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Research Article

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Dependent versus state-permeated capitalism: two basic options for emerging markets

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Abstract: Can comparative capitalism (CC) assist us in understanding both the rise and the current challenges of emerging market capitalism? This article applies analytical instruments developed in CC scholarship on emerging markets to address this question. During the last two decades, CC scholarship – defined by common features such as the emphasis on institutional contexts that are sticky and most important at the national level – has evolved considerably. This contribution to the third generation of this scholarship highlights the degree of international economic integration as the central strategic choice to be faced by emerging economies. It does so by systematically comparing dependent market economies of East Central Europe with the state-permeated economies of China, India and Brazil. The core finding is that both types of capitalism have been able to mobilize substantial institutional complementarities during the last three decades but will face considerable economic and political challenges in the years ahead.

Keywords: emerging markets, comparative capitalism, dependent market economies, state-permeated market economies

1 Introduction

Research on emerging markets has been neglected in the comparative capitalism (CC) research tradition. The original Varieties of Capitalism (VoC) framework [Hall and Soskice, 2001] did not pay attention to emerging markets at all. Its basic features, a juxtaposition of coordinated market economy (CME) and liberal market economy (LME), were mainly based on illustrations of the German and US economic systems. However, its basic features still are canonical for CC scholarship today, in particular the distinction of five institutional spheres (corporate governance, financial system, industrial relations, education and training as well as innovation) and their governance by a cross-cutting coordination mechanism (interfirm networks and associations in CMEs, in contrast to competitive markets and formal contracts in LMEs).

A second generation of CC research has partially made up for this shortcoming by postulating additional types of capitalism specifically for application to emerging markets.[1] This "post-VoC" [Bruff et al., 2015, p. 34] agenda has broadened the geographical coverage of the paradigm toward Eastern, Northern and Southern Europe, as well as Asia, Latin America and South Africa. It has a stronger focus on historical and political (instead of functional) determinants of economic institutions (including attributing a more prominent role to the state) and highlighted processes of institutional change within different types of

1 For a more systematic discussion of the three generations of CC scholarship, see Nölke (2016, pp. 145–147).

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capitalism. The original VoC focus on rational choice institutionalism here has been complemented by historical and sociological institutionalism [e.g. Yamamura and Streeck, 2001; Schmidt, 2002; Amable, 2003; Coates, 2005; Hassel, 2006; Jackson and Deeg, 2006; Hancké et al., 2007; Becker, 2009, 2013; Hall and Thelen, 2009; Schneider, 2013; Thelen, 2014; Farkas, 2016; Próchniak et al., 2016; Feldmann, 2017].

More recently, a third generation of CC research has emerged. This body of work extends the first two generations of scholarship by including the study of the demand side of various national varieties of capitalism, thereby complimenting the exclusive focus on the supply side of the original VoC approach. Furthermore, the third generation of CC research places a strong emphasis on the international integration of national VoC instead of treating them as closed containers. A major contribution of this scholarship is the shift toward emerging markets with a focus on the related tensions within the global political economy [e.g. Nölke and Vliegenthart, 2009; Nölke, 2011, 2018; Bohle and Greskovits 2012; Kalinowski, 2013; Vermeiren, 2014; Nölke et al., 2015, 2018, forthcoming; Suau Arinci et al., 2015; De Ville and Vermeiren, 2016, May and Nölke 2018].

I argue that the issue of international integration as highlighted by the third generation of CC scholarship is key for any understanding of economic policy choices and institutional development in emerging markets. The most important fundamental decision that has to be made in all emerging markets is whether to embrace international economic integration wholeheartedly or to go in for a certain degree of protection against full integration. This is certainly not an easy decision. Given that emerging markets are latecomers with regard to the development of their capitalist systems, they need foreign economic inputs in order to modernize their economic systems. Here, the focus is on both the provision of modern technologies and an institutional framework that enables domestic companies to compete on international markets.

Historically, emerging markets have reacted to this challenge in two completely different ways. On the one hand, some emerging markets have embraced foreign economic integration and have invited both foreign direct investment and global financial markets in order to modernize their economies and create employment. On the other hand, many emerging markets have chosen to protect their companies against international competition in order to give them an opportunity to develop domestically before being exposed to international market competition.

In order to systematically explore these two alternative policy options, I apply a CC framework to a number of selected emerging economies. As an illustration for the first option of full international integration, I choose the dependent economies of East Central Europe, namely, the *Visegrád* States (Czech Republic, Hungary, Poland and Slovakia). As an illustration for a more protection-oriented strategy, I discuss the state-permeated market economies (SMEs) of China and India. For the purpose of analyzing the situation of emerging economies that have not made a clear choice in favor of either of the two strategies, I analyze the case of Brazil. Finally, both types of emerging economies are contrasted with archetypical CMEs (Germany, Japan) and LMEs (UK, US).

The study pursues an eclectic approach drawing on all three generations of CC research. From the first generation of CC research, it utilizes the distinction between the typical institutional spheres (corporate governance, finance, industrial relations, education and training, innovation system), as well as the identification of a general coordination mechanism that cuts across these spheres. The second generation of CC research mainly inspires my research regarding the need to develop additional models of capitalism (besides CME and LME) in order to investigate emerging market capitalism. Moreover, the second generation of CC research inspires us to study institutional changes, crises and instabilities in contrast to the rather functionalist equilibrium perspective that has guided much previous CC research. The third CC generation is particularly important for the analysis below for two reasons. First, it highlights the importance of the demand side as a complement to the focus on the supply side of traditional CC scholarship. Second, its focus on the interactions among different types of capitalism is particularly important for CC research on emerging markets in view of the crucial influence of the mode and timing of the integration into global capitalism for economic institutions in emerging markets.

My paper is a contribution to the growing body of CC research on emerging economies [e.g. McNally, 2007; Carney et al., 2009; Nölke and Vliegenthart, 2009; Bohle and Greskovits, 2012; Boschi and Santana, 2012; Boyer et al., 2012; Bresser-Pereira, 2012; Becker, 2013; Padayachee, 2013; Schneider, 2013; Benney, 2014; Witt and Redding, 2014; Nölke et al., 2015; Farkas, 2016; Próchniak et al., 2016; Feldmann, 2017; McNally, 2017; Rougier and Combarnous, 2017; Nölke, 2018; Nölke et al., 2018, forthcoming; May and Nölke 2018]. In contrast to most of these literatures, however, the focus of this paper is on specific countries or regions, but on the systematic comparison of the two most basic types of emerging market capitalisms.

In order to implement this research strategy, I first highlight the institutional advantages of coherent types of capitalism that stand at the center of the CC research strategy (section 2). Next, I identify the central coordination mechanisms governing the two basic types of emerging market capitalism (dependent versus state permeated), as well as the conditions of their historical emergence (section 3). Central to argument of the article is a systematic comparison of capitalist institutions in dependent versus state-permeated capitalisms (section 4). The article concludes by looking at the long-term perspectives of the two models of emerging market capitalism (section 5).

2 Institutional advantages of coherent types of capitalism

By choosing rather simple and broad general types, I am following the original VoC research strategy that focuses on the development of a few ideal types instead of looking closely at the features of individual countries. Of course, there is a substantial variation between countries classified under one heading, but for certain research purposes, it is quite helpful to focus on a rough simplification and concentration on a few basic models. After all, this approach has contributed considerably to the success of the VoC research strategy, for example in comparison with the somewhat less parsimonious approach favored by Amable [2003].

Also in line with the basic VoC research strategy, my argument is based on the general assumption that countries that are close to a coherent ideal type are economically more successful than countries that are hybrids combining different types [Hall and Soskice, 2001]. The basic argument here is that only within a coherent ideal type can the institutional complementarities, which are key to the VoC argument, be mobilized. Countries that are more mixed types have certain deficiencies with regard to these complementarities and are expected to have an inferior economic performance.

Instead of using a more comprehensive (but also a far more challenging) perspective, which also incorporates issues of distribution, economic performance is treated here quite simply as economic growth. The main reason for this choice is that the causal claim of the original VoC model relates to the identification of competitive institutional advantages with regard to certain types and the corresponding development of a successful profile with regard to certain goods and services produced, leading to strong economic growth. In a nutshell, VoC argues that each coherent type of capitalism has competitive institutional advantages for specific types of production. CMEs, for example, are rather successful with regard to incremental innovation, in particular high-technology projects such as machineries and luxury automobiles. LMEs, in contrast, are supposed to have an advantage with regard to radical innovation processes, for example, in the IT or biotechnology branches. These competitive advantages are supposed to translate into favorable trade balances and economic growth, although the demand perspective of third generation of CC research has also alerted us to the fact that demand not only is based on these kinds of supply side factors but also has to undertake demand side factors and macroeconomic policies. In both cases, however, the theory does not claim that these competitive advantages necessarily translate into an equitable and fair distribution of the spoils of production. Countries can be successful with regard to the claims of VoC if they have comparative advantages with regard to certain product lines and at the same time also increasing inequality or even poverty.

Where are the comparative institutional advantages of different types of emerging economies? It turns out that these advantages are quite different in dependent market economies (DMEs) and SMEs. DMEs have advantages as a platform for the assembly of semi-standardized industrial goods such as automobiles. Here, the main innovative processes are retained at the headquarter of the multinational company producing these goods, but important tasks with regard to the assembly of the final products are being executed in emerging markets due to lower wages. Their preference is for emerging markets that are geographically close both to the headquarters of the multinational corporation and to important markets for these products. East Central Europe thus is best suited for automobile production and is a focal point for the German automobile industry [Nölke and Vliegenthart, 2009].

SMEs, in contrast, have a different type of institutional advantage, focusing rather on the production for mass markets in developing and emerging economies. For this purpose, products do not have to be particularly advanced in terms of technology but rather have to be affordable and robust. Although fundamental technological innovation has been undertaken in industrialized economies, in this case, emerging market companies are creatively adapting imported products toward the particular environment of emerging and developing economies. They usually do not belong to a multinational corporation headquartered in an industrialized country but rather are headquartered in an emerging economy [Nölke et al., 2015].

3 Central coordination mechanisms and the evolution of emerging market capitalisms

How can we explain the emergence of these two different types of institutional advantages and product specialization? Keeping in line with traditional VoC reasoning, these different profiles can be explained by looking at the typical economic coordination mechanism, as well as typical features of the most important economic institutions governing capitalist economies. However, also taking into account the further development of second generation of CC scholarship, we also need to look at the historical evolution of this type of capitalism. Finally, based on the third generation of capitalism reasoning, we also have to look at the demand side and specific features of international economic integration.

What is the central economic coordination mechanism in DMEs? Here, the typical feature is the dependency on the hierarchies in multinational corporations that are headquartered abroad. DMEs are more strongly dominated by foreign direct investments than any other type of capitalism. Almost all strategic sectors, including the most advanced production lines and the financial sector, are usually controlled by foreign companies. In East Central Europe, many of these companies are headquartered in Germany and Austria. Correspondingly, these economies have a rather limited degree of economic sovereignty and are rather dependent on decisions that are taken elsewhere, e.g. in Wolfsburg, Frankfurt, Munich or Vienna [Nölke and Vliegenthart, 2009].

The central coordination mechanism in SMEs is quite different. Here, the focus is on a close collaboration between state authorities and (major) domestic companies. The focus of SMEs is clearly on the national control of economic development. This national control is considered to be indispensable in order to avoid colonization by, or dependency on, outside forces. Therefore, foreign multinationals are only given a rather limited role with regard to decisions on economic development. While this focus on national control is quite typical for many cases of late industrial development – starting with Germany and the US in the 19th century via France, Japan and the Soviet Union in the early 20th century to the East Asian developmental states in the mid-20th century – the specific style or organization is quite different in SMEs. Given that strong centralized control (as in the Eastern Asian developmental states or in France) is considered to be neither feasible nor suitable for large emerging markets in the early 21st century, the coordination between state authorities and business is quite decentralized. Thus, we can identify multiple public–private coalitions, for example, constituted at the local or regional level. A good case in point would be the collaboration of local or regional Chinese authorities with major companies that are headquartered in their jurisdiction. Alternatively, this collaboration can be organized on a functional or sectional basis, with regard to specialized ministries and the companies in their sector. Here, a typical example would be the close collaboration between the Brazilian ministry charged with modern agricultural development and large-scale agricultural producers. Coalitions are kept together typically via the principle of reciprocity, meaning that favors are being exchanged but not necessarily at the same time. In order to make sure that cooperation can be trusted, personal loyalty relations are quite important, for example, being supported by a common social and educational background, in particular within the domestic elite [Nölke et al., 2015].

How was the evolution of these two different types of emerging market capitalisms possible? Arguably, the SME model is the more typical one. Most emerging markets prefer a heavy dosage of national control over their long-term economic development path. Be it due to the experience of colonization, foreign-induced economic crisis or long-term planning, there is considerable emphasis on keeping national control over the path of economic development. However, not all emerging markets can "afford" this strategy. Emerging markets very often have to compete for modernizing inputs such as foreign direct investments and financial flows. Therefore, it is rather difficult to uphold the preference for national control. However, large emerging markets such as China and India – and to a certain extent also Brazil – are in a somewhat more comfortable position with regard to these policy priorities. Given their size, they have an excellent negotiation position with regard to foreign investors. In present-day capitalism, access to the large domestic markets of major emerging economies is of high priority for most multinational companies. Correspondingly, these companies do accept the conditions imposed by emerging market governments. These governments thus do not have to "sell-out" to foreign investors [Nölke et al., 2015].

To be more specific, the governments of large emerging markets can exempt certain economic sectors that they deem to be of high strategic importance from economic opening, on the one hand, and can also impose conditions with regard to technology transfer on foreign multinationals, on the other hand. To give an example, German car producers are only allowed to set up shops in China if they are willing to establish a 50/50 joint venture and are also willing to undertake a certain amount of technology transfer. The large size of emerging market economies such as China and India has other attractions too. Large domestic markets can serve very well as a home base for the development of their own "national champions". Successful companies very often need economies of scale in order to develop internationally competitive production facilities. While this may be a problem for small emerging markets, the large domestic markets of countries such as China, India and Brazil allow for these economies of scale. Small- and mid-size emerging markets, in contrast, have a much weaker position, with regard to both negotiations with foreign multinationals and economies of scale for domestic companies.

The situation of the DMEs in East Central Europe in this regard is quite different. First, they are markets of limited size. Second, the decision with regard to the fundamental economic strategy to be adopted was taken in a very specific situation. After the end of the Cold War, both the majority of the population and the elites of these countries had a strong interest to open up to the West after decades of domination by the Soviet Union. At the same time, Soviet rule had greatly weakened the national bourgeoisie that normally is the most important force with regard to opposition to foreign economic domination. In contrast to countries such as China and India, in Central Eastern Europe, there were hardly any national elites that strongly opposed the "sell-out" of national industry to foreign investors or foreign competitors. Moreover, the opening up to the West was undertaken in a situation that put a strong premium on economic liberalism, which was considered at that time to be "the end of history", as Fukuyama put it. Last but not the least, based on their fundamental economically liberal outlook, international organizations such as the European Union and the European Bank for Reconstruction and Development strongly supported the opening up of Central and Eastern European markets. Correspondingly, multinational companies that are always on the lookout for regions with an excellent factor endowment and low wages encountered particularly favorable situations that allowed them to dominate the economies of Central and Eastern Europe in a far more powerful way than those of other world regions [Nölke and Vliegenthart, 2009].

4 Capitalist institutions in dependent and state-permeated capitalism

The very different trajectories of DMEs and SMEs also become obvious when comparing the usual institutional spheres of CC. Given the need to compare a whole range of countries (CMEs, DMEs, LMEs and SMEs, each with more than one case), we need to rely on rough quantitative proxies and cannot go into country details or illustrations.[2] For each indicator, the most recent data have been chosen, in order to update the somewhat dated empirics in the original discussion of the DME and SME types [Nölke and Vliegenthart, 2009; Nölke et al., 2015].

Starting with corporate governance, it is quite obvious that the share of foreign direct investment stocks with regard to gross domestic product is much lower in China and India as compared to the DMEs of Central Eastern Europe. Brazil takes on an intermediate position, whereas Germany and Japan show strikingly different trajectories (see Figure 1). Whereas Japanese domestic elites clearly prefer to keep control over domestic companies, similar to their counterparts in China and India, Germany demonstrates a much higher openness toward foreign ownership – but not as open as the LMEs of the US and UK or the four DMEs.

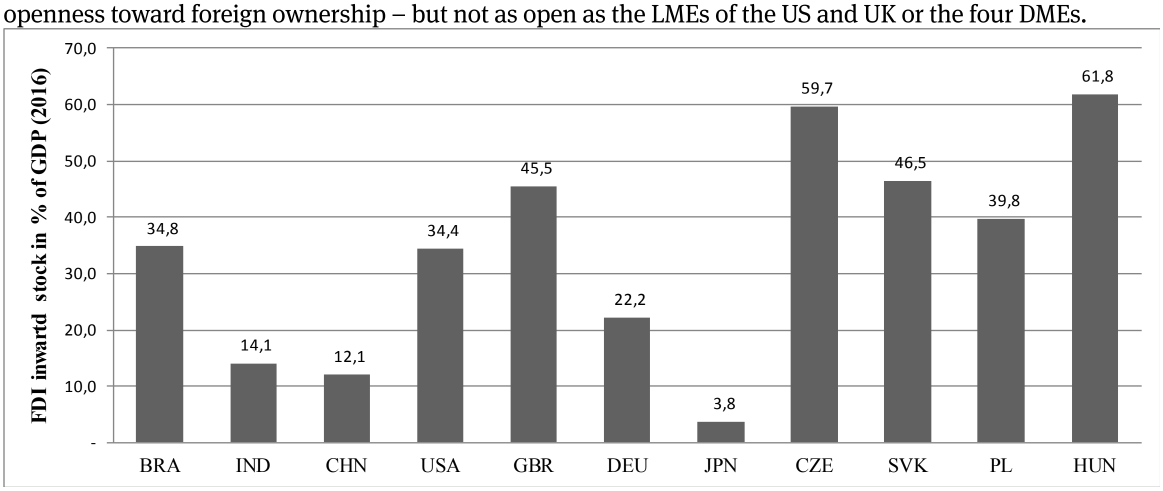

Figure 1. Corporate governance: foreign direct investment stock as share of gross domestic product [2016]. Source: UNCTAD World Investment Report 2016, Annex table 07.

A second issue with regard to corporate governance in emerging markets is the degree of state control. Here, we can draw on an indicator assembled by the OECD. It comprises both public ownership and other forms of state intervention. SMEs such as China and India show a very high degree of state control in order to safeguard the basic parameters of a long-term economic catchup strategy. Not only LMEs but also SME and DMEs show a much lower degree of state control as measured by the OECD (see Figure 2).

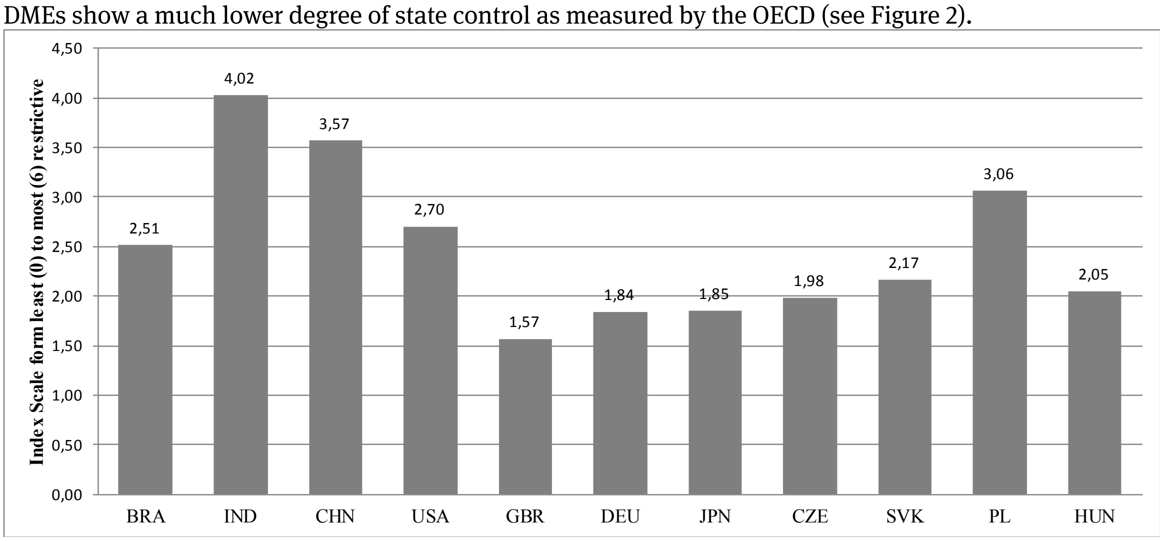

Figure 2. Corporate governance: levels of state control [2013]. Source: OECD, Product Market Regulation Database

2 For the latter, please see Nölke and Vliegenthart (2009) and Nölke et al. (2015, forthcoming).

Similarly striking differences between DMEs and SMEs can be noted for the issue of corporate finance. Studying the sources for corporate finance in the two types of economies, we note that equity finance plays a much lower role in large emerging markets than in the former transition economies of Central Eastern Europe [Nölke et al., 2015, p. 549]. While retained earnings are of similar importance for investments in both types of economies, bank loans are of a higher importance in state-permeated economies. Again, the desire to retain control over a long-term economic development is at the core of these differences. A strong role of equity finance may lead to widespread “short-termism” e.g. the conduct of company policies with a strong stress on earnings and share price development is likely to divert attention from the priorities of long-term company development. Patient capital such as bank loans is preferable from this perspective [Nölke et al., 2015].

Moreover, it is also important to look at the sources of bank loans. Again, there are considerable differences between DMEs and LMEs. Whereas bank loans in DMEs mainly stem from foreign banks, bank loans in SMEs predominantly stem from domestic sources with a particularly high share of loans from public banks (Figure 3). Again, there is a close linkage between the latter financing structure and the pursuit of a long-term development strategy. Foreign banks may withdraw credits in a situation of economic crisis as witnessed by the Baltic economies during the global financial crisis, when Scandinavian banks suddenly decreased their exposure. Nationally controlled banks are unlikely to do so. Moreover, public banks are an excellent lever to convey priorities for national economic developments, as demonstrated, for example, by the large Chinese banks or the Brazilian Development Bank BNDES.

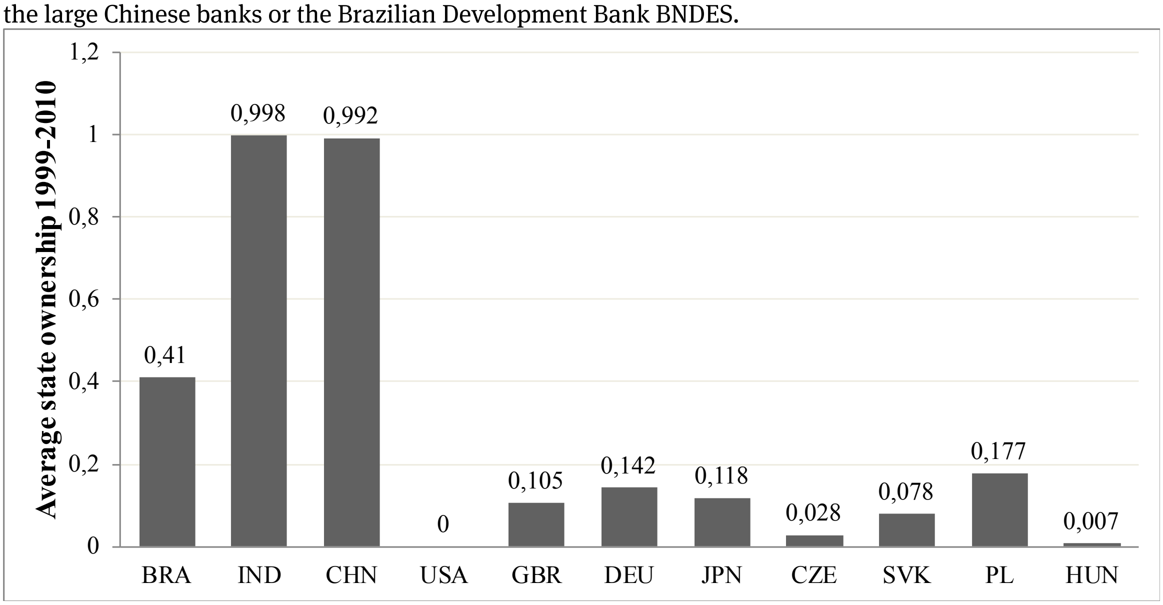

Figure 3. Corporate finance: state ownership of banks in percent (1999–2010). Source: Bertay, C.A. et. al. (2015): Bank ownership and credit ower the business cylce: Is lending by state less procyclical? In: Journal of Banking & Finance 50 (2015) 326-339.

Somewhat less surprising are the differences between DMEs and LMEs with regard to their systems of industrial relations. Since the latter cannot be measured quantitatively in a reliable model, we are using the level of wages as a rough proxy. Expectedly, wage levels are much lower in the Brazilian or Indian economy compared to wages in Central and Eastern Europe (but wages in China are gaining quickly). Both, however, are much lower than in CMEs and LMEs (Figure 4). These different wage levels clearly reflect not only the different levels of economic development within the two types of economies but also the geographical proximity and economic integration of the DMEs within the European Union. Too low wage levels are followed by large-scale migration, which has surfaced over the last decade as a major issue for these economies.

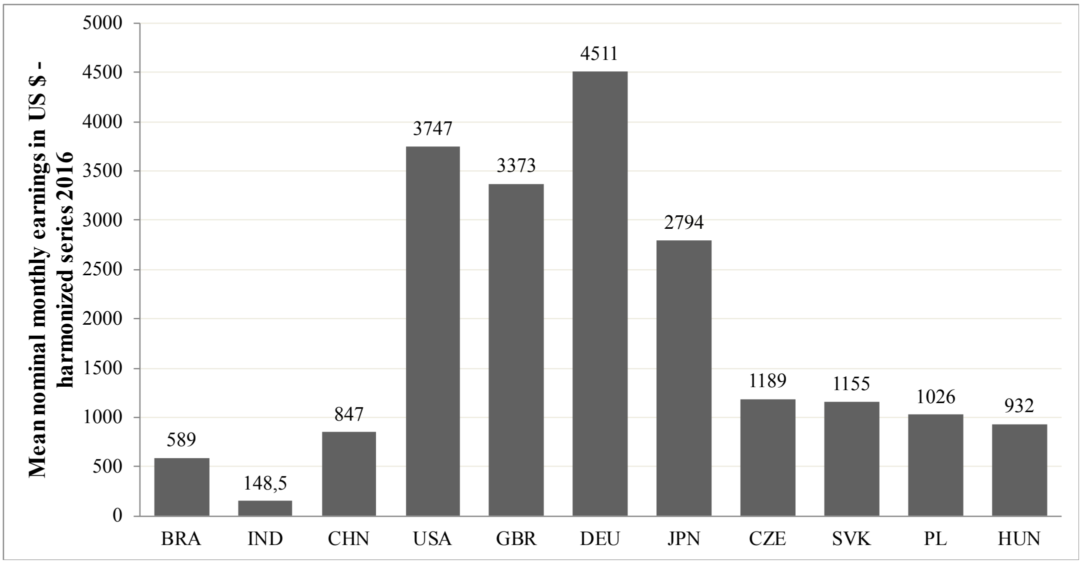

Figure 4. Industrial relations: nominal monthly average wages in US$ (2016). Source: International Labour Organization/ Statistics and Database, ILO- Global Wage Report

SMEs can also capitalize on their low labor cost strategy by keeping social expenditures very low (the welfare system very often is treated as a complement to industrial relations in CC – after all lower wages can be compensated by higher welfare expenditures, in principle). DMEs cannot match this strategy – for good reasons – and, therefore, are forced to compete with other emerging markets on the basis of higher qualifications and productivity (Figure 5).

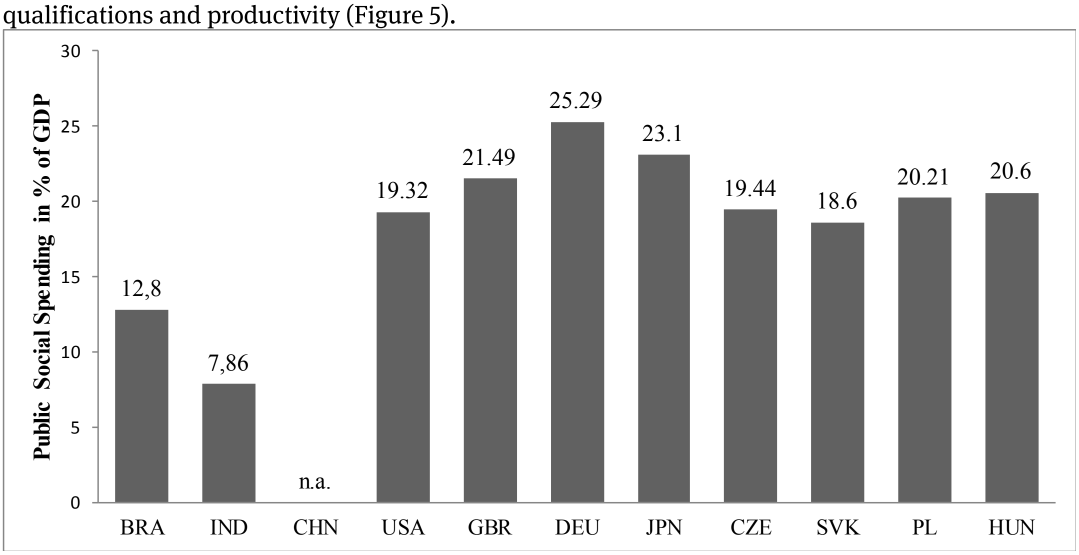

Figure 5. Industrial relations: levels of public social expenditure as percentage of GDP (2016). Source: OECD Social Expenditure database, UN Database on Social Investment in Latin America and the Caribbean, National Institution for Transforming India (NITI Aayog)

More striking with regard to the different trajectories of the two types of capitalisms, therefore, are the shares of expenditure for research and development, as a core indicator in the CC realm of innovation and training. Here, both DMEs and SMEs are inferior to CMEs and LMEs. However, the share of public expenditures for research and development with regard to the gross domestic product in SMEs tends to be higher – and, in particular, advances much faster – as in DMEs, as witnessed in the case of China (Figure 6).

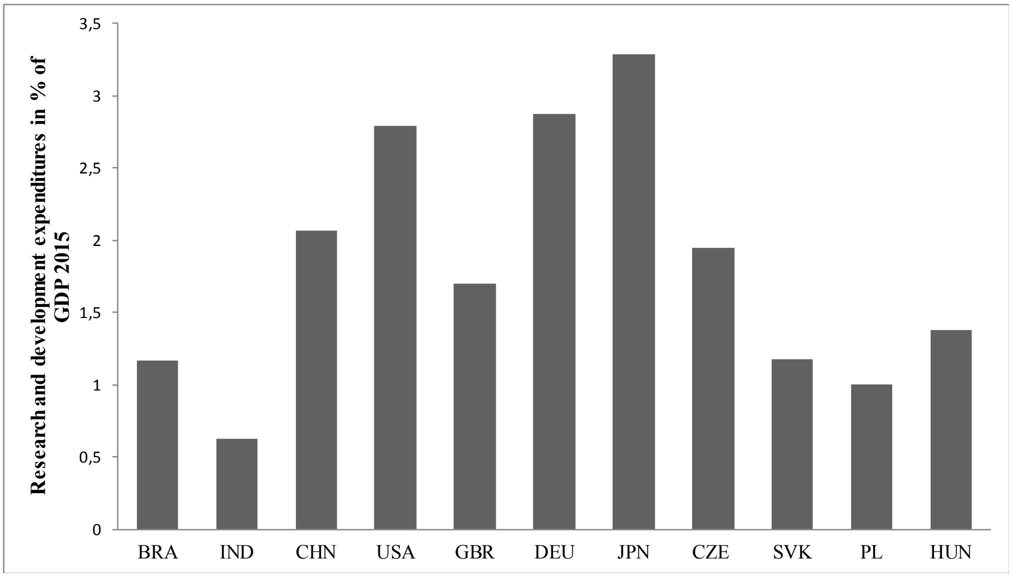

Figure 6. Innovation and training: public expenditures on research and development as a percentage of GDP. Source: World Bank Database

High expenditures for research and development are a core requirement for catchup strategies of industrialization. While both types of economies thus have strong incentives for the mobilization of high expenditures in this realm, DMEs face serious limits with regard to an increasing share of these expenditures relative to fiscal resources. One major factor limiting the accumulation of fiscal resources in these economies is the competition for foreign direct investments, whereas multinational companies can choose between multiple destinations of their investments. Incentives such as tax rebates are an important factor for the attraction for foreign direct investments. However, the necessity to please foreign investors at the same time makes it difficult to mobilize considerable resources for public research and development, given similar requirements for other types of expenditures. Thus, DMEs risk falling back with regard to their technological catchup strategy against SMEs due to the limited fiscal means for this purpose. This has not been a major problem so far, given the high level of both education and research quality inherited from the previous system of state socialism. However, these advantages tend to wear out some three decades after the demise of this economic system.

Finally, third generation of CC scholarship not only looks at the important institutional spheres as identified by VoC scholarship but also looks at the issues of demand and international economic integration. Again, SMEs and DMEs show striking differences with regard to the demand dimension. Whereas SMEs tend to protect national markets in order to stimulate demand for domestic companies, DMEs do without this high degree of protection as indicated by the OECD indicator for product market regulation (Figure 7).

Even more striking are the differences between DMEs and SMEs with regard to indicators on international economic integration. Leaving the issue of integration into global financial markets aside [see Nölke, 2018], the question of barriers to incoming FDI is crucial in this regard. Similar to Japan, SMEs impose restrictive regulations on inward foreign direct investments in order to avoid the “sell-out” of domestic companies. DMEs, in contrast, do without these kinds of restrictions since they have to attract as much foreign direct investments as possible (Figure 8).

Finally, SMEs differ markedly from DMEs with regard to the accumulation of foreign reserves, another important indicator with regard to the mode of international economic integration. In order to make sure that long-term processes of economic catchup are not threatened by short-term currency fluctuations – as witnessed, for example, during the East Asian Crisis in 1998 – SMEs accumulate large amounts of international reserves in order to be able to intervene in financial markets in case of a sudden devaluation of their domestic currency (Figure 9). DMEs are more vulnerable in this regard.

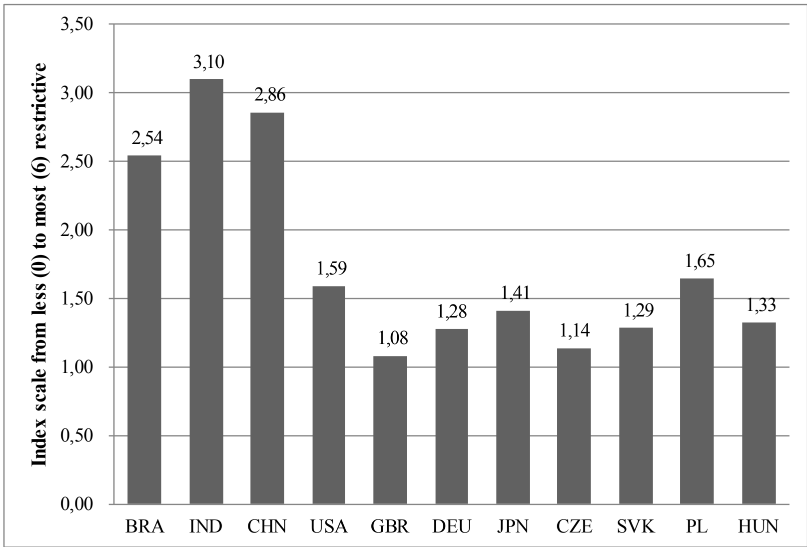

Figure 7. Domestic demand: regulation levels of national product markets (2013). Source: OECD Product Market Regulation Database

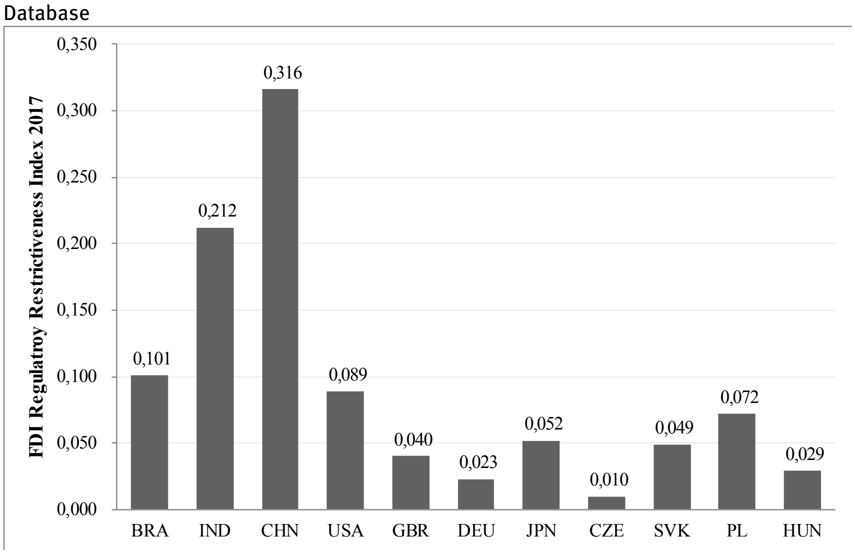

Figure 8. International economic integration: FDI regulatory restrictiveness index 2017. Source: OECD FDI Regulatory Restrictiveness Database

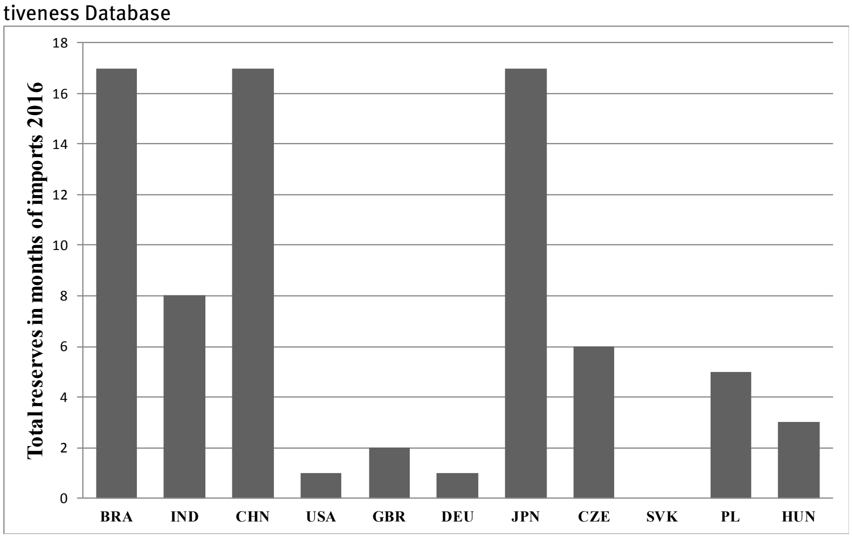

Figure 9. International economic integration: international reserves minus gold in months of imports. Source: World Bank Database

To wrap up, capitalist institutions in emerging markets differ not only from those of the established CME and LME models (for example with regard to industrial relation systems) but also between the DME and SME types. Whereas DMEs embrace foreign economic integration wholeheartedly, SMEs put a strong premium on national control and long-term stability.

5 Long-term perspectives of emerging market capitalisms

As stated earlier, both models of emerging market capitalism have been successful over the last three decades, both based on very different institutional complementarities. However, what about their long-term perspectives? Here, we may expect quite different trajectories for DMEs and SMEs. Both face social and political challenges but of a different nature.

DMEs face the problem that the most innovative and most profitable activities within the value chain remain in the multinational corporation headquarters abroad. Moreover, the continuing competition for FDI hardly allows for the collection of sufficiently high taxes in order to finance high-quality education and research expenditures by the DME state. Over time, they may witness an exhaustion of the initial capital of the high level of education and training that the central Eastern economies have inherited from communist rule. While levels of education and training will remain substantial, they may still fall behind the more dynamic development of research and development expenditures in SMEs such as China. At the same time, the advantage of fairly low wages compared to CMEs and LMEs may slowly erode in part due to labor migration. The strong role of foreign multinationals will inhibit both the collection of higher taxes (due to the thread of relocation) and the development of "national champions" (due to heavy competition). Particularly in a situation of global economic crisis, the strong dependency on both exports and international financial markets can lead to heavy fluctuations with regard to economic development. Even in a stable economic situation, the pronounced differences between those parts of the population that benefit from FDI-led growth – particularly in the urban centers – and those that do not can lead to social and political instability, as predicted by Nölke and Vliegenthart [2009].

In the meantime, the difficult mid- to long-term development in DMEs has led to social and political upheaval and development of non-liberal governments (e.g. Hungary and Poland). These governments have tried to tackle some challenges of the DME model but so far in a rather haphazard way. On the one hand, they have tried to decrease the prominent role of foreign multinationals in the domestic economy, for example, by introducing specific taxes that make the local subsidiaries of these companies less profitable. A case in point is specific taxes on foreign banks and supermarkets in Hungary. On the other hand, particularly in Poland, the right wing populist government has tried to reduce the role of foreign multinationals and the related dependencies by trying to increase the role of the state with regard to economic development. Here, the focus is on the mobilization of domestic savings and its allocation toward investment in domestic companies and a domestic economic development that is more broadly conceived [Morawiecki, 2016]. Again, this strategy is constrained by the volume of fiscal resources currently available. For the smaller DMEs, their limited market size would require far more comprehensive regional economic cooperation than currently undertaken [Jasiecki, 2016].

SMEs face limits of their own. Again, these limits can be discussed with regard to the most important institutional spheres identified by CC scholarship. With regard to corporate governance and corporate finance and the globalization of financial markets, domestic capitalists have been tempted constantly to invest their resources in financial investments that are more profitable in the short run rather than in the long-term development of domestic companies. Correspondingly, there is the risk of increased volatility. With regard to the level of innovation and the type of institutional competitive advantages, these emerging markets may face the so-called "middle income trap", where strongly rising wages make the existing production lines less profitable, whereas the upgrading of production toward higher value products takes too much time and fiscal resources to be successful in the short run. Finally, as in the case of DMEs, the most substantial challenge may stem from the social and political realm. Continuing economic growth over three decades has led to the emergence of a substantial middle class in these countries. The middle class is more prone to demanding political participation than the poor who have been more prominent in these countries previously. Still, they do not care too much about political participation as long as growth rates are continuously high. If growth rates, however, decreases over an extended period of time, they may become more sensitive to issues of political participation. Usually, these demands are focused on the scourge of corruption. This is not only a topic that allows for easy social and political mobilization but also a wide spread phenomenon in the SME model, given the need for close collaboration between domestic capitalists and state authorities. Very often, social and political upheavals lead to massive anti-corruption campaigns. The latter, however, may have negative repercussions on economic growth in this model of capitalism as they pose a threat to the central coordination mechanism in this type of capitalism [Nölke et al., 2018].

6 Conclusion

We have seen the emergence of two very different basic types of capitalism in emerging markets. Both have their merits, their specific economic institutions, but both are also facing considerable challenges. Neither of them is easily replicable, the DME type because of its very specific emergence after the end of communism and the SME type because of its reliance on a very large economy. Correspondingly, emerging markets that do not fully share these advantages have to make very difficult choices. The case of Brazil – with its current economic and political crisis – indicates how unstable a hybrid combination of state-permeated and dependent capitalism can be.

For emerging markets, the core question with regard to economic strategy is thus how to handle the relationship with the global economy. Should emerging markets embrace the global economy wholeheartedly or should they rather focus on protection against the global economy? Depending on location, size and timing, emerging markets have answered this question in very different ways. Today, the most extreme differences are between the transition economies of Central Eastern European, on the one hand, and the extremely large Chinese economy, on the other hand. The former has chosen to open up markets completely and focuses on attracting foreign direct investment in order to modernize the economy after the end of communism. While this strategy has been very successful in terms of economic growth, it also leads to a high degree of dependency on foreign investors.

Giving up control over the economy in favor of foreign investors is no option for a country like China. National control over the economy is not only a political prerogative but also an economic one. Keeping control over major companies in national hands allows for a high degree of insolation vis-à-vis fluctuations in global capital markets. Close collaboration between state agencies and domestic capital also allows for the development of a fairly coherent strategy of industrial development where the education and training systems are geared toward the provision of adequate skills. At the same time, industrial development does not have to forego positive aspects of foreign investment such as a healthy dose of competition and the transfer of advanced technologies. Based on the bargaining chip of the access to a very large domestic market, China can impose conditions on foreign investors, such as the transfer of innovations within joint ventures.

However, the model of state-permeated capitalism is not unique to China. We can also identify the most important components of this model in India and, in a more moderate and temporary form, in Brazil during the rule of the Labor Party. In both economies, most major companies are controlled by either national capital or the state. In Brazil, however, Western multinationals play a major role as well, dominating a number of sectors that usually are considered quite important for late industrialization (electronics, car manufacturing, etc.). In both cases, however, companies are fairly independent of global financial markets. Investments are usually financed by retained earnings or bank credit, with the major banks being under national control or even wholly public. Both corporate governance and corporate finance thus are organized in a way to enable long-term stability, at least for major corporations.

Moreover, we are witnessing specific institutional complementarities in each of the two ideal types of economic models in emerging economies. DMEs can be described as a paradise for foreign multinationals, based on high levels of control via multinationals headquarters, a strong role of foreign direct investment and foreign banks with regard to company finance, a medium level of wages constituted by high wages for highly qualified workers in production for multinationals and very low wages for other workers, low research and education expenditures/low taxes and the mobilization of innovations by transfer from headquarters of multinational companies. SMEs, by contrast, focus on long-term processes of economic catchup, based on a rather limited role of foreign directors in corporate governance, a strong role of the state both with regard to domestic companies and control over credit allocation, and a fairly low level of wages but increasing expenditures for research and development in order to allow upgrading in the long term. This catchup strategy is being protected by a mode of international economic integration that harbors a fairly high degree of protection of national markets and restrictive regulations for foreign direct investments in order to curtail the latter for domestic purposes.

While both types of emerging market capitalism have been successful over the last three decades, they both face specific economic and political challenges. Economically, DMEs are threatened by the relocation of foreign direct investments to even cheaper locations, given that the multinational corporations dominating these economies have a lower degree of loyalty with these countries compared to domestic companies. Politically, the uneven distribution of the spoils of foreign direct investments has given rise to populist governments, which may not always find it easy to mobilize sufficient public resources for the massive investments needed for research and development. SMEs too have to undertake massive public investments into their education and research systems in order to avoid the "middle income trap". In terms of political stability, the challenges they face may be even greater, given the rise of substantial middle classes that may claim greater participation in economic decision-making, if growth slows down. Therefore, further research needs to focus on the long-term stability of emerging market capitalism. For the time being, however, the juxtaposition of these two basic types of capitalism should allow policy-makers to make basic choices about the fundamental options at hand for emerging economies.

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