Chapter 8

EU Integration and Post-communist Welfare: Catch-up Convergence before and after the Economic Crisis

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Introduction

As 2009 marks the 20th anniversary of the fall of the communist regime, as well as the fifth year of EU membership for eight post-communist countries, a range of new questions arises about the transformation of post-communist welfare states in terms of the impact of the EU, and patterns of both economic and social convergence. Have the new EU member states showed any catch-up with EU15 in terms of their welfare efforts and performances? Can we detect, and if so, how, the impact of the EU in welfare developments in the last ten years? And how has the developments of the last ten years been influenced by the current economic crisis?

This chapter pursues three main arguments. Firstly, along with Dyson (2007), it will be argued that rather than talking about overall convergence, and a single eastern European world of Europeanization, analytically it is more fruitful to conceptualize Europeanization as clustered convergence highlighting the many worlds of post-communist welfare capitalisms that have emerged in the region in the last 20 years. Secondly, the chapter argues that eastern Europe has not followed the patterns of the Cohesion countries, where EU Accession had been accompanied by welfare expansion and large scale social investments. Instead, fast economic convergence in the last 10 years has been coupled with social divergence in which the distance between 'Old' and 'New' Europe in many respects has increased rather than decreased. This, as it will be argued, sheds light on issues such as policy learning, the role of domestic politics, and the dynamics of the economic and social agenda of the EU. Finally, the chapter will locate the convergence debate within the context of the current economic crisis. As it is already clear that this economic crisis hit eastern Europe particularly hard, and in many countries has wiped out ten years of employment gain and considerably increased the demands upon the welfare state, the chapter will argue that this external shock will necessarily impact on particular Europeanization paths of the new EU member states, and depending on domestic developments and the role the EU, the economic crisis could initiate new possible pathways for socio-economic models in post-communist Europe. This will no doubt lead to new forms of convergence and divergence in the region.

Some Notes on the Concept of 'Convergence' and 'Catch-up'

When in 2004 ten new countries joined the EU, scholarly debates intensified in terms of future scenarios for both the prospect of 'Social Europe' in an enlarged European Union, as well as prospects of Europeanization and 'catch-up modernization', versus 'Latin-Americanization' of new post-communist welfare states.

Expectations and possible scenarios for the Eastern Enlargement in 2004 have been marked by two competing narratives, emanating from two different sets of literatures. On the one hand, previous Enlargements of Southern European countries in the 1980s have given rise to a literature, which emphasized the important role of EU integration in welfare expansion, and 'catch-up modernization' of welfare systems in countries like Greece, Spain and Portugal. Guillen and Matsaganis (2000) asserts that 20 years after EU Accession, Greece and Spain has seen a remarkable convergence of their social protection systems, with increased welfare spending, universalization of health care, investment in social services, and increased active labour market spending. Importantly, they argue that this expansionary drive has taken place in a context in which there has been a widespread political support for welfare state development in the name of 'catch-up with Europe', and within this political discourse social spending has not been linked to economic competitiveness. This scenario has foreshadowed a possible scenario, in which economic convergence is followed by social convergence, in which welfare expansion is discursively linked to a 'return to Europe' and participation in 'Social Europe'. Indeed, many similarities between Southern Europe and Eastern Europe, such as post-authoritarian legacies and low welfare spending, made this comparison quite plausible.

The other narrative that offered a possible scenario for the post-enlargement era has been the so-called race-to-bottom scenarios, which have argued that the New Eastern European member states could drive social standards down, engage in a tax competition, and 'outliberalise' 'Old Europe' both in economic and social terms. Importantly, both narratives implicitly assume that the world of post-communist Europe is a single one, with particular regime characteristics that are similar across countries. Similarly, the welfare state literature that emerged on the transformation of welfare in Post-communist Europe, although contributing greatly to an understanding of the transformation process, left behind the illusion that there is such a thing as a single post-communist welfare state, a uniform regime, which combines different Western European welfare elements, yet is dominated by similar communist legacies and institutional patterns (Hacker 2009). However, a range of institutionalist and capitalist diversity literature has increasingly unfolded the subtle differences in socio-economic trajectories followed by different post-communist countries (Bohle and Greskovits 2007, Bruszt and Greskovits 2009, Drahokoupil, 2008).

Theoretically this chapter is located at the capitalist diversity literature, with three main lines of arguments. Firstly, the chapter argues that post-communist welfare is a highly plural and diverse institutional architecture. Secondly, the chapter sees Europeanization as fundamentally and predominantly a bottom-up process, in which the focus is directed towards the domestic rather than the supranational. Finally, this diversity lens also expects to find divergence rather than convergence when we are talking about the European integration project.

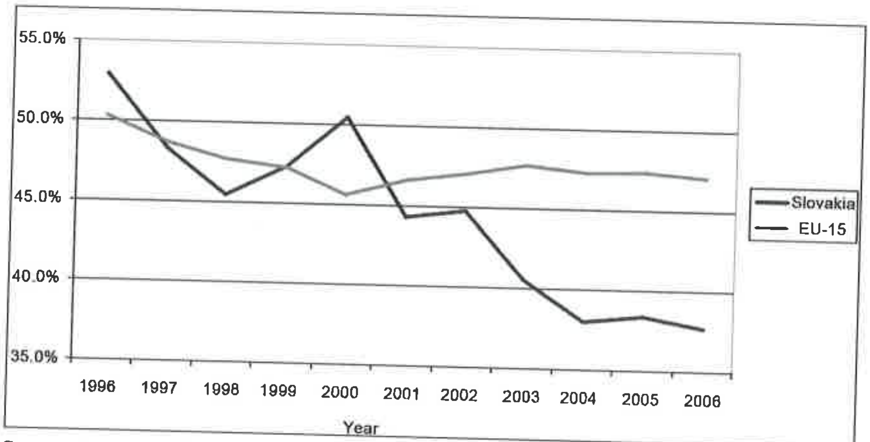
Welfare Regimes and Clustered Europeanization in Post-communist Europe

Primarily considering welfare state efforts, performances and outcome indicators, this chapter clusters post-communist welfare states into three main groups: the 'neoliberal welfare states' in the Baltic States and Slovakia; what I call the 'dual regimes' of Hungary and Poland; and the 'social corporativist' regimes in Slovenia and the Czech Republic. Importantly I see these clusters not as static, locked in, but rather as dynamic clusterings, in which countries can and have moved from one regime type to another. Having said that, regimes are characterized by distinct sets of economic and social policies, institutional patterns and discursive formations with regards to welfare spending, redistribution, inequalities and poverty, which implies very distinct social trajectories.

Neoliberal Regimes: the Baltic States and Slovakia

In the last 15 years Estonia, Latvia, Lithuania, and later Slovakia, the four fast-growing small states, have opted for radical economic reforms resulting in minimal states, low welfare spending, low taxes, strongly deregulated labour markets and widespread liberalization. Estonia and Slovakia have the highest trade openness in the region (with 176 per cent and 170 per cent of GDP in 2006, while the same figure in the euro area was 80 per cent) (von Hagen and Siedschlag 2008). Despite the geographic proximity and the influence of the Nordic countries, the Baltic States have opted for radical neoliberal economic reforms already in the mid 1990s, soon after their independence. In a complex neoliberal economic package Estonia was the first in Europe to introduce flat tax rate at 26 per cent in 1994. Soon after, Lithuania and Latvia followed the trend and lowered their tax rates, particularly their corporate taxes. Currently Latvia has the lowest corporate tax rate in the EU at 15 per cent. Since the mid 1990s the tax rates have gradually been lowered in all Baltic countries. In 2004, Slovakia has joined the Baltic groups by introducing a flat tax rate at 19 per cent and alongside introduced one of the most radical economic and social reforms that the region has seen. This particular tax regime resulted in a record low tax-revenue-to-GDP ratio in the EU27 – while on average countries collected 41.2 per cent of their GDP in tax revenues in 2006 in the EU27, the same ratio in Slovakia was 29.5 per cent, Lithuania 30 per cent, Latvia 30.4 per cent, and Estonia 31.1 per cent (Eurostat 2008).

The four countries in this group have also opted for small governments – in 2004 they spent around 36–38 per cent of their GDP through government (Schneider and Zapal 2006). Importantly, in the period between 1998 and 2004, in the process of European Accession, government expenditure has fallen in all of the four countries. Indeed, in a path-breaking development, Slovakia has produced one of the most spectacular government shrinkage in history (Schneider and Zapal 2006) with the government expenditure falling from 65 per cent of GDP in 1997 to 37 per cent of GDP in 2006 (Figure 8.1).



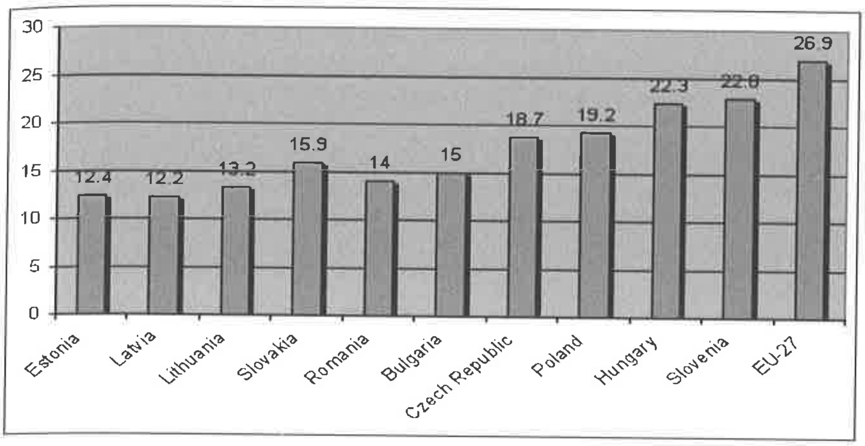
Source: Eurostat, New Cronos Database

Figure 8.1 The fall of government expenditures in Slovakia

Estonia in particular has been described as a prime example of an implementer of radical economic reforms. In the Variety of Capitalism (VoC) literature Estonia has often been used to represent the Liberal Market Economy (LME) model. In this theoretical framework, the LME in Estonia has been characterized by low union membership, weak collective bargaining, shorter job tenure, and very high stock market capitalization with the predominance of short-term capital (Feldmann 2007).

Low tax-revenue-to-GDP ratio and small governments fundamentally determine the room left for welfare spending. The welfare efforts measured in social protection expenditure as percentage of GDP are extremely low in the four countries, far the lowest in the EU27 (Figure 8.2).

The European Commission in its Joint Report on Social Protection and Social Inclusion (2007) made it clear that those countries have 'huge social inclusion needs'. Low minimum wages, high tax burden on low wage earners, high private health care costs, and the high share of working poor means that 'growth and jobs' has not been able to create an 'inclusionary' developmental path in those countries. The social problems facing these countries are numerous. Despite fast economic growth, relative poverty rates between 2000 and 2007 have increased in the Baltic states. The Joint Social Protection Report also highlights a range of social issues, such as high poverty rates, strong inequalities, high in-work poverty, low replacement rate of pensions, poor targeting performance of social benefits,



Source: Eurostat (2009)

Figure 8.2 Social protection expenditure as % of GDP in 2006

and under-funded health care and social services (Joint Social Protection Report 2007). The Baltic states are also at the bottom of the EU league table in terms of total health care expenditure, and the share of out-of-pocket payments as a share of total health care expenditure, which makes health care institutions under-funded, and inaccessible for those in need (JSPR 2010). The Baltic states also have the lowest life expectancy in the EU27. The wealth of new data in the field of poverty and social exclusion reveals that the Baltic states are performing very poorly in terms of composite indicators of child well-being, suffer from very high old-age poverty, high income inequalities, and high level of housing deprivation, and has the largest prison population in the EU27 (Eurostat 2010).

To sum up, neoliberalization as a distinct pattern in these countries represents a regime in which radical economic reforms are coupled with minimal social commitments and poor welfare performances. In this group Europeanization is fundamentally framed by an economic agenda aiming for competitiveness and a race to attract FDI, leaving the welfare state underdeveloped, at the expense of high social costs. As we will see later, this particular set up will make the Baltic states highly vulnerable at the time of the economic crisis.

'Dual' Regimes: The Case of Poland and Hungary

In trying to map the region, Bohle and Greskovits (2007) characterize the Visegradi countries (Poland, the Czech Republic, Slovakia and Hungary) (V4), from the point of view of industrial relations, as an embedded neoliberal regime, where

> selective and limited inclusion parallels, and occurs at the expense of and exclusion of the remaining social actors by disarticulating and neutralizing their

> capacity for collective action …. (and) … this dual logic is complemented by an unequal distribution of resources, where benefits are only extended to allied sectors of business and labour. (Bohle and Greskovits 2007:454)

As I have argued above, in many regards Slovakia has left the V4, with a radical withdrawal of the state from welfare commitments, from 2004 onwards. In the section below I will also argue that the Czech Republic also represents a diverging case. What left is Poland and Hungary, and the story of dual, and in many ways, incongruous welfare regime formation.

Importantly, unlike the previous group, both Poland and Hungary finances 'big governments', and spends 42.4 per cent and 50.1 per cent of GDP through their governments. In order to join the race in the regional tax competition, both Poland and Hungary has significantly reduced their corporate taxes to 19 per cent and 16 per cent, while their personal taxes are very similar to the EU25 standing at 38 per cent and 40 per cent. However, there is a range of generous tax concessions available to foreign investors. 'Big governments' in both countries come with serious fiscal policy imbalances and challenges. In July 2004 both countries came under the Excessive Deficit Procedure (EDP), which although later has been loosened, it signalled the serious challenges that the two countries have faced in terms of consolidating their public finances. According to Schneider and Zapal (2006) fiscal consolidation efforts in these countries in the 1990s and 2000s have been unsuccessful. Similarly, taking a close look at the Hungarian situation, Gyorffy (2007) argues that instead of anticipated fiscal adjustment in line with the efforts of joining the Euro, Hungarian fiscal policy in fact has continued to be expansionary, and led to the raise of fiscal indebtedness of the country in recent years. This moral hazard, as she argues, resulted in a completely counterintuitive effect of EU integration: namely higher and not lower public debt. In both cases, the high political volatility of fiscal policy goes hand in hand with the declared aim of joining the Euro. As Dyson (2007:433–4) explains

> The Visegradi states face a second inducement to lengthen the timetable for euro entry from the high level of welfare 'stress' that they face. They have inherited large welfare states, face substantial social risks of vulnerable groups falling into poverty, have made substantial use of disability benefits and early retirement schemes to mask unemployment, and have relatively low spending on active labour market measures. Consequently social policy commitments, especially in pensions, and pressures for more spending on active labour market policies to increase levels of social spending. Welfare 'stress' increases incentives to lengthen the timetable for euro entry in order to avoid short-term painful (and politically costly) cuts to social benefits and to address the mounting social and regional disparities. The level of welfare stress rises, and incentives to defer entry increase, the higher are the ratios of public debt and deficits to GDP and hence the more circumscribed the room for manoeuvre to tackle welfare state problems.

The duality of pressures and institutional responses to competing socio-political and socio-economic issues have also been emphasized by Mykhnenko (2007). He argues that Poland has developed a very incongruous capitalist system, which can be characterized by heavily regulated product markets, a large public sector, administrative burden for corporations, barriers to entrepreneurship and a high protection against foreign trade and investment, *at the same time* Poland has a deregulated labour market, significant FDI, and weak state involvement in industrial relations and labour policies. In that sense both strong protectionism as well high level of openness of the Polish economy co-exists. Shields (2007) sees the Polish incongruities in terms of competing political agendas between neoliberalism and neopopulism.

These competing pressures have created somewhat different responses in the two countries. The Polish welfare state has been contracting in size between 2000 and 2006. Welfare retrenchment has taken place in the context of already very high poverty rates, raising inequalities, stagnant labour market and jobless growth (despite significant economic growth, employment rate has fallen between 1998 and 2007, from a low 59 per cent to an even lower rate of 57 per cent). Although the unemployment rate has fallen it was still one of the highest in the EU standing at 10 per cent in 2007. The rate of working poor is also the highest in the EU. Health care institutions are heavily indebted, while they still work with long waiting lists (Joint Inclusion Report, 2007). There is a total absence of an active employment policy, while passive labour market policies are weak (Myshknenko 2007). As Myshknenko argues 'given the chronically high levels of unemployment in Poland and contracting level of public social spending, Poland's conservative continental welfare state has been unable to provide an adequate amount of social protection and poverty alleviation' (Myshknenko 2007:374).

In Hungary the welfare state has actually seen a slight expansion between 1998 and 2007. However, similar structural problems to Poland prevail, such as a stagnant labour market, low employment rate, high material deprivation and high income and consumption based inequalities. Both the Polish and Hungarian welfare states are also very much oriented towards pensioners, which makes them 'pensioner states' as Rhodes and Keune (2006) put it, as they spend disproportionate amount of social expenditures on pensions resulting in high replacement ratios and in record low old age poverty, but very high child poverty. Poland and Hungary also have two of the lowest average ages for withdrawal from the labour market in the EU (Bukowski et al. 2008), not least because early retirement schemes are widely available.

The common features of this particular pattern of Europeanization are that the 'social' remains fragmented, volatile and subject to economic policies or politically motivated interventions. In this two countries welfare policies are locked in between strong neoliberal and neopopulist political agenda that create a stop-and-go attitude to welfare reforms and more broadly to regime formation.

The Czech Republic and Slovenia: A Social Corporativist Regime

The Czech Republic and Slovenia in many respects are the 'Scandinavian islands' of post-communist Europe. Both countries have inherited very favourable economic situations within the Communist Bloc. Both Slovenia and the Czech Republic manage 'big governments', with the highest social spending in the region, and high efficiency of redistribution towards vulnerable groups. Slovenia devotes almost 23 per cent of its GDP to social protection, which represents the highest welfare commitment in the region. The Czech Republic is more modest in its share of social protection expenditures as a percentage of GDP with almost 19 per cent, but due to relatively high GDP per capita, this share of social protection expressed in PPS is similar to Hungary's 22.3 per cent social expenditures. In both countries the welfare state is strongly built on corporativist principles. In the Czech Republic 80 per cent, while in Slovenia almost 70 per cent of social expenditures are funded by social contributions, which is significantly higher than the EU27 average of 59 per cent in 2006. High share of social contributions are supported by high employment rates in both countries. Importantly, these two countries have the lowest poverty rates not only among the New member states, but also in the whole of the EU. Relative poverty rate is one of the social indicators, which places the two countries at the top of EU's 'social league tables'.

The Czech and the Slovene welfare state are founded on strong political and popular consensus, which results in coherent public policy supporting an inclusionary capitalist regime. Vecernik (2008) argues that in the Czech Republic social protection was always highly valued and wasn't questioned in any fundamental way. Similarly, Potucek (2007:139) argues that '(b)y and large, the European social model (ESM) … and the Czech social model … are fully compatible in terms of history, culture, institutional frameworks, attitudes of the population and political legitimacy'. In Slovenia, too, the welfare state developed in a balanced fashion in the 1990s where the economic, political and social considerations produced and maintained a strongly redistributive welfare state. The system has to a large degree remained generous, particularly in comparison with those in other Central Eastern European (CEE) countries (Stanovnik 2004).

The balanced socio-economic development in these two countries has been able to maintain a very favourable social situation. Both poverty rates as well as social inequalities are lower than in the EU27 thanks to generous welfare provisions and effective redistribute mechanisms. Europeanization in the two countries is also associated with some positive developments. In the Czech Republic for example policy efforts to integrate Roma communities have been positively acknowledged by the EU; in Slovenia, life-long learning figures have improved spectacularly in the last few years.

Economic versus Social Convergence: Expectations and Realities

What the previous section has demonstrated is not only that there is no such a thing as a single post-communist welfare state, but also that NMSs are scattered both at the top and at the bottom of the 'social league table' of the EU27 along various different social and welfare indicators. In this context, we need to be very careful with aggregate indicators measuring processes of convergence and catch-up, and have to look at the differential patterns across countries for each of the various indicators. It is also important to critically scrutinize the available indicators to see what exactly they are measuring and how confident we can be that those indicators capture crucial processes in welfare state development and their societal impacts.

The Eastern Enlargement very much came with the expectation of fast catch-up mostly defined in economic terms. The European Commission (2009) in its Report on the economic lessons of Enlargement argued that the catch-up of New member states has been impressive: it is estimated that the Accession has given an extra growth boost of 1.75 per cent to the economies of the new member states, which contributed to the super fast economic growth between 2000 and 2008. While GDP growth in new member states was 3.4 per cent before accession between 1999 and 2003, it accelerated even more after accession reaching 5.6 per cent between 2004 and 2008, at the time when the same figures for old member states stood steadily at 2.2 per cent throughout the same period. As the Report asserted 'the stronger growth performance enabled the new member states to catch-up in terms of GDP per capita from some 40 per cent of the EU15 average five years before enlargement to 52 per cent in 2008' (European Commission 2009b:11) (Table 8.1).

Table 8.1 GPD per capita in PPS in new member states 2000–2008

	EU27	Czech Republic	Estonia	Latvia	Lithuania	Hungary	Poland	Slovenia
2000	100,0	68.5	44.6	36.7	39.3	56.1	48.2	79.8
2005	100,0	75.9	61.1	48.6	52.9	63.2	51.3	87.4
2006	100,0	77.4	65.3	52.6	55.5	63.6	52.3	87.7
2007	100,0	80.2	68.0	54.7	59.5	62.6	53.4	89.3
2008	100,0	80.6	64.8	52.6	59.9	61.5	54.3	89.3

Source: European Commission's Joint Report on Social Protection and Social Inclusion, 2009. Data not available for Slovakia in the Report.

Rapid trade integration and restructuring of the economy helped new EU member states to modernize their economy and was argued to lay grounds for 'swift economic catching-up' (European Commission 2009b:20).

Employment Convergence

For social convergence, a key question is how fast economic growth translates into job creation, increasing employment rate and falling unemployment. Seemingly the NMS have managed to capitalize on economic growth; unemployment rates have strongly converged towards the EU15 between 2000 and 2007. In 2000 the average unemployment rate was 3 percentage point higher in the NMS, compared to the EU15, but by 2007 the figures equalized and stood at the same, around 7 per cent (Funk 2009). However, unemployment data is highly unreliable for a number of reasons: migration flows, low levels of unemployment benefits and low take-up of those benefits, as well as the high share of the informal sector means that often there is little incentive to register. Employment rates tell us a lot more about the actual labour market situation in the region. The trends in employment rates have shown a great variation over time. Between 1998 and 2000, when the annual employment growth rate in the EU15 was around 2 per cent, almost all Eastern European countries had negative employment growth rates. In particular the Baltic states, Slovakia, Poland and the Czech Republic have been hit hard; employment rate has contracted by 7.8 per cent in Estonia, 7 per cent in Lithuania, 5.1 per cent in the Czech Republic, 4.9 per cent in Slovakia and 4 per cent in Latvia. The period of 2000–2006 has seen a speedy recovery and pick up of employment rates for some NMS such as Estonia, Latvia, Lithuania and Slovenia (Table 8.2).

Table 8.2 Employment rates 1998–2006 (%)

	Estonia	**Lithuania**	**Czech Republic**	**Latvia**	**Slovakia**	**Hungary**	**Poland**	**Slovenia**	**EU 15**
1998–2000	–7.8	–7.0	–5.1	–4.0	–4.9	+6.5	-4.3	+2.0	+5.8
2000–2006	+8.8	+4.5	+0.3	+8.8	+2.6	+1.0	-0.5	+3.8	+2.6

Source: Employment in Europe 2007 and Eurostat.

However, this meant that overall the employment gap between the EU15 and EU8 has increased from 2 per cent in 1998 to 3.4 per cent by 2006, which represents a serious hindrance to reaching the Lisbon target by 2010. Indeed, the Joint Employment Report 2005–2006 classified 5 NMS as low progress countries in terms of employment. However, these overall figures hide huge intra-regional differences. While Slovenia, the Czech Republic, Estonia and Latvia had an employment rate that exceeded the average of the EU27 by 2006, Poland, Hungary and Slovakia had a particularly low and sluggish employment rate, all below 60 per cent. These poor employment rates are associated with deep structural problems in the labour market, and poor labour market policies in all the three countries. Three important trends are worth noting here. Firstly, as Anspal and Vork (2007) find, despite persistent structural problems in the majority of the NMS, both passive and active labour market spending has declined between 1996 and 2004, which throws NMSs very far apart from both the old member states as well as from the 'flexicurity' agenda of the European Union. Secondly, data on adult participation in lifelong learning also suggest that the gap between the EU15 and the EU8 has widened between 2002 and 2006. In some countries, such as Latvia and Slovakia, participation rate in fact has fallen in a time period when the participation rate has increased significantly in the EU15 (Industrial Relations in Europe 2008). Slovakia is also the lowest spender on education in the EU, despite having the single largest unemployment rate for people with primary education. Thirdly, employment is particularly important as labour market participation strongly structures life chances in the NMSs. On the one hand, there are major gaps in the welfare system in terms of accessing benefits during unemployment. The Social Situation in the European Union 2008 reports that in the Baltic states two/third of those unemployed for more than six months receive no social benefits at all during the year; the same figure is 60 per cent in Poland. Unemployment benefits are a lot less generous in their duration than in the EU15 countries and the actual amount is very low in some countries. Indeed, in the NMS 41.6 per cent of the unemployed were at risk of poverty in 2007, which is comparatively higher than in the EU15 (38.6 per cent) (Combating Poverty and Social Exclusion 2010). On the other hand, in-work poverty rate are well exceeding the EU27 average in Poland (12 per cent) and Latvia (10 per cent), and stands the same as the EU27 average at 8 per cent in Estonia and Lithuania.

Convergence also seems to be weak in terms of employment policies, as the EU came to embrace 'flexicurity' as a flagship concept in the last decade, there is little sign that NMS are committing themselves to it. As Cazes (2008) points out, up until the early 2000s Central and Eastern European countries have opted for a 'pure flexibility' approach in which liberalization of employment protection legislation has been combined with poor social protection and under-developed active labour market policies. Palpant (2006) argues that poor convergence in employment policies is partly due to the shortcomings of the European Employment Strategy (EES) itself, which failed to address concerns specific to NMS. She argues that the misfit between the guidelines and the labour market needs of the NMS meant that it was rarely possible to take on the common objectives at national level in the Eastern European member states.

Welfare Convergence

Welfare catch-up convergence could be measured at two levels. First, measured in terms of welfare efforts, i.e. social spending as a share of GDP, or expressed in PPS per capita, secondly, measured at a performance level looking at poverty rates, inequalities, welfare state efficiency, etc. Looking at the first, Draxler and Vliet (2010) finds that social expenditures (percentage of GDP) have shown divergence between the NMS and the EU15 between 2000 and 2006. While social expenditures increased in the Old member states by 1.43 percentage points, in the same period social spending has fallen in the NMS by 1.31 percentage points. Social protection expenditures also show differentiated patterns across NMSs. While in Hungary, the share of social spending has increased as a percentage of GDP between 1998 and 2006, it remained stagnant in Poland and the Czech Republic, and has fallen in some cases very significantly in the three Baltic states, Slovakia and Slovenia. However, a modest convergence can be observed if we look at social spending per capita in PPS (Table 8.3).

Table 8.3 Social protection expenditure per capita (PPS) 2001 and 2005

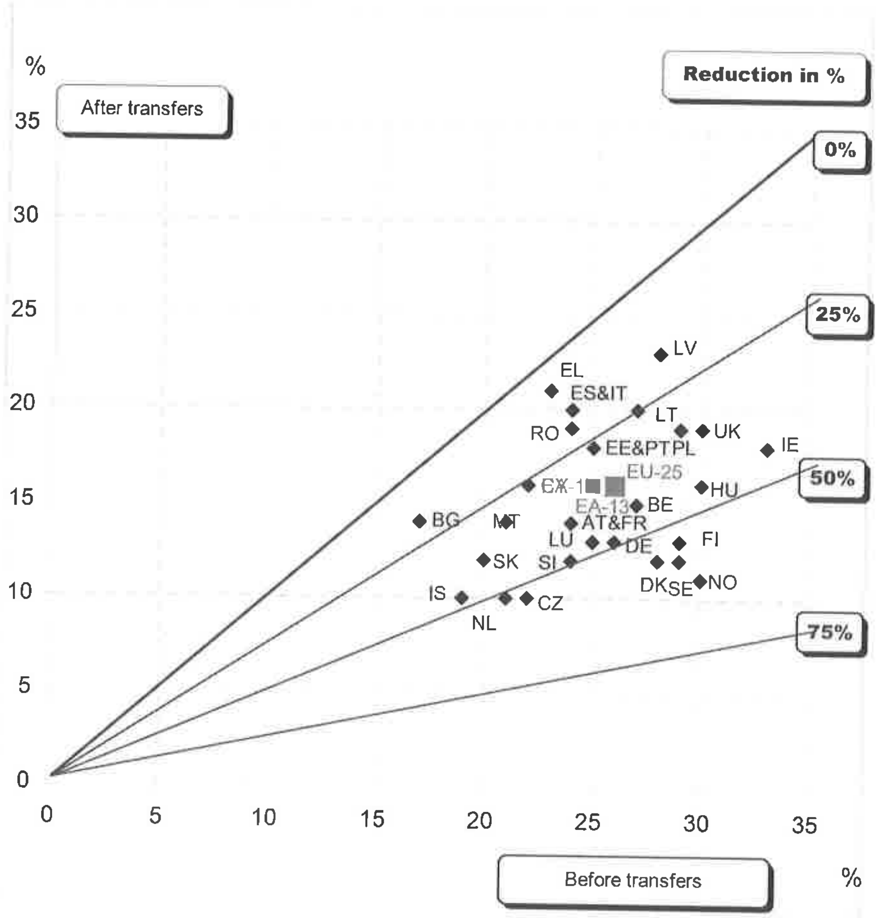
	EU25	Slovenia	Czech Republic	Hungary	Poland	Slovakia	Estonia	Lithuania	Latvia
2001	100	68	49	46	35	34	23	22	20
2005	100	71	52	50	35	35	27	25	22

Source: Eurostat, 2009.

Although public welfare spending in itself tells us little about actual welfare restructuring, generosity, coverage, and effectiveness, generally speaking, we know from the comparative welfare literature that there is a strong link between welfare efforts and welfare outcomes. Indeed, welfare states in high social spender countries such as Slovenia, Hungary and the Czech Republic are showing strong performance in terms of the capacity of the welfare state to reduce poverty. For example the Czech welfare state's performance in terms of poverty reduction is equivalent to the Scandinavian welfare states, which puts the Czech Republic at the top of EU27's league table with the lowest poverty rates. At the other end, the Baltic states show a significantly lower welfare capacity of poverty reduction (around 25 per cent) and are at the bottom of the social league table of the EU with the highest poverty rates (Figure 8.3).

Welfare spending is also in direct relation with levels of poverty. Importantly, relative income poverty has increased in the NMSs between 2003 and 2008. It has done so quite dramatically in Latvia and in Lithuania, and to a lesser extent in Estonia, Hungary, Slovenia and the Czech Republic. It stayed stagnant in Poland, and although it seems to have fallen in Slovakia, due to a break in the data series, it is difficult to assess the reliability of that particular figure (Figure 8.4).

For other measures of poverty and social exclusion we do not have sufficient data to establish trends in the last five to ten years. However, a range of other social

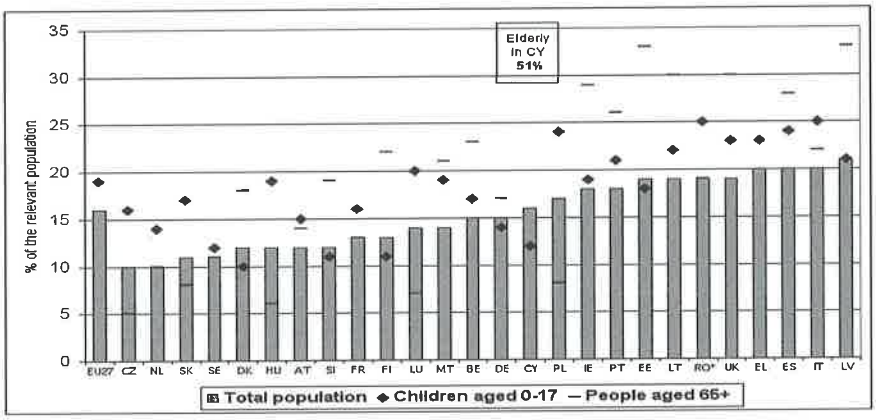


Source: The social situation in the European Union, 2009: 128.

Figure 8.3 Relative income poverty before and after social transfers – the effectiveness of the welfare states in the EU27

exclusion indicators suggest that poverty and social exclusion remains a major societal issue in the majority of the NMSs (Table 8.4).

Social inequalities have also increased in the majority of NMSs between 2000 and 2005. The Gini coefficient increased significantly in Hungary, Latvia and Lithuania, and slightly in Poland, and Slovenia. It stayed the same in the Czech Republic and improved somewhat in Estonia in the same period. Regional inequalities are also on the rise in the region with the argument that there is a widening dispersion of regional GDP per capita in all new member states since 1999. Indeed, as the European Commission in its Report on the economic lessons of enlargement has pointed out rapid economic growth was also associated with



Source: JRSP 2010.

Figure 8.4 At risk of poverty rate EU27 in 2007

Table 8.4 Poverty and social exclusion in the NMSs

	At risk of poverty rate 2008 (%)	Material deprivation rate 2008 (%)	Income below EUR5 per day 2005 (%)	Financial exclusion 2003 (%)
EU27	17	17	3	(EU15) 7
Czech Republic	9	16	1.7	17
Slovenia	12	17	0.4	6
Hungary	12	37	8.8	34
Poland	17	32	18.1	40
Slovakia	11	28	9.0	26
Estonia	19	12	10.9	16
Latvia	26	35	32.1	48
Lithuania	20	27	29.6	41

Sources: JRSP 2009, Lelkes 2007.

growing regional disparities in all new EU member states between 1995 and 2005, and the emergence of limited number of regional growth poles, which contrast to the growth patterns in the old member states in the same time period, which was more regionally balanced (European Commission, 2009b:50).

As Rhodes and Keune (2006) has argued the Lisbon agenda has focused primarily on the notion of 'active welfare states', with policies encouraging activation in the field of employment, social inclusion and ageing. Although the Europeanization of welfare literature has placed high expectations on the OMC and soft convergence in terms of policy learning and discursive Europeanization, there is little evidence that the activation agenda has actually been taken on board by the post-communist welfare states. Active ageing agenda has been hampered by the widespread use of early retirement schemes in countries like Poland and Hungary, and various other disability schemes across the whole region, but activation measures have also been weak in terms of coordination between employment, education and welfare policies. 'Active inclusion' also seems to be a scattered concept that is pursued primarily by Structural Fund projects (the only developmental engine in social policy in the region), but which does not seem to be channeled into policy making. Although there are some progresses in fields like fighting child poverty by offering more generous family benefits, some of the policies adopted in the NMSs reflect demographic concerns of drastically falling fertility rates, rather than being pursued within the EU's framework of fighting poverty and social exclusion.

To sum up, convergence in both welfare outcomes and welfare policies are rather weak and scattered. On the one hand, the Lisbon targets set for 2010 represented no challenge for the NMSs, in areas such as school drop-out rates, female employment, and educational attainment level, where some of the NMSs have already reached the target soon after they joined the EU in 2004. In other areas, however, as we have seen above, in areas such as total employment rate, R&D spending, and life-long learning, the gap has widened between the old and new member states. Indeed, the paradox is that on quantitative terms the so-called Speedometer 2007 showed that the Baltic states have produced one of the fastest progresses towards the Lisbon targets both in the region and in the EU25, but they have done so at a very high social cost.

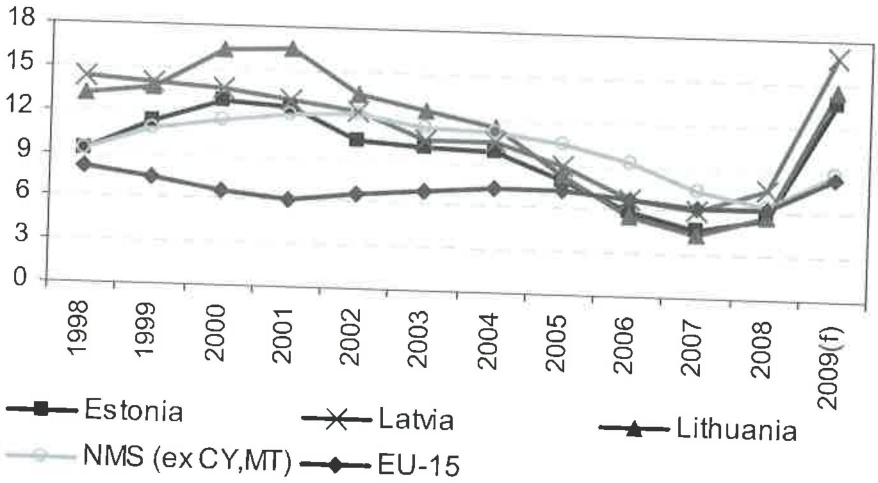
The Economic Crisis: The New Chapter in the Convergence Debate

The financial and economic crisis has hit the new member states particularly hard. Due to its dependency, as Offe (2009) puts it, 'when the west catches a cold, the east will begin to suffer from pheumonia'. According to Kattel (2010) the exposure of the Eastern European economies stems from three main sources: massive inflow of FDI oriented towards low value added activities with low domestic linkages, the transformation of the banking sector, which breaks ties with the domestic productive sector and is based on cross-border lending, and finally the hollowed out policy space in which R&D, industrial restructuring and labour market policies are weak. As a result, while Eastern European countries 'face a huge challenge in coping with the financial and economic crisis, most of these countries lack policy capacities to strategically devise response plans in order to launch structural reforms and in generating industrial, innovation and labour policies that would re-inforce catching-up processes' (Kattel 2010:13). Similar concerns have been formulated by the European Commission (2009) in terms of the capacity of the national welfare states to pick up the social costs of the crisis in the context of contracting public revenues, to use the welfare state as an automatic stabilizer, and the capacity of various countries to launch investment programmes in order to boost domestic demand. The Social Protection Committee in its Report on the Growth, Jobs and Social Progress in the EU (2009) also concludes that

> Social protection system can play a crucial role as automatic stabilisers and sustain the productive capacity of the economy. However, Member states are in very different positions to face the crisis. In some countries, there are significant weaknesses and loopholes in social safety nets. In others with mature social protection systems that cushion the impact of the crisis, financial sustainability is questioned in the long run. Countries faced with major public finance imbalances are left with little room for manoeuvre to address the social consequences of the crisis. This raises particular concern for those who also have weaker levels of protection. (SPC 2009:78)

The crisis has had a differential impact on different member states. The economic crisis has resulted in one of the sharpest recession of the Baltic states' economies in Europe: the double digit fall in real GDP, the 10 per cent fall in employment rate, the sudden rise in unemployment and drastic fall in public revenues have had dramatic effect in those countries. In the course of this crisis, in many respects the Baltic states have lost all of the employment gains of the last ten years (Figure 8.5).

A Report by the European Commission on the economic challenges in the Baltics (2009) have argued that the steep recession in the Baltic states have been a result of a derailed catching-up process in the 2000s, characterized by fast



Source: European Union 2010: 27.

Figure 8.5 Unemployment rate in the Baltic States between 1998 and 2009

economic growth, which in fact was an overheating of the economy coupled by huge imbalances and internal problems (such as current account imbalances, fast growing domestic demand financed by easy credit, imbalances between output structure and labour skills, fast growing social inequalities, and deterioration of demographic situation). The primary response to the economic crisis in the Baltic states, as Table 8.5 shows, has been budget cuts and fiscal consolidation. Latvia has issued a sharp spending cut in health care, and reduced pension benefits by 10 per cent. Although pension and health care expenditures represent two of the most significant components in welfare expenditure, the problems of high old age poverty and already poor access to health care will likely become accelerated as a result of the crisis. In Lithuania, the general trend seems to be freezing benefit levels or cutting eligibility periods, and reducing the generosity of health care insurance. The overall picture seems to be that the Baltic states experience a sharp deterioration of income for most groups, but there are very few measures available for introducing income support schemes that are able to counteract the social consequences of the crisis (SPC-EC 2009). In Latvia, the World Bank is funding a project to develop a Social Safety Net Strategy that is able to create a framework in which special attention is given to mitigate the effect of the crisis on groups most in needs. According to the SPC-EC forecast, the Baltic states will see the biggest rise of welfare expenditure as a share of GDP between 2007 and 2010 in the whole of the EU. In Slovakia the economic recession has been less severe, yet the labour market suffered strongly from the downturn. Unemployment increased by 50 per cent in just 13 months between October 2008 and December 2009, and youth unemployment has increased by 14 percentage points in the same period, which meant one of the sharpest increases in unemployment in the EU27 (EU Employment Situation and Social Outlook, February 2010). The SPC-EC Report argues that Slovakia 'has not invested in expanding protection systems which resulted in a particularly vulnerable situation in the current economic backdrop' (SPC-EC 2009:130).

In Hungary the crisis has been less severe in terms of output and employment contraction compared to the Baltic states, and yet, it exposed the severe structural problems in terms of high current account deficit and government debt, which means that there is no fiscal space to manoeuvre and to mitigate the impact of the crisis. The country has agreed an IMF loan of 16 billion US$, which was conditioned upon a fiscal adjustment resulting in spending cuts in pension and maternity benefits, two areas of welfare spending that were overly generous. While Hungary had no fiscal room to manoeuvre, Poland has managed to put in place a rather big recovery package, almost 2.75 per cent of GDP, which includes public investment, a rise in minimum wage, reduction of personal income tax, and the flexibilization of working hours. According to the SPC-EC Report the Polish recovery package does not include any concrete labour market measures. Finally, Slovenia and the Czech Republic, with their 'comprehensive social protection system' are 'well placed to protect the most vulnerable in the current crisis' (SPC-EC 2009:128). Slovenia is

Table 8.5 The economic crisis in new EU member states

	Estonia	Latvia	Lithuania	Czech Republic	Slovenia	Poland	Hungary	Slovakia
Real GDP fall	−13.7% in 2009 −0.1% in 2010	−18% in 2009 -4% in 2010	−18.1% in 2009 -3.9% in 2010	−4.8% in 2009	−7.4% in 2009	+1.2% in 2009	-6.5% in 2009 -0.5% in 2010	−5.8% in 2009 +1.9% in 2010
Employment contraction	−9% in 2009 −2.5% in 2010	−11.9% in 2009	−11% in 2009		−2.6% in 2009	−0.7% in 2009	-3% in 2009 -0.8% in 2010	-3.8% in 2009 0% in 2010
Unemployment	15.2% in 2010	19.7% in 2009 reaching 19.9% in 2010	17.6% by 2010	7.4% by 2010	6.7% in 2009 rise to 8.3% in 2010	8.4% in 2009	9.5% in 2009 and over 10% in 2010	Up by 50% reaching 13.6% by 2009
Youth unemployment	24.1% in 2009, the fastest relative rise in the EU	30.5% in 2009	31.2% in 2009	16% in 2009	16% in 2009	20.5% in 2009	24.9% in 2009	32.9% in 2009
Repossession	Up 300% in 2008 and 50% in 2009	No data	24% of impaired loans	No report of significant problems	No data	No data	No data	No data
Take up of benefits	No data	+45% in 2009	+117% between 2008 and 2009	+11% between 2008 and 2009	No data	dropped	dropped	+12.4%

Take up of benefits	No data	+45% in 2009	+117% between 2008 and 2009	+11% between 2008 and 2009	No data	dropped	dropped	+12.4%

	Estonia	**Latvia**	**Lithuania**	**Czech Republic**	**Slovenia**	**Poland**	**Hungary**	**Slovakia**
Policy responses	Budget cuts fiscal consolidation, flexibility of labour market increased	World Bank loan 'Social Safety Net Strategy' 10% reduction in pension and social benefits	Containing the increased budget deficit reduction in social benefits		Development-oriented package, boosting ALMP, life-long learning, and social security	Budget deficit will rise to 6.4% of GDP in 2009 and 7.5% in 2010	Reorganizing Structural Funds away from social areas IMF loan of 20 billion euros	

Source: SPC-EC 2009.

introducing a comprehensive development-focused recovery package in which active labour market measures are playing an important role.

Based on the projection of the SPC-EC Report, the crisis might well increase welfare spending significantly in the three Baltic States and in Slovenia, but will also considerably increase it in Poland and in the Czech Republic. The crisis might well lead to tax convergence too, in that the low tax rate countries will be under pressure to increase public revenues, while the higher tax rate countries (Poland and Hungary) will decrease some of their tax rates in order to stimulate employment and economic growth. It is therefore quite possible that the economic crisis will pull the welfare states in the region towards a converging trend: increasing welfare spending in the Baltics, addressing structural imbalances in Poland and Hungary, and further social investment, but with fiscal adjustment in the Czech Republic and Slovenia.

Concluding Remarks

So what are the implications of all this? Clustered convergence reasserts the point that domestic politics matters in the ways in which domestic socio-economic models are chosen, followed, and implemented. It also seems to suggest that the Europeanization literature has over-emphasized the role of policy learning and soft convergence (OMC). In the perspective of the last decade welfare convergence has been weak both measured in classic welfare terms as well as in terms of 'frame convergence'. It may well be that the economic crisis, and the socio-economic shock it causes will be more significant in forging convergence than the EU governance has been able to achieve in the last ten years.

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