinghaus/Manow 2001). Firstly, it is a micro-approach placing firms as central actors of an economy in the centre of analysis. Secondly, it identifies complementarities between areas within an economy, thereby seeking to explain how institutions are linked together in a systemic way. Thirdly, these differing institutions lead to comparative institutional advantages of national models of capitalism.

The point of departure is the way behaviour of firms is determined by the surrounding institutional setting (institutional embeddedness). A firm is faced with innumerable coordination problems which need to be solved. The authors argue that the way of coordination distinguishes different types of capitalism. In Liberal Market Economies (LME) the coordination is primarily characterized by arm’s-length relations and formal contracting in competitive markets. In contrast to that, in Coordinated Market Economies (CME) there are several non-market institutions that influence processes of strategic interaction. This division is understood as a continuum on which countries cluster around the prime examples Germany and USA. See Table 1 for a brief overview.

**Table 1: Coordinated versus Liberal Market Economies**

<table>
<thead>
<tr>
<th>CME (Prime example Germany)</th>
<th>Sub-system</th>
<th>LME (Prime example USA)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Encompassing trade unions and employers’ associations,</td>
<td>Industrial relations</td>
<td>Weak trade unions and employers’ associations,</td>
</tr>
<tr>
<td>high coverage of collective agreements; co-determination.</td>
<td>Corporate Governance</td>
<td>firm-level agreements.</td>
</tr>
<tr>
<td>“Patient” capital, concentrated ownership,</td>
<td></td>
<td>Short-term capital, dispersed ownership-structure,</td>
</tr>
<tr>
<td>stakeholder value; consensusal decision-making in two-tier</td>
<td></td>
<td>shareholder value; strong CEO,</td>
</tr>
<tr>
<td>board structure, comparatively small stock-markets</td>
<td></td>
<td>large stock-markets.</td>
</tr>
<tr>
<td>Inter-company networks, strategic cooperation (vocational</td>
<td>Inter-firm relations</td>
<td>Standard market-relationships</td>
</tr>
<tr>
<td>training, R&amp;D)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Both high employment and high</td>
<td>Social security</td>
<td>Both low employment and low</td>
</tr>
<tr>
<td>unemployment protection</td>
<td></td>
<td>unemployment protection.</td>
</tr>
<tr>
<td>Dual apprenticeship system fosters firm-specific and</td>
<td>Vocational training</td>
<td>Traineeships and in-house training of</td>
</tr>
<tr>
<td>industry-specific skills</td>
<td></td>
<td>general skilled labour.</td>
</tr>
</tbody>
</table>


Although deviations occur within these groups, the Scandinavian countries, the Continent and Japan are regarded as CMEs, whereas the UK, Ireland, Canada, New Zealand and Australia complete the group of LMEs. Different modes of coordination in various sub-systems of an
economy (industrial relations, corporate governance, social system, vocational training and inter-firm relations) are linked to each other in a mutually reinforcing, systemic way. These complementarities are the building blocks of national production systems. They will be discussed in detail below when presenting the cases of Estonia and Slovenia. The next step the authors take distinguishes VoC qualitatively from its predecessors: Hall and Soskice argue that these complementarities bring about comparative institutional advantage giving economies a competitive edge within certain branches. This comparative institutional advantage is connected to different types of innovation: the overall longer-term investment horizon and more consensual model of a CME enables firms to pursue strategies that rely on incremental innovation, which is necessary for diversified quality production. Complementarily workers and firms in CMEs have incentives to invest in firm-specific and industry-specific skills. In LMEs the institutional setting characterized by faster decision-making and fierce competition in various sub-systems generally favours investment in general skills. This leads to a comparative advantage when it comes to products based on radical innovation. Accordingly, comparing patents in Germany and the US, Hall and Soskice (2001: 41-44) observe that German firms are relatively more active in sectors like machine tools, consumer durables or mechanical engineering, while American firms are relatively better in areas such as biotechnology, semiconductors or telecommunication. The notion of comparative institutional advantage has important implications for discussions about convergence of systems, which are often connected to the phenomenon of “globalization” (Hay 2002). The line of argumentation presented here speaks against convergence. Actors are well aware of the comparative institutional advantages and will stand up for its continuity (Fioretos 2001). Producers recognize institutional advantages and shift production to where the institutional setting best supports it.

Having presented the VoC-approach, we can now turn to apply it to Estonia and Slovenia.

3 Estonia and Slovenia as LME and CME

Although geographically distant from another, Estonia and Slovenia share some features that make it valuable to compare them. Both Estonia and Slovenia are small countries, with about 1.4 and 2 million inhabitants. Furthermore, they both gained independence by splitting of a larger state, the USSR and Yugoslavia respectively, in which both were their country’s richest region. As a consequence they both faced the additional task of building the most basic institutions necessary for a functioning state. Both countries were part of the socialist world, however, there were differences in this respect. Estonia was integrated into the highly centralized Soviet planning system. During the 1980s only 2-3 % of its exports went outside
the USSR (Fischer 1994). Slovenian firms, in contrast, were integrated into western markets before independence: only 25 % of exports was sold to other Yugoslav republics, while the lion’s share of exports went to western economies. The single firm was much more independent following reforms from the 1960s onward when self-management was introduced. (Pleskovic/Sachs 1994).

We now turn to further examination of both countries. Where necessary, national peculiarities resulting from the socialist system and corresponding reforms are mentioned. Then the now existing institutions are described with regard to the concept of complementarities, thereby testing Feldmann’s above mentioned hypothesis that Estonia can be seen as an LME, whereas Slovenia as a CME.

**Industrial relations**

Two features of industrial relations are especially relevant for the VoC-literature, specifically wage-bargaining and workers’ participation. In CMEs wages are set on industry level, so that workers on the one hand have a certain wage protection, which is an incentive for them to invest in firm- or industry-specific skills. On the other hand it is difficult for other firms to poach workers by offering wage differentials, which is a precondition for employers to be prepared to costly investments in specific skills of their employees. On the firm level works councils represent workers with considerable power over layoffs. Co-determination secures optimal use of specifically skilled workers (Hall/Soskice 2001: 24-25). In LMEs, on the other hand, wage-bargaining mostly occurs on the firm level. Management has strong unilateral decision-making power over ‘hire-and-fire’. There does not exist a comparable system of works councils as in an archetypal CME like Germany. Therefore, neither workers nor employers have an incentive to invest in firm-specific skills, because they cannot be safe that the investment pays for itself (Hall/Soskice 2001: 29-30). Accordingly, Estonian and Slovenian industrial relations will be examined with respect to unions, employer associations, wage bargaining, and participations.

**Trade unions, employers and wage-bargaining**

Industrial relations in socialism were fundamentally different from the ones in western market economies. Trade unions were part of the regime, and usually not rooted on firm level. Membership was compulsory for workers. From this it follows that reputation of unions was overall bad, so that a drop in membership after the dismantling of the system was inevitable (Boeri/Terrell 2002). Correspondingly, membership figures in both Estonia and Slovenia dropped sharply, in Estonia from 93 % of workers unionized in 1990 to 14 % in 2001, and in
Slovenia from 69 % in 1989 to 40 %. However, Slovenian figures are the highest of all CEE countries (Feldmann 2002).

In Estonia there are two umbrella organizations, which represent different smaller unions, EAKL, the successor of Soviet time with 26 members and 58.000 workers, and TALO, joint organization for 11 unions and 40.000 workers. Apart from these, ETMAKL, the farmers’ union has about 9.600 members. On the employer side we find ETTK, the Estonian Central Employers’ Organization, which represents a mere 4 % of firms (Feldmann 2002). There are both tripartite and bipartite agreements. The former include the State, unions, and employers and mainly deal with minimum wages and overall working conditions. The latter are not very far-reaching: 28 % of workers are covered by a collective agreement, while at the same time, agreements on firm level are the most common. The Ministry of Social Affairs prompts social partner to bilateral agreements, but at the same time explicitly underlines their voluntary character (Eamets/Philips 2003a).

In Slovenia, there are 6 umbrella associations, whereby the leading role is played by the successor organisation from communist times, ZSSS, which represents about half of the organised workforce. Furthermore 17 independent unions exist. The most influential employers’ organisation is the Slovenian Chamber of Commerce, to which membership is compulsory (Stanojević 2000). Wage bargaining legislation makes agreement between unions and employers compulsory. This, together with compulsory membership in the Chamber of Commerce creates a situation, in which almost 100 % of the workforce is covered by collective agreements. A new law, which is still in parliamentary process would most certainly reduce this high figure, because compulsory agreements are against the guidelines of both ILO and EU (Skledar 2002).

To sum up, while in Slovenia we find strong employers’ associations and unions with far-reaching agreements on wages, in Estonia both is weakly developed. In most cases, wages are set on firm-level. Complementarily to this, on the firm level we expect to find considerable workers’ participation in the Slovenian case.

Worker participation

In Estonia first experimental reform measures were taken in the second half of the 1980s. Workers’ councils were founded in a number of firms. Following independence these projects lost significance very fast, councils split off along ethnic lines, while the independence movement was the dominating issue. “Soviet experiments” were discredited and eventually dropped (Wielgohs 2001). Nowadays workers’ councils do not play any significant role anymore (Feldmann 2002).
By contrast, in Slovenia workers’ councils have considerable influence, a fact that can be traced back to peculiarities of the Yugoslavian system of self-management. As a consequence workers’ involvement in decision-making of the firms increased. In 1993 the system was transformed into a system of councils modelled on German *Betriebsräte* (Stanojević 2001).

This very brief review of industrial relations in both countries has shown that in this sphere Estonia and Slovenia can be regarded as “polar opposites” (Feldmann 2002: 17). While in Estonia we find firm-level wage-setting accompanied by weak unions and employers organisations, wage-bargaining in Slovenia is conducted industry-wide and both unions and employers are strongly cohesive. This is in line with the given complementarities of VoC. While in this sub-system the results are clear-cut, in the next area of corporate governance the picture is less evident.

### 3.1 Corporate governance

The creation of private property is the most fundamental challenge transitional economies are facing. Privatization has a decisive impact on reformation of ownership structure and thereby on corporate governance. To incorporate corporate governance into the analysis, Hall and Soskice roughly distinguish between the consensual, long-term stakeholder model and the short-term shareholder model. For VoC this distinction comprises further complementarities. In the stakeholder model ownership structure is quite concentrated with one or two strategic investors. Firms are characterized by a two-tier board structure with management and supervisory board. Control is exerted through representation of investors on supervisory boards where they influence important decisions thereby securing their investment. This is reinforced by dense inter-company networks, to a large part based on reputation, which serve as information channels. They will be discussed in 3.2. This consensual model facilitates “patient capital”, which in turn makes a longer investment horizon possible. Again, for workers this considerable safety promotes investment in firm-specific skills, because they are not fired on the spot when the investment makes losses at an early stage. Apart from other stakeholders as banks (with, in Germany at least, decreasing involvement) or other firms, workers usually are represented on supervisory boards as well. On the contrary, within the shareholder model we find widely dispersed ownership. Institutional investors (for example pension funds) exert control by means of the capital market, which is usually larger than in CMEs. That is why firms must have an eye on short-term profitability indicators. This is partly ensured by a one-tier board
system with a strong CEO, who has considerable unilateral power over ‘hire-and-fire’. As already seen above worker participation is not institutionalized. Overall, workers cannot be sure to stay sufficiently long in a firm as to make an investment in firm-specific skills attractive (Vitols 2001). Form this short comparison it becomes clear which characteristics must be examined in the Estonian and Slovenian case: ownership structure, organization of management, representation of stakeholders and market capitalization.

**Ownership structure**

In Estonia first small privatizations already started in October 1990, when it was possible to sell off 20 % of a firm to employees. Apart from that, small firms (book value < 500,000 Roubles) could be sold entirely. After introduction of the Estonian Kroon (1992) a small privatization scheme was established, which was modelled on the German Treuhandanstalt. Small privatization proceeded very fast, so that all small enterprises subject to privatization were sold by 1994. For large privatization German experts from the Treuhand were hired to advise a newly founded agency. So the main form of privatization was direct sales. Equal treatment of foreign investors was secured (Mygind 1997: 40-44). The applied method of privatization is still visible in the large ownership concentration: on average the largest shareholder in Estonia holds 56.2 % of shares, while the second and third largest are relatively small holding 9 % and 4 % respectively (Berglöf/Pajuste 2002). This does not correspond to the typical picture of an LME, where we normally find widely dispersed ownership.

In Slovenia vouchers were issued in size of 40 % of GDP. In the privatization process 40 % of the capital of a firm had to be transferred to three state-controlled funds (SCFs), while for the remaining 60 % there were two options: they could be sold either to employees or directly to the public. Privatization Investment Funds (PIFs) were founded to exert active control. Today’s ownership structure (of firms listed on Ljubljana Stock Exchange end of 2000) still reminds of Slovenia’s privatization method: 25 % of firms are held by PIFs or their successors, 16 % by insiders, the same amount by SCFs, and 15 % by firms. 12 % of shares are hold by small investors. On average the largest owner controls 32 % of shares, with 15 % and 11 % for the second and third largest investor. The average coalition voting block of the three largest owners in over 70 % of firms amounts to 62 %. This figure is close to Austrian and German percentages (Gregorič 2003: 33ff.).

**Organisation of management**

In 1995 the new Commercial Code brought far-reaching changes for Estonian enterprises. A two-tier board structure was introduced, which is based on the German model
with management board and supervisory board (Gerndorf et al. 1999). Like Estonia, Slovenia as well adopted a two-tier board structure following legislation in 1993 (Bohinc/Bainbridge 1999).

**Representation of stakeholders**

The Estonian Commercial Code does not define more detailed the composition of the supervisory board: “The presence of the workers’ and interest groups’ representatives on the Supervisory Board is not required and does not happen in practice“ (Gerndorf et al. 1999: 13). Shareholders holding more than 50 % of shares have the right to unilaterally set the composition of the supervisory board.

In Slovenia, there have to be workers’ representatives among other interest groups on the supervisory board. In firms employing more than 1.000 workers, half of the board consists of workers’ representatives. Moreover, in firms with more than 500 employees, one representative has to be seated on the management board (Bohinc/Bainbridge 1999).

**Market capitalization**

Figure 1 displays the development of market capitalization for Estonia and Slovenia.

Figure 1:

The Estonian stock-market has been larger than the Slovenian since the beginning of the transition process, with the exception of 1998, which resulted from the Russian crisis.
Moreover, the Estonian stock-market capitalization is the highest of all eight Eastern European accession countries, which will be members of the EU on May 1st 2004 (EBRD 2003). However, the Estonian value is still much smaller than corresponding values for typical LMEs as the UK and the USA (Berglöf/Pajuste 2002).

Comparing our results with practice prevailing in UK, an LME, and Germany, a CME, we observe the following picture:

**Table 2:** Comparison of basic corporate governance features of Estonia and Slovenia with the UK and Germany

<table>
<thead>
<tr>
<th></th>
<th>LME</th>
<th></th>
<th>CME</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Estonia</td>
<td>UK</td>
<td>Slovenia</td>
<td>Germany</td>
</tr>
<tr>
<td><strong>Ownership structure</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ownership structure</td>
<td>Very strong largest voting block</td>
<td>Small largest voting block; overall dispersed</td>
<td>Relatively large voting blocks (large coalitions)</td>
<td>Large voting blocks (large coalitions)</td>
</tr>
<tr>
<td><strong>Management</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Management</td>
<td>Two-tier board structure with management and supervisory board</td>
<td>One-tier management board</td>
<td>Two-tier board structure with management and supervisory board</td>
<td>Two-tier board structure with management and supervisory board</td>
</tr>
<tr>
<td><strong>Representation of stakeholders</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Representation of stakeholders</td>
<td>Voluntary</td>
<td>Voluntary</td>
<td>Workers’ and other interest groups’ representatives on supervisory board</td>
<td>Workers’ and other interest groups’ representatives on supervisory board</td>
</tr>
</tbody>
</table>

Two observations catch the eye: first of all the striking similarities between Slovenia and Germany regarding management organization and representation of stakeholders clearly confirms the view of Slovenia as a CME. In both areas legislation was modelled on the German example. Looking at ownership structure we find legacies of post-socialist reforms though: the considerable shares of insiders and state-controlled funds still hinder an effective governance (Berglöf/Pajuste 2002). Banks do not play any significant role in corporate governance apart from influence exerted through bank-owned PIFs (Gregorič 2003). The second observation is not that straightforward, on the contrary, the Estonian picture seems highly inconsistent with VoC. On the one hand Estonia has the biggest capital market in CEE
and representation of stakeholders is voluntary. This does not go well together with large ownership concentration and German-type two-tier board structure. However, looking at practice, we discover deviations from the stakeholder model. Gerndorf et al. (1999) report that in daily practice supervisory boards are often circumvented when it comes to decision-making. It is perceived as overly bureaucratic. Moreover, the high concentration of ownership allows circumvention of the system by carefully choosing members of the supervisory board. More generally it might not be feasible to introduce a market-based system of corporate governance right away from the beginning. When protection of small investors is still weak and not credible, experts lack, firms are still very risky, and information gathering costly, capital markets cannot evolve (Berglöf/Bolton 2002).

To sum up, while in Slovenia we find a typical stakeholder approach to corporate governance, analysis of the Estonian case reveals a somewhat imperfect stakeholder approach to corporate governance, or stated differently, the Estonian model seems to be neither a pure shareholder nor a perfect stakeholder approach. This, in turn, poses the question if in Estonia there might be mechanisms at work which are not captured by the VoC framework and which could be functional equivalents to the complementarities suggested by Hall and Soskice. Before coming to a final conclusion the remaining areas of inter-firm relations, social security and vocational training are examined.

3.2 Inter-firm relations

Relations between firms in CMEs are characterized by a variety of cooperation in different areas. The diffusion of new technologies and standard-setting is supported by business associations, research and development is often carried out jointly by firms (Hall/Soskice 2001: 26). Furthermore, as we have seen above, inter-firm relations play an important part in the sphere of corporate governance by providing information through dense networks. By contrast, in LMEs inter-firm relations are almost exclusively based on “standard market relationships”. It is not credible for firms in LMEs to engage in longer-term commitments when they have to be very sensitive to short-term profitability. There do not exist comparable dense networks as in CMEs that could foster this kind of relationships. Technology diffusion mainly occurs by scientists moving across firms, standard-setting is characterized by a “market race”, in which the winner sets the standards. Complementarily in LMEs we find a extensive culture of venture capital (Hall/Soskice 2001: 30-31).

Due to state control, in socialist countries these kinds of company-relations did not exist. R&D was centrally conducted by planning authorities, which also decided, in which sectors which technology for which production should be used (Kornai 1992: 111 ff.).
After removal of the planning system firms had to find ways how to cooperate. In Estonia, no significant attempts to cooperate “beyond the market” were made; following VoC this is not necessary and not possible, due to lack of encompassing business organizations. When it comes to CMEs, Goodin (2003: 208-212) remarks that trust is a precondition for the building of committed cooperation between firms. For many firms had to build up completely new relationships with new business partners following the breakdown of firms and markets in CEE, it is not surprising that in Slovenia trust is not well developed, yet\(^3\) (Czaban et al. 2003). Nevertheless, institutional infrastructure enabling cooperation is given by the strong presence of chambers and business associations.

The next chapter deals with Estonian and Slovenian social security systems.

### 3.3 Social security systems

VoC distinguishes between employment protection (EP) and unemployment protection (UP). Whereas in LMEs both are weakly developed, in CMEs one can find a mix of both. There are countries where both are highly generous (Germany), others where UP is low and EP is high (Japan) or where the reverse is true (Denmark). Again, this has consequences for skill formation: in Germany workers can be sure to have a considerable income even if they are fired (which is less likely than elsewhere exactly due to high EP), so investment in industry- and firm-specific skill mix pays off. In Denmark industry-specific skills are most common, whereas in Japan firm-specific skills due to very high EP. As argued above, in LMEs the weak protection systems produce a general skills equilibrium (Estevez-Abe et al. 2001: 149-153).

Before turning to the contemporary situation in both countries under study, first peculiarities within this system during socialist rule are described. In socialism the state fulfilled a paternalistic function. There was a job guarantee for every citizen, and losing one’s job rarely happened. Therefore EP was very high in socialism. Firms were also involved in other welfare activities by providing kindergarten, health care and the like. On the other hand, UP was low for citizen, who were not part of the workforce, apart from subsidies on rents and basic food (Götting 1998: 57-88). Thus, the task for transitional economies was to change labour legislation to more market-based rules and to institutionalize a system of UP.

\(^3\) However, more recent data is needed to assess this more accurately, for Czaban et al. (2003) report research conducted in the first half of the 1990s.
Employment protection

To compare LMEs and CMEs Estevez-Abe et al. (2001) calculate an index consisting of two OECD-indexes, employment protection legislation (EPL), which captures the restrictiveness of individual hiring and firing rules for regular employments, and collective dismissals protection. As a third indicator they construct an index of company-based protection (see Table 2 for explanations). With the help of these three indexes an overall index of employment protection is calculated as a weighted average. In Table 3 we calculate this index for Estonia and Slovenia using figures for EPL and collective dismissals protection by Riboud et al. (2002), and compare it with results for the USA (LME) and Germany (CME). For Slovenia two figures are given to capture changes associated with a new Labour Code that came into force January 1st 2003.

Table 3: Employment protection in the UK, Estonia, Germany and Slovenia.

<table>
<thead>
<tr>
<th></th>
<th>Employment protection legislation (EPL by OECD, regular employment)</th>
<th>Collective dismissals protection (OECD)</th>
<th>Company-based protection</th>
<th>Index of employment protection</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>0.8</td>
<td>2.9</td>
<td>1</td>
<td>0.18</td>
</tr>
<tr>
<td>Estonia</td>
<td>3.1</td>
<td>4.1</td>
<td>1</td>
<td>0.44</td>
</tr>
<tr>
<td>Germany</td>
<td>2.8</td>
<td>3.1</td>
<td>3</td>
<td>0.59</td>
</tr>
<tr>
<td>Slovenia</td>
<td>2.9 (3.4)c</td>
<td>4.9 (4.8)</td>
<td>3 (3)</td>
<td>0.67 (0.71)</td>
</tr>
</tbody>
</table>

a based on the following criteria: (a) presence of employee-elected bodies with a significant role in manpower decisions, (b) existence of strong external unions with some monitoring and sanctioning capacity, and (c) use of employee sharing practices like job-sharing or job-rotation. Where at least two criteria are met, a ‘3’ is assigned, and a ‘1’ where none is present. A ‘2’ for mixed cases (Estevez-Abe et. al 2001: 166). Due to the existence of workers’ councils and strong unions we assigned a ‘3’ for the Slovenian case, the absence of both in Estonia allows a value of ‘1’. To our knowledge job-rotation or the like is not practiced in the transition world, and furthermore it does not seem very likely in a state of transition.

b weighted average of columns 1-3, after each indicator has been standardized to vary between 0 and 1. The weights are 5/9, 2/9 and 2/9, as in Estevez-Abe et. al (2001). However, values for the USA and Germany differ from Estevez-Abe et. al (2001), because they use the highest value of the sample as reference value when standardizing the EPL-index. To be able to compare the indexes with the CEE ones, here EPL is standardized for the scale of the OECD, which takes values between 0 and 6. This does not change the ranking of values.

c values in brackets refer to the old Labour Code.

Sources: Estevez-Abe et. al (2001: Table 4.1), OECD (1999), Riboud et al. (2002), own calculations.
The similarity between Slovenia and Germany is striking. The higher overall value of 0.67 almost exclusively can be put down to a higher collective dismissals protection in Slovenia. With respect to EPL-values Slovenia can be grouped together with Germany, Austria or the Netherlands (OECD 1999). In Estonia EPL-Index is still higher than in Germany, the archetypal CME. A new, more flexible Labour Code is being discussed in Parliament most probably leading to a lower value of EPL (Eamets/Philips 2003b, 2004).

Comparing the EPL-index (first column of table 3) for groups of CMEs, LMEs, and transition economies, the following picture emerges:

Figure 2

Figure 2 reveals that overall employment protection in transition economies is higher than in typical LMEs. One can find still legacies from communist past in this area. The Slovenian figure, which captures the EPL after reforms, fits very well among the first group of CMEs. However, the Estonian index would sit awkwardly among the second cluster of LMEs. The reform process in Estonia in this regard has not come to an end, yet. From a VoC-logic we would predict a substantial lowering of the employment protection.

Unemployment protection

To compare different degrees of unemployment protection Estevez-Abe et al. (2001: 167-169) make use of net replacement rates, i.e. unemployment benefits as percentage of previous income net of taxes. Furthermore, the share of GDP paid in unemployment benefits as a percentage of the share of unemployed in the total population is considered. As a third
measure they construct an index of “definition of ‘suitable’ job”, which expresses the
discretion an unemployed person has in rejecting a job offer without losing eligibility for
benefits. As in the case of EP from these three indicators an overall index of UP is calculated.
For lack of exactly corresponding data, we contend ourselves with indicators, from which
similar conclusions can be drawn. We use gross replacement rates, as a second indicator the
share of GDP paid in unemployment benefits as a percentage of the share of unemployed in
total labour force, and thirdly maximum duration of unemployment benefits. These figures are
presented in Table 4.

Table 4: Unemployment protection in the UK, Estonia, Germany and Slovenia, end of 1990s.

<table>
<thead>
<tr>
<th></th>
<th>Gross replacement rate (%)(^a)</th>
<th>Share of GDP paid in unemployment benefits as a percentage of the share of unemployed (%)(^b)</th>
<th>maximum duration of unemployment benefits (in months)</th>
</tr>
</thead>
<tbody>
<tr>
<td>UK</td>
<td>36</td>
<td>17</td>
<td>12</td>
</tr>
<tr>
<td>Estonia</td>
<td>40(^c)</td>
<td>2</td>
<td>12</td>
</tr>
<tr>
<td>Germany</td>
<td>61</td>
<td>39</td>
<td>32</td>
</tr>
<tr>
<td>Slovenia</td>
<td>63</td>
<td>22</td>
<td>24</td>
</tr>
</tbody>
</table>

\(^a\) Unemployment benefits as percentage of previous income.
\(^b\) Share of unemployed in total labour force. Can be interpreted as follows: in the UK 17 pence of every pound
earned by a member of the labour force is used for unemployment benefits.
\(^c\) estimation for 2003 by Vodopivec et al. (2003); 50 % in the first 100 days of unemployment period.

Sources: Riboud et al. (2002), Vodopivec et al. (2003)

The Slovenian replacement rate is, with the exception of Hungary, the highest of the
studied transitional economies (Riboud et al. 2002). It is well in line with the German rate. In
addition, its expenditures are the highest, although lower than in Germany. This is most
probably due to strained budgets in most transition countries. In Estonia a new legislation
went into force in 2003. Before that replacement rate was 10 % (!) of average income.
Vodopivec et al. (2003) estimate a rate of 40 % of previous income (50 % in the first 100 days)
for the new law. Still, it seems that it is too early to clearly evaluate the new legislation,
because discussions about further reform go on (Leetmaa 2003). That means that the value for
unemployment benefits (2 %) might be a too small estimate, too. Still, all this goes to show
that both countries coming from similar points of departure went into opposite directions.
Slovenia built up a CME-like system with a generous replacement rate, relatively high overall
expenditures, and long maximum duration of payments. Alternatively, Estonia stuck to a policy of very low replacement rates and expenditures similar to LMEs throughout the 1990s, only to raise them a little above the value for the UK. Duration of benefits is the same as in the UK.

To complete this overview, vocational training in both countries is examined.

3.4 Vocational training

The area of vocational training is important, because here appropriate skills are formed for above mentioned innovation strategies. In Germany, for example, the dual system of apprenticeships is monitored by both trade unions and employers. Standards and minimum amounts of apprentices are jointly set. Thereby workers acquire both firm-specific and industry-specific skills, so that they can be sure that their skills will be applicable in other firms of the same sector when they cannot be employed by the firm at which they were trained. Employers can be safe to a certain extent that no other firms free-ride on training costs of others (Hall/Soskice 2001: 25-26). In LMEs the most common skill type are general skills. They are provided predominantly by private institutions. Firms are not in the position to offer education in more specific skills, because without encompassing monitoring authorities there is the risk of free-riding by other firms. Workers will not be ready to invest in skills other than general as a result of low employment protection and unemployment protection. Firms in LMEs embark on a great amount of in-house training (Hall/Soskice 2001: 30).

In socialism vocational training was more or less the same in all CEE countries: large state-controlled firms cooperated with state-run technical schools. This led – very similarly to Germany – to firm-specific and industry-specific skill formation. Along with the collapse of many firms at the start of transition, schools lost the opportunity to train students appropriately (Roberts 2001: 317-320). Thus a new way of vocational training eventually had to be found.

In Estonia the inherited Soviet-style training scheme was retained until 1998. Then curricula of high-school and vocational schools were brought closer to each other. The explicit goal was to prepare students to more general tasks, which could be applied more broadly. This meant a fundamental change of the system of education and vocational training, and at the same time a shift towards an emphasis on general skills (OECD 2001, ch.4).

In contrast, in Slovenia, the struggling old system was put on a new basis by introducing a dual system of apprenticeships, very much like the German system. Apprentices are trained
both at firms and in vocational schools, thereby acquiring both firm-specific and industry-specific skills (Geržina et al. 2000: 51ff.).

As before the hypothesis is confirmed by very consistent results in the sphere of vocational training: again development after independence was entirely contrary in both cases. While Estonia abandoned the old system and thereby obviously moved into direction of an LME, Slovenia successfully tried to keep up the old system.

4 Conclusion
In the Slovenian case the observed picture is highly consistent and in line with the VoC framework. Encompassing trade unions and employers’ associations with a large scope of collective wage-bargaining go well together with a system of social security, which is similarly generous as the German one. This provides incentives for both workers and employers to invest in firm-specific and industry-specific skills, which, in turn, the reformed vocational training system can provide. In the sphere of corporate governance, the consensual two-tier model of management and supervisory boards reinforces this. Inter-firm relations still seem to be weakly developed, yet, but the institutional infrastructure for cooperation between firms exists.

In the Estonian case, in most of the studied areas the picture is quite clear, too: in industrial relations we find a dominance of firm-level agreements and weakly organised ‘social partners’. In such an environment incentives to acquire specific skills are very small. Complementarily, the system of vocational training was explicitly remodelled to favour general skills. In the area of social security, we find inconsistencies: firstly, employment protection is very high, the Estonian EPL-figure exceeds the German, which is commonly regarded as the archetypal CME. This is a legacy from socialist past, where employment protection was very high, as we have seen. Nevertheless, as reported, changes can be expected in the near future. However, despite overwhelming evidence pointing to a very liberal model in Estonia, the VoC runs into problems when dealing with corporate governance. The observed picture does not seem to be complementary to the institutional forms in other subsystems of the economy, because in the realm of corporate governance Estonia seems to be in between the typical stakeholder and shareholder approach. Here, different mechanisms than those suggested by Hall and Soskice are at work. That would mean that the VoC framework as it exists now, is only very carefully applicable to other countries than high-income OECD countries. A more in-depth examination of Estonian practice is needed, looking more closely at distribution of ownership and identity of owners (particularly with regard to FDI).
At present one can only speculate on possible reasons why the VoC framework obviously runs into problems when applied to eastern Europe: one explanation might be that in transition economies a bulk of legacies, also with regard to cultural understandings, still prevents a liberal western-style model from evolving. Generally, in middle-income countries there might not be a sufficient support for a more liberal approach to corporate governance.

The VoC approach can gain from emerging capitalisms in Eastern Europe: by studying transition economies one could get a better understanding of the role of the state in the VoC framework. Moreover, emerging capitalist systems provide a very good field to study the emergence of institutions: while the VoC approach explicitly takes a functionalist view to institutions, political driving forces behind evolving institutions can be examined.
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