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Varieties of capitalism and the Estonian economy: Institutions, growth and crisis in a liberal market economy

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ABSTRACT

This article examines Estonia's economic institutions, performance and vulnerability to the global economic crisis in the context of the varieties of capitalism framework. It shows that Estonia shares many characteristics of a liberal market economy, but that there are also some features which do not fit the classical model, notably its corporate governance institutions. It also suggests that the varieties of capitalism framework can account for key features of Estonia's economic performance, including its growth trajectory and adjustment to the global financial crisis. The article also reflects on the broader significance of these findings for understanding post-communist capitalism.

Many of the academic and policy debates about Central and Eastern Europe in the first decade of post-communist transition revolved around market reform and construction of capitalism. The introduction of a market economy, alongside democratization, was viewed as one of the most important goals of transition and a key task for policy-makers. Apart from some dissenting voices, most analysts did not address the question of what kind of market economy might emerge (Amsden et al., 1994). Instead the end goal of this process was generally taken to be a generic capitalist economy based on private property and the predominance of free markets. The World Bank, the EBRD and other organizations developed various indicators to measure progress towards this goal, and they provided advice on how to make further advances (EBRD, 2009; World Bank, 2002).

By contrast, in the last few years a new debate has emerged among political scientists, sociologists, economists and geographers working on the political economy of post-socialist transition. Scholars have started to ask whether transition has led to multiple varieties of capitalism (VoC) in Central and Eastern Europe and the former Soviet Union. This debate is in large part inspired by the seminal volume on *varieties of capitalism* edited by Hall and Soskice (2001) – one of the most influential books in political science and political economy in recent years.[1] The Hall and Soskice volume identified two distinct varieties of capitalism in the OECD – liberal and coordinated market economies. Each variety is characterized by a different set of institutions and comparative institutional advantages, yet both kinds of market economies can be viewed as efficient and successful. Scholars working on Central and Eastern Europe have sought to make sense of capitalist diversity and explain economic performance in the region. Some scholars have built on the VoC framework (Feldmann, 2006; Buchen, 2007; Adam et al., 2009), whereas others have sought to go beyond it by identifying new varieties (Nölke and Vliegenthart, 2009) or developing new typologies (Bohle and Greskovits, 2007; Lane and Myant, 2007; King, 2007).

[1] According to Google Scholar it had been cited 5820 times by October 2013 (http://scholar.google.co.uk/scholar?hl=en&q=hall+soskice&btnG=&as_sdt=1%2C5&as_sdtp=), accessed on 28 October 2013.

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Table 1
Liberal vs. coordinated market economies.

Institution	Liberal market economy: market coordination	Coordinated market economy: Strategic coordination
Industrial and employee relations	Decentralized at the individual or firm level; limited collective bargaining; low levels of unionization; limited membership of employers' associations; limited inter-firm relations	Greater role for the national or sectoral level; significant collective bargaining; higher levels of unionization and greater membership of employers' association; dense inter-firm relations
Education and training	Emphasis on general skills, incl. secondary and university education	Emphasis on specific skills, incl. traineeships and industry training
Corporate governance	Shareholder capitalism, maximization of shareholder value; footloose capital	Stakeholder capitalism, exercise of voice by key stakeholders; patient capital
Specialization	Rapid innovation (high tech sectors) and services	Incremental innovation, incl. high-skill manufacturing (e.g. car industry)
Performance	High growth, relatively high inequality	High growth, relatively egalitarian

Source: Hall and Soskice (2001)

Estonia has become a key focus of this debate. On the one hand, its economy has been touted as very successful. Estonia has joined the EU in 2004, the euro zone in 2011 and also the OECD in 2010, which is often viewed as a confirmation of a country's status as an advanced market economy. International organizations and various scholars have pointed to Estonia's rapid growth and convergence with the West, as well as other economic indicators to suggest that it is a model for other transition countries to emulate. Many of these observers have attributed Estonia's success to the fact that it has systematically implemented market reforms and that it can be seen as a paragon of a free market economy (Laar, 1996). A number of scholars have also suggested that Estonia is, at least in many respects, a good example of a liberal market economy (Feldmann, 2006; Buchen, 2007).

On the other hand, Estonia was recently hit by a sharp recession during the global economic crisis in 2008–2009. While growth resumed in 2010, some critics have suggested that the Estonian economic miracle was built on a shaky foundation. In particular, they have noted that there was excessive private borrowing and that there has been limited upgrading of Estonia's economic structure. They have pointed to the predominance of low-quality manufacturing in the country's export profile and suggested that it can therefore not be viewed as a pure liberal market economy. Unlike in the USA, the role of cutting edge innovation and high tech industries in Estonia's exports is rather limited (Myant and Drahokoupil, 2012; Bohle and Greskovits, 2007). The crisis and its aftermath therefore provide an important reason to re-examine the Estonian model (Kuokštis, 2011).

The purpose of this article is to revisit this controversy and to investigate whether Estonia, known for the pursuit of free market policies, has also developed into a liberal market economy (LME).[2] It develops a framework for applying the theory of VoC to relatively new market economies, such as the countries in Central and Eastern Europe. Unlike the long-established market economies in Western Europe and North America, where it is possible to identify stable institutions and patterns of specialization that have generated strong economic performance over many decades, market-supporting institutions are relatively new in Estonia. Many of them have been changing over time not only as part of the transition process itself, but also as a result of EU integration. This article shows that Estonia shares many characteristics of a LME and that it is in some respects arguably even more liberal than the classical LMEs, such as the UK or the US. However, there are some features which do not fit the classical model, notably corporate governance institutions. This article suggests that the VoC framework is useful for understanding key features of Estonia's economic performance. In contrast to analyses emphasizing the success or failure of free market policies or specific sectors, this approach can account for the consequences and trade-offs associated with the kinds of institutional arrangements that Estonia has adopted, including the foundations of rapid growth as well as the vulnerability to the global financial crisis and the nature of subsequent adjustment policies. More generally, such an analysis of the Estonian experience through a varieties of capitalism lens makes it easier to compare and contrast the Estonian experience to growth and crisis trajectories across the OECD.

The article begins with an overview of the theoretical literature on varieties of capitalism and the controversies surrounding its application to Eastern Europe. The following two sections examine whether Estonia can be viewed as an LME in terms of its economic institutions and whether this can account for patterns of economic specialization and performance. The final section concludes with some general lessons about the strengths and weaknesses of the VoC approach for understanding the transition process in Estonia and post-communist capitalism more generally.

1. Varieties of capitalism and its application to Central and Eastern Europe

Political economists have long focused on the differences between market economies. The literature on capitalist diversity could be said to date back to the works of classical economists and social theorists, such as Max Weber. In the post-World War

[2] Difference is discussed below.