6

Globalization and the Future of Welfare States in the Post-Communist East-Central European Countries

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How has globalization influenced welfare state development in the post-Communist states? Since 1989 the leading east-central European accession states, Poland, Hungary, and the Czech Republic, have experienced radically different welfare state developments from their neighbors in the former Soviet Union. The first part of this chapter analyzes the "Europe effect" that we find to be the source of this differentiation and argues that globalization has not had a uniform impact on post-Communist welfare states. Rather, the effect of globalization differs 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 former Soviet states have allowed their welfare state to collapse 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. 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 policy makers to initiate policy change (Balcerowicz 1995), and they did so in fairly idiosyncratic ways that reflected the current state of domestic and international welfare state thinking and priorities.

This essay 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 European states maintained a strong welfare state commitment 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 influencing the specific paths countries take on the way to Europe.

For the purposes of this chapter, we adopt a carefully conscribed economic definition of globalization that encompasses five trends, following Glatzer and Rueschemeyer (this volume). Under this definition, globalization consists of:

- Expanding international trade in goods and services
- Expanding international capital flows
- Increasing globalization of production (through transnational corporations and global commodity chains)
- The 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 directly fulfill a state's declared commitment to the economic welfare of its citizens.

The Europe Effect

Starting in 1989, the post-Communist countries of east-central Europe, southeastern Europe, and the former Soviet Union were swept by a dramatic systemic transformation that fundamentally altered many of the social and economic conditions upon which their welfare states were built. This upheaval created pressures on post-Communist welfare states that went far beyond those experienced by more stable states under conditions of globalization. Systemic 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 directions were highly unpredictable at the outset of transition. In contrast to Pierson's (1994, 15) concept of "systemic retrenchment," the post-Communist transition created systemic pressures on welfare states, but not necessarily in the direction of retrenchment. 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 post-Communist welfare states to react in broadly similar ways (Frye 2001). But this was not 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 (though less pronounced in the latter). Because this differentiation so neatly correlated with geography, we call it a "Europe effect," underpinned by economic and political trends.

Transition Outcomes

In a comprehensive study of post-Communist welfare state adjustment, the World Bank (2000) found that in the first decade of transition, post-Communist states separated into two categories of adjustment, European and Eurasian. These two categories appeared for the most part to be 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 1989–1991. The European transition countries experienced lesser transitional recessions, and their per capita incomes were higher (see fig. 6.1). The European countries also enjoyed stronger institutional and administrative capacity. By 2000, in the leading European transition countries, growth had resumed and real wages had increased, though unemployment remained a problem (World Bank 2000, 2).

All of these factors pointed in the direction of higher welfare state spending for the European transition countries. Starting from very similar pretransition 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 fig. 6.2). Since pensions are usually the largest portion of cash social benefits in the post-

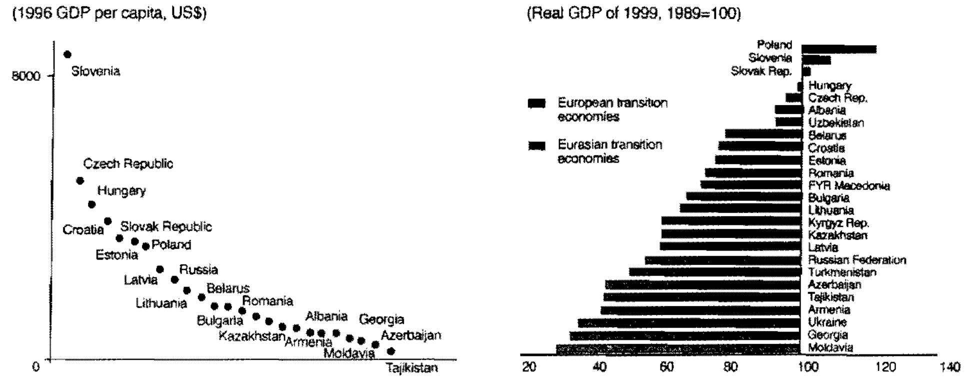

Fig. 6.1. Transition economies fall into two broad groups in terms of economic performance. Data from World Bank 2000, 2.

Communist 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 countries (ibid., 3). The World Bank data concludes that overall economic, social, and administrative performance since 1989 is a good indicator of total social spending in the late 1990s, and performance correlates strongly with geography.

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 the post-Communist 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. Our hypothesis here is consistent with the findings of Frye (2003), who concludes that EU integration correlates with higher spending on health and education in transition countries. Like Kopstein and Reilly (2000, 28), we suggest that the EU provided "the crucial external push that has altered domestic interests in favor of accomplishing some of the key tasks of postcommunism."

Integration, however, is a relational process and east-central European countries also were pushed toward Europe by internal factors. Their prospects of joining Europe depended not only on the European Union recognizing east-central Eu-

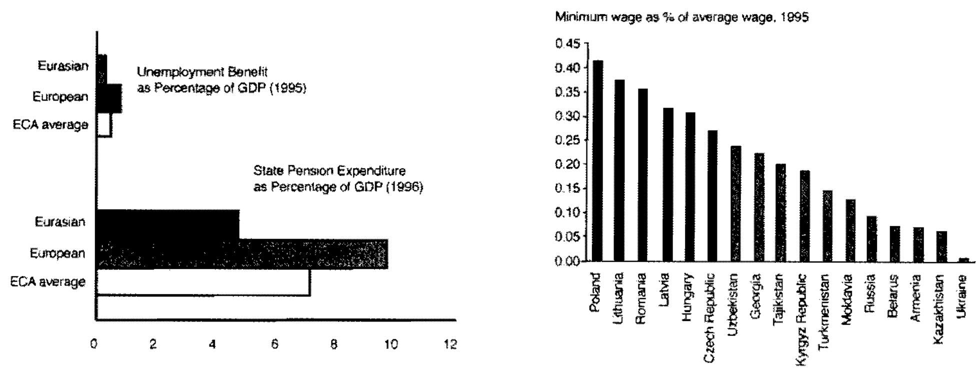

Fig. 6.2. Social protection systems also differ. Data from World Bank 2000, 3.

ropean countries as potential members, but also on their similarity to current EU members in culture, organization, and history and their expressed desire to become more "European," adhering 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.

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 post-Communist 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 why European ties and influence in all three domains may have 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 smaller first-wave countries, Estonia, Latvia, Lithuania, Slovakia, and Slovenia, and to a somewhat lesser degree to the second-wave countries, Romania, Bulgaria, and Croatia, that is, to most of the World Bank's "European" group, but particularly the leading countries among them.

In the economic sphere, the east-central European countries quickly carved out a privileged place in European trade and investment networks. 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. To a degree 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. Distinctive among the post-Communist countries, east-central Europe quickly and successfully integrated into the global economy (Kierzkowski 2000; Fidrmuc 2000; Eichengreen and Kohl 1998). In this, east-central Europe differed sharply from some of its neighbors to the south and east (compare Cook, this volume).

Like the rest of the post-Communist world, 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 Gros (1997) estimate that trade collapsed to 87 percent of the pretransition level in Hungary, and to a lesser extent in Poland. Remarkably, east-central European countries quickly reoriented their trade toward 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 1996 (Kierzkowski 2000, 15). Germany quickly became the largest trading partner for all of 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's (ibid., 18).

In addition to successful redirection of trade toward 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 1996 (Fidrmuc 2000, 87). However, Poland and Romania, whose economies have been fed more by low-cost production, are expected to swiftly move up the production chain in the coming years. Brenton and Gros (1997) conclude that "the more advanced countries in Central and Eastern Europe are 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 EU (Fidrmuc 2000, 91). In line with the "compensation hypothesis" of welfare state development, we suggest that successful trade integration in east-central Europe will support and enable continued high levels of social spending, as in other European countries.

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 foreign direct investment (FDI) per capita that approach developed-country levels (Kierzkowski 2000, 20). The largest trade partners tend to be the largest investors, with Germany, the United States, and the Netherlands leading the way in FDI (Hunya 2000, 91). Such investment in east-central Europe appears to be fully compatible with high social expenditures since it is premised on European Union membership. Indeed, there is no evidence that among the post-Communist 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 have helped, as have 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, enabling interest groups to lobby more effectively for a continuation of high levels of welfare provision. Garrett and Nickerson (this volume) argue that democracy mediates the relation between globalization and state spending. European Union membership prospects may also constrain political parties' views of the range of possible policy options. For instance, anticipating EU membership, political parties on the right and left in central and Eastern Europe have felt compelled to commit to European norms and levels of social expenditure (Cook, Orenstein, and Rueschemeyer 1999). The advent of membership negotiations in the mid-1990s reminded east-central European officials that Europe feared mass immigration from the East. East-central European countries that aspired to EU membership would have to maintain social provisions on a European level, to avoid "social dumping." 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 differences among the post-Communist states (for example, Cameron 2001; Kopstein and Reilly 2000, 10). 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 (see also Kapstein and Milanovic 2003, 52).

In short, while the countries of the former Soviet Union provide evidence for the "efficiency" hypothesis that globalization forces countries to scale back welfare state spending, the experience of east-central Europe argues for the opposite "compensation" hypothesis, that greater economic integration provides both the economic basis and need for high welfare state spending (Cameron 1978; Glatzer and Rueschemeyer, introduction; Frye 2003). 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, parliamentary democracy, and trade openness together facilitated the adoption of like policies in the accession states.

Welfare State Choices within East-Central Europe

So far, we have discussed general trends in welfare state spending across the post-Communist region and argued that EU accession countries have been distinguished from their Eurasian counterparts by 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 post-Communist transition overtaxed 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 domestic and foreign sources. 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 (Kapstein and Milanovic 2003, 47). We argue that this relative neglect left domestic policy elites reasonably 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 particular 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 post-Communist 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 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 post-Communist welfare states.

Major Policy Developments

A general picture of how social policy evolved in Hungary, Poland, and the Czech Republic after 1989 is shown in table 6.1. These countries followed broadly similar patterns of social policy transformation in a time sequence that generally 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 transition (Blanchard et al. 1991). Later, post-Communist 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 twelve or even eighteen months at fairly generous levels, but were later cut to six months and reduced in size (Godfrey and Richards 1997, various chapters). Poland, for instance, began to offer a flat-rate unemployment benefit of 36 percent of average wage starting in 1992. Eligibility rules were also restricted. Minimum wage regulations were introduced or reintroduced in all countries at the start of transition, but provided only a low level of protection for low-income workers (Standing and Vaughan-Whitehead 1995).

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 Milanovic (1999) 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 was unimportant to households and only a

Table 6.1 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%) 1994 (10.8%) 1998 (8.0%)	1994 (7.8%) 1998 (7.2%)	1989 (3.0%) 1994 (4.5%)
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%) 1994 (10.8%)	1989 (8.3%) 1994 (8.4%) 1998 (9.1%)	1989 (6.7%) 1994 (15.8%)
Summary Indicators			
Payroll tax levels	1995 (60%) 1999 (53.8%)	1996 (49.4%) 1999 (47.5%)	1996 (48%)
Total social expenditures (% GDP)	1995 (28.6%)	1994 (21.3%)	1995 (26.7%)

small percentage received benefits in any case (Milanovic 1999, 136).

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 Europe (UNICEF 1994), 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 study, but probably fell closer to the Hungarian model.

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 Bank (compare World Bank 1995d; Barr 1994, 192). In fact the Braithwaite, Grootaert, and Milanovic study (1999) 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-wing government. Therefore, in social assistance, major structural variation among the three countries in the initial 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 Ringold (1999, 34) shows that countries that established such a payroll tax spent significantly more on health than countries that did not. The 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. In 1994, Poland spent 15.8 percent 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 percent, compared to 46.8 percent in the Czech Republic or 56.9 percent in Hungary in 1994.

Poland's more rapid increase in pension expenditure has concerned policy makers and analysts alike. Several authors (Cain and Surdej 1999; Kapstein and Milanovic 2000) have tried to explain why Poland's pension system expanded so rapidly, 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 gradually started to 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 funds (Müller 1999; Orenstein 2000). Differences in the methods and timing of change, however, had major impacts on pension spending, creating significant long-term path dependencies for reform.

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 to reduce universality starting in 1995–1996. While clear trends are visible, so are major differences among 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.

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 have varied 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. Openness to trade also does not explain differences in spending levels among these three countries. Hungary and the Czech Republic are the most advanced and successfully integrated, as well as the smallest, most open economies in this set. Poland stands out by being four times larger in population, therefore less exposed to trade than its smaller neighbors, and poorer and less advanced economically. By any version of the compensation thesis (compare Cameron 1978), 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 spending (Hagemejer 1999).

Various political economy explanations for Poland's rapid increase in social spending all come up short (Cain and Surdej 1999; Kapstein and Milanovic 2000). Cain and Surdej use a 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 Milanovic 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 constituencies (Orenstein 2001).

Another surprising point about post-Communist social policy is that many developments do not seem to be closely related to party ideology. While previous work (Cook, Orenstein, and Rueschemeyer 1999) 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 transition (Lipsmeyer 2000), 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 what follows, we propose to explain this variation among countries' social transformation paths 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 confronted (compare Cohen, March, and Olsen 1972). However, policy thinking and advice received differed in each country, often idiosyncratically, explaining a large part of the seemingly unsystematic differentiation in countries on more or less equivalent paths toward Europe.

The Domestic Politics of Decision Making

At the national level, transition social policy was set by small groups of politically connected social policy experts (Jenkins 1999). 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 that 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 powerful (Balcerowicz 1995; Kolodko 1999). Therefore, it is important to examine the terms of their ideological discourse. Broadly speaking, there were three main trends in post-Communist thinking on social policy that correspond fairly well with Esping-Andersen's (1990) 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 Europe (Deacon 1997; Szacki 1995). However, the influence of liberal ideas in the social policy area was muted by the fact that neoliberal thinkers' emphasis lay elsewhere. Post-Communist economic programs emphasized price and trade liberalization, privatization, and stabilization (Blanchard et al. 1991). Neoliberals often left social policy matters in the early years to experts who came from other ideological camps (Orenstein 2001). The primary one, of course, was the broadly socialist or social democratic camp. East-central European social policy experts generally disagreed with neoliberal principles (Nelson 2001; Müller 1999) 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 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 family in state social support (Kulczycki 1995).

Since the political backing (by the Communist Party and trade unions) for socialist welfare states 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 transition (Balcerowicz 1995). 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 post-Communist 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.

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 years (Deacon 1997; Ringold 1999; Kapstein and Milanovic 2000). The transition years can be divided into two periods of international attention to social policy transformation: a first period from 1989 to 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 agenda (Sachs 1995; World Bank 1996c). 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 toward 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 post-Communist states. Setting up unemployment systems was the only area of priority concern (Blanchard et al. 1991), but otherwise neoliberal policy makers 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 change (Sachs 1995; Cook and Orenstein 1999). Second was a widespread recognition that poverty had increased dramatically in central and Eastern Europe during the early transition years. Early on, prominent economists disputed this fact (Sachs 1995), 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 poverty (Milanovic 1998; Gomulka 1998), 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 priority (Sachs 1995). Fourth, major international organizations, particularly the World Bank, shifted their global policy priorities toward issues of poverty, which had not been a primary focus before (World Bank 2000). 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 post-Communist countries took off in 1996, rising from around five hundred million dollars to two billion dollars in just two years, as shown in figure 6.3 (World Bank 2000).

Increased global attention had a material effect on post-Communist welfare state transformation, for it led to the development of a more consistent global agenda, and placed greater homogenizing pressures on east-central European welfare states. This emerging global social policy for the region (Deacon 1997) 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 re-

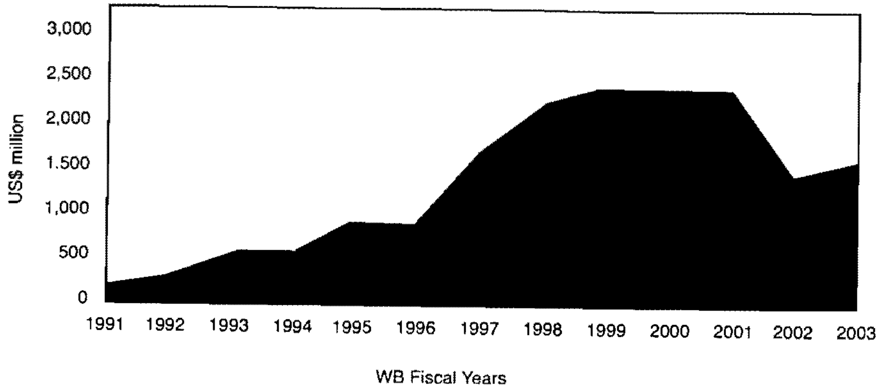

Fig. 6.3. Social protection World Bank Europe/Central Asia lending portfolio

views 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 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 implemented radical pension reforms in 1998–1999. Both of these events, and others, show the strong agenda-setting influence of the World Bank (Müller 1999; Orenstein 2000).

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 to 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.

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 percent to 15.8 percent 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 1996 (Cain and Surdej 1999, 150).

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 unemployment (ibid. 1999, 167); this was not well thought out. Polish policy makers 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 1.75 (ibid. 1999, 150). 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 period (World Bank 2000, 75). Although all the post-Communist 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 Surdej (1999) point to the transitional policies of Solidarity governments between 1989 and 1993. The first Polish reform governments, under finance minister Leszek Balcerowicz and labor minister Jacek Kuron, 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 toward 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 Kuron, the fiscal laxity of his pension 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 make 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 Kuron 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 extended 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 years (Kuron 1991). 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 overload (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 policy making in the overall transition program. Therefore, officials like Kuron 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 sent its own experts to help establish a pension reform team within the Polish government. 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 term (Müller 1999; Orenstein 2000). This reform was conducted with extensive World Bank involvement, financing, and advice, and implemented key elements of a "new pension orthodoxy" (Müller 1999) 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.

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 transformation (Orenstein 2001). 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 policy makers were left to their own devices. Therefore, as in Poland, small groups of domestic policy makers 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 Tomes, 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 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 percent in 1989 to 52 percent in 1992 and 44 percent in 1994. The neoliberal government of Prime Minister Vaclav Klaus also passed legislation gradually increasing the pension age (Müller 1999, 136–37).

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 policy makers located mainly in Czech and Polish Ministries of Labor between 1989 and 1992. International influence on these decisions was very limited, as was the influence of top neoliberal policy makers in government at the time. As a low-priority area, social policy reform was delegated in both countries to the Ministry of Labor (and Ministries of 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 1993 (Orenstein 2001).

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 1995 (Müller 1999). Although 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 accounts (Jelinek and Schneider 1999).

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 1980s (Müller 1999), 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's, 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 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 1994 (Cook and Orenstein 1999).

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 Poland (Müller 1999; Orenstein 2000). 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.

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 figs. 6.1 and 6.2). Broadly speaking, east-central European countries' trend toward 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 transitions (Orenstein 2001). It was a choice that demanded a great deal of the prospective member countries, including placement of certain parameters on 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 executive positions during the early transition years. Overwhelmed by numerous problems of transition, the domestic politics of decision making was 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 in order 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 post-Communist 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.