

Session 4: Social Policy

Globalization and the Development of Welfare States in Postcommunist Europe¹

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I. Introduction

How has globalization influenced welfare state development in postcommunist Europe? We focus in this paper on the leading East-Central European accession states, Poland, Hungary, and the Czech Republic, and show that these states have experienced radically different welfare state developments since 1989 from their neighbors in the former Soviet Union. The first part of the paper proposes that these divergent paths can be explained by a “Europe effect”. We argue that globalization has not had a uniform impact on postcommunist welfare states. Rather, the effect of globalization has differed greatly, depending on a country’s position in the international economy and geopolitical relations. We demonstrate that countries closer to the European Union have used welfare state programs to compensate citizens for the traumas of system transition and economic openness, while the welfare systems in the former Soviet states have collapsed to a far greater extent.

After showing why East-Central European welfare states have taken a different path from their neighbors in the former Soviet Union, we explore the roots of differentiation within the East-Central European welfare states themselves. Despite participating in a common process of European integration, East-Central European welfare states have taken different routes to Europe. We argue that these differences can best be explained with reference to the domestic politics of transition and a “global politics of attention” in social policy advice. The transition period offered extraordinary opportunities for small groups of policymakers to initiate policy change⁴, and they did so in ways that were

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⁴ Balcerowicz (1995).

sometimes idiosyncratic and sometimes similar, reflecting the current state of domestic and international welfare state thinking and priorities.

This paper contributes to the debate on globalization and welfare states in several ways. First, contrary to those who argue that globalization necessarily forces states to cut commitments to welfare, we find that Central and Eastern Europe states maintained strong welfare state commitments during a period of rapid economic liberalization and globalization. Second, we argue that the effects of globalization on welfare states are mediated by politics, in three ways: 1. by *a country's geopolitical position*, in this case proximity to a regional trading bloc with strong welfare state norms and commitments; 2. by *the domestic politics of decision-making*, in this case taking place in an extraordinary period of systemic transition; and 3. by *a global politics of attention*, in this case the role of powerful international actors in influencing the specific paths that countries take on the way to Europe.

For the purposes of this paper, we adopt a carefully specified economic definition of globalization that encompasses five trends, following Glatzer and Rueschemeyer⁵. Under this definition, globalization consist of:

- Expanding international trade in goods and services
- Expanding international capital flows
- Increasing globalization of production (through transnational corporations and global commodity chains)
- Growing role of international organizations such as the World Trade Organization, the World Bank, and the IMF
- Greater transnational flow of economic ideas.

We define welfare states as the collection of state programs, regulations, and actions that are intended to fulfill directly a state's declared commitment to the economic welfare of its citizens.

The paper is organized as follows. First, we show that a pervasive Europe effect can be observed in postcommunist welfare state development and discuss the economic and political mechanisms that underpin this effect. Second, we examine the differences within East-Central Europe in more detail, exploring the distinctive domestic politics of decision-making during transition and how this interacts with agenda-setting by international organizations and a global politics of attention. We then illustrate these interactions with reference to three short case studies of decision-making in the area of pension reform in Poland, the Czech Republic and Hungary.

II. The Europe Effect

Starting in 1989, the postcommunist countries of East-Central Europe, Southeastern Europe, and the former Soviet Union were swept by a dramatic system transformation that fundamentally altered many of the social and economic conditions upon which their welfare states were built. This upheaval created pressures on postcommunist welfare states that went far beyond those experienced by more stable states under conditions of globalization. System

⁵ Glatzer and Rueschemeyer (forthcoming).

transformation or “transition” involved not only very rapid trade liberalization, but also radical changes in economic structures, political institutions, and state administration. Developments in all of these spheres forced a radical reorientation of welfare state conditions, commitments, and structures – but in directions were highly unpredictable at the outset of transition. Upheaval made it certain that old structures could not be maintained forever, but uncertain, for instance, whether welfare state spending would rise or fall, whether commitments would be changed or maintained in a new way, or whether the socialist safety net would simply cease to exist. Given similar pressures of globalization and transition, one might have expected the postcommunist welfare states to react in broadly similar ways⁶. But this was not to be the case. Instead, a process of rapid differentiation began. East-Central European states maintained a high commitment to welfare that actually grew as a percent of GDP, while at the same time falling in absolute levels, in line with declines in GDP. Former Soviet welfare states experienced a dramatic decline in both absolute and relative terms. Because this differentiation so neatly correlated with geography, we call it a “Europe effect,” underpinned by economic and political trends.

a. Transition outcomes

In a comprehensive study of postcommunist welfare state adjustment, the World Bank⁷ found that in the first decade of transition, postcommunist states separated into two categories of adjustment, European and Eurasian. These two categories appeared to be largely geographically determined. According to the World Bank, the “European” category included the East-Central European countries (Czech Republic, Hungary, Poland, Slovakia), the more successful Balkan and former Yugoslav republics (Slovenia, Croatia, FYR Macedonia, Romania, Bulgaria), and the Baltic states (Estonia, Lithuania, Latvia). The Eurasian category encompassed the former Soviet republics (Belarus, Uzbekistan, Kyrgyz Republic, Kazakhstan, Russia, Turkmenistan, Azerbaijan, Tajikistan, Armenia, Ukraine, Georgia, Moldova), minus the Baltics, plus Albania.

What differences did this study find between the two adjustment regimes? Compared to the Eurasian countries, the European countries restructured their economies more aggressively and effectively after 1989-91. The European countries experienced lesser transitional recessions, and their per capita incomes are higher (see Figure 1). The European countries also enjoy stronger institutional and administrative capacity. By 2000, in the leading European countries, growth had resumed and real wages had increased, though unemployment remained a problem⁸.

All of these factors pointed in the direction of higher welfare state spending for the European transition countries. Starting from very similar pre-transition levels, by 1996 the European transition countries spent an average of 10 percent of GDP on pensions, compared to 5 percent for the Eurasian countries (see Figure 2). Since pensions are usually the largest portion of cash

⁶ Frye (2001).

⁷ World Bank (2000a).

⁸ World Bank (2000a), p. 2.

social benefits in the postcommunist countries, this gives a good sense of the direction and magnitude of changes in welfare state spending. Unemployment benefits and minimum wages were also substantially higher in the European countries⁹. The World Bank concludes that overall economic, social, and administrative performance since 1989 was a good indicator of total social spending in the late 1990s, and performance correlated strongly with geography.

[World Bank Figures 1, 2, 3, about here; these are appended in two TIF files]

Despite starting with very similar welfare state structures and spending levels, European and Eurasian countries diverged dramatically during the first decade of transition. During the first ten years, welfare state spending increased on average in the European countries, while it stagnated or fell in the Eurasian countries. But why has geography had such a significant effect? What is it about the geographical position of East-Central European countries in particular that helped them navigate postcommunist transition with far less of an economic collapse and far greater commitment to welfare? We propose that the answer is Europe. In short, those countries with good prospects of joining the European Union faced an entirely different set of economic, political, and administrative opportunities and incentives that pulled in the direction of higher economic growth, increasing these states' commitment to, and ability to support, welfare state spending. In addition, East-Central European countries were pushed towards Europe by internal factors. Their prospects of joining Europe depended not only on the European Union recognizing East-Central European countries as potential members, but also on their similarity to current EU members in culture, organization, and history and their expressed a desire to become more "European" and adhere to European norms of political and economic organization. Such internal factors also differentiated East-Central European countries from their neighbors to the South and East.

b. The regional politics of the European Union

The radical disjuncture between the European and Eurasian experience suggests that the international position of the East-Central European countries was the most significant determinant of their postcommunist welfare effort. We believe that this is because of a pervasive "Europe effect" that can be seen in the domains of economics, politics, and state administration. This section will show that European ties and influence in all three domains supported continued commitment to high levels of welfare state spending in the accession countries. We focus on the three largest countries in the first wave of EU membership negotiations, Poland, the Czech Republic, and Hungary. However, the argument applies equally to the two smaller first-wave countries, Estonia and Slovenia, and to a somewhat lesser degree to the second wave countries, Romania, Bulgaria, Slovakia, Croatia, Latvia and Lithuania, i.e. to most of the World Bank's "European" group, but particularly the leading countries among them.

⁹ World Bank (2000a), p. 3.

In the economic sphere, the East-Central European countries quickly carved out a privileged place in Europe. In the first years of transition, they underwent a massive trade reorientation. Partly this was natural, due to shared borders and previous periods of industrial cooperation. Partly, it was facilitated by state treaties called “association agreements” with the EU, which reduced tariffs on trade, with a goal of eventual elimination. Expectations of future EU membership also enhanced inward foreign investment, after a lag period during the chaotic, early years of reform. Soon, East-Central Europe was perceived as an attractive, relatively low-cost manufacturing base within Europe. Over time, several leading East-Central European countries, particularly Hungary and the Czech Republic, began to show evidence of increasing involvement in European intra-industry trade networks and higher-value-added production. Alone among the postcommunist countries, East-Central Europe quickly and successfully integrated into the global economy¹⁰. In this, East-Central Europe differed sharply from its neighbors to the South and East¹¹.

Like other postcommunist countries, East-Central Europe experienced a severe trade shock in the early 1990s as a result of the collapse of Soviet bloc trade that contributed to a reduction in GDP. Brenton and Gros¹² estimate that trade collapsed to 87 percent of the pre-transition level in Hungary, and to a lesser extent in Poland. However, East-Central European countries remarkably quickly reoriented their trade towards the West. Between 1988 and 1996, the three largest East-Central European countries, Poland, Hungary and the Czech Republic, doubled the share of their exports going to the EU from the 30-37 percent range to 59-67 percent by 1996¹³. Germany quickly became the largest trading partner for all East-Central Europe. In 1996, Germany took 29 percent of Hungary’s exports, 35 percent of Poland’s, and 36 percent of the Czech Republic’s¹⁴.

In addition to successful redirection of trade towards the West, quality of trade also began to improve in East-Central Europe. Whereas early in the transition, questions were raised about the ability of these economies to integrate into global production networks, between 1990 and 1996, intra-industry trade with the EU increased from 43 to 62 percent in the Czech Republic and from 47 to 57 percent in Hungary. Slovenia’s share of intra-industry trade also reached 60 percent in 1996. At that point, the leading East-Central European transition economies matched the EU intra-industry trade levels of Sweden, Spain, and Italy. Poland was somewhat of a laggard, with intra-industry trade increasing from 36 to 41 percent in 1996¹⁵. However, Poland and Romania, whose economies have been fed more by low-cost production, are expected to swiftly move up the production chain in coming years. Brenton and Gros¹⁶ conclude that “the more advanced countries in Central and Eastern Europe are

¹⁰ Kierzkowski (2000), Fidrmuc (2000), Eichengreen and Kohl (1998).

¹¹ Cook (forthcoming).

¹² Brenton and Gros (1997).

¹³ Kierzkowski (2000), p. 15.

¹⁴ Kierzkowski (2000), p. 18.

¹⁵ Fidrmuc (2000), p. 87.

¹⁶ Brenton and Gros (1997).

indistinguishable from Western market economies.” These economies have successfully carved out a niche in EU trade and moreover appear not to be replacing Southern European trade, but rather inducing increased specialization in the EU¹⁷. And as with other European countries, successful trade integration will enable continued high levels of social spending.

Foreign direct investment lagged trade growth during the first decade of transition, but again the most successful East-Central European countries, particularly Hungary, have begun to achieve levels of FDI per capita that approach developed-country levels¹⁸. The largest trade partners tend to be the largest investors, with Germany, the United States and the Netherlands leading the way in FDI¹⁹. Such investment in East-Central Europe appears to be fully compatible with high social expenditures, as it is premised on eventual European Union membership. Indeed, there is no evidence that among the postcommunist countries, investment seeks the lowest wage, as FDI is far higher in East-Central European countries than in the former Soviet republics. Instead, FDI flows to those countries with relatively stable political and social environments. In addition, the promise of joining the European trade zone helps, as do domestic “European” factors such as good schooling, high skill levels, a history of capitalist industrial organization, and reliable social protection systems, including unemployment and health insurance.

Successful integration into global, but particularly European, trade and production networks appears to be one major factor enabling maintenance of relatively high levels of welfare state spending in East-Central Europe. However, there are other aspects of the Europe effect. In the political sphere, the drive to rejoin Europe has reinforced institutions of parliamentary democracy in East-Central Europe, enabling interest groups to lobby more effectively for a continuation of high levels of welfare provision. Anticipating EU membership, political parties on the right and left understand the need to commit to European norms and levels of social expenditure²⁰. And in the administrative sphere, the advent of membership negotiations in the mid-1990s reminded East-Central European countries that Europe feared mass immigration and “social dumping” from the East. East-Central European countries that aspired to EU membership would have to maintain social provisions on a European level. Starting in the mid-1990s, the EU began to work with East-Central European ministries to provide experience and expertise on European social welfare, through twinning projects with West European ministries, and other projects. Thus, economic, political, and administrative developments related to the project of rejoining Europe all tended to push in the direction of increased social spending, and continued commitment to social welfare in East-Central Europe.

We believe that this Europe effect explains the significance of a regional variable, measured often as the distance from Brussels, in many studies of

¹⁷ Fidrmuc (2000), p. 91.

¹⁸ Kierzkowski (2000), p. 20.

¹⁹ Hunya (2000), p. 91.

²⁰ Cook, Orenstein, and Rueschemeyer (1999).

differences among the postcommunist states²¹. Distance from Brussels really is significant, not for purely geographic reasons, but because it is a proxy for the cultural, political, and economic commitment to East-Central European accession that has placed these countries in a privileged position in the global economy.

In short, while the countries of the former Soviet Union provide evidence for the view that globalization forces countries to scale back welfare state spending, the experience of East-Central Europe argues for the opposite view, that greater economic integration constitutes both the economic basis and need for high welfare state spending²². We suggest that the East-Central European experience shows that geopolitics matters. The place of states in the international economy and geopolitical relations has a fundamental impact on the way they will react to similar pressures of economic globalization. In the case of East-Central Europe, proximity to and promises of eventual membership in a free trade zone that symbolizes and embodies norms of welfare state provision and openness together facilitated the adoption of like policies in the accession states.

III. Welfare State Choices Within East-Central Europe

So far, we have discussed general trends in welfare state spending across the postcommunist region, and argued that EU accession countries have been distinguished from their Eurasian counterparts by their higher spending levels overall. At the level of individual country adjustment, however, the picture becomes much more complex, and the variation among the individual states within East-Central Europe is quite stark. Below, we describe this variation and also point to some trends toward increasing similarities, focusing particularly on the cases of Hungary, Poland, and the Czech Republic. We then address the causes of these differences and similarities, and explain them through an analysis of decision-making in transition. We argue that the large number of programmatic problems for welfare states generated by the postcommunist transition over-taxed the policy capacity of these governments, and forced them to seek out new policy ideas and solutions, in a relatively unsystematic fashion. New ideas and solutions came from two sources: domestic and foreign. The foreign sources included international organizations, bilateral aid agencies, and their consultants. However, international organizations paid little attention to social policy in the first years of transition, instead focusing on macroeconomics and privatization. We argue that this relative neglect left domestic policy elites relatively free to set transition social policy. They did so in an idiosyncratic manner that reflected momentary alignments of intellectual and political resources and historical conditions in a particularly country. Thus, policy differed widely from country to country. However, starting in the mid-1990s, a more coherent and forceful international social policy agenda began to appear for the postcommunist states, crafted by a World Bank that was increasingly cognizant of East-Central European countries' EU aspirations. Although East-Central European welfare states still display unique features, reflecting prior institutional

²¹ See Cameron (2000).

²² Cameron (1978), Glatzer and Rueschemeyer (forthcoming).

paths, and the particularities of transition decision-making, which has long-term path dependencies of its own, this international agenda has had a growing impact. Overall, we stress the power of policy ideas, those of the international community and domestic elites, in reshaping postcommunist welfare states.

a. Major policy developments

A general picture of how social policy evolved in Hungary, Poland, and the Czech Republic after 1989 is shown in Table 1. These East-Central European countries followed broadly similar patterns of social policy transformation, in a time sequence that broadly concurred with that mapped out for them by the World Bank and leading economists of transition. In the first years of the transformation, the emphasis was largely on setting up unemployment systems, since unemployment was widely expected to be the most serious and potentially destabilizing social issue of transition²³. Later, postcommunist welfare states began to focus on transforming their systems of social assistance, then health and pension systems.

Developments in unemployment insurance were broadly similar in the three countries. After the initiation of unemployment insurance in 1988-1990, benefits were scaled back as unemployment rates rose. Initially, benefits were provided for 12 or even 18 months at fairly generous levels, but were later cut to 6 months and reduced in size²⁴. Poland, for instance, began to offer a flat-rate unemployment benefit of 36% of average wage starting in 1992. Eligibility rules were also restricted. Minimum wage regulations were also introduced, or re-introduced in all countries at the start of transition, but provided only a low level of protection for low-income workers²⁵.

²³ Blanchard et al. (1991).

²⁴ Godfrey and Richards (1997), various chapters.

²⁵ Standing and Vaughan-Whitehead (1995).

Table 1. Welfare State Transformation at a Glance in East-Central Europe

Policy Area	Hungary	Czech Republic	Poland
Labor Market Policies			
Unemployment Insurance Founded	1988	1990	1989
Restricted/Reduced	Reduced in 1993	Reduced in 1991, 1992	Reduced in 1992
New Minimum Wage Legislation	1989	1991	1990
Level (1990-1993)	50-60% of avg. wage	40-50% of avg. wage	30-40% of avg. wage
Social Assistance			
Minimum Living Standard Established	n/a	1991	n/a
Social Assistance System Targeted	1995	1996	
Health and Pensions			
Health Fund Payroll Tax	1992	1993	1999
Private Health Insurance Funds	1993	1993	n/a
Total Health Expenditures (% GDP)	1989 (5.7%)		1989 (3.0%)
	1994 (10.8%)	1994 (7.8%)	1994 (4.5%)
	1998 (8.0%)	1998 (7.2%)	
Retirement Age Increased	1996 to 62 for men and women	1996 from 60/55 to 62/57-61 by 2007	constant at 65/60
Voluntary Private Pension Funds	1993	1994	1999
Mandatory Private Pension Funds	1998	n/a	1999
State Pension Spending (% GDP)	1989 (9.0%)	1989 (8.3%)	1989 (6.7%)
	1994 (10.8%)	1994 (8.4%)	1994 (15.8%)
		1998 (9.1%)	
Summary Indicators			
Payroll Tax Levels	1995 (60%)	1996 (49.4%)	1996 (48%)
	1999 (53.8%)	1999 (47.5%)	
Total Social Expenditures (% GDP)	1995 (28.6%)	1994 (21.3%)	1995 (26.7%)

Social assistance policies in East-Central Europe differed substantially when these countries started the transformation, and these differences persisted during the first several years. A major World Bank study by Braithwaite, Grootaert, and Milanovic²⁶ showed that in 1993, social assistance systems in the region divided into three groups: concentrated, dispersed, and irrelevant. In concentrated systems (Poland and Estonia), only a small percentage of households received assistance, but this assistance was relatively important for them. In dispersed systems (Hungary and Russia), a high percentage of households received assistance, but this assistance was often only a small proportion of household budgets. In irrelevant systems (Bulgaria), social assistance is unimportant to households and only a small percentage receive benefits in any case²⁷.

Table 2. Social Assistance in Five Postcommunist Countries (1993)

	Poland	Hungary	Estonia	Bulgaria	Russia
% of HHs receiving SA	3.7	24.4	2.7	2.55	13.0
SA as % of total expenditures	0.74	1.1	0.38	0.11	0.45
SA per recipient HH (\$/month)	54	17	33	10	5
SA as % of expenditure of recipient HHs	22.1	4.7	14.8	4.1	3.5
% of SA received by lowest decile	20.5	27.2	34.7	22.3	8.2

Source: Milanovic (1999), p. 132. HH = household. SA = social assistance.

Among the East-Central European countries, Hungary was exceptional in the coverage and generosity of its family benefit system, which was one of the most developed in Europe²⁸, while Poland had a less extensive, more targeted system that provided a higher average benefit for a much smaller number of recipient households. The Czech Republic was not included in the 1993 study, however 1996 data provided by Jiří Večerník, a leading Czech sociologist who has worked extensively to analyze household income data²⁹, suggests that the Czech Republic lay somewhere in between the categories.

Starting in 1995, however, all three countries began to target their social assistance systems, in line with neoliberal thinking and advice primarily from the World Bank³⁰. In fact the Braithwaite, Grootaert, and Milanovic study was part of this effort to make the East-Central European welfare states more focused on providing benefits for the poor. The shift was most dramatic in Hungary in 1995, when a Socialist government initiated severe cuts in family benefits under the so-called Bokros package of reforms, to respond to a serious fiscal and balance of payments crisis. The Bokros reforms touched off vigorous public protest, and a stormy period of reform that ended in 1996 with Finance Minister Lajos Bokros's resignation from office. Targeting also proved controversial in the Czech Republic, where it was initiated by a right government. Therefore, in social assistance, major structural variation between the three countries in the initial

²⁶ Braithwaite, Grootaert, and Milanovic (1999).

²⁷ Milanovic (1999), p. 136.

²⁸ UNICEF (1997).

²⁹ Večerník (1999), (2000), Večerník et al. (1999).

³⁰ See World Bank (1995).

period of reform gave way to increasing structural similarity after 1995, under the influence of the World Bank.

Health and pension systems also saw major variations initially, followed by convergence in the late 1990s. Both Hungary and the Czech Republic established independent health insurance funds early in the transition, funded by special, earmarked health insurance payroll taxes. Poland did not do so until much later, due to concerns about the expense. This difference was important, as Ringold³¹ shows that countries that established such a payroll tax spent significantly more on health than countries that did not. Czech Republic and Hungary developed systems of private health insurance funds in 1993, while Poland established regional funds in 1998/1999, as part of its later health reform.

In pensions, Hungary and the Czech Republic founded voluntary pension funds with significant tax or budgetary advantages in 1993 and 1994, well before Poland, which took this step with its major pension reform in 1999. Poland, meanwhile, spent far more on public pensions during the first years of transition than either Hungary or the Czech Republic (see Table 3 below). In 1994, Poland spent 15.8% of its GDP on pensions that were more generous than the Central European norm. This is largely because pension levels were higher. Poland's average replacement rate (the percent replacement of previous income) was 74.8%, compared to 46.8% in the Czech Republic or 56.9% in Hungary in 1994.

Table 3. Pension Spending in East-Central Europe (% GDP)

	1989	1990	1991	1992	1993	1994	1995	1996	1997
Poland		8.7	14.2	15.8	15.8	15.8	14.1	13.9	13.7
Hungary			10.5	10.4	10.4	11.4	10.5	9.7	
Czech R		7.9	7.5	7.5	7.6	7.7	8.2	8.4	
Slovakia		7.4	8.1	9.3	9.4	8.9	9.1	8.3	
Slovenia			9.3	12.5	13.0	13.4	13.6	13.4	

Source: World Bank (2000a).

Poland's more rapid increase in pension expenditure has concerned policymakers and analysts alike. Several authors have tried to explain why Poland's pension system expanded so rapidly³², causing serious fiscal strain and placing downward pressure on other social spending. It was not until 1999 that Poland finally dealt with its problems by passing a comprehensive pension reform that would reduce spending as a percentage of GDP over the long term. The Czech Republic had been more successful in containing pension spending early in the transition. In 1996, both Hungary and the Czech Republic started to gradually increase the statutory pension age in an effort to control spending. And in 1998 and 1999 respectively, Hungary and Poland conducted major reforms of their pension systems, partially replacing their pay-as-you-go public systems with mandatory, private, defined-contribution funds³³. Differences in the methods and timing of change, however, had major impacts on pension spending, creating significant long-term path dependencies for reform.

³¹ Ringold (1999), p. 34.

³² Cain and Surdej (1999), Kapstein and Milanovic (2000).

³³ Müller (1999), Orenstein (2000).

To summarize, in unemployment benefits, Hungary and the Czech Republic were more generous at first, but quickly scaled back. Poland offered less generous benefits from the beginning. In health insurance, Poland did not create an earmarked health insurance tax until after a decade of transition, constraining health spending relative to its neighbors. However, Poland spent more on pensions than either Hungary or the Czech Republic as a percent of GDP. In part because of higher spending, Hungary and Poland conducted major structural reforms of their pension systems in the late 1990s, while the Czech Republic did not. And in social assistance, after wide early variation in policies, all three countries began to target assistance and reduce universality starting in 1995-1996. While clear trends are visible, so are major differences between the three countries. These differences are important to analyze, not only because they had a major impact on welfare during the transition, but also because they marked paths of welfare state development for the future.

b. Explaining trends and differences

To what extent are trends and differences in East-Central European welfare state transformation explained by globalization? We argued in the previous section that the East-Central European countries' relatively successful integration into the international economy, reflected in rapidly expanding international trade, particularly with Europe, higher FDI, and integration into European production networks, was associated with a general upward trend in social spending during the transition, and the continued commitment of these states to social protection. However, we have also seen that the extent and paths of this adjustment has varied radically from country to country.

These differences among country adjustment paths cannot be explained by any consistent theory about exposure to trade or trade openness. For one, the impact of trade is not precise enough to account for numerous policy differences among these three countries. But openness to trade also does not explain differences in spending levels among these three countries either. Hungary and the Czech Republic are a) the most advanced and successfully integrated, as well as b) the smallest, most open economies in this set. Poland stands out by being a) four times larger in population, therefore less exposed to trade than its smaller neighbors; and b) poorer and less advanced economically. By any version of the compensation thesis³⁴, which posits that smaller, more open economies spend more on welfare states, Hungary and the Czech Republic would be expected to spend more during the transition. Also, if welfare states were a luxury that could be afforded by wealthier states, the same result would pertain. However, it was Poland that increased its social spending most rapidly and radically during the transition, as a percent of GDP, mostly through a dramatic increase in pension spending³⁵.

Various political economy explanations offered for why Poland had such a rapid increase in social spending all come up short³⁶. Cain and Surdej³⁷ use a

³⁴ For instance, Cameron (1978).

³⁵ Hagemeyer (1999), See also Table 3.

³⁶ Cain and Surdej (1999), Kapstein and Milanovic (2000).

combination of transition politics and public choice theories to convincingly explain the expansion of pension spending in Poland, but they do not address other cases, where spending was not so extreme. Kapstein and Milanovic³⁸ argue that political leaders faced a strategic choice during the transition, whether to curry favor with pensioners, and therefore increase pensions and slow privatization, or with workers, and therefore speed privatization and reduce pensions. Poland, they suggest, took the former strategy, while Russia and the Czech Republic took the latter one. However, they have yet to defend this thesis with reference to Polish voting statistics, and it seems implausible that the early Solidarity governments that ruled Poland would have intentionally favored pensioners over workers. Also, our previous work suggests that East-Central European leaders were guided more broadly by economic ideas in their choice of transition strategies, whether neoliberal or social-democratic, rather than by narrow appeals to age-based constituencies³⁹.

Another surprising point about post-communist social policy is that many developments do not seem to be closely related to party ideology. While previous work⁴⁰ showed that left parties in post-communist countries advocated broadly social-democratic welfare state themes, they were just as likely as right parties to implement austerity measures when fiscal crisis threatened, as in Hungary in 1995. Therefore, cross-national studies show that the partisan hue of government has little relation with overall social spending in the first decade of transition⁴¹, and in fact, there is some evidence that right governments have spent slightly more. Of course, this ignores variation in long-term structural changes, that may differ between right and left, but not show up in yearly spending figures. However, it does suggest that social policy transformation has been largely driven by other factors (such as transition upheaval) that transcend party affiliation.

In our view, this variation among countries' social transformation paths is best explained by the dynamics of transition decision-making. During a chaotic transition, small groups of specialists were often granted extraordinary authority by executives and parliaments to set social policy along new lines. At the same time, decision-makers drew upon available domestic and international sources of policy advice to formulate responses to the plethora of transition problems they confronted⁴². However, policy thinking and advice received differed in each country, often idiosyncratically, explaining a large part of the seemingly unsystematic differentiation we observe in countries on more or less equivalent paths towards Europe. After describing the players and processes of domestic and global policy formation, we illustrate the interplay between domestic decision-making and the global politics of attention in case studies of pension reform in Poland, the Czech Republic, and Hungary.

³⁷ Cain and Surdej (1999).

³⁸ Kapstein and Milanovic (2000).

³⁹ Orenstein (2001).

⁴⁰ Cook, Orenstein, and Rueschemeyer (1999).

⁴¹ Lipsemeyer (2000).

⁴² See Cohen, March and Olsen (1972)

c. The domestic politics of decision-making

At the national level, transition social policy was set by small groups of politically connected social policy experts⁴³. These expert groups occupied various spaces in the state apparatus, whether at ministries, social security agencies, or government research institutes. They were often granted a great deal of autonomy in the early transition years, both from civil society and parliamentary pressures, as well as from the executive branch. However, they were all relatively small and lacking in resources, compared with their West European counterparts, for instance. Small groups of policy experts flowed in and out of government, based on personal connections with particular political parties and leaders. Once located in the executive branch, these groups were confronted with numerous overwhelming problems that were unlike those faced by their counterparts anywhere in the world, at this moment in time.

In the fluid institutional moment of transition, in the face of many conflicting pressures and relatively few available solutions, the ideas of these people about how to reshape social welfare commitments could be extremely powerful⁴⁴. Therefore, it is important to examine the terms of their ideological discourse. Broadly speaking, there were three main trends in postcommunist thinking on social policy, that correspond fairly well with Esping-Andersen's⁴⁵ typology of European social welfare state ideas. First, and most prominently, was the liberal or neoliberal strain of thinking that swept East-Central Europe after 1989. Liberal ideas about rendering welfare states as means-tested "safety nets" began to be heard in East-Central Europe⁴⁶. However, the influence of liberal ideas in the social policy area was muted by the fact that neoliberal thinkers' emphasis lay elsewhere. Postcommunist economic programs emphasized price and trade liberalization, privatization, and stabilization⁴⁷. Neoliberals often left social policy matters in the early years to experts who came from other ideological camps⁴⁸. The primary one, of course, was the broadly socialist or social democratic camp. East-Central European social policy experts generally disagreed with neoliberal principles⁴⁹, and tried instead to steer the transition from paternalist socialism toward a more European concept of socialism. While they tended to stay in the background, one could say that this broadly socialist strain dominated East-Central European welfare state thinking during the first five years of transition, and will perhaps remain a dominant trend over the longer term. Finally, and less significantly, conservative social thinking was on the rise in East-Central Europe, sponsored primarily by Christian-Democratic right parties who wanted to emphasize church and/or family in state social support⁵⁰.

⁴³ Jenkins (1999).

⁴⁴ Balcerowicz (1995), Kołodko (1999).

⁴⁵ Esping-Andersen (1990).

⁴⁶ Deacon (1997), Szacki (1995).

⁴⁷ Blanchard et al. (1991).

⁴⁸ Orenstein (2001).

⁴⁹ Nelson (1997), Müller (1999).

⁵⁰ Kulczycki (1995).

Since the political backing for socialist welfare states (communist party and trade unions) had fallen apart dramatically in 1989, small groups of reformers occupying strategic places in the executive branch could have great influence on the course of social policy early in the transition⁵¹. However, the fluidity of transition politics and the relatively low priority of welfare state reform made the disposition of these power resources somewhat haphazard. When reformers did get into positions of power, they often chose to do things on purely ideological grounds that were not necessarily well supported by careful planning or structural preconditions. This autonomy of small groups of reformers in a fluid political situation, armed with new ideas, challenged by a host of problems, and not so constrained by past legacies, gave the early years of postcommunist social policy reform a chaotic character. It meant that countries faced with identical problems would choose to address them in very different ways, depending on the specific policy discourse and opportunities of small expert groups.

e. The global politics of attention

International organizations, economists, and consultants provided another major source of policy ideas after 1989. However, the international policy community was not primarily focused on social policy in the early transition years⁵². Instead, we believe that the transition years can be divided into two periods of international attention to social policy transformation: a first period from 1989-1995, in which international attention to this issue domain was low, and a second period, starting in 1995, when social policy moved to the top of the international agenda⁵³. At that time, a variety of international organizations began to implement and further develop a social policy agenda that pushed East-Central European countries more consistently towards a single model of welfare state reform. This influence often came through the international organizations' vastly superior capacity for policy development and argumentation, as well as their control over critical financial resources.

During the early years of transition, international actors paid little attention to social policy in the postcommunist states. Setting up unemployment systems was the only area of priority concern⁵⁴, but otherwise neoliberal policymakers focused on the stabilization, liberalization, and privatization policies that were at the heart of their strategy. All this began to change in the middle of the 1990s, for a number of reasons. First was the "return of the left" that demonstrated frustration with neoliberal reform agendas, and popular willingness to support parties, even discredited former communist ones, that promoted a more social vision of economic change⁵⁵. Second was a widespread recognition that poverty had increased dramatically in Central and Eastern Europe during the early

⁵¹ Balcerowicz (1995).

⁵² Deacon (1997), Ringold (1999), Kapstein and Milanovic (2000).

⁵³ Sachs (1995), World Bank (1996).

⁵⁴ Blanchard et al. (1991).

⁵⁵ Sachs (1995), Cook and Orenstein (1999).

transition years. Early on, prominent economists disputed this fact⁵⁶, arguing that poverty had not been measured properly, and that living standards had not fallen at all. But gradually, as evidence piled up, this position became impossible to maintain, and a widespread consensus developed during the middle of the 1990s that the transition had been accompanied by massive increases in poverty⁵⁷, even in relatively successful East-Central European countries. Third, neoliberal economists began to realize that their lack of attention to social policy matters in the early stage of transition had not caused social welfare states in the east to wither away, but rather to grow dramatically in some cases, like Poland. Neoliberal economists began to view this welfare state expansion as a major impediment to growth – and cutting spending a top policy priority⁵⁸. Fourth, major international organizations, particularly the World Bank, shifted its global policy priorities towards issues of poverty, which had not been a primary focus before⁵⁹. The EU increased its attention to the accession process at the same time, bringing to the table its greater concern with social issues in transition. All of these international trends encouraged greater attention to issues of poverty and social policy reform in Central and Eastern Europe.

In the mid-1990s, social policy transformation became the subject of major international conferences and debate, and World Bank social sector lending to the postcommunist countries took off in 1996, rising from around \$500m to \$2b in just two years, as shown in Figure 4⁶⁰.

[World Bank Figure 4, attached as separate TIF file]

Increased global attention had a material effect on postcommunist welfare state transformation, causing a more consistent global agenda to emerge, and placing greater homogenizing pressures on East-Central European welfare states. This emerging global social policy for the region⁶¹ emphasized targeting of social assistance, partial privatization of pension systems, and systemic reforms in health and education. While each of the major international organizations had different emphases, and even conflicting programs in some areas, the World Bank tended to dominate the agenda, coordinating with the EU on issues of preparation for accession. Indeed, the World Bank conducted major reviews of East-Central European countries' economic policies in preparation for accession, that included extensive analysis of social welfare systems and state administration, in addition to macroeconomic policy, financial sector regulation, and other economic policy areas that were central to the early transition agenda. As a result, East-Central European countries found themselves part of a social policy discourse that primarily included their governments, the EU and the World Bank, with the latter doing much to set the agenda for these discussions. It is

⁵⁶ Sachs (1995).

⁵⁷ Milanovic (1998), Gomulka et al. (1998).

⁵⁸ Sachs (1995).

⁵⁹ World Bank (2000b).

⁶⁰ World Bank (2000a).

⁶¹ Deacon (1997).

notable that both Hungary and the Czech Republic made efforts to target their more diffuse social assistance systems in 1995-1996, while Hungary and Poland both implemented radical pension reforms in 1998-1999. Both of these events, and others, show the strong agenda-setting influence of the World Bank⁶².

IV. Country Studies

Domestic and international pressures and agendas combined to produce welfare state transformation in East-Central Europe after 1989. In the early period, where international attention to social policy matters was low, domestic policy elites had more room for maneuver. Starting in the mid-1990s, though, social policy was increasingly dominated by an international agenda set largely by a World Bank that was cognizant and supportive of East-Central European countries' EU membership preparations. In order to illustrate these trends, we use examples of decision-making on the transformation of pension systems in the three largest East-Central European countries, Hungary, the Czech Republic, and Poland. We show that this decision-making was driven by a desperate search for solutions to overwhelming social policy problems, that small elite groups often had considerable leeway in restructuring welfare state policy in the early period of reform and that these early choices had strong path dependencies. These case studies show that East-Central European countries have made a range of adjustment choices that reflect distinct paths of decision-making in transition, but that there is also increasing evidence of similar overall trends that are driven by the global politics of attention.

a. Poland

Poland experienced a dramatic pension crisis after 1989, with spending increasing at a much higher rate than in most East-Central European countries. Spending on pensions almost doubled from 8.7% to 15.8% of GDP between 1990 and 1994, creating serious problems for the government budget. To make up a growing social insurance fund deficit, the government had to make substantial subsidies to the two pension funds (employees and farmers), amounting to 3.9 percent of GDP in 1996⁶³.

Pension spending shot up in Poland during the early years of transition mainly because the government took a set of decisions to use the pension system as a buffer for unemployment⁶⁴. The way this was done not well thought out. Polish policy makers both loosened eligibility requirements for pensions, and guaranteed their levels relative to the average wage. As a result, between 1990 and 1994, the "system dependency ratio," which measures the number of workers per pensioner declined in Poland from 2.49 to 1.75⁶⁵. Meanwhile, the "replacement ratio," which measures the size of the average pension as a percent of the average wage, increased from 57 to 66 percent over the same

⁶² Müller (1999), Orenstein (2000).

⁶³ Cain and Surdej (1999), p. 150.

⁶⁴ Cain and Surdej (1999), p. 167.

⁶⁵ Cain and Surdej (1999), p. 150.

period⁶⁶. Although all the postcommunist East-Central European countries faced similar issues of how to deal with rising unemployment and the increasing need for social protection, Poland was the only country to dramatically loosen eligibility requirements in this way while increasing the value of pensions as a proportion of the average wage.

Why did Polish governments react in this way? Cain and Surdej⁶⁷ point to the transitional policies of Solidarity governments between 1989-1993. The first Polish reform governments, under Finance Minister Leszek Balcerowicz and Labor Minister Jacek Kuroń, extended generous early retirement benefits to ease the transition out of the labor force for older workers, and to provide social protection for existing pensioners. These compensation measures were directed towards compensating people for the collapse of the communist system and the new stresses of market competition, including exposure to foreign trade and investment. Despite the worthy goals of Labor Minister Kuroń, the fiscal laxity of his pensions policies is striking, given that this was completely at odds with Solidarity government policy in other areas. At the same time, Finance Minister Balcerowicz launched a major “shock therapy” restructuring of the Polish economy, which included measures to cut public sector deficits and civil service pay. Why would the same government take decisions to dramatically expand subsidies and guarantees for pensioners?

Such behavior can only be explained with reference to the lack of attention the finance ministry and leading reformers paid to the social sector under neoliberal adjustment plans. Labor Minister Kuroń provides ample evidence in his 1991 book, Moja Zupa, to suggest that he did not understand the Polish social system well when he was appointed Labor Minister, and made a number of decisions, including on pension eligibility, that he later regretted. For instance, one decision was to extend pension benefits to veterans of the Polish home army and other independent fighting units during the Second World War, who resisted the Nazi and Soviet occupations. An important political gesture, this extension of pension benefits, however, raised serious administrative problems, since the records, if any, of these groups had mostly disappeared over the years⁶⁸. The Ministry of Labor was deluged with requests from pensioners accompanied by little documentation. Pensions were also extended to victims of layoffs, with no provisions for withdrawing them when people found new work. As a result, many middle-aged people claimed benefits and continued to work. Poland’s eligibility problem ballooned between 1989 and 1992, when a major spike in the number of people collecting pensions occurred. Later governments restricted eligibility, again suggesting that the increase had been a mistake. When Balcerowicz later wrote that failure to reform the social security system had been the major error of the reform governments, he explained that reformers had simply been unable to deal appropriately with all issues confronting them, because of lack of time and problem overload⁶⁹.

⁶⁶ World Bank (2000a), p. 75.

⁶⁷ Cain and Surdej (1999).

⁶⁸ Kuroń (1991).

⁶⁹ Balcerowicz (1995).

The Polish case therefore offers clear evidence connecting the expansion of pension spending to the lack of attention to social sector restructuring in early neoliberal programs. Local officials' lack of attention to social sector reform reflected priorities articulated by major Western international organizations and their consultants during the first period of transition. In this sense, local and global officials agreed about the low priority of social policymaking in the overall transition program. Therefore, officials like Kuroń with little economics, public administration, or social insurance training had great latitude to make policy decisions that did not support or even contradicted major principles of the economic reform that was taking place in the chaotic environment of 1989-1992.

Starting in 1995, as international attention was drawn to the problems of social sector reform in East-Central Europe, Polish governments began to seriously confront reform of the pension system. The World Bank seconded its own experts to help establish a pension reform team within the Polish government. And indeed, succeeding governments were successful in implementing major pension reform legislation in 1997 and 1998 that is expected to reduce government spending and replacement rates over the long term⁷⁰. This reform was conducted with extensive World Bank involvement, financing and advice, and implemented key elements of a "new pension orthodoxy"⁷¹ promoted by the World Bank. Poland therefore offers a clear example of unusual deviation during the early adjustment period, taking a path in pension spending far more exaggerated than its neighbors, while later conforming to World Bank policy advice.

b. Czech Republic

Pension developments unfolded in the Czech Republic in an even more distinctive way. Early Czechoslovak governments paid a relatively high degree of attention to reforming the social system from the early days of transition. This is because early Czechoslovak governments were not completely dominated by neoliberals, but rather by a broad coalition of neoliberals and social democrats (including former communists on both sides) that implemented a "social-liberal" strategy for transformation⁷². Czechoslovak reformers passed a social reform program, drafted by social democrats, at the same time as a radical neoliberal economic reform program in late 1990. The social program included a variety of structural measures designed to maintain the fiscal health of the system during transition. Since international organizations were at the time paying very little attention to social policy reform, Czechoslovak policymakers were left to their own devices. Therefore, as in Poland, small groups of domestic policymakers had extraordinary influence on shaping the future development of the Czech pension system. Under the initiative of a team of experts at the Ministry of Labor, including Igor Tómes, who later became a World Bank consultant, early Czechoslovak governments got rid of many special pension benefits enjoyed by numerous and well-organized groups, like miners. They did this in part through

⁷⁰ Müller (1999), Orenstein (2000).

⁷¹ Müller (1999).

⁷² Orenstein (2001).

direct negotiation, making a variety of side-payments and guarantees to ensure compliance. One was the establishment of a system of private, optional pension funds that would allow for additional funded pensions for different occupational groups. Miners were among the first to found such a fund. The Czech Republic adjusted to the increased burden on its pension system by steadily reducing the proportion of pensions to the average wage, from 64% in 1989 to 52% in 1992 and 44% in 1994. The neoliberal government of Prime Minister Vaclav Klaus also passed legislation gradually increasing the pension age⁷³.

The radical differences in the domestic adjustment strategies implemented in the Czech Republic and Poland reflected very different approaches to the problems of transition among small groups of policymakers located mainly in Czech and Polish Ministries of Labor between 1989-1992. International influence on these decisions was very limited, as was the influence of top neoliberal policymakers in government at the time. As a low-priority area, social policy reform was delegated in both countries to the Ministry of Labor (and Social Affairs or Social Policy) and developments took place that were seemingly out of sight and out of line with neoliberal government economic policies in other areas. For instance, interviews with top policy makers suggest that Finance Minister Vaclav Klaus seriously opposed the overall social policy of the early Czechoslovak governments, and tried to alter it when he became Prime Minister in 1993⁷⁴.

However, these initial social policy strategies shaped the paths for future developments. Because the Czech Republic managed to transform its pension system without creating a high degree of debt or fiscal imbalance, it did not come under serious international pressure to adopt a World Bank model of reform after 1995⁷⁵. While Poland and Hungary engaged in almost simultaneous and similar reform efforts in 1997-1998, the Czech Republic has so far been unaffected by this trend, though several domestic analysts have begun to promote a fully-funded system based on individual accounts⁷⁶.

c. Hungary

Developments in Hungary took a rather different direction in the first period of transformation. Hungary's pension system was experiencing increasing problems and fiscal imbalance already during the 1980s⁷⁷, but the first democratic governments were not ready to do much about it. Still, their adjustment strategy differed both from Poland's with its dramatic spending expansion, and from the Czech Republic, which managed to hold the line by cutting benefit levels. Hungary took a middle path, slightly reducing benefit levels through incomplete indexation, while the pension system dependency ratio increased. In Hungary, the average pension/average wage ratio declined from 65 percent in 1990 to 61 percent in 1994, while the system dependency ratio

⁷³ Müller (1999), pp. 136-137.

⁷⁴ Orenstein (2001).

⁷⁵ Müller (1999).

⁷⁶ Jelinek and Schneider (1999).

⁷⁷ Müller (1999).

increased sharply. Increasing reliance on pensions forced the system into a deep deficit, supported out of Hungary's increasing budget deficit which reached 7 percent of GDP in 1994⁷⁸.

In 1995, Hungary adopted a neoliberal reform program under Finance Minister Lajos Bokros that, among other things, cut family benefits and targeted them. Bokros also initiated a process of pension reform planning that bore fruit in subsequent years, after he was forced from office. In 1996 and 1997, Hungary planned and implemented a major pension reform that was remarkably similar in design to that implemented a year or so later in Poland⁷⁹. As in Poland, the Hungarian system partially replaced the state-run pay-as-you-go system with a mandatory, private system based on fully-funded individual accounts managed by private pension investment funds. There were a few notable differences between the two programs. Hungary diverted a slightly smaller share of payroll tax to the new private system than Poland, and the regulatory structure for the private funds was somewhat different. Most importantly, Poland simultaneously conducted a complete reform of its state system, while Hungary only changed it in parts. But both systems were clearly cut of the same cloth, and both were advised and supported by the social protection division of the World Bank.

V. Conclusions

East-Central European welfare states have generally grown as a percent of GDP since their entry into the global economy. This contrasts sharply with the experience of most former Soviet Union countries, where social spending as a percentage of GDP has stagnated or even declined, and where transitional recessions were both deeper and longer (see Figures 1 and 2). Broadly speaking, East-Central European countries' trend towards higher social spending is underpinned by their privileged position as potential EU members, and the resulting regional politics of EU accession. Prospects of EU membership have helped to foster successful trade integration and foreign direct investment, increasing the ability of East-Central European countries to pay for continued welfare state guarantees. At the same time, EU prospects encouraged more representative democracy, greater openness to interest group pressure, and greater political and administrative commitment to social welfare norms than in most former Soviet states. Of course, East-Central Europe's better prospects of EU membership were determined not only by external, but also internal factors, particularly their greater similarity and proximity to core EU member states in politics, economics, and culture. However, EU membership was not a natural phenomenon, but a state project that gave overall direction to the East-Central European transitions⁸⁰. It was a choice that demanded a great deal of the prospective member countries, including certain parameters to their social policy transformations.

At the individual country level, the picture is far more complex. Social policy was dominated by small domestic elite groups located in strategic

⁷⁸ Cook and Orenstein (1999).

⁷⁹ Müller (1999), Orenstein (2000), Gedeon (2001).

⁸⁰ Orenstein (2001).

executive positions during the early transition years. Overwhelmed by numerous problems of transition, the domestic politics of decision-making were often driven by a rapid search for solutions that resulted in idiosyncratic policies being adopted. When international organizations, particularly the World Bank and the EU, began to pay greater attention to social policy transformation in East-Central Europe, and focus their enormous policy resources in this area, a more consistent policy agenda began to emerge across the region, reflecting the global politics of attention. The resulting social policy transformations bear the marks of both periods, with the effects of early decisions persisting as pressure from a global social policy agenda grows.

At the outset of transition, likely paths of welfare state development were unclear. It was possible that the former socialist welfare states would contract, because these relatively weak economies could not sustain generous spending. But it was also plausible that they might grow, to buffer people from the impact of system transformation. Indeed, analysts frequently predicted intense conflict between populations with high welfare state expectations and states with insufficient means. However, the outcomes of postcommunist welfare state adjustment turned out to be less homogeneous than either of these predictions suggested. Former Soviet welfare states declined along with the collapse of Soviet state structures generally, while East-Central European countries found themselves in a corner of this globalizing world that supported continued welfare state commitment, and provided the means to finance it through increased trade, investment, and growth. Globalization thus appears to have very different effects on welfare states, depending on their geopolitical position and the interplay between their domestic politics of decision-making and the global politics of attention.

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