INTRODUCTION

Transformation of the Transformation?

The Middle-Income Trap and the Search for a New Development Strategy in the Post-Communist States of Central and Eastern Europe

Yaman Kouli and Uwe Müller

For centuries, the European continent has been characterized by the uneven level of socioeconomic development in its subregions (see Broadberry and Malinowski 2020, 23; Kopsidis and Schulze 2020, 42). At least since the industrialisation in the nineteenth century, the West has been a constantly present point of reference as the more modern part of the continent for the economic and political elites of Eastern Europe. In the twentieth century, various attempts were made in the East to catch up with the West, for example, through economic nationalism and import substitution in the interwar period or even through the installation of a completely new economic system, that is, the socialist planned economy (Janos 2000). It was largely the fact that the party and state leaders had not succeeded in achieving the economic efficiency and material standard of living of the states of Western Europe which caused the collapse of communism as a political system in 1989 in Central and Eastern European states. After an initially and often rather painful transformation process to a market economy system in the early 1990s (Kollmorgen 2019), many national economies of Central and Eastern Europe finally found the chance to catch up with the West.

From a historical perspective, the overall framework conditions for the catching-up process were exceptionally favourable. This was especially true for the East Central European (the so-called Visegrád) and Baltic states (Orłowski 2020, 15). The individual opportunities for advancement as well as the high acceptance of the Western model of democracy and market economy in these countries led to a spirit of optimism in large segments

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of the population. In countries such as Hungary and Poland, attempts at market-economy reforms had already taken place during the communist era and could be taken up during the transition period once again (Pula 2018, 67–90). In general, the communist economic system had left behind an outdated, partly dilapidated capital stock in industry and infrastructure,[1] but the level of human capital was high both in terms of general school education and training of skilled workers and engineers.

The external framework conditions were also generally favourable. The Eastern European economies opened up to the influx of capital from Western Europe, the US and Asia, the latter of which was looking for profitable yet safe investment opportunities. In contrast to the interwar period, which was characterized by crisis and economic nationalism (Szlajfer 2012), the integration of the Eastern European transformation states into the world economy, especially into the European Union, was actively supported by Western states, because it corresponded with Western economic and political interests. Aiming at preparing the accession of the Central and Eastern European states, the European Union's cohesion policy ensured compliance with standards important from the European Union's point of view and thus simultaneously promoted the reform process in the Central and Eastern European countries (Berend 2009).

Economic growth and structural change in the countries were driven to a very high degree by foreign direct investment (FDI). A large amount of the goods produced in the new enterprises were in turn exported to Western Europe (Pula 2018, 108–41; Orłowski 2020, 21–22). This flow of capital and goods was also chiefly facilitated by association agreements with the EU and by accession to the EU (Kossev and Tompson 2020). This situation without a doubt also meant that Central and Eastern Europe once again took on a semiperipheral position in the European and global economies, as they often had in history (Morys 2020). Nonetheless, taking the growth of economic output as a yardstick for convergence to Western levels of development, one can observe a massive process of convergence taking place in Central and Eastern Europe, especially between 1995 and 2008 (Galgóczi and Drahokoupil 2017, 8), which incidentally also applies to indicators reflecting the standard of living, such as life expectancy.

The economic and financial crisis of 2008/09 affected the states in Central and Eastern Europe to varying degrees (ibid., 8). Although all countries returned to a growth course in the 2010s, admittedly with the exception of Romania, growth rates did not reach the level of the precrisis years (Orłowski 2020, 23–24). Therefore, the financial crisis of 2008 'marked a breaking point in the growth and development model of Central and Eastern European . . . middle-income economies'. Galgóczi and Drahokoupil are convinced that the 'CEE middle-income economies need to refine the

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future role of FDI and at the same time explore other growth engines in order to continue the process of convergence with the high-income countries' (Galgóczi and Drahokoupil 2017, 7). After 2008, the number of newly created jobs declined significantly, as did the amount of FDI that flowed into Central and Eastern Europe, as well as Greece and Portugal (Hunya 2015, 58). Still, the decline in FDI was not catastrophic; it was even minor in parts, depending on the economic branch (ibid., 44).

Compared to some southern European countries, the EU member states from Central and Eastern Europe were considered relatively stable economies. Nevertheless, the discussions on the economic development in the countries themselves gained an increasingly critical tenor. The fact that globalisation and economic growth has produced not only winners but also losers was for a long time a significant debate subject.[2] It was assumed that innovative and modern economies would sooner or later develop, from which the majority of the working-age population would automatically benefit. This expectation was in stark contrast to the employment history of a specific group of the workforce that had been forced to make personal sacrifices as a result of an economic policy from which they hardly benefited for several decades. Low national debts, increased productivity per capita and falling unemployment figures were therefore juxtaposed against a perceived increase of precarious employment opportunities, lower wages and the latent risk of job losses as a result of the structural change. The increasing critique of these growing insecurities was for a long time underestimated in the Western 'core' of the European Union, whose attention was directed mainly at the Euro and the fiscal crises in some Southern European countries, the Brexit process, the growing external challenges from rising China and the often unpredictable United States in the Trump era (Szabo and Laguna 2021, 49–52). The critique addressed some problems accompanying the transformation process almost from the beginning, such as the growing regional inequality within the countries – that is, the divergence between the capital regions and centres of FDI on the one hand and rural peripheries on the other – and the increasing social inequality, in particular the polarization of the wage distribution (Gorzelak and Smętkowski 2020; Tyrowicz and Szewczyk 2020, 144–47).

Summing up, FDI-led economic growth on the one hand and integration in the Single European Market on the other, even though inseparable, had contradictory effects. Theoretically, one might make a good case in arguing that economic integration caused the problems that we tackle in this book. Were it not for international competition, there would not be a situation where countries try to attract buyers and investors by being cheap. The countries did have to pay a price for international economic integration.

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What was new in this discussion is the identification of a 'middle-income trap'. An already existing or looming 'middle-income trap' is increasingly cited as a central argument for the need to stop relying primarily on a growth model based on FDI. 'The dependence on foreign investments and poor endogenous potential for innovation that have not been overcome in the course of transformation are considered as the main weaknesses of the CEE economies, which can remain stuck in the "middle income trap"' (Gorzelak 2020, 1–2). This argument is combined with a call for a change in the position of Central and Eastern European economies in international supply chains and a critique of EU structural policies. The fight against the 'middle-income trap' plays a central role in the economic policy programmes of the Central European governments and even becomes explicit in the Polish case,[3] showing the awareness of countries about the challenge.

The most obvious way out of this state of low innovation is hardly surprising: the countries must unlock new productivity reserves through innovations. Yet the trap mentioned earlier makes it hard to achieve and creates several problems. The Central and Eastern European countries are confronted by contradictory economic incentives. While there is no fail-safe way to create innovation-based economic growth, several influential levers are certainly well-known: investing in academic education, research and development, and a vocational training system. Yet, these measures are associated with higher government spending and whilst Germany invests 3.1 percent of its GDP into research and development, Hungary invests only 1.5 percent and Poland only 1.2 percent (2018 figures).[4] Consequently, higher state investments could require higher taxes. However, by increasing taxes, the countries catching up in economic terms would risk becoming less attractive to investors that continue to appreciate the comparatively low wage and employment costs.

The number of patents granted is one of the most meaningful indicators of the innovative capacity of an economy. While other production factors like the amount of human capital are extremely hard to quantify, patents can be counted easily. However, they still have shortcomings. There are inventions that cannot be patented, or cannot be patented in every country because of legal differences. Moreover, not every patent is equally profitable. The number of patents does therefore not allow a precise assessment of the innovativeness of a country. That is not to say that measuring patent-output is not of value (see Streb 2016, 449). Yet it is also important to consider that a service-based economy depends less on patents than an industry-based one does. This explains the difference between the UK on the one hand and Germany, Belgium or France on the other. Nevertheless, Table 0.1 shows that the ability to develop innovations was unevenly distributed among the EU regions. It most certainly reflects the different economic structures on

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Table 0.1. Patents per 1 million inhabitants.

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
France	74	75	71	82	106	110	128	131	124	100
Germany	166	167	162	174	228	228	251	255	241	199
Italy	38	39	37	41	53	51	57	62	64	54
Belgium	101	101	100	121	156	171	195	198	199	167
Netherlands	102	112	101	118	164	187	220	250	228	168
Denmark	101	109	106	123	181	187	197	226	218	196
United Kingdom	32	32	32	32	45	47	58	62	60	48
Ireland	42	41	55	58	82	92	104	109	123	104
Greece	3	3	2	2	4	3	4	5	8	6
Portugal	3	2	2	4	6	7	9	11	12	11
Spain	9	8	10	11	16	17	21	20	19	17
Finland	124	123	116	136	197	224	280	294	283	220
Austria	95	99	105	121	157	167	188	188	197	149
Sweden	166	187	177	199	270	290	349	375	346	279
Hungary	4	5	4	4	6	6	7	8	8	5
Estonia	4	7	6	7	8	14	16	12	15	9
Lithuania	2	2	3	4	6	7	5	8	6	7
Latvia	3	2	6	4	8	7	6	3	3	10
Poland	2	2	3	4	5	6	6	6	7	6
Slovenia	18	25	25	32	39	45	37	35	45	37
Slovakia	2	1	2	2	3	3	5	6	3	6
Czech Republic	5	6	6	7	9	12	12	16	14	13
Bulgaria	1	1	1	1	2	3	3	2	3	3
Romania	0	0	0	0	1	1	0	1	1	1
Croatia	3	2	2	1	1	1	1	3	2	2

Source: European Patent Office (EPO), Eurostat, for the population of the UK in 2021 https://databank.worldbank.org/source/population-estimates-and-projections.

these countries. Nonetheless, the table clarifies the imbalances among the European countries. The EU members in Southern Europe (Greece, Portugal and also Spain) stand out as countries that 'produce' relatively few patents, even though Italy performs well in the peer group. Specifically

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striking is the case of the new member states. They show a low performance. Among them, only Slovenia stands out. At the same time, even countries that are praised for their economic policy – namely Poland – have much room for improvement. It is also striking that the number of patents does not grow in some of the new member states. In Poland, Slovenia and in the Czech Republic, there is growth, yet only on a low level. In the remaining countries, the number of patents stagnates.

Nominally, the advantages of a more innovation-driven economy are obvious. First – this has been indicated by works focusing on economic geography, for example – knowledge-based companies are less mobile than companies relying largely on semi-skilled labour. This reduces the risk of such companies choosing the exit option and deciding to shift to a 'cheaper' country with little effort. Second, a better qualified workforce is usually associated with higher wages and therefore with an increase in domestic demand, which can be a stabilising element. Third, the existence of such companies can at least mitigate the emigration of qualified workers, a chance that cannot be underestimated. For example, between 1990 and 2015, Poland has witnessed a yearly emigration of between 18,000 and 47,000 people.[5]

This book starts from the diagnosis that the concept of the 'middle-income trap' is used in many ways in the (economic) policy debate while rarely critically questioned. In the following, we explain the basic assumptions about the concept and examine its empirical evidence for Central and Eastern Europe. It becomes clear that the evaluation of the FDI-driven growth model requires an economic-historical view of the transformation process. For an adequate analysis of the successes and side effects of this growth model, it is necessary to include non-economic perspectives, too. In this book, authors with diverse disciplinary backgrounds review different parts of the transformation of societies and economies in Central and Eastern Europe. What unites the authors within this book are their common interests in the analysis of the manner of socioeconomic transformation, the question of the relevance and possible impact of the middle-income trap and finally the search for ways to escape this trap. They consider an economy based more heavily on knowledge and modern technologies as the way out of the middle-income trap. In many contributions, the European Union plays an important role, which is sometimes seen as part of the problem but should also be part of the solution.

Which Kind of Middle-Income Trap?

When journalists and scholars mention the middle-income trap, there appears to be two profoundly different perspectives on it and hence two

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different versions of the phenomenon. The first is based on the purely macroeconomic perspective which models economic growth as the pure result of input factors. The better the availability of these input factors, the higher growth per capita. Consequently, the aim is to compute the threshold that marks the middle-income trap. Eichengreen, Park and Shin arrive at the conclusion that there are two figures of per capita GDP that mark a threshold – 11,000 and 15,000 US$ (2005) – even though they add that they 'continue to find considerable dispersion in the per capita incomes at which slowdowns (of GDP per capita growth rates, Y.K./U.M.) occur' (Eichengreen, Park and Shin 2013). From this point of view, the middle income is defined by a certain level of economic production per capita which seems to be hard to pass through. Some experts do not even consider this threshold to be a huge obstacle. With regard to Poland, Piątkowski forecasts that Poland will grow through the critical phase (Piątkowski 2018).

There is, however, a second perspective on the middle-income trap. It focusses more on the necessary conditions that come with FDI. Due to the lack of innovative power, these emerging countries attract FDI by low costs. This concerns the revenues themselves, which are significantly lower in the emerging countries than they are in the EU15 (Galgóczi and Drahokoupil 2017, 9). These countries also keep costs low by limiting labour expenditures. A glance at the social protection expenditure figures between 2003 and 2013 confirms this assumption: in 2018, Poland's welfare spending amounted to 19.2 percent of GDP; the Czech Republic spent 17.9 percent, Estonia, 16.1 percent – to name but three examples, in comparison to Germany's 28.4 percent and France's 31.4 percent).[6] In this case, the notion 'trap' does not refer exclusively to production levels but rather to the economic and social policy that comes with the necessity to remain attractive for FDI. The more labour and welfare expenditures increase, the less attractive the countries are for foreign investors. In this respect, the FDI-driven growth model slows down the growth not only of individual incomes but also of societal wealth. On the other hand, as long as salaries and welfare spending remain on a low level, the national market cannot grow. In this case, producing for exports remains top priority. As low prices for export goods improve their competitiveness, export-driven production is an incentive to freeze labour costs and intervene once there is a risk of a significant increase. There is also another mechanism which is a direct consequence of the fact that FDI tends to flow where the prices are low and the potential returns-on-investment are higher. It is always possible for any country to be even cheaper than others, which may draw FDI away from countries that hitherto profited from capital net-inflows. Even though it is impossible to know if and when that threat is imminent, it is still a powerful incentive to keep labour costs low. This might explain why the 'social model

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Causes, Consequences and Strategies in Post-Communist Countries
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Europe' is not particularly attractive to these governments, as it would require them to increase welfare expenditures.

Some authors argue that there is an issue that further complicates the question of how countries can free themselves from the trap, as correct timing is both extremely important and almost impossible. Theoretically, there is little argument that investment in highly qualified personnel is key to reach sustainable growth. Moreover, these investments have to be made while FDI-driven growth is still successful and generates growth. Yet there is no guarantee that investments in human capital will remain in the country to be harvested. 'As things are now, the CEEC R&D sectors are close to extinction, with the more creative personnel leaving for the United States or Western Europe, while production, banking and trade are firmly in foreign hands – as it used to be the case over a couple of recent centuries' (Podkaminer 2013, 41). This quote is from nine years ago. Since then, the economic growth has not deteriorated. Yet, the overall argument remains valid, for highly qualified people, especially within the European Union, are always free to leave their country for an economically more attractive job abroad. Theoretically, this can also go the other way around, as it is similarly possible to attract highly qualified people from abroad and profit from their human capital.

In short, although higher prices for labour and labour quality are in the interest of a country, the incentives to prevent these from happening are still powerful and 'trap' the economy at its current state. Therefore, the distinction of the two different kinds of traps are not merely academic; it is at the heart of economic policy. Ideally, countries are able to attract FDI *and* to successfully develop an economy that is able to nurture self-sustaining, intensive growth based on innovations. If the middle-income trap were merely a productivity-threshold that countries had to leave behind, it would be possible to achieve both. Social scientists, however, insist that the economies that attract FDI are profoundly different from more innovation-based ones.[7]

Authors who disagree argue that FDI actually can induce knowledge transfer. Theoretically, if the transfer of knowledge solved *the* main issue that FDI caused, it would indeed be possible to exploit the comparative advantage of low prices and develop an innovative economy at the same time (Szabo and Laguna 2021, 48–49). Some authors describe this as a paradox, as trade and foreign investments make technology transfer actually possible (Gomułka 2016, 22). The more firms invest in human capital, the better they are able to absorb new technologies via technology transfer (Chiacchio, Gradeva and Lopez-Garcia 2018, 23–24). Hence they arrive at a conclusion similar to that which Borensztein, Gregorio and Lee published twenty years earlier. Borensztein and his colleagues argue that 'FDI is in

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fact an important vehicle for the transfer of technology' and that 'there is a strong complementary effect between FDI and human capital' (Borensztein, Gregorio and Lee 1998, 117). At this point, however, this expectation turns into a circular reasoning. To attract FDI, costs have to remain low. Yet, for FDI to induce technology improvements – and therefore the foundations of long-term growth – it is imperative to invest in human capital. This puts any government in an even more serious dilemma.

Common Diagnosis, Different Therapies

From a researcher's standpoint, the question is how things turned out 'in reality'. Evidently, the answer depends not only on the reviewed case but also on the point of view. The contributions in this volume are written by authors with different disciplinary backgrounds and with diverging perspectives, who also evaluate certain developments differently. As the editors, we see this as an advantage since a single volume can provide only interim results of an ongoing discussion.

However, the divergent results are sometimes related to the fact that the authors examine different levels: the spectrum of foci in the chapters in this volume ranges from the relationship of Central and Eastern European countries and economies with the EU and the world market (Daniel Šitera, Cornel Ban and Zoltán Mihály, Kiril Kossev, Christian Schweiger), to national policies (Šitera, Birgit Glorius, Tal Kadayer, Yaman Kouli), to regional levels (Andrea Filippetti and Raffaele Spallone, Kossev), as well as individual sectors (Ban and Mihály) and companies (Grzegorz Lechowski).

Despite different disciplinary backgrounds and levels of investigation, there are four common diagnoses.

First, there is a consensus that a catching-up process has taken place, but its continuation is at serious risk with the middle-income trap playing a central role. Most authors emphasize the extraordinarily dynamic economic development of the states of Central and Eastern Europe in the last twenty-five years, especially between 1998 and 2008. After the drop in economic output between 1990 and 1993, the CEE7 (Bulgaria, the Czech Republic, Hungary, Poland, Romania, Slovakia and Slovenia) enjoyed five years of growth of about 3 percent in average. During the following decade (1998–2008), the average growth amounted to almost 5 percent (Voskoboynikov 2020, 392). However, the outcome of this catching-up process varies greatly among the individual countries. Among the Central and Eastern European EU members, the difference in the pace of growth was the greatest between Poland and Bulgaria. The GDP per capita of Poland, measured in PPS, increased from 78 percent of the Bulgarian level in 1989

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to 136 percent in 2017 (Orłowski 2020, 11–12). However, this was also a result of the low starting level on the Polish side, which was caused by the deep recession in the country during the 1980s (see Kouli, Chapter 1) and by the fact that Poland was the only country in Europe that did not experience a decline in social product during the financial crisis of 2008/09 (Barczyk, Breziński and von Delhaes 2012).

Even Daniel Šitera, who is generally critical of the development of the last decades, admits that 'most of the ECE states have experienced socio-economic catch-up', especially 'Czechia, Hungary, Poland, and Slovakia are categorized as ranging from "less" to "moderately developed" economies'. But the author criticizes that they were 'falling behind the "highly developed" club in the EU' and 'remaining in this never-ending catch-up game'. According to Šitera's interpretation, the problem of the middle-income trap, at least in the case of East-Central Europe, is that while there is a possibility of moving up from 'less to moderately developed', a 'highly developed' level is unattainable (Chapter 7 in the book). The decisive criterion for evaluating a catching-up process should therefore not be the growth rates of an economy but its structural change.

Indeed, in order to explain the phenomenon of the middle-income trap, one needs to analyse not only the growth rates but also the changes in structures, which leads to the question of the structural effects of the FDI-based growth model. It must first be emphasized that FDI significantly slowed down the inevitable deindustrialisation of Central and Eastern Europe after the collapse of communism (see Ban and Mihály, Chapter 3). The countries in Central and Eastern Europe had experienced at least forty years of a socialist planned economy. Especially in the first two decades after the war, the socialist economies had been able to realize relatively high and extensive economic growth through the development of heavy industry. In the 1970s and especially in the 1980s, however, a glaring weakness in innovation became apparent. In addition, a growing share of the national product was used for consumption and social policy in order to maintain political stability. This happened at the expense of investment, leaving the physical capital in an extremely poor condition in 1990 (Vonyó and Markevich 2020; see also Kouli, Chapter 1, on the Polish case).

Therefore, all former socialist states were dependent on the urgent import of technology and capital from the West. After the collapse of an economic system tending towards autarky and the dissolution of the CMEA, access to new export markets was also necessary. Integration into European value chains and access to the EU internal market were thus essential prerequisites for the catching-up process of the Central and Eastern European economies. At least for the Polish case, we know that the FDI had a positive impact on labour productivity and thereby also on the competitiveness of

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Causes, Consequences and Strategies in Post-Communist Countries
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https://www.berghahnbooks.com/title/KouliMiddleIncome
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the manufacturing sector on the world market – in the vast majority of industries (Weresa 2008).

The contributions by Cornel Ban and Zoltán Mihály and Kiril Kossev offer comparisons between countries as well as groups of countries (East-Central Europe/Visegrád, South-Eastern Europe, the Baltic States as [potential] EU members, South-Eastern Europe outside the EU/Western Balkans, Ukraine and other post-Soviet states). These comparisons show that the degree of openness of the economies and their geographical and cultural proximity to Western Europe correlated positively with economic development at least until 2008. Ban and Mihály emphasize that the rise of East Asia has been primarily at the expense of Latin America and the non-EU Eastern European states, while East-Central Europe has nonetheless rather improved its position in the world economy. Tal Kadayer, on the other hand, points to the close connection between the course set in the early period of transformation, the extent of FDI and economic growth. For example, countries that relied less on management buyout and issuing of vouchers during privatisation and more on the direct sale of former state property were particularly attractive for FDI (see also Kossev, Chapter 6). The same applies to the liberalisation of wages: 'wage liberalization is crucial for increasing productivity, as productivity and compensation are tightly correlated. Wage is strongly connected to competitiveness and productivity. Countries that maintained high control of wages prevented the private sector's share in the economy from increasing' (Kadayer, Chapter 2, p. 78).

However, the phenomenon of the middle-income trap draws attention to the fact that the liberalisation of wages cannot permanently guarantee the competitiveness of an economy. In the first phase of transformation, which Kadayer focuses on, the pace of change might have been more important for medium-term success than the often cumbersome attempts of the state to regulate this change. In the present, by contrast, overcoming the middle-income trap is obviously only possible through active state intervention. This argument is supported by the analyses of the situation in Central and Eastern Europe presented in this book as well as by examples of success, such as South Korea and Taiwan (Wade 2018).

From our point of view, neither an orientation towards a normative free-market model nor a blanket criticism of 'neoliberalism' is helpful. What is decisive is the classification of an issue in the respective historical context. This also applies to the legacy of the communist period, which differed between the individual countries within the 'Eastern bloc' more than one would expect. Kadayer points out that relatively good initial conditions favoured the active promotion of transformation. Yaman Kouli discusses this question with a focus on Poland. He shows in his contribution

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https://www.berghahnbooks.com/title/KouliMiddleIncome
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that even though the transformation is supposed to have profoundly reshaped the national economies, they are still to a large extent shaped by their heritage. Poland's industrial capital was in a bad state compared to Czechoslovakia and Hungary. Ironically, there is good reason to assume that it was this low starting position of Poland that played a key role in its high growth rates. Yet these rates, by 2019, did not let Poland overtake the GDP per capita of the Czech Republic or Hungary. The expectation that the middle-income trap will not hinder Poland from becoming a high-income economy may therefore be premature.

The *second* basic consensus among our authors is that the FDI-based growth model has reached (or will soon reach) its limits in Central and Eastern Europe and these economies have fallen (or will soon fall) into a middle-income trap. Some authors even tend to believe that the concept of the middle-income trap indicates that the neoliberal reform policies and the past waves of foreign investment in the post-communist Central Europe have created massive barriers to further growth by stabilizing the national economies on the path of development driven by low wages (see especially Šitera, Chapter 7; as well as Myant 2018; Gorzelak 2020, 3).

Other negative side effects of the growth model developed during the transformation phase are also becoming increasingly clear. First and foremost among these are the growing regional and social disparities, as presented in Chapter 6 by Kossev. From an economic-historical perspective, it is true that such disparities are to some extent unavoidable in fundamental processes of structural change (Williamson 1996). However, the hopes that FDI would bring about transfers of modern technologies, the involvement of suppliers from the region (spread effects) and an increase in human capital have not been sufficiently fulfilled. Kossev concludes:

> The region must tackle the underlying inefficiencies of unbalanced growth and newly created inequalities and must seek to reinvigorate its economic institutions. This means devising a new growth model that is mindful of regional disparities, can find an economic place for those that have been left behind by the early transition, and provides an incentive to keep institutional modernization reform going. This will assist the Central and Eastern European countries to avoid falling into the middle-income trap and experiencing a long-term economic stagnation. (Chapter 6, p. 171)

However, there are also other assessments with regard to the connection between the FDI growth model and the middle-income trap. While Cornel Ban and Zoltán Mihály acknowledge the danger of the middle-income trap in Romania's case, they also point to the potentials of the current growth strategy. In their view, the main obstacle is inadequate state action. Grzegorz Lechowski points out that larger countries such as Poland and Roma-

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Causes, Consequences and Strategies in Post-Communist Countries
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nia have a smaller share of foreign companies in the national product and are also less dependent on exports. He analyses the domestically driven industrial dynamics in post-communist Central Europe and questions the general validity of the thesis of its failure in a dual economy. Evidence of this hypothesis is provided by two Polish IT companies which were founded in the 1990s, then adapted Western technologies to answer to the needs of Polish customers, and are now becoming multinationals in their own right. Decisive for this success has been the growing demand for IT systems, the increasing specialisation in the IT industry, as well as positive framework conditions in Poland, such as the existence of relevantly trained university graduates, a national banking system and the Warsaw Stock Exchange.

Third, many contributions also study the role of the EU, be it in the implementation of the FDI-based growth model, in the path into the middle-income trap or in developing possible strategies leading out of this trap.

Overall, it must first be emphasized that the process of preparing the new member states for admission to the European Union has made an important contribution to the formation of institutions that strengthen the principles of democracy, market economy and the rule of law (see Schweiger, Chapter 8). Šitera criticizes, however, that in its behaviour towards the (potential) new member states, the European Union from the beginning pursued an economic policy strategy that primarily benefited the old (Western) member states. This strategy consisted of actively supporting the FDI model, which turned Central and Eastern Europe into an extended workbench of Western European corporations. For this reason, the Visegrád states in particular have developed into 'dependent market economies' (Nölke and Vliegenthart 2009). This 'division of labour' was seen as an instrument to preserve the EU's competitiveness in global competition. The economies of Central and Eastern Europe were given the task of holding their own against competition from Asia, primarily through low manufacturing costs, while the Western European economies were able to concentrate on improving their technological competitiveness. A particularly problematic result was concentrated in areas with low labour costs. Moreover, the EU continued this strategy even after the 2008 crisis. This can be seen, for example, in the criticism of the allegedly excessive wage increases in Romania in 2017 and 2018 by the World Bank and the European Bank for Reconstruction and Development. As Ban and Mihály argue, these wage increases were still below productivity growth and therefore quite justified in economic terms.

Schweiger illustrates that the peripheralisation of the Central and Eastern European countries within the framework of the European Union went beyond assigning them the role of an extended workbench with correspondingly low wages. The social spending of the new member states,

The Middle-Income Trap in Central and Eastern Europe
Causes, Consequences and Strategies in Post-Communist Countries
Edited by Yaman Kouli and Uwe Müller
https://www.berghahnbooks.com/title/KouliMiddleIncome
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too, generally remained below the EU average. This enabled the Eastern European states to attract foreign investors through low non-wage labour costs. In addition, low social spending facilitated the consolidation of state budgets, which was essential for admission to the EU, and especially in some cases (Slovenia, Slovakia, Baltic states) also for participation in the Euro area. Lower wages, poorer social security, the restrictions on the free movement of workers from the states that joined the union in 2004 and 2007, which were in place for several years, as well as the unequal treatment vis-à-vis southern European states in the Euro crisis reinforced the impression of many citizens of the new member states that they were seen as second-class Europeans.

According to Šitera, for the EU to implement the 'dual' economic policy strategy to increase global competitiveness its most important instrument was the so-called cohesion policy. This may seem surprising at first glance, as the main task of cohesion policy was actually to compensate for the disadvantages caused by the internal market (see Filippetti and Spallone, Chapter 9). However, Šitera claims that the infrastructure investments made under cohesion policy have mainly favoured FDI. At the same time, the core of the EU has de facto bought the consent of the new EU member states with the lure of cohesion policy. This naturally raises the question of the extent to which cohesion policy has also promoted the other parts of the national economy.

Andrea Filippetti and Raffaele Spallone point out that the middle-income trap can also be observed at the regional level, often allowing for a more precise identification of its structural causes. In its cohesion policy, the European Union has for more than two decades given greater priority to the promotion of regions, on the one hand, and to increasing expenditure on research and development, on the other. Nevertheless, many European regions, especially in Southern Europe and Eastern Europe, currently have 'middle-income status'. Filippetti and Spallone attribute this fact to the relative easiness of implementing regional redistribution through Keynesian policies in a Fordist economy in comparison to the implementation of cohesion policies in knowledge economies. The production factor 'knowledge' is obviously much less mobile than one would expect despite the increasing availability of digital networks.

Fourth, nevertheless, the expansion of digitalisation and the shift to knowledge-based industries are considered the most important strategy towards more balanced growth and getting out of the middle-income trap (Kossev, Chapter 6). But how can this structural change be initiated and enforced?

The geographers Filippetti and Spallone see two approaches that should ideally complement each other: the promotion of individual agglomera-

The Middle-Income Trap in Central and Eastern Europe
Causes, Consequences and Strategies in Post-Communist Countries
Edited by Yaman Kouli and Uwe Müller
https://www.berghahnbooks.com/title/KouliMiddleIncome
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tions, such as technology parks, by the respective headquarters and a consistent decentralisation that relies on regional diversity giving birth to different forms of knowledge-based economies.

In contrast, more state-driven and 'developmentalist' industrial policies have dominated in Central and Eastern Europe for some years. In this context, the political scientist Šitera speaks of nationalist development strategies that determine economic policy above all in Hungary, Poland and to some extent also in the Czech Republic (Scheiring 2020; Smiecinska 2021). Shifting the focus of support from a few multinational to many medium-size enterprises would certainly be suitable for bringing the development levels of these two elements of an overly dual economic structure closer together. Šitera doubts, however, whether nationalist strategies can lead the countries out of their semiperipheral positions in the global economy and peripheral positions in the EU. Above all, it is quite questionable whether the structural problems that led to the middle-income trap can actually be solved in this way. He argues that especially illiberal democracies fail to offer good conditions for managing the shift of the engine of economic growth from industry to human-capital-intensive services, as economic freedom plays a much greater role in bringing about this second great structural change than what was the case for industrialisation (Winiecki 2016). Technology upgrading is a shift to higher value-added products and production stages through increasing specialization; instead of national isolation, it requires greater international integration (Gereffi 1999). The key to a significant strengthening of the knowledge economy, according to all authors, lies in an expansion of activities in the field of research and development by both the EU and the nation states as well as by private companies and – even more important – in the transfer of new technologies into economic application (see also Radosevic, Yoruk and Yoruk 2020). Almost all authors emphasize that the countries of Central and Eastern Europe spend too little on research and development compared to other EU countries.

Despite these deficits, there is apparently the possibility in individual cases to escape the middle-income trap. Lechowski points out that there have been development opportunities for innovative companies on the national market in Poland long before the turn to etatist strategies. In the long term, however, the prospects of such companies depend on successful specialisation and their own orientation towards international markets. Therefore, economic nationalist concepts tend to be counterproductive. Ban and Mihály also point out that there are some niches at the sectoral level that can circumvent the middle-income trap. Structural changes at the national economic level, however, would fail mainly due to the inefficient policies of the state and the neglect of research and development. The Romanian state

The Middle-Income Trap in Central and Eastern Europe
Causes, Consequences and Strategies in Post-Communist Countries
Edited by Yaman Kouli and Uwe Müller
https://www.berghahnbooks.com/title/KouliMiddleIncome
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subsidizes individual sectors through tax privileges, but ultimately only a small part of the economy benefits from this. More important, however, would be investments in innovation, health, and education by the state, whereby the optimal use of European funding programmes is of central importance.

A major obstacle to the strengthening of knowledge-based industries that is often overlooked by economists is the lack of adequately qualified labour. While a very small portion of the workforce are well trained, many highly qualified and skilled workers and university graduates leave Central and Eastern European countries and emigrate to the West. The middle-income trap also plays a role in this because low wages are still the most important motive in the decision to emigrate. In her chapter on Bulgaria, which has been hit by the problem particularly hard, Birgit Glorius points to a way of reducing the shortage of well-educated labour forces. Thirty to 50 percent of Bulgarians who emigrate to Western Europe are willing to return home under certain circumstances. Social and emotional motives often play a major role here – in contrast to emigration. Potentially returning migrants are thus quite willing to accept a loss of salary under certain conditions. These include, among other things, the possibility of becoming self-employed in the knowledge economy. The state should encourage return migration – something that has been almost non-existent up to now. More importantly, the state and administrative structures should be more open and flexible than in the 'established' West, while still preventing corruption.

Glorius thus directs attention to the actors who might be able to overcome the middle-income trap not only for themselves but ultimately also for their country. This is not necessarily about being at the forefront of technology. The success stories described in various contributions (Lechowski, Chapter 4; Ban and Mihály, Chapter 3) show that the strengthening of science and research and the implementation of modern technologies in companies and, finally, the openness of markets are the most important preconditions in order to escape the middle-income trap. National and European economic and technology policy should focus on achieving these conditions.

Conclusion

Since the 1990s, the Central European countries have greatly profited from economic growth. They were able to capitalize on their comparative advantage of lower costs, close proximity to the highly developed Western European states, and relatively well-developed human capital. Con-

The Middle-Income Trap in Central and Eastern Europe
Causes, Consequences and Strategies in Post-Communist Countries
Edited by Yaman Kouli and Uwe Müller
https://www.berghahnbooks.com/title/KouliMiddleIncome
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sequently, they have successfully attracted FDI, the social and economic improvements of which have been undeniable. This strategy of FDI-driven growth, however, needs to be revised in the near future. The question the new EU member-states currently have to tackle pertains to the nature of the changes to be employed now. Even though it is unclear whether FDI-driven growth can still offer some potential, the general impression is that its end is near. The majority of publications indicate that the development of a more innovative economy and therefore higher investments in research and development and human capital as well as an increase of wages and social expenditures are key for future economic growth. These steps, however, are evidently incompatible with a low-cost strategy usually associated with FDI-fuelled growth.

As the contributors to this volume demonstrate, the problems linked with the middle-income trap depend on the specific perspective and the respective object of investigation. The overall successful economic development of the new member states should not cloud the fact that each of them has developed very differently. The general picture becomes even more complex once the analysis focusses on specific countries, economic branches or regions. Escaping the middle-income trap appears to be much more complicated and cannot be reduced to a matter of economic growth. The new economic policies need to be accompanied by modified social policies and strategies to increase the national human-capital stock.

There are good reasons to assume that the main challenges that will come with this change of strategy are not economic but political ones. Although not at the centre of this book, the argument that the current appeal of illiberal policies may be one of the results of a social policy that exists mainly to keep costs low is still worth mentioning. Relatively low labour costs even for well-educated labour can provide economic reasons to attract FDI. Yet, in the long run, they increase dissatisfaction among the population. The role of good and well-paying jobs for social cohesion is obvious. Yet creating such jobs is a long-term project. In this situation, populists with illiberal economic policies might appear attractive, which would explain the popularity of the democracy-backlash in many Eastern and Central European countries. Maybe, this is the irony of the middle-income trap. It has helped populists reach political power, even though the solutions they propose – for instance, shutting off the national market and fighting immigration – are insufficient to deal with the problem. Thus, the (economic) middle-income trap has brought about a political trap.

The contributions to this edited volume lay bare that to better understand current developments in Central and Eastern Europe, it is essential to also understand the impact of the middle-income trap.

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Causes, Consequences and Strategies in Post-Communist Countries
Edited by Yaman Kouli and Uwe Müller
https://www.berghahnbooks.com/title/KouliMiddleIncome
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Yaman Kouli wrote his dissertation at the Chemnitz Technical University and worked there as a research assistant from 2011 to 2018. From 2012 to 2013, he was also an A.SK-fellow at the Berlin Social Science Center. In 2018 and 2019, he was a visiting scientist at the UMR Sirice 8138 in Paris, funded via a scholarship from the Alexander von Humboldt Foundation. From October 2019, he has worked as a research assistant at the Heinrich-Heine-University in Düsseldorf. His fields of expertise are Poland's economic history during the twentieth century, the knowledge-based economy and European economic integration before 1914.

Uwe Müller earned a PhD in economic history at the Humboldt University in Berlin. He has done research and taught at the Humboldt University, the European University Viadrina in Frankfurt (Oder) and the Saarland University in Saarbrücken. Since 2011 he is a senior researcher at the GWZO Leibniz Institute for the History and Culture of Eastern Europe. His research interests include the economic history of Eastern Europe from the middle of the nineteenth century to the present day with a special focus on the integration of this region in the European and world economy.

Notes

1. As has recently been shown, the state of the infrastructure and the capital stock differed widely among the Central and Eastern European states (Vonyó and Klein 2019; Vonyó 2017); see Kouli's contribution (Chapter 1) in this volume.
2. As presented in the renowned book by Joseph Stiglitz (Stiglitz 2003).
3. The 2017 Polish 'Plan for Responsible Growth' (Plan na rzecz Odpowiedzialnego Rozwoju, retrieved 30 April 2021 from https://www.gov.pl/web/fundusze-regiony/plan-na-rzecz-odpowiedzialnego-rozwoju) was directed explicitly against the middle-income trap. One key step of the plan against the trap was to raise investments in 'Research and Development' to a level of 2 percent of national GDP.
4. Gross domestic spending on R&D, retrieved 16 May 2021 from https://data.oecd.org/rd/gross-domestic-spending-on-r-d.htm.
5. Source: Główny Urząd Statystyczny, Struktura Ludności, retrieved 10 March 2021 from https://stat.gov.pl/obszary-tematyczne/ludnosc/ludnosc/struktura-ludnosci,16,1.html. More information on the socioeconomic status of the emigrants is not available.
6. Expenditure on social protection benefits, 2018, retrieved 16 May 2021 from https://ec.europa.eu/eurostat/statistics-explained/index.php?title=Social_protection_statistics_-_social_benefits.
7. Although not in the centre of this publication, there is also a political side to this argument. While countries may usually not complain against considerable investments by big companies, they are nonetheless undeniably reluctant to always pay the price. As Galgóczi and Drahokoupil emphasize, it has come to a distinction be-

The Middle-Income Trap in Central and Eastern Europe
Causes, Consequences and Strategies in Post-Communist Countries
Edited by Yaman Kouli and Uwe Müller
https://www.berghahnbooks.com/title/KouliMiddleIncome
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tween 'good' and 'bad' FDI. Especially the idea that big foreign companies come to CEE to profit from the attractive market only to later repatriate economic surpluses made Poland and Hungary introduce taxes in order to fight this strategy (Galgóczi and Drahokoupil 2017, 11). There are also additional incentives to reduce the dependence on FDI. The volatility of FDI-inflows is a problem in and of itself, as the dependency on FDI is high and every reduction has direct effects on the production levels.

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The Middle-Income Trap in Central and Eastern Europe
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The Middle-Income Trap in Central and Eastern Europe
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