Chapter Eight
The Transformation of the Socialist Welfare State, 1990-2005

In Eastern Europe, political transitions occurred nearly simultaneously and very rapidly in 1989-1990 (Figure 8.1). Poland held constrained elections in the spring of 1989, but by the end of that year democratic movements were on the ascent across the region. The overthrow of Ceaușescu did not initially result in the installation of a fully democratic regime, and Slovakia showed some departure from democratic norms in the early 1990s. But even in those two countries, political change was dramatic and by the end of the 1990s all of the countries in our sample had achieved a level of political competition that met standard thresholds.

Figure 8.1: Polity Values for Eastern Europe: 1980-2003

The evolution of social policy in the new democratic regimes occurred in the context of extraordinarily deep economic crises and profound structural transformations. Figure 8.2 shows
the path of GDP growth from the mid-1980s through the mid-2000s. All of the countries in our sample suffered severe recessions during the early transition years. These bottomed out by 1992, and Hungary, Poland and Slovakia witnessed fairly robust recoveries after that point. But Bulgaria and Romania experienced “relapses” in the mid- to late 1990s and growth slowed substantially in the Czech Republic as well. Growth slowed again in the late 1990s across the region as a consequence of the fall-out from emerging-market crises in East Asia and Russia, but by the beginning of the 2000s growth rates had converged around a more stable path.

Figure 8.2: GDP Growth (Three Year Moving Average) for Eastern Europe: 1985-2005
All governments in the region faced severe fiscal constraints at some point in the 1990s (Afonso et. al. 2005). Standard data on deficits (Figure 8.3) underestimate the extent of these problems, particularly those hidden in the balance sheets of the central bank and state-owned banking system. These fiscal crises came earlier and were deeper in Hungary and Bulgaria, but Poland, Romania, and the Czech and Slovak Republics also faced important adjustments, most undertaken in the context of IMF programs.

**Figure 8.3: Budget Balance as a Percent of GFP**
*(Three Year Moving Average)*
*for Eastern Europe: 1985-2005*
Except for the Czech and Slovak Republics, crises were also associated with bouts of high and even hyper-inflation (Figure 8.4). Hungary’s inflation looks low by comparison to the other cases but it undertook a serious stabilization effort in 1995. Poland had a very high transitional inflation that preceded its distinctive “shock therapy” approach to reform. Romania and Bulgaria undertook early stabilization efforts but subsequently sought to maintain employment by slowing the pace of privatization and maintaining subsidies to both state-owned and private enterprises. Bulgaria had a bout of near-hyperinflation in the mid-1990s that triggered the adoption of a currency board system. Romania, by contrast, cycled through a succession of failed stabilization efforts.

Figure 8.4: CPI Change (Three Year Moving Average) for Eastern Europe: 1985-2005

[Diagram showing CPI change for Eastern European countries from 1985 to 2005]
Finally, all countries in the region underwent the shock of wide-ranging structural reforms associated with the transition to the market; Figure 8.5 tracks this process using the average of the European Bank for Reconstruction and Development (EBRD) reform indices for eight discrete policy areas. The figure shows considerable divergence between the early reformers, which exploited popular revulsion against the old order to institute wide-ranging reform programs, and Bulgaria and Romania, which took a more gradual approach to the transition. By the early 2000s, however, all six countries had undertaken extensive structural changes.

Figure 8.5: Overall Reform Index in Eastern Europe: 1989-2002
As in Latin America, crises enhanced the political influence of technocrats who figured prominently in efforts to reform the socialist welfare state. Despite its shortcomings and the underfunding of entitlements, however, the inherited system of social protection and services had a profound influence on public expectations, and thus influenced the policy positions of parties across the ideological spectrum. The socialist welfare state also had defenders in organized stakeholders with an interest in the existing system of entitlements and services.

Table 8.1 provides insight into the depth of these political constraints by summarizing public opinion data from the mid-1990s on the government’s social policy responsibilities. Well after the transition, expectations about an expansive role for the state remained extremely high. The data show near unanimity of opinion with respect to health, education, and pensions. Publics not only affirmed a government responsibility, but overwhelmingly called for “more” or “much more” spending on these entitlements. Lipsmeyer (2003: 550-555) notes the relatively weak preferences for spending on unemployment compensation but this comes in the context of widespread belief that the government should actually guarantee employment!

Table 8.1: Public Attitudes Toward Government Social Responsibilities in Bulgaria, Czech Republic, Hungary, and Poland, 1996

<table>
<thead>
<tr>
<th>Government should: (percent agreeing)</th>
<th>Bulgaria</th>
<th>Czech Rep</th>
<th>Hungary</th>
<th>Poland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Provide jobs for everyone</td>
<td>79.2</td>
<td>74.9</td>
<td>85.4</td>
<td>86.4</td>
</tr>
<tr>
<td>Provide health care for the sick</td>
<td>95.8</td>
<td>95.7</td>
<td>97.7</td>
<td>95.2</td>
</tr>
<tr>
<td>Spend more on healthcare</td>
<td>92.2</td>
<td>80.9</td>
<td>91.6</td>
<td>90.6</td>
</tr>
<tr>
<td>Decent old-age living standard a</td>
<td>96.3</td>
<td>95.6</td>
<td>97.1</td>
<td>96.1</td>
</tr>
<tr>
<td>Spend more on retirement</td>
<td>77.1</td>
<td>64.6</td>
<td>82.9</td>
<td>79.0</td>
</tr>
<tr>
<td>Spend more on education</td>
<td>79.0</td>
<td>65.5</td>
<td>79.9</td>
<td>79.0</td>
</tr>
<tr>
<td>Support unemployed a</td>
<td>85.9</td>
<td>39.9</td>
<td>60.4</td>
<td>71.6</td>
</tr>
<tr>
<td>Spend more on unemployment</td>
<td>64.4</td>
<td>18.5</td>
<td>33.1</td>
<td>41.0</td>
</tr>
<tr>
<td>Reduce income differences</td>
<td>72.8</td>
<td>74.3</td>
<td>73.2</td>
<td>83.1</td>
</tr>
</tbody>
</table>
We focus in particular on two important cross-regional differences in the politics of social policy. First, new democratic governments in Eastern Europe attached a much higher priority to the establishment of social safety-nets aimed at compensating formal sector workers displaced by economic reform. These safety net programs were by no means uniform in their design or generosity and initial commitments were not necessarily sustained. Nonetheless, the contrast remains noteworthy; compensation for unemployed formal sector workers was much less of a priority in Latin America.

The second, and more striking, difference has to do with the approach to the reform of social insurance and services. In both regions, economic crises and fiscal constraints increased the power of technocrats and placed the reform of costly entitlements on the agenda. In Latin America, however, narrow coverage made social insurance more vulnerable to liberal reform in the wake of crises. In Eastern Europe, by contrast, publics expected governments to maintain an array of protections on a universal basis at low—or even no—cost. When governments shifted from direct government financing and provision to social insurance models, they nonetheless maintained principles of universalism de facto if not de jure. Initial reforms were even cast in terms of increasing \expenditures and the public sector continued to play a large role in both the financing and provision of social insurance and services.

Moreover, those liberalizing reforms that were attempted were vulnerable not only to significant political compromises, as was also the case in Latin America, but to outright reversal by subsequent administrations. Governments found it extremely difficult to rationalize the finances or benefits of new social insurance systems put in place during the transition, and as a result programs operated on soft budget constraints similar to those seen during the socialist era.
The Eastern European cases exhibit a somewhat greater homogeneity with respect to both their economic circumstances and social policy legacies. As a result, we find much greater evidence of convergence on similar social policy systems than is the case in Latin America. Nonetheless, there are differences in the timing of economic reform efforts and recovery in Eastern Europe which, as in both East Asia and Latin America, proved consequential for the course of social policy. We begin our discussion with the early reformers, Poland and Hungary, followed by a consideration of the Czech and Slovak Republics and closing with Bulgaria and Romania which delayed social policy reforms until the late 1990s. In each case, we begin with the policy challenges of the early post-transition period: crises, economic reforms, and the effort to forge new social safety nets. We then turn to conditions in the mid-1990s, as the first elected governments turned over and as economic and fiscal conditions led to the initiation of more institutionally-complex “second round” reforms of pensions and health care systems. In the conclusion we return to the debate over convergence and divergence in more detail, and address the possible effects of entry into the European Community and regional diffusion processes.

Early Reformers: Poland and Hungary

The political and economic transitions in Poland and Hungary exhibit a number of similarities. Both had experimented with political and economic liberalization prior to the end of Communist rule. In both cases, these reforms facilitated the transition to governments headed by opposition forces and the early initiation of market-oriented reforms. In both countries, subsequent stabilization efforts paved the way for improved relations with the IMF. Fiscal constraints, as well as the declining coverage of pensions and quality of health care, provided the opening for liberalizing reforms of core social insurance functions. Yet as elsewhere in the region, these efforts were constrained by the policy legacy of socialist rule.
**Poland**

Poland was the first of the Eastern European Communist regimes to fall. Roundtable negotiations between the martial law government of Wojciech Jaruzelski and the opposition Solidarity movement produced a transitional agreement that reserved two-thirds of the parliamentary seats for the Communists and their allies. Competitive elections for the remaining one-third of seats produced a smashing victory for Solidarity. In June 1989, Tadeusz Mazowiecki, a Solidarity leader, became the first non-communist to head an Eastern European government since the late 1940s. Full parliamentary elections were held in January 1990, and for the next fifteen years, coalitions led by Solidarity and Socialist governments alternated in power in roughly four-year cycles: Solidarity from 1990-1993; the Socialists from 1993-1997; a reconstituted alliance of Solidarity again from 1997-2002; and an alliance of Socialists and Liberals through 2005 when we end our account. These governments differed somewhat in their overall approach to reform, but we see some important continuities across governments with respect to social policy.

*The Early Transition Period: Creating Social Safety Nets*

By 1988, inflation in Poland had climbed close to 60 percent, and threatened to veer into a full-blown hyperinflation. Partial reforms attempted under the last socialist government had failed and reformers within the communist party and leaders of the Mazowiecki government agreed on the need for a bolder approach (Johnson and Kowalska 1994, 193-196; Orenstein 2001, 30-32). The initial reform package was designed by a team of economists and foreign advisors led by Finance Minister Lesczek Balcerowicz and featured rapid trade and price liberalization, the unification of the exchange rate, sharp cuts in subsidies to state enterprises, and a highly restrictive incomes policy (Orenstein 2001, 32). Parliament quickly ratified the
program in January 1990, even though the communists and their former allies still held a majority of seats. As the crisis deepened from 1990-1992, serious conflicts over the reforms and their social consequences emerged both within the heterogeneous Solidarity movement and from the reconstituted communist party. However, broad support for the transition, the rapid restructuring of the Polish economy and the inability of the opposition to propose credible alternatives limited the influence of opposition forces (Johnson and Kowalska 1994: 230-231).

Solidarity had labor roots and the new government committed itself quite early to the establishment of a social safety net for formal sector workers. The government passed a comprehensive and generous package of unemployment benefits sponsored by Jacek Kuron, the Minister of Labor in the first transition government and a towering figure in the Solidarity movement (Brown 2005: 113-116). This program was scaled back as it became clear that high levels of benefits were not fiscally sustainable. But the ad hoc use of early retirement and disability pensions and family allowances continued to provide a relatively broad safety-net, and social spending increased sharply during the early transition (Surdej 2004, 7; see also Appendix Six).

This increase in social spending occurred in the context of a sharp decline in revenue, partly as a result of the rapid growth of the informal economy. Throughout the early 1990s, a succession of Solidarity governments tried unsuccessfully to reduce ballooning deficits. A suspension of IMF disbursements in 1991 marked the low point of this struggle. In 1992, a new government headed by Hana Suchocka succeeded in regaining IMF support for a new stabilization initiative that brought the budget toward a more sustainable position. Parliamentary criticism of fiscal austerity came from within the governing coalition and from the opposition Socialist party, and echoed criticism from unions and civil society groups. Strikes broke out in
the transport, communications, and agricultural sectors over the collapse of real wages and unemployment. Approval ratings for the Solidarity coalition plummeted, and the reformed Socialists, with the support of ex-communist unions, gained substantial ground in the 1991 parliamentary elections. Although Suchocka’s stabilization program held, her term in office did not. Following a decision to hold the line on wage increases in the health and education sectors, the government lost a vote of no confidence pressed by the Solidarity unions and was forced to resign.

With the return of robust growth, the pressure on social spending abated and the new socialist government that came to office following the elections of 1993 could increase spending modestly. For example, although the socialist government tightened eligibility requirements for unemployment insurance, it also increased benefits, extended concessions to miners, farmers, and railroad workers, and sought foreign support for active labor market policies. Moreover, the government continued to use early retirement and other ad hoc assistance programs to manage structural unemployment (Cain and Surdej 1999: 159). Despite the shortcomings of this ad hoc social safety net (OECD 2004: 97-107, Brown 2005: 122-155), household surveys provide strong evidence that government interventions mitigated the effects of poverty among families headed by older workers and reduced the income inequality associated with the transition (Keane and Prasad 2002: 17-19) The programs had political effects as well. Transfers played a role in maintaining social stability and reducing political resistance to structural reform (Keane and Prasad 2002, 23).

*Second Round Reforms I: The Pension System*

In part because of expenditures on early retirements, the pension system was in serious financial difficulty by the time the Socialists came to power (Müller 1999, 96). As in all of the
Eastern European countries, future benefit payments were projected to increase dramatically as the ratio of contributors to beneficiaries declined. Previous governments had attempted to relieve fiscal pressures by adjusting the indexation of benefits, but a Constitutional Court ruling argued that such caps on pension benefits violated the "acquired rights” of citizens (Inglot 1995, 369).

For the financial technocrats in the incoming government, a more systematic reform of the system was a high priority and was explicitly included as a priority in the standby agreement negotiated with the IMF in 1994 (Government of Poland 1994, 33). Proposals for the establishment of a fully-funded second pillar were first advanced in 1994 by Finance Minister Grzegorz Kolodko, but passage was delayed for over three years by bureaucratic infighting with the Ministry of Labor and arduous negotiations with unions, pensioners, and party leaders (Hausner 2001: 215-216, Orenstein 2001)

Declining benefits and widespread public doubts about the sustainability of the existing system provided the political basis for a substantial reform. The reform provided for a fully-funded second pillar that, according to Brooks’ (2007: xx) simulations, would pay almost half the benefits for workers entering the labor force. Moreover, the new law included a variety of parametric changes in the first pillar, including an increase in the retirement age.

To secure these reforms, the government had to accommodate both the electoral interests of the parties and the concerns of unions and pensioners. A widely publicized statement of principles issued in 1997 guaranteed the acquired rights of current pensioners and pledged “full security” to all age groups (Hausner 2000, 217). The reform did not touch the beneficiaries of disability insurance or special funds for miners, railroad workers, and other branches that had been privileged under the old system. Moreover, the costly non-contributory pension system that served Poland’s large rural population was excluded from the reform altogether and continued to
place exceptional burdens on fiscal policy. In sum, despite strong pressures for liberalization of the pension system, the new system guaranteed protection of the elderly and left a number of entitlements from the socialist period intact.

*Second Round Reforms II: The Health Care System*

Poland came late to the reform of its health system. As in other Eastern European countries, doctors quickly gained the right to enter private practice and larger cities were granted ownership of some public hospitals and outpatient centers. But internal divisions within the Solidarity coalition and the rapid turnover of governments delayed a more comprehensive financial and organizational reform (Bosserth and Wlodarczyk 2000: 8-13, Nelson 2001: 253-261). Until the late 1990s, the basic features of the old system remained in place, despite widespread dissatisfaction with low quality of care, de facto rationing of access, and concerns over costs (Sitek 2005, 123).

After a lengthy period of debate, the socialist government legislated a new system of financing and provision in 1997. The reform replaced financing through general taxation with a payroll tax at rates set annually by the Sejm. In an effort to control costs, the new legislation established regional insurance funds that were to negotiate contracts with both public and private providers. But newly-established insurance funds remained within the public sector and retained monopsonistic bargaining power with respect to providers within their respective regions. Although the system was nominally contributory, the Constitution passed by referendum in early 1997 enshrined a commitment to universal coverage. As Mihalyi (2000: 26) shows, the payroll tax proposal was seen by the public as well as by doctors and health care providers as a way to *increase* funding by providing a dedicated and secure source of revenue.
The Solidarity coalition (AWS) that came to office in 1997 had sharply criticized the statist orientation of the socialist reforms (Bossert and Wlodarczyk 2000: 14), and was allied with a small liberal party, the Freedom Union (AU). Moreover, the AWS also had links to provider groups that sought to limit the power of the insurance funds. Nonetheless, the new law that was passed in 1999 “did not mark a radical departure from the 1997 legislation with respect to coverage, benefits promised or even fundamental organization” (Sitek 2005, 134).

The fights over efforts to control costs and the organization of the insurance funds illustrate the political limits on liberalizing reforms. These fights pitted doctors and nurses linked to Solidarity against the Finance Ministry, which was controlled by the AU and headed again by Leszek Balcerowicz. Health providers pressed for higher payroll contributions and increased spending, and sought to increase their leverage in the negotiation of contracts by opening the insurance market to greater competition. However, Balcerowicz had observed the failure of the more liberal Czech reform, which had foundered on problems of information asymmetry, moral hazard, and the political difficulty of imposing hard budget constraints. He also argued that the reform should not be an excuse for an increase in public spending or payroll taxes. He prevailed on both points: the 1999 legislation retained the socialist framework of non-competing regional funds, and payroll contributions in the 1999 legislation were lowered from 10 to 7.5 percent of earnings (Sitek 2000, 146).

The promise to maintain universal coverage and generous benefits in the face of relatively modest contributions made the question of cost control crucial. The new model assumed that competition for contracts would force a wide-ranging rationalization of provision. In fact, the quality of coverage and benefits began to diverge across regions and opinion surveys showed that large and increasing majorities viewed the new system as worse than the one it
The government was forced to lend money to strapped regional funds and continued to subsidize hospitals.

The Socialist government elected in 2001 reacted by moving back toward a more centralized approach to healthcare financing and administration. Although the regional funds remained in operation, their powers were significantly curtailed. The national government reassumed responsibility for financing and defining the package of services available to the public. This re-centralization preserved the principle of providing universal care, but did little to address the underlying problems of financing and the quality of care that such a commitment entailed.

**Hungary**

The first free parliamentary elections in Hungary were held in January 1990, after several years of internal reform within the communist party and several months of so-called Roundtable negotiations with the opposition. The largest party to emerge from the transitional election was the Hungarian Democratic Forum (MDF), a loose collection of anti-regime notables with a conservative, nationalist orientation. In coalition with small Christian Democratic and Peasant parties, the MDF formed the first transition government under Jozsef Antall.

Unlike Solidarity, the new governing coalition did not emerge from an upsurge of civil society opposition, and the MDF disappeared from the political scene after losing to the reformed Hungarian Socialists in the general election of 1994. The political space they occupied was filled by FIDESZ, a party that drew support around nationalist and religious issues. The principal competitor to FIDESZ was a coalition of reformed socialists and liberals whose appeal to voters rests on their internationalist and secular orientation (Grzymala-Busse 2002, 171-173, 215-225). The post-transition period saw an alternation in power between these two blocks. The
Socialists and their liberal allies held power from 1994-1998. FIDESZ followed in 1998-2002, and was in turn replaced by the socialist-liberal alliance in 2002.

As in Poland, these competing coalitions agreed on the need to move toward democracy and a market economy. But voters and organized interests expected a continuation of the broad entitlements acquired under socialism, expectations that were also incorporated into the Constitution as citizenship rights.iii At the time of the transition, Hungary devoted about one third of its GDP to spending on social programs, a share that exceeded that of any of the other Eastern European countries (Orenstein and Wilkins 2001, 4; see also Appendix Six). Governments of both partisan orientations proved reluctant to liberalize the welfare system, even when faced with significant fiscal pressures. When they did, they paid a political price at the polls and their initiatives were modified or reversed by their successors. This was particularly the case with aspects of the Bokros package of the mid-1990s to which we pay particular attention.

Social Protection and Fiscal Policy in the Early Transition

In contrast to Poland, the new Hungarian government was rhetorically committed to a gradualist approach to reform (Stark and Bruszt 1998, 149-153; Bartlett 1997). However, privatization, bankruptcy and accounting legislation imposed hard budget constraints on firms and had radical consequences that were not fully anticipated at the time. Although the government eventually bailed out some of the larger enterprises, unemployment increased rapidly.

As in Poland, the Antall administration viewed the establishment of a broad social safety-net as a component of its overall approach to the transition. The unemployment insurance introduced at the onset of the transition was even more generous than Poland’s and spending on it was sustained for a longer period of time (Orenstein and Wilkins 2001, 10). The government
also placed greater emphasis than Poland on active employment policies (Brown 2005: 161-166) and maintained an array of commitments from the socialist era. In addition to pension and healthcare commitments, family allowances and child support programs in Hungary were particularly generous and in the run up to the 1990 elections were made a universal right (Szikra 2005: 9).

Both new social expenditures and existing entitlements resulted in high levels of social spending during the early transition period despite a sharp drop in revenue and the emergence of exceptionally large fiscal deficits (Figure 8.3). A 1993 letter of intent to the IMF spelled out a number of specific actions related to social security, including targeting of family allowances, lowering pharmaceutical subsidies, and introducing co-payments for some healthcare services (Bod and Szabo 1993, 7). However, in the absence of the kind of overt inflationary crisis that had spurred reform in Poland, the Antall government delayed fiscal adjustment and only one disbursement from the standby was ultimately made (Haggard, Kaufman, and Shugart 2001, 79; Greskovits 2001: 119-130).

Electoral and interest group politics played a significant role in these delays. In 1993, an effort to close the deficit was greeted by a wave of hunger strikes organized by NGOs and strike threats by post-communist unions in the strategically important steel, railroad, and mining sectors (Greskovits 1998, 157). To gain support for the stabilization package, the government offered the post-communist unions representation on new tripartite bargaining councils, yielded on proposed cutbacks in family allowances and accepted increases in the minimum wage. Although civil society in Hungary was weak compared to Poland, the wave of social protest increased the risk of parliamentary defections from the government’s coalition (Greskovits 1998, 166). Fiscal policy continued to drift through the end of Antall’s term.
In 1994, a new government led by the Socialist party came to office and assumed the political risks associated with undertaking a delayed stabilization. The 1995 program—typically referred to as the Bokros package after Finance Minister Lajos Bokros – provides an important example of both the economic conditions in which technocrats acquire influence over social policy and the constraints placed on them by the socialist legacy.

The Hungarian Socialist party, like its Polish counterpart, had thoroughly shifted course by the early 1990s. By the time it regained office, it had established an important constituency in the emerging private sector, and its leadership had come to include a small but influential liberal faction. Nevertheless, the ex-communist union movement remained a core constituency of the party and the Socialists had campaigned promising greater attention to social issues.

Upon assuming office, the government initially sought a negotiated agreement on macroeconomic policy with representatives of the unions and business organizations in the tripartite Interest Reconciliation Council (IRC). After nine months of bargaining, negotiations remained at a stand-still. At the end of 1994, the dangers posed by the growing fiscal deficit were compounded by contagion from the financial crisis in Mexico. Both the IFIs and the Western European governments signaled that financial assistance would not be forthcoming without a serious adjustment effort. With its back to the wall, the government abandoned negotiations through the IRC and turned to an internationally respected economist, Lajos Bokros, to craft a stabilization package (Haggard, Kaufman, and Shugart 2001: 196-200).

The ensuing 18 months—first under Bokros and later under a new Minister of Finance Péter Medgyessy—marked a high point of technocratic influence in Hungary. The Bokros package was unveiled in March 1995 without prior consultation with other ministers or party leaders. It closed the budget gap mainly by raising revenues with a temporary surcharge on
imports and a large devaluation that had the effect of reducing real wages in the public sector. Although this provoked bitter controversy, it was ratified by the government coalition.

In its original version, however, the package also tackled the political taboo of the country’s generous welfare system, a reform effort supported by the IMF (Bokros and Suranyi 1996, 38). The most controversial steps concerned changes in the structure of family allowances: families with incomes in the top 10 percent were to be excluded from eligibility; paid maternity leaves were to be eliminated altogether. Although the government was able to push through the limits on family allowances, widespread protests erupted over the need to apply for benefits that had formerly been granted without a cumbersome administrative procedure (Szikra 2005: 9). The powerful Constitutional Court also ruled that an immediate suspension of maternity payments would violate the “acquired rights” of women who were already pregnant, removing the cuts from the stabilization initiative.

The Bokros package contributed to a marked turnaround in the Hungarian economy and in 1997, the country entered a period of vigorous growth. As growth returned, however, successive governments of both parties reversed many of the changes instituted during the Bokros period. Family benefits again provide an example. During 1998-2002, the FIDESZ government under Victor Orban fully reinstated the maternity leave program. Inflation eroded the real value of family support payments, but the government restored the principal of universal entitlement that the Bokros package had sought to address by moving toward more targeted distribution of benefits. The subsequent Socialist government, stung by its experience under Bokros, promised to raise expenditures and followed through in 2004 with a 40 percent increase in benefits and a “thirteen month” bonus (Szikra 2005: 9). Increasing budget constraints limited
the capacity of governments to sustain the generosity of family transfers, but a strong defence of its basic principles was a recurrent feature of the political process.

_Pension Privatization_

By 1996, the short-term stabilization package had succeeded in staving off an immediate fiscal and balance of payments crisis and provided an opening for the economic team, together with World Bank advisors, to focus on longer-term fiscal issues, including pension reform (Haggard, Kaufman and Shugart 2001: 160-163, Nelson 2001: 238-242). As in Poland, the declining real value of pension benefits had changed public opinion on the necessity of pension reform (Nelson 2001, 245). Predictably, pensioners conceived of “reform” as leading to an increase in benefits. Pension privatization also threatened stakeholders in the Ministry of Welfare and the ex-communist unions. These unions had unexpectedly triumphed in elections held for managerial positions on the boards governing the pension and health funds, and they emerged as among the most intransigent opponents of the reform.

Negotiations leading up to the final legislation occurred principally within the government and the Interest Reconciliation Council. As in Poland, reforms such as an increase in the retirement age were made possible only by costly concessions to beneficiaries. The indexing of benefits was timed in a way that locked in large increases in payments to existing pensioners. Compulsory contributions to the new system applied only to new entrants into the labor market. The unions’ opposition to the reforms was mitigated by new governing arrangements that actually strengthened their representation on the social security and health funds.

As with family allowances, the terms of the pension reform have been subject to continuing adjustments as new governments have come to office. Concerned with restraining expenditures and reducing union control over payroll tax revenues, the FIDESZ government that
succeeded the Socialists in 1998 reclaimed central government control over management of the funds. The government also undertook a variety of ad hoc measures to reduce the strain on the public pillar such as a new indexing scheme. But a planned increase of employee contributions to the private pillar was postponed (Tomka 2005: 9, Simonovits 2002: 16), and the Orban government eliminated the requirement that made affiliation with the private pillar compulsory for new entrants into the labor market. The significance of the shift to a mixed, multipillar system should not be underestimated but as Simonovits (2002: 17) has observed, the “lion’s share of the contributions and probably most of the benefits will come to/from the public pillar.”

Reforming Healthcare

Hungary moved much more quickly than Poland to shift the financing of both pensions and health care from general taxes to compulsory insurance. The separation of financing and provision was, in principle, expected to reduce healthcare expenditures. In practice, the implementation of hard budget constraints was impeded by an ongoing commitment to universal access, the failure to redefine the benefits package, and the continuing ability of doctors and municipal governments to resist cuts in the public hospital sector. As Mihalyi (2000: 13) summarizes, “In theory, health care is provided on an insurance basis. In reality, care is extended to all citizens irrespective of payments and the benefit package remains contractually and/or legislatively undefined.” The government was required to pay for the contributions of important groups such as pensioners and to cover deficits in the funds. Despite nominal social insurance principles, the contribution of the central government to the HIF ranged from about 6 to 11 percent of total public expenditures during the first half of the 1990s (Gaal 2004, 39).

As we would predict, the onset of the fiscal crisis in 1994 was followed by efforts on the part of the Bokros team to rationalize both the financing and provision of health care. Yet despite
substantial increases in real health spending (Gaal 2004, 51) it proved difficult to raise taxes or even halt the slide in contributions, let alone redefine benefits or rein in providers. Attempts to close underutilized hospitals met with local protests. New legislation in 1996 called for a reduction in hospital beds, but the task of deciding which ones to eliminate was given to county-level “consensus teams”; as a result, oversupply remained very high by OECD standards. A final effort at more comprehensive financial reform by the Finance Ministry ran up against the electoral clock in 1997-98 (Mihalyi 2005: 10)

Other attempts to trim benefits (for dental care, for example) were later reversed. Health spending declined as a share of GDP in the second half of the 1990s (Appendix Six), but HIF deficits peaked at almost 13 percent of total public healthcare expenditures in 1998—well after the Bokros program—and remained at close to 10 percent in 2000 (Gaal 2004, 39).

The cycle of piecemeal reform continued under the next two governments. The center-right coalition of Victor Orban (1988-2002) showed somewhat more interest in efforts to spur private insurance and provision than the socialist-liberal coalition under Medgyessey. The new government lowered payroll taxes and sought to exercise more direct control over spending by appointing his own nominees to the health fund and shifting control to the office of the Prime Minister (Gaal 2004, 107-110). But the Orban government’s proposal to create competing private funds was dropped. An OECD assessment in 2005 underscored similar structural problems to those outlined by critics over a decade before (OECD 2005: 4-5): perverse incentives with respect to treatment by both doctors and hospitals, waiting lists and effective rationing of care, and the persistence of under-the-table payments. vi.
The Czech and Slovak Republics

The collapse of the old regime occurred quite rapidly in Czechoslovakia. After demonstrations in December 1989, the conservative leadership of the Czech Communist Party abdicated, leaving a rump group to negotiate the transfer of power. The first “government of national understanding” was dominated by leaders of the two main opposition movements: the Civic Forum that had emerged in the Czech lands and its Slovak counterpart, Public Against Violence. Following the general election of June 1990, most of the top positions in the national government were held by leaders of the Civic Forum, which included both social democrats such as the new president, Vaclav Havel, and militant free-market liberals such as Finance Minister Vaclav Klaus (Orenstein 2001, 61-96). In the Slovak regions, more nationalist and conservative factions headed by Vladimir Meciar’s Public Against Violence predominated.

In contrast to Hungary and Poland, the purges of 1968 left the Communist party without a strong reformist faction and it was rapidly marginalized as a competitive electoral force (Grzymala-Busse 2002, 30-41). Although electoral support for the Social Democrats was also quite limited in the first half of the 1990s, the collapse of the Communist party opened the way for them to quickly capture the leadership of the union movement.

With the parliamentary elections of June 1992, the political trajectories of the two regions began to diverge sharply. In the Czech lands, Klaus’ liberal Civic Democratic Party (ODS) won a substantial plurality (34 percent) and formed a government with the Christian Democratic Party (KDS). In Slovakia, Meciar’s nationalist Movement for a Democratic Slovakia (HZDS) won an even more decisive victory, setting the stage for the two rivals to negotiate the so-called “velvet divorce” of January 1993.
The Czech Republic

Klaus projected himself as the Thatcher of Eastern Europe. As Finance Minister of Czechoslovakia, he pressed for a radical reform strategy with a relentlessness and intellectual force that overwhelmed his more gradualist opponents. Klaus’s initial social policy agenda also focused on the goal of limiting the role of the government: privatization of pensions, a strengthening of the insurance principle and individual responsibility in the health sector, and a move toward means testing and tightened eligibility requirements in other areas of social (Vecerník 2004: 4-5).

This aspect of Klaus’s agenda encountered considerable opposition, however, forcing Klaus to sustain the broad framework of social protections (Potůček 2001, 88-98; Orenstein 2001). One reason for the relatively limited support for more liberal social reforms was that the fiscal pressures to liberalize were much more limited than in most of the other Eastern European countries. Although Czechoslovakia experienced a transitional recession as deep as those in the rest of the region, the post-transition government did not inherit the serious macroeconomic imbalances visible in Poland, Bulgaria and Romania or even in Hungary. The budget remained in surplus for longer than the other countries in our sample and inflation was negligible (Figures 8.3 and 8.4). Unlike Hungary and Poland, external debt contracted by the old regime was also modest. The absence of structural fiscal constraints, or even short-term fiscal problems, limited the ability of reformers—led in this instance by Klaus himself—to tackle the large social welfare entitlements of the socialist era.

Equally if not more important were the political constraints on reform. Prior to the velvet divorce, Klaus’s room for maneuver was limited by coalition partners and social forces that advocated a more gradualist and social democratic approach to the transition: intellectuals with
strong social democratic orientations, such as Vaclav Havel; reformers who had been expelled from the Communist party in 1968; Slovak nationalists such as Meciar; and a relatively powerful union movement that benefited from tripartite structures.

The strong showing of the ODS in 1992 would appear to have weakened these constraints. However, social programs were popular with voters and important for sustaining the political base of the ODS and its two coalition partners. This was even more true following the 1996 elections when the Social Democrats made significant gains on a platform of defending welfare, labor-protective legislation and pensioners and forced the ODS to rule as a minority government. Moreover, labor was organized in a peak union association that was relatively strong and was able to institutionalize a meaningful tripartite structure early in the transition (Brown 2005, 58; Avdagic 2003, 9-13). As Vecernik (2004, 7) summarizes, from the mid-1990s through 2004 “not much [went on] in the social sphere.”

*Social Protection: The Social-Liberal Compromise under Klaus*

A number of important comparative studies have noted the contrast between the “neoliberal” orientations of the early economic reform processes in Poland and Hungary and the “social liberal” compromises forged during the transition in Czechoslovakia (Stark and Bruszt 1998, Orenstein 2001: 61-96 Potůček 2001, Brown 2005: 157-261). The early social policy components of the Klaus program—prior to the split—were framed mainly within the Ministry of Labor, and rested on an explicit quid pro quo negotiated between unions and the government within a tripartite framework. Wage restraint was the key concession on the labor side, and contributed to the low-inflation, high-employment outcome we have already noted.

In exchange, the program presented by Klaus in 1990 granted temporary protection to viable enterprises, provided through credits from state-controlled banks, outright subsidies, and
delays in implementing bankruptcy legislation (Stark and Bruszt 1998, 155; Orenstein 2001, 74). By the late-1990s, such policies had contributed to banking and financial scandals that led to Klaus’s resignation and to the defeat of the ODS in the parliamentary elections of 1998. However, the gradual approach to reform was at least one factor behind the lower level of transitional unemployment. Total employment fell by 13-16 percent in Poland, Hungary and Slovakia in 1989-92, but only 9 percent in the Czech Republic.

Labor market policy also played an important role in the Klaus strategy. Early in the transition, the government created a network of regional labor offices to administer very generous unemployment benefits and active labor market policies. In early 1992, the priorities shifted. Drawing on Western European practice and ILO advice, the government initiated subsidies for private sector employment and cut unemployment benefits. In subsequent years, funding for active labor market policies fell, but this was possible in part because of the underlying compromise on corporate restructuring, the relative success of employment policies, and above all, the return to growth.

Pension reform moved far more slowly than in Poland and Hungary. The Klaus government did set up a voluntary supplemental pension in 1994. However, technocratic efforts to shift the agenda to wider privatization goals were stymied by the Ministry of Labor and Social Affairs (Müller 2002b: 297-299). Because the system did not pose an immediate fiscal threat, the Ministry of Finance had little influence on the issue, and in the absence of serious external constraints on the government, neither did the IFIs (Potůček 2004, 259, 263). In the run-up and immediate aftermath of the 1996 election, the government faced mounting political resistance from both labor and the Social Democrats, who dramatically increased their share of votes and seats. The window for a more wide-ranging reform quickly closed. Retirement ages remained
relatively low and minimum contribution periods to receive a full pension were short. In fact, the solidarity of the system actually increased under Klaus—and the link between contributions and benefits correspondingly weakened—due to generous new provisions for early retirees, families with children, the unemployed, students and self-employed.

Efforts to reform the health care system reflected a more radical market-oriented approach, but the effort retained universal coverage and ultimately failed in a spectacular fashion. Legislation passed in 1992 opened the social insurance market to 27 newly-established private funds on the assumption that such funds would provide greater choice for consumers and incentives to control medical costs. However, the government also established a General Health Insurance Corporation (GHIC), funded out of the general budget, to cover uninsured sectors of the population. In the absence of effective cost controls, the funds began to fail. By 2000, the GHIC covered approximately 75 percent of the population, including almost all non-wage earners. Moreover, survey evidence showed strong support for these arrangements.viii

Other areas of social policy showed similar compromises with prevailing preferences for comprehensive public protection. Like Hungary, Czechoslovakia had a generous system of family allowances. In 1995, the Klaus government succeeded in introducing means testing of these benefits. But allowances were still granted to households earning up to three times the living minimum and continued to support dependent children up to the age of 26! Even broader protections were provided through minimum income guarantees that provided cash transfers to families whose incomes fell below a minimum threshold (Brown 2005, 71). In combination, these benefits yielded one of the most generous safety-nets in the OECD (Scheuer and Gitter 2001, 49).
By 1997, Klaus’ ODS was not only subject to coalitional constraints, but forced to confront scandals, a series of bank failures and a sharp economic downturn. This “second round” crisis forced the government to undertake a stabilization effort that included budget cuts and a devaluation (although it did not necessitate an IMF program). Following Klaus’ resignation in November 1997, a caretaker government held office for six months before general elections brought the Social Democrats to power, which they were to narrowly retain through the 2006 elections.

The Socialists had run for office against the “residualist” social policy of the ODS and on a platform of protecting social entitlements. Once in office, they adopted the European Social Charter and a National Employment Strategy designed to address rapidly rising unemployment through a revival of active labor market policies. Like Klaus, however, the Social Democrats confronted competing pressures on social policy. On the one hand, they were forced to deal with a steady deterioration in the country’s public finances which forced an abandonment of some of the core program of increasing social welfare benefits. At the same time, their hold on office rested on a particularly fragile coalition that impeded efforts to address structural problems in the social sector (European Commission 2003, 4, 7): adverse medium-term developments in the pension system; the aftermath of the collapse of the health insurance funds; and high levels of expenditure on other social transfers. Through 2005, the Social Democrats had managed only the most marginal parametric changes in welfare system.

Given the crisis, the Social Democrats initially focused their attention on a reform agenda to return to growth. The government resolved remaining issues surrounding accession to the EU, sought to attract FDI and undertook a costly privatization of the banking system. Efforts at social
policy reform proved more difficult. In 1997, pension payments exceeded receipts for the first time in the post-transition period, but Parliament defeated two efforts to raise premiums in 1998. In 1999, the government formed a pension committee to try to forge a consensus among the parties on a wider reform, and in 2001 succeeded in passing measures to marginally reduce incentives to early retirement. But until 2005, the two major parties remained far apart on any fundamental reform of the system and the Czech Republic remained the only case in our sample that had not undertaken at least some pension privatization.

Health care reform proved even more difficult. As the private funds failed, the task of financing health care reverted back to the central health insurance fund. By 2003, no less than 91 percent of all health spending went through public channels. Yet a survey from that year also showed that 68.4 percent of respondents found the efficiency of the health care system either “very” or “quite” good (Vecerník 2004, 14), making fundamental reform of the system politically difficult. The majority of hospitals remained in state or municipal government ownership, heavily dependent on subsidies and grants. Despite ballooning costs, the Social Democrats proved unable to introduce even minor parametric reforms.

With little room to raise contributions given high overall payroll taxes (26 percent for pensions, plus another 13.5 percent for health care), cost containment would have to come through classic liberalization measures: consolidation of hospitals and improvements in management and efficiency; cost controls on private providers; and increased payments from beneficiaries. Yet in 2005, with doctors going on strike to protest late and inadequate payments from the insurance fund, the Social Democrat Minister of Health stated flatly that citizens would not pay one additional crown for services. Clearly, the system was fiscally unsustainable and
some reform initiative seemed likely to follow the 2006 elections. Yet it was equally certain that any reform would be constrained to maintain key features of the existing system.

Slovakia

Politics in Slovakia from independence through 1997 was dominated by Vladimir Meciar and his party, the HZDS.\textsuperscript{ix} Although Slovakia was nominally democratic, Meciar’s government was characterized by the centralization of political and economic power, strong nationalist appeals, and intolerance toward the ideologically-divided opposition and ethnic minorities. Studies of public opinion have detailed how Slovaks showed much greater reticence about the transition and more support for an extensive state role in the economy (Henderson 1994). Slovakia also inherited a strong peak union organization as well as the tripartite institutions established during the early transition period. Union membership fell dramatically over the course of the decade, but until 1997 the Meciar government signed general social agreements with the social partners each year. The statist and populist orientation of the leadership and the constraints posed both by voters’ preferences and the organization of stakeholders meant that the pressures to retain social protections were even greater than in the Czech Republic.

In July 1997, Slovak politics was jolted by the country’s exclusion from negotiations on both NATO and EU membership, a joint American-European rebuke to Meciar’s autocratic tendencies. The parliamentary elections of September 1998 ousted Meciar’s HZDS and brought a broad four-party left-right coalition government to power that was united primarily in its opposition to Meciar. Although the coalition was able to pass the constitutional changes and market reforms required for EU entry, it was internally divided on social policy reform. Not until a decline of both the HZDS and the left in the 2002 elections did center-right, pro-European parties gain a mandate that permitted important social policy reforms.
Managing the Transition: the Meciar Years

As elsewhere, early Slovak social policy combined new social safety nets with the maintenance of existing commitments. In addition to unemployment insurance, the Slovak government developed an even more extensive array of active labor market policies than in the Czech Republic, providing large subsidies for private-sector employment and the creation of public sector jobs (Lubyova and van Ours 1997, 93-95).

As in other countries in Eastern Europe, financing of social insurance was shifted to formally independent social security agencies. But entitlements established during the socialist period were not reformed, and the government continued to finance the contributions of a number of stipulated groups. In the run up to the 1998 election, the Meciar government paid off key bases of support by creating non-contributory pensions for the police, customs, intelligence, and security forces. An early retirement option played a politically important social policy role in the transition, exercised by nearly 80 percent of all new claimants by 1994. Disability pensions also increased sharply.

Throughout the Meciar years, Slovakia saw a number of efforts to initiate a pension reform, driven by the eroding finances of the pension fund. None succeeded. Unions effectively vetoed even parametric adjustments in eligibility or benefits, and used their position to influence annual pension adjustments toward greater generosity (Svorenova and Pretasova 2005, 123).

A broadly similar pattern of limited reform is visible with respect to health insurance (Svorenova and Pretasova 2005 199-219; Hlavacka, Wáagner and Rieseberg 2004, 91-106). Early institutional reforms created autonomous health care facilitiesm privatized primary health care and pharmacies, and allowed private insurers to enter the healthcare market. But the constitution confirmed access to medical care as a citizenship right regardless of contributions and
implementing legislation offered generous packages of services. Altogether, the state contributions covering such groups as children, pensioners, and students provided health insurance for no fewer than 3.1 million persons in 2001 out of a total population of about 5 million people (Svorenova and Pretasova 2005, 111). Opposition to increases in the payroll tax, combined with evasion and company failures, caused contributions to lag well behind the payout of generous mandated benefits. As a result, approximately half of the small number of private insurers either failed or were consolidated by the end of the decade. By the end of the Meciar years, the health care system faced a standard set of “soft budget” problems: hospitals that were chronically under-financed and heavily in arrears; drug companies and pharmacies not fully reimbursed by insurance companies; and increasing lags in contributions.

Child allowances provide a final example of policy continuity with the socialist era. As in the Czech Republic, the government moved from a principle of universal fixed entitlements to means testing. This policy was relaxed, however, as the combination of means-testing and failure to adjust entitlements in the face of inflation resulted in a decline in coverage and generosity of benefits. Parliamentary legislation in 1994 and 1997 restored coverage to fully 83 percent of all children in the country (Bednarik 1998, 12).

Second Stage Reforms: from Deadlock to Reform

The coalition government that came to office following the 1998 elections enjoyed a mandate to reverse the creeping authoritarianism and corruption of the Meciar years. The coalition quickly outlined a major economic package in May 1999 that involved not only a current account and fiscal adjustment but dramatic price liberalization, banking reform, corporate restructuring, bankruptcy legislation and efforts to jump-start the process of EU accession and
attract foreign investment. Later in its term, the center-right parties in the coalition began to advocate radical tax cuts as a way of stimulating investment and growth.

Despite a steady increase in the operating deficit of both the pension and health funds, however, it proved much more difficult for the government to extend its reform program into the social sector. Despite relatively high unemployment and growing liabilities in the social insurance funds, the country did not experience a full-blown crisis and was not dependent on the IMF. The resumption of growth initially made it difficult for reformers to gain traction.

After 2000, EU accession negotiations and the requirement to meet the Maastricht fiscal targets provided an indirect, but nonetheless important source of external pressure for social policy reform. Although economic conditions did not warrant a standby with the IMF, the government agreed to a World Bank loan that was linked to EU accession targets and monitored by the IMF. In addition to a deepening of market reforms, the program also envisioned deregulation of the labor market, rationalization of healthcare provision, and overhaul of the pension system. Nevertheless, little action was taken on these social policy reforms until after the 2002 elections.

The main constraints were political. Not only was the ruling coalition fragmented, but it included the reformed communist party. The government sought to secure social support for its reforms by reviving the tripartite mechanism that had lapsed in the late Meciar years. Labor strength had waned considerably, but unions used the tripartite structure to voice concerns over a range of issues including social policy, tax benefits for low-income workers and the minimum wage. Significant pension reforms also met strong political opposition, and the government chose the softest of the three proposals under consideration; an increase in the retirement age
favored by the trade union confederation (Svorenova and Pretasova 2005, 126). Changes in the health care sector were similarly modest in scope.\textsuperscript{xi}

In the elections of September 2002, the path to more decisive social policy reform was cleared by a sharp drop in support for the post-communist left and by the continuing political isolation of Meciar’s HSDZ. The center-right and right parties quickly formed one of the most ideologically cohesive coalitions in our sample and moved quickly to undertake broad reforms of both the pension and healthcare system. Despite resistance from both labor and business in the tripartite council, the government passed a fundamental overhaul of the pay-as-you-go system in 2003, and an even more fundamental tax reform the following year.\textsuperscript{xii} The reform raised the retirement age, rewrote the benefits formula to give greater weight to actual contributions, and took indexation decisions out of the hands of parliament through a formula. Despite some side payments to secure support, there can be little question that the reform marked a departure from the more solidaristic approach of the pre-reform period. A second law passed in October 2003 established the second pillar, which was compulsory for new entrants into the workforce.

The reform of the healthcare system began with the introduction of co-payments in 2003, a reform introduced over a presidential veto, strong criticism from both the opposition and labor, and an important constitutional court challenge. The Ministry of Health also undertook a number of important internal, administrative reforms, including of the payment system and the network of public provider institutions. The second phase of the reform sought to limit public responsibility by outlining a basic solidaristic benefits package and encouraging private insurance. The reform legislation included strong incentives for both employees and employers to enroll and to make contributions, including a limit of public guarantees to urgent care only and
requirements that the unenrolled be forced to pay for services (Hlavacka, Wagner, and Rieseberg 2004, 24, 99-103).

The Slovak reforms of the early 2000s rank among the most decisive in our sample of East European cases. With respect to pensions, the reform established a relatively large second pillar. The reform of the healthcare system increased the scope for private insurers and providers, rationalized public provision and introduced limits on the scope of public responsibilities. The government also managed to tighten eligibility requirements and reduce the size and duration of welfare payments.

Why did Slovakia go as far as it did? A number of factors contributed: strong public support for integration with Europe following the isolation of the Meciar years; the very particular external constraints on fiscal policy associated with accession; the ideological cohesion of the ruling coalition after 2002 and the fragmentation and isolation of the opposition. The political costs of the reforms, however, were high. Despite a dramatic upturn in growth, the government experienced a sharp drop in public support and in the election of 2006 was soundly defeated by a left-leaning party (SMER) that campaigned on promises to restore the “solidaristic” features of the social safety net and healthcare systems. Moreover, it is important to put Slovakia’s liberalizing reforms in comparative perspective. The pension privatization retained the effective universalism of the pension system, and was sold in part by arguing that replacement rates would rise. Health care reforms were similarly coupled with a restatement of the commitment to broad coverage, promises to improve the quality of care, and important concessions to low-income households. In these crucial respects, the system maintained important links to the commitments of the socialist era.
Bulgaria and Romania

Bulgaria and Romania share a number of features that differentiate them from the other Eastern European countries. The two countries had lower per capita incomes at the time of the transition, and more pressing problems of absolute poverty, particularly among minority Roma populations. Both have been characterized as slow reformers. Both experienced lower overall growth during the first decade of the transition that can be traced to “second round” crises in the mid-1990s. These crises forced a new round of stabilization programs, structural adjustments and negotiations with creditors, the international financial institutions and the EU. Although Bulgaria undertook a more wide-ranging reform effort than Romania, both countries were late entrants into the EU and did not sign accession treaties until 2005.

This slower reform path, in turn, has also been related to differences in the nature of the political transition. Although Romania did achieve a democratic breakthrough, the power of relatively unreformed post-Communists and the strength of the presidency under Iliescu raised doubts about democratic rule that were even more serious than those raised by Meciar’s autocratic tendencies in Slovakia. Bulgaria’s transition to democratic rule was cleaner, but post-transition politics was also dominated by a reformed Communist party.

These economic, policy and political differences mattered for both the timing and nature of social policy reforms. In Romania, features of the political landscape limited both the depth and coherence of reform initiatives well into the 2000s. In both cases, however, we also see early attention to creating social safety nets and continuity in the universal approach to core benefits. Moreover, we find a distinctive interest in both countries in addressing problems of structural poverty and inequality.
Bulgaria

The political transition in Bulgaria took place through the forced resignation of Todor Zhivkov in late 1989 and his replacement by a younger generation of party leaders. This first post-Communist government won a majority of seats in the June 1990 parliamentary elections, but fell only five months later following a wave of strikes by post-communist and opposition unions. In the ensuing seven years the country was ruled by a succession of fragile, short-lived governments: three left (1989-1990, 1992, 1995-1997), one right (1991-1992), one transitional coalition (1990-1991) and two interim governments appointed by the President (November 1994-January 1995 and February-April 1997).

The right-of-center Union of Democratic Forces (UDF) was the first government to complete its term (1997-2001). Coming to office in the wake of a hyperinflation, it quickly stabilized the economy and initiated a new round of economic reforms and important institutional changes in the social welfare system. Despite reasonable economic performance in the aggregate, the UDF fell to voter disaffection over continuing high unemployment and particularly perceptions of corruption (Valev 2004, 416-421). They were displaced not by the post-Communists, but by a conservative-populist party that emerged only shortly prior to the 2001 elections, the National Movement Simeon II (NMS II). Yet despite this somewhat more turbulent political history, we find very similar patterns to the other cases with respect to the evolution of social policy.

*Coping with the Transition* xiii

The succession of early Bulgarian governments had to deal with the largest drop in output in our sample of countries, the steepest decline in state sector employment, and the highest transitional inflation (Minassian 1998, 331-342). Although a newly-emergent opposition
union confederation (Podkrepa) played a key role in bringing down the first socialist government, it cooperated with the stabilization effort undertaken by the UDF government under IMF auspices in 1991 (Iankova 2002, 52-91).xiv

Nonetheless, the weakness of successive governments meant that they were held hostage to consensus among the major parliamentary blocs; in the words of one prime minister, Lyuben Berov, “if just one group said no, the question was closed (quoted in Stone 2002, 214).” In return for concessions, labor effectively controlled key social policy ministries, including under the UDF government, and participated in a wide-ranging network of tripartite institutions that exercised strong influence over social policy (Iankova 2002, 52-91). Labor argued successfully for the introduction of social safety nets, the maintenance—at least initially—of centralized wage bargaining, and continuity or even expansion of established social transfers.xv

Unemployment insurance was introduced in late 1989 for the first time, initially to handle the displacement of Communist Party officials in the wake of the democratic transition. Benefits were modest at first and coverage was lower than in the other countries in the region, but by 1998 they were comparable to those in the Czech Republic and Hungary (Cazes and Nesporova 2003, 116-117). The absence of effective monitoring meant that the unemployed could collect benefits while working on informal contracts, which employers favored to avoid steep payroll taxes.

In addition to unemployment insurance, the government also revamped the social assistance scheme inherited from the socialist period. The new scheme shifted from eligibility based on membership in defined categories, such as the disabled or single elderly, to an income formula and introduced a guaranteed basic minimum income (BMI). Several studies find that these safety nets ameliorated both poverty and inequality during the transition (Hassan and
Peters 1996, 64; Orenstein and Wilkens 2001, 1-2), but benefits were in fact widely spread despite nominal efforts at targeting. In 1992, the middle 60 percent of the income distribution received 59 percent of unemployment benefits, 69 percent of children’s allowances and 57 percent of all social assistance, with significant shares also going to the top 20 percent of the income distribution as well (Hassan and Peters 1996, 642).

Pensions and disability payments became a further route for cushioning the transition. Despite a low retirement age—60 for men and 55 for women—strikes in 1990 secured even earlier retirement for a number of occupational categories, including fully 30 percent of all state employees.

In the 1994 elections the socialists were returned with 43 percent of the vote and an absolute majority of seats on the populist ticket of “moderating the social costs of transition.” The new government pushed through a package of policy measures based on the concept of “public correction” that included extensive price regulation, subsidies to energy, wider regulation of economic activity, and increasing credit from state-owned banks to keep state-owned enterprises afloat. Prior to the 1994 elections, Bulgaria’s relations with the IMF had been anything but smooth (Stone 2002, 210-217; Nicolov et. al. 2004); following the elections they soured badly. Fiscal policy was a major issue of contention. The contingent liabilities of the banking sector became an increasing point of technical concern, but entitlements also constituted a major fiscal drain. In principle, the socialist system had been organized on a social insurance basis with a single unified fund covering a wide variety of risks. But earmarked taxes did not increase along with growing outlays, and as early as 1992 the government was forced to cover deficits in the social insurance fund equal to nearly two percent of GDP (Hassan and Peters 1996, 641).
The problems were not only transitional but structural, and included a high ratio of beneficiaries to contributors and the exemption of certain classes of individuals and households from contributions (the military, women on maternity leave). Strong moral hazard problems operated. Private employers had strong incentives to evade payments. State-owned enterprises made payments but relied on subsidies provided through the banking system. The socialist government did separate the pension fund from the state budget and create an independent National Social Security Institute, managed on a tripartite basis. But the social partners could not reach consensus on a reform that would address underlying structural problems (Shopov, Noncheva and Tafradjiyski 2005, 9-14).


The economic crisis overlapped with a political crisis. In late 1996, the presidential election brought the UDF candidate Petur Stoyanov to office, and in December the Socialists relinquished sole control of the government in the face of political unrest that extended through the elections in April. The transitional government of Stefan Sofianski, in office only 90 days from late February through the elections, initiated a number of significant reforms. But with the decisive victory of the UDF—which gained an absolute majority of both votes and seats—Bulgaria had its first opposition government and one with a strong mandate to accelerate the reform process.
Second-Round Reforms

The first task of the UDF government was stabilization, which was achieved through the controversial mechanism of a currency board introduced on July 1, 1997. Inflation fell to near-zero levels by 1998. Structural reforms, including privatization, were equally dramatic. In November 1996, 67 percent of workers were still in the public sector; by December 2000 this was down to just under 40 percent.

Somewhat more gradually, the UDF government also undertook reforms of social policy. The poor performance of the pay-as-you-go pension system provided a particularly important target for technocratic reformers. Thanks to the near-hyperinflation and lags in indexing, the average pension in 1998 was worth only about one-third of its value in 1989 (International Monetary Fund 2000, 45-6). The reform thus promised not only to increase the financial soundness of the system but to increase coverage and benefits as well (Shopov, Noncheva and Tafradjiyski 2005, 14-18).

As in the other cases we have reviewed, the reform was forged through a series of compromises that limited the costs for existing pensioners, maintained broad coverage, and left longer-term problems unaddressed (Noncheva 1999, 22-26). In 1992, the World Bank had held seminars on the Chilean experience and a handful of liberal think tanks argued for a full-fledged defined contribution model. This option was quickly rejected in favor of a three-pillar approach. The reforms of the first pillar raised the retirement age, tightened the links between contributions and benefits, and gradually shifted the balance of contributions toward employees. However the first pillar remained large, and although there was no commitment to a particular replacement rate, the reforms were based on projections that it would finance between 40 and 50 percent of retirement earnings. Reforms were not paid for through substantially increased contributions or
reduced benefits but a combination of borrowing, privatization receipts, transfers from the budget and a slowing of the diversion of contributions from the first to the second pillar (International Monetary Fund 2000, 50).

A number of crucial categories of citizenry were also effectively exempted from contributions or gained access to non-contributory transfers. The agricultural sector was not formally excluded, as in Poland, but participation was extremely low. The loophole with respect to the self-employed and those not working on formal contracts remained open. At the same time, the government retained a variety of obligations that were ultimately funded directly from the treasury, such as disability pensions (16 percent of all pensioners) and additional social assistance payments to low-income pensioners. Although income and property tested, those qualifying for these additional benefits also equalled no fewer than 16 percent of the number of all pensioners in 2000 (Tafradjiyski et. al. 2002, 15).

The health care reform followed a sequence similar to the other cases, including the decentralization of medical facilities, the establishment of private practices, and the formation of new medical associations. But the growth of private provision hit limits even more quickly; by 2000 only about 20 percent of doctors even offered services privately, and virtually all of them maintained their jobs in the state sector (Noncheva 2001, 27). With the coming of the economic crisis, the health care budget fell (Tragakes 2003, 35). Utilization fell, gratuities remained pervasive and satisfaction with the status quo plummeted (Balabanova and McKee 2002, 379-384). Despite these problems, the socialist government remained divided on a course of reform and failed to formulate a new approach.

As with the deterioration of the pension system, the deterioration of healthcare provided an opportunity for the UDF to reform the system. The most important healthcare initiative was the
Health Insurance Law of 1998, which established a compulsory health insurance system that guaranteed provision of a basic package of services. The inauguration of social insurance was seen both as a way to rationalize the system and as a means to increase dedicated resources in the context of fiscal constraints; doctors and other health care providers supported the social insurance principle precisely on those grounds. The ultimate bargaining around the finalization of the bill hinged in large part on the level of the payroll tax contribution. Bulgarian and foreign experts estimated that contribution of about 12 percent of income would be required to finance the services envisioned (Tragakes 2003, 26). In view of the difficult economic situation and the simultaneous introduction of the pension reform, however, the government opted instead for a 6 percent contribution rate.

The objective of shifting to a contribution-based system, strong political pressure to limit payroll taxes, and continuing expectations of universal coverage stood in quite obvious contradiction. Both central and local governments continued to cover a substantial share of the total healthcare bill; in 2000 the National Health Insurance Fund (NHIF) covered only 13 percent of all public health care expenditures. Contributions for large sectors of the population were still covered from general revenues: the unemployed and poor, pensioners, students, solders, civil servants and some other vulnerable categories. Hospitals continued to rely on central government transfers and arrears to suppliers.

The final component of the UDF reforms was a rationalization of labor market policy through the Protection against Unemployment and Promotion of Employment Act of 1997. In addition to restricting unemployment compensation, the new act moved toward more targeted forms of social assistance for the long-term unemployed. However, the new act also included expanded commitments in which European—as opposed to IFIs—consultancies played a major
role: job information and consultations; training; support for entrepreneurship, as well as income support (Noncheva 2001, 22).

The fall of the UDF government in 2001 and the inauguration of the more conservative NMS II government might have presaged further liberalization of social policy commitments. Although the new government took some administrative reforms and maintained a conservative fiscal policy, subsequent changes were largely parametric in nature. If anything, the onset of accession negotiations provided Bulgaria with new opportunities to tap Community resources to expand social policy commitments, for example, through access to regional funds and the initiation of new anti-poverty programs.

**Romania**

The transition to democratic rule in Romania was the last and most difficult in Eastern Europe (December 1989). It was marred by violence against the opposition and doubts about the intentions of the National Council of the Salvation Front (NSF), a populist-nationalist party dominated by former communists. Through 1996, political power was held by the NSF, later the Party of Social Democracy in Romania (PSDR) and by its leader Ion Iliescu, who was elected to a relatively powerful presidency with an overwhelming mandate of 80 percent of the vote in May 1990.

The ruling coalition started to fray in late 1995, opening the way for a brief period of opposition rule. Between 1996 and 2000, power was held by a series of short-lived anti-communist coalitions and then by two technocratic governments: one headed by National Bank headed by Radu Vasile of the Peasant Party, which lasted barely a year before being replaced by a government under National Bank governor Mugur Isărescu. In the 2000 elections, Iliescu and
the PSDR came back into power as the center of the political spectrum collapsed and right-wing nationalist candidates and parties showed major electoral gains.

The center-right did manage to reconstitute itself in subsequent years, and was returned to office in elections of questionable integrity in 2004 (Pârvulescu 2004, 7-24). Yet for the period up through the 2004 elections—our focus here—Romania saw the longest period of rule by post-communist parties (1989-1996, 2000-2004). When anti-communist forces did capture government, they faced ongoing conflict and deadlock with post-communists and nationalists, intra-coalitional rivalries and high cabinet turnover.

These political circumstances were related as both cause and effect to the particularly inauspicious economic and social circumstances of the Romanian transition. The extreme depredations of the late Ceauşescu period made the post-transition electorate particularly vulnerable to populist appeals, and the NSF had close ties to the post-Communist unions. Technocrats had little political space in which to operate. Prime Minister Petre Roman’s attempts at economic reform were blocked by the conservative wing of the party and in September 1991, he was forced to resign after a second miner’s uprising in Bucharest. Loss-making SOEs were sustained by direct budgetary subsidies (up to 13 percent of GDP in 1992) and increasing reliance on both domestic and foreign debt. From 1995, the share of non-performing loans in the banking system also started to rise. These adverse trends culminated in a balance of payments and financial crisis in 1997.

As in Bulgaria, it fell to the opposition government to introduce a difficult stabilization. The second transitional recession in Romania was even deeper than in Bulgaria, however: the economy contracted by 6.6 percent in 1997, 5.4 percent in 1998 and 3.2 percent in 1999. 1999 was a year of a near-debt crisis that forced a major balance of payments and fiscal adjustment.
The technocratic government of Mugur Isărescu exploited negotiations with the EU to formulate a reform plan that was finally adopted by parliament in May 2000. But both the National Front and the far right ran against the plan during the election campaign of that year, and subsequent relations with both the EU and the IMF were subject to ongoing conflict.

*Dealing with the Transition*

Although the post-transition governments in Romania sought to retain employment in the state-owned enterprise sector, they also sought to construct new social safety nets for those displaced by the transition. The reconstitution of tripartite structures served, at least initially, as a forum for negotiations over these policies (Iankova 2002, 5). The government introduced an unemployment scheme in 1991, and in 1995 added a social assistance scheme (the Social Aid Law) targeted toward low-income sectors. In practice, severe fiscal constraints sharply limited the scope of such programs; during the crisis of the late 1990s, only 8 percent of poor families received assistance through the Social Aid Law (World Bank 2002b, 11-12). But even more than in other countries, the Iliescu government supplemented new safety nets with the expansion of existing entitlements from the socialist period. In 1990, a relaxation of restrictions on early retirement led to the most rapid increase of retirees of any Eastern European country; by the end of 1991, the number of beneficiaries had increased by 40 percent. Eligibility for disability pensions was also relaxed, leading to a 270 percent increase in such pensions during the period 1990-98.

As elsewhere in the region, the number of contributors to the system dropped as a result of increased unemployment and the migration of workers into the informal sector. An increase in the payroll tax in 1992 – from 14 to over 25 percent of wages— had little effect on actual revenues. The relatively large rural sector posed a particular problem, given its electoral weight,
the high share of the elderly in the rural population, and the effective bankruptcy of a number of the cooperative farms. The government created a special pension for retired agricultural workers, funded by a supplementary tax on food distributors, although benefits were small. Throughout the remainder of the NSF government, the main means of managing mounting pension obligations was through inflation. Prior to the elections in 1996, the real value of benefits were temporarily increased by changes in rules governing work histories and entitlements, but these populist measures fed directly into the broader macroeconomic problems and contributed to the crisis of 1997.

Among inherited entitlements, family allowances had played a particularly important role as part of Ceauşescu’s pro-natalist policies. Beginning in 1993, the government came under pressure to expand the child allowance to make it a universal benefit, which was done in 1994. However in contrast to Hungary’s more encompassing benefits, parental leave and pay could only be claimed by women with an employment history; Romania is thus intermediate between Hungary and Poland in the generosity of these benefits (Fodor et. al. 2002, 483-488).

Second-Round Reforms

Accumulated imbalances and populist measures undertaken in the run-up to the November 1996 elections contributed both to a rapid deterioration in the financial integrity of the social insurance fund and a wider fiscal and financial crisis. In a report on Romania’s progress toward EU accession issued just before the 2000 elections, the European Commission found that Romania still did not have a “functioning market economy”—a requirement for entry—and specifically cited the relaxation of fiscal policy and the failure to undertake adequate reforms of the pension and health care systems. But fragmented and unstable coalition governments were unable to act in the face of labor militancy and severe problems of poverty. Indeed, the social
portfolios were typically allocated to the parties most committed to retaining existing entitlements.

In the health sector, debate on comprehensive reforms accelerated after 1996, spurred on by the World Bank, the EU, and bilateral aid agencies. As in the other cases, however, reforms were constrained by broad public expectations and pressure from professional associations and unions. The 1997 Health Insurance Law shifted from a tax-based system to mandatory health insurance organized at the regional level. But central government transfers covered the non-insured and the reform explicitly sought to increase health spending (European Observatory 2000, 67).

Pension reform was also a core objective of the new government and was incorporated as a condition of a World Bank adjustment loan that had been suspended under the old government. Initially conceived as a three-pillar reform, the effective insolvency of the pay-as-you-go system made reform of the first pillar a top priority. The legislation submitted to parliament in 1998 and passed in late 1999 gradually raised the retirement age, tightened eligibility for early retirement, and established a virtual link between contributions and benefits. However, the counterpart of the tighter provisions introduced in the new public law was a generous indexation formula and a massive “recorrelation” that effectively guaranteed to older retirees the additional benefits extended in the populist “reforms” of 1996 (de Menil and Sheshinski 2002).

Almost immediately on implementation, the new system ran into a firestorm of controversy as it appeared to dramatically lower the replacement rate for certain workers, leading the next administration to both raise the maximum pension allowed and to make further adjustments in the equalization efforts. Legislation governing the creation of a second pillar had to be withdrawn by the Isărescu government and was not re-introduced.
Probably the most important reform of this 1997-2000 period—and one affecting a number of other discrete policy areas—was the adoption of a new Law on Local Public Finance formulated under the Cişmigiu government and adopted in October 1998. Decentralization expanded local financing and administrative responsibilities for many basic social services, including education, social assistance and services, and some health services. The incentives for such a change were multiple, and included political reform. Nonetheless, as the World Bank (2002b, 6) notes “the need to confront the budget shortfall provided an incentive for the government to shift increasing expenditure authority to lower levels of government.” The reforms resulted in the emergence of major inequities in the level and quality of services across the country, as poorer jurisdictions found themselves overwhelmed by the demand for services and without the fiscal resources to respond effectively. These problems were particularly visible in the health sector (World Bank 2002c, 64-65) and ultimately resulted in strong political pressures for recentralization.

Despite efforts of the outgoing government to buy support through increased pension benefits and an increase in the minimum wage to public sector workers, the November 2000 elections saw a complete rout of the center-right by the left and an upsurge of support for the extreme nationalist-populist Greater Romania Party. With near majorities in both the upper and lower houses, the PSDR formed a minority government in control of all ministries. The new government quickly faced the conflicting circumstances visible in the second round crises in Bulgaria, including large budget deficits and increasing external pressures associated with EU accession negotiations and balance of payments problems. In the fall of 2001, the government reached a preliminary agreement with the IMF on a new program implicitly linked to accession.
However in contrast to Bulgaria, these tasks fell to a leftist party with a core base of support that included industrial workers, pensioners and the poor.

The PSDR did have certain political advantages in its ability to secure parliamentary and support for its initiatives. However, the government inherited expansionary promises in the two largest social insurance areas—health and pensions—and from the outset spending in these two areas increased. Some of these increased costs reflected efforts to rationalize the system, such as changes in the calculation of benefits that encouraged early retirement. Yet other costs reflected political compromises and new social commitments: the quarterly indexation of pension benefits; a 40 percent increase in the minimum wage; an increase in transfers to the rural sector; and the creation of a minimum income scheme that was anticipated at the time to cover nearly 600,000 households and cost nearly .5 percent of GDP (EIU 2001a).

Romania subsequently secured entry to the EU, and moved toward a number of reforms that paralleled the social insurance models seen elsewhere in the region. But progress remained very limited through the early 2000s. In the key area of pension reform, the government finally mandated the establishment of a second pillar in 2004. But negotiation of critical details continued to lag, and implementation was not projected to begin until at least 2007.

By way of conclusion, it is worth considering some of the salient differences between the course of social policy reform in Bulgaria and Romania. Both experienced “second round” crises. But Bulgaria’s very high inflation provided an opening for more dramatic reforms that reached into the social sector. In Romania, by contrast, the second recession was more prolonged but the absence of high inflation weakened support for a more radical reform effort. Partisanship and the fragmentation of government coalitions also played a role in the timing of reforms. In Romania, fragmented opposition coalitions were hamstrung in their ability to initiate virtually
any social policy reforms. In Bulgaria, reform of the pension and health system was facilitated by a relatively unified government. Even there, however, liberal reformers accommodated citizen expectations regarding coverage and made new efforts to address labor market insecurity, long-run unemployment and poverty.

**Conclusion**

The transition to the market spelled the end of the employment guarantee in Eastern Europe. The shift from direct state financing of entitlements to social insurance principles arguably marked an important change in principles. Subsequent fiscal constraints and the ascent of market-oriented political forces and policy networks subsequently encouraged some movement in the direction of more liberal welfare principles, as a number of critics feared. Yet despite rapid and wrenching transitions to the market, the principles of comprehensive protection that underlay the socialist welfare systems showed surprising resilience in Eastern Europe. Moreover, although governments certainly differed in their exact approach to social policy, the countries we consider show a substantial convergence when compared with either Latin America or East Asia (Table 8.2).

**Table 8.2: Social Policy Developments in Eastern Europe, 1980-2005**

<table>
<thead>
<tr>
<th>Early Reformers</th>
<th>Pensions</th>
<th>Health</th>
<th>Social safety nets</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Poland</strong></td>
<td>Moderate privatization establishes second pillar but retains broad coverage and large public pillar (1998). Rural population covered under old non-contributory system.</td>
<td>Shift to social insurance system (1997) but with guarantees of universal coverage</td>
<td>Unemployment insurance supplemented with generous use of disability pensions, early retirement and family allowances</td>
</tr>
<tr>
<td><strong>Hungary</strong></td>
<td>Moderate privatization establishes second pillar but retains broad coverage and large public pillar (1997).</td>
<td>Early shift to social insurance system (1992) but with guarantees of universal coverage</td>
<td>Unemployment insurance, active labor market policies and generous use of family and child allowances. Strong opposition to rationalizing family allowances</td>
</tr>
<tr>
<td>Country</td>
<td>Initial System Description</td>
<td>Reforms Impact</td>
<td>Current System Description</td>
</tr>
<tr>
<td>------------------</td>
<td>------------------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>No pension privatization through 2005.</td>
<td>Radical reform establishes private insurance funds (1992). Reform fails, and system reverts to government social insurance.</td>
<td>Limited unemployment facilitated by government encouragement of employment guarantees and active labor market policies. Generous family allowances and minimum income guarantee.</td>
</tr>
<tr>
<td>Slovakia</td>
<td>Old pension system maintained until relatively extensive privatization in 2002.</td>
<td>Shift to social insurance but marginal changes until 2003 reforms including limiting benefit package and encouraging private insurance</td>
<td>Limited unemployment facilitated by government encouragement of employment guarantees, active labor market policies and public employment schemes. Generous family allowances and minimum income guarantee.</td>
</tr>
<tr>
<td>Bulgaria</td>
<td>Moderate privatization establishes second pillar but retains broad coverage, large public pillar (1999). Large non-contributory disability pension and social assistance to low-income pensioners</td>
<td>Shift to social insurance system (1998) but with guarantees of universal coverage and substantial healthcare financing through general revenues.</td>
<td>Unemployment insurance supplemented with generous use of disability pensions and early retirement; some reform of these entitlements after 1997 with more active labor market policies. Broadly targeted minimum income scheme (1992).</td>
</tr>
</tbody>
</table>

First, in most countries government financing of uninsured groups reflects de facto commitments to universalism, particularly in the area of healthcare and old-age protections. In some countries and policy areas, de jure commitments to universalism have been enshrined in new constitutions. These commitments stand in contrast to the continuing fragmentation of Latin America’s social insurance systems and the ongoing deficit in access to even basic health and education that persists in a number of countries in the region.
The Eastern European countries show not only wide population coverage, but also commitment to insurance against a fairly wide range of risks, closer in principle to the broad European conception of social insurance enshrined in the ILO than more liberal models. Much more than in Latin America, governments remained committed not only to public health insurance, but to active and passive labor market policies, disability insurance, and family allowances of various sorts. These commitments have generally been reflected in the continuing allocation of substantial fiscal resources for the social sector (Appendix Six). Recurrent fiscal constraints eroded entitlements and resulted in a deterioration in the quality of services, queuing for services and the persistence of under-the-table payments for services. Despite their defects, however, principles of broad coverage persisted. Liberalizing reforms were not only slower to emerge than in Latin America, but were often reversed when they were tried. We have attributed these continuities to the influence of common welfare legacies. The organization and coverage of the old system produced strong and widely-shared public expectations about the role of the government in providing protections and services, expectations that are repeatedly confirmed in the survey research literature (for example, Lipsmeyer 2003). This policy inheritance generated strong electoral and interest group pressures on governments.

More than in the other regions, our analysis of the post-socialist transitions has relied on a relatively straightforward path-dependence argument. We are not alone; others have made similar arguments. Yet this approach cannot be sustained without taking into account alternative explanations that might account for the convergence we see across the region.

The most important candidates are approaches that stress common external pressures and influences. One version of this argument, advanced most forcefully by Deacon (1997, 2000; Deacon and Stubbs 2005) and Orenstein (2006), is that the international financial institutions
played a crucial role in defining social policy options in the region, both directly by providing intellectual templates and indirectly by pressing for fiscal adjustments (see also Stone 2002).

The IFIs play a role in our account as well, but in a somewhat different way than suggested by Deacon and Orenstein. We argue that the influence of the IFIs is not constant but rather contingent on economic circumstances. Crises and the emergence of pressing fiscal constraints are associated with an increase in the influence of both technocrats and of the international financial institutions. We also emphasize that external influence faced important domestic political limits. A substantial number of IMF programs were cancelled or did not go to their conclusion (Stone 2002, 67-73). Similarly, welfare reforms accommodated the domestic political coalitions we have identified, and were frequently modified or even reversed when fiscal conditions eased.

A second, quite different source of external influence is associated with the proximity of the European Union. Orenstein and Haas (2005), for example, argue that the “European” and “Eurasian” successor states had similar social policy regimes prior to the transition, but only the “European” ones have maintained broad social insurance coverage and innovated new programs (see also Cook 2007). They explain this difference by what they call the “Europe effect.”

On closer inspection, European influence on social policy is by no means clear, as Wade Jacoby (2004) has also argued in a thoughtful study of the influence of EU enlargement on Eastern Europe. After 1995, the EU gravitated toward the view that new members should conform closely to common EU standards from the outset rather than being allowed a lengthy transition process as had been the case in the Southern European applicants during the 1980s. The direct transposition of the 80,000 page *acquis communautaire* became the formal target for candidate members, organized through negotiations of 31 discrete “chapters.” Moreover, there is
ample evidence that—fears of rampant neoliberalism to the contrary—Eastern Europe borrowed widely from the diverse palette of Western European social policies.

But the direct European influence on social policy outcomes was relatively limited in the core areas of interest to us. First, our case studies show that a number of key decisions on social protection came very early in the transition. These included both the promise to maintain certain commitments, such as healthcare, and the innovation of new ones, such as social safety nets. At that point, prospects for membership in the EU were highly uncertain even in the early reformers let alone in Slovakia, Bulgaria and Romania.

A closer look at the relevant sections of the *acquis communitaire* also suggests that the direct influence of the EU was fairly restricted (Wagener 2002, 167-170). The single market requires conformity with a number of health and safety restrictions; moreover, the amended European Social Charter, incorporated into the Treaty of Amsterdam, addresses a number of social issues including working time, equal opportunity, and “social dialogue.” But the EU negotiations did not require the adoption of the social security and health policies discussed in this chapter. The Social Charter stipulates basic rights of collective bargaining and enumerates rights to social security (ESC Arts. 12, 22); to protection of health (ESC Art. 11); to social assistance and services (ESC Arts. 13, 14); and to family protection (ESC Art. 17). But these are outlined as a statement of aims, not specific requirements. More important, they are subject to the arguably contradictory pressure of meeting the strict fiscal requirements of entry, which by contrast are very precise. In the cases of Slovakia and Romania in particular, the indirect influence of the community probably pushed in the direction of the rationalization of social expenditure rather than convergence on Western European models.
As Jacoby (2004, 45-64) argues with respect to health care, finally, it is not clear what it means to speak of a “European” influence. Much of the literature on the European welfare state has been devoted to outlining and explaining its diversity, from pensions and healthcare to unemployment insurance, labor market policies, and family policy. Although some protagonists such as Klaus might have looked longingly at Thatcherism, others sought policy advice from countries in the Community with quite different systems. In one interesting health policy experiment in Bulgaria, the government self-consciously invited advisors from four different countries and even initiated pilot projects for the purpose of weighing the costs and benefits of different policy approaches.

We do not rule out the complex if important possibility that social policy models owed some intellectual debt to borrowing from extant European ones. But this is a much more modest claim, and advocates of this diffusion approach have to explain why the borrowing took the particular form it did. Answers to that question can only come from some consideration of the political selection process. Notwithstanding deep market reforms, broad entitlements were difficult to fundamentally amend due to both electoral constraints on politicians and pressure from organized stakeholders. Expectations with respect to the public sector’s role in cushioning against risk contributed to the creation of new social safety nets and efforts to alleviate poverty and inequality. The relatively uniform nature of the socialist legacy that we outlined in Chapter Five is ultimately mirrored in important continuities in Eastern European social policy in the post-transition period. As in the other regions, the social policy equilibrium that we identify as of 2005 is by no means immune from further revision. Yet 2005, Eastern European social policy had “settled out” to a significant
extent, revealing important contrasts with the Latin American cases in how new democracies respond to economic crises.

\[\text{The eight areas of reform are large privatization, small privatization, corporate governance, foreign trade and currency liberalization, price liberalization, competition, bank reform and securities market reform.}\]


\[\text{“Citizens of the Republic of Hungary have the right to social security; they are entitled to the support required to live in old age, and in the case of sickness, disability, being widowed or orphaned and in the case of unemployment through no fault of their own.” Article 70D.}\]

\[\text{The Socialists had also induced the Free Democrats—a small market-oriented party—to join the governing coalition.}\]

\[\text{The reform of 1992 separated healthcare financing under a nominally independent Health Insurance Fund (HIF) controlled by the Ministry of Health. Doctors gained the right to organize and the Antall government legalized the private provision of primary care. But the control of polyclinics and private hospitals was devolved to local governments; outside of general practitioners, little was done to privatize provision.}\]

\[\text{On the general persistence of these problems in the post-socialist health care system, see the analysis of Kornai and Eggleston 2001. On Hungary, see Osveiko 2002.}\]

\[\text{There is substantial debate on the ultimate sources of the relatively low unemployment in the Czech Republic during the transition, including not only active labor market policy but the effective move of labor into self-employment as a result of small-scale privatization and the slow pace of restructuring in privatized firms. See Boeri, Burda and Kollo 1998, 34 for data cited in text and 82-86; Ham, Svejnar and Terrell 1998; Terrell and Sorm 1999.}\]
In 1998 surveys cited in Vecernik (2004, 6), 50.8 percent of respondents favored state health care “without limits” and another 44.8 percent with “certain limits.”

For an overview of the Meciar years, see Krause 2001. For a comparison of the Czech and Slovak political systems, see Krause 2006.

The parliament rebuffed proposed rules that would have limited their capacity to spend and unilaterally voted substantial increases in pension benefits in 2000 (EIU 2001b). Broader reforms continued to be debated in the tripartite committees.

In 1999, the government restated the commitment to universal access and high quality health care while also promising to contain costs by addressing the adverse selection problems created by the existence of private insurers. But these parametric reforms “failed to address the essential issue of the future scope of the benefit catalogue covered by solidaristic financing” (Hlavacka, Wagner and Rieseberg 2004, 24).

See Moore 2005 for an overview of these reforms.

For an overview of social policy during the transition see Sotiropoulos, Neamtu and Stoyanova 2003.

The collapse of state sector employment also forced labor to back away from its initial desire to maintain an employment guarantee (Deacon and Vidinova 1992, 82).

For overviews of the early political fights over social policy, see Deacon and Vidinova 1992; Shopov 1993; Shopov 2002.

Orenstein and Wilkens (2001, 1-2) estimate that pensions accounted for 83 percent of total social insurance spending during the 1991-95 period, the highest ratio of the countries of interest to us.
Concern over the transition costs was one element, but the funded option was also opposed by unions, which sought to guarantee an institutional role for themselves both in the regulatory process and in holding shares in the proposed fund. Efforts to resolve these differences deadlocked and no further reform was undertaken during the Năstase government (Vasile and Uegaki 2003, 13-15).


Examples include Kovacs 2002; Inglot 2003; Manning 2004; Cerami 2005)