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# The Crisis and the Consequences of Austerity Policies in Central and Eastern Europe – Comparative Analysis

This paper draws a comparative analysis on policy responses to the Europe's financial crisis and its consequences in five Central and Eastern European countries, namely Croatia, Estonia, Romania, Slovakia and Slovenia. As already discussed in the case studies of each country, the crisis has revealed the strengths and weaknesses of CEE countries' national labour markets as well as their coordinated policy responses. More importantly, their policy approach can be put in comparative perspectives. The paper employs a theoretical framework of the 'Varieties of Capitalism' (VoC) as a basis for this comparative study. In the VoC model developed by Bohle and Greskvotis (2012), CEE states are mainly classified as *neoliberal* (Estonia and Romania), *embedded neoliberal* (Slovakia and Croatia), and *neocorporatist* (Slovenia). Given this account, the paper aims to examine to what extent these countries have shifted, if at all, in their approach to labour market policies after the crisis.

The main question therefore posits as follows: Have these welfare states (neoliberal, embedded neoliberal, neocorporatist) adopted policies in accordance to their institutional structures? To put it differently, do we see a policy convergence – or divergence – in the country's labour market in the post-crisis period?

Against this backdrop, the paper first provides a theoretical background on the divergent models of capitalism in Central and Eastern European countries. In the subsequent sections the paper analyzes the pre-crisis economic and political context of five countries as well as consequences of the crisis in comparative perspectives. Then it presents a comparative analysis of post-crisis policy responses brought by each country. All in all, the present study will serve as part of a broader project titled "Project on European Employment Responses to the Financial Crisis", commissioned by the European Commission.

## Theoretical Background: Varieties of capitalism (VoC)

After the fall of socialism in the 1990s, many doubted that capitalist democracy would take place in post-socialist countries, those known to be severely lacking cultural, political and economic pre-conditions to establish market economy. Despite prevailing doubts, capitalism emerged as countries of Central and Eastern Europe began to adopt key institutions of market economy as well as democracy, while successfully paving its way to becoming Member States of the European Union (EU).

However, the breakdown of the socialist system has, instead of forming a single market society, led to the emergence of diverse institutional configurations. It is thus argued that, although post-socialist states have thus far remained both capitalist and democratic, the transformation of post-socialist states is distinguished by divergent models of capitalism (Bohle and Greskovits, 2012).

In fact, the 'Varieties of Capitalism' (VoC), an earlier body of research developed by Hall and Soskice (2001), attempts to explain how different institutional configurations in capitalist states shape their behaviour and national strategies to cope with challenges brought by the global economy. Such as the liberal market economy (LME) and coordinated market economy (CME) have been suggested as one of their basic configurations; the former characterizes the prevalence of market relations that helps foster radical strategies, whereas the latter relies more heavily on consensual and cooperative relations among enterprises with a focus on incremental innovation.

In response to the earlier work of the VoC literature, Bohle and Greskovits (2012) however acknowledge the limits of its application to CEE countries. As argued, the VoC approach has been derived from Western forms of capitalism and thus originally designed to examine advanced economies. For this reason, the VoC approach falls short in adequately analyzing the varieties of post-socialist capitalism (Ibid). Furthermore, post-socialist countries, while lacking sufficient economic and political institutions at the time of their emergence, have been more strongly influenced by international and transnational actors than the Western countries had. As a result, Bohle and Greskovits (2012) once again underline that the application of the original VoC approach to post-socialist capitalism would be inadequate to fully understand the emergence of its national institutions in CEE.

In recognition of such limits, Bohle and Greskovits (2012) then develop three capitalisms specifically applied to Central and Eastern European states: namely, a pure neoliberal type in Baltic States (Estonia, Latvia and Lithuania), an embedded neoliberal type in the Visegrad countries (Czech Republic, Slovakia, Hungary and Poland), and a neocorporatist type in Slovenia. Additionally, they suggest that Bulgaria and Romania, though developed with different paths and delays, have adopted features of the neoliberal model, while Croatia has fallen under the embedded neoliberal regime.

The logics behind such divergent paths of capitalism formation are attributable to factors including, initial transformation strategies by political elites, consequences of policies and institutions, and impacts of transnational and international actors. Yet, more specifically, Bohle and Greskovits (2012) derive their model based on a theory of capitalism developed by Karl Polanyi. In Polanyi's view, capitalism is considered a multilateral (both international and national) form of political economy which produces wealth and freedom at the expense of what Polanyi called the double movement – that is, "the tension between a constant push towards self-regulating markets and spontaneous resistance to the subordination of society to market forces" (Bohle and Greskovits, 2012: 61).

Taking this Polanyi's notion of market society – a dynamic entity of tensions and contradictions, Bohle and Greskovits (2012) forms the basis of their capitalist varieties that are characterized by the opportunities and risks in a given international order, and by the push and pull of contradictory motives, social forces and institutions. All of these, as Bohle and Greskovits claim, can be distinguished and compared according to their specific configurations and their coordinating capacities to cope with capitalism's conflicts.

Together with the Polanyian origins, Bohle and Greskovits (2012) expand the VoC model by proposing their definition of post-socialist regime to be: 1) types of national political economies,

2) deeply and variable integrated in the neoliberal global and European order, (3) tend to pursue marketization and transformation cost compensation with different amounts of vigor and in varied forms, and lastly (4) politically govern the pursuit of these conflicting and contested social objectives in different ways and with varied effectiveness (Ibid: 78-79).

Along the above lines, each post-socialist regime encompasses the following distinctive features under the Bohle and Greskovits' VoC model. Firstly, *the neoliberal regime* is characterized by a combination of market radicalism, together with meager compensation for transformation costs and the limitation of citizens' and social groups' influence in policy-making. This was especially the case for the Baltic welfare states, including Estonia (and later followed by Romania). Although the Baltic States rapidly instituted market economies, they neither mitigated businesses' risks and losses nor provided adequate policies or sufficient protection against social inequality brought by the country's innovation. On the other hand, *the embedded neoliberalism* found in the Visegrad states distinctively relies on the search for compromises between market transformation and social cohesion. Countries like Slovakia (and later followed by Croatia), as Bohle and Greskovits (2012) underline, mobilized substantial resources to compensate for the transformation costs of domestic firms, while at the same time encouraging the expansion of new transitional industries. Such generous welfare schemes as well as the grant of political rights to all citizens are also the often observed features of this type of regime. Lastly, unlike the above two regime types, the neocorporatist regime shows the least radical strategy of marketization, coupled with the most generous compensation for losers of the transformation. Slovenia precisely falls under this regime. Not only their post-socialism policy geared towards nurturing domestic industries and managerial talent, but also the strong notion of democratic corporatism is largely found. Under their corporatist policy, collective bargaining agreements and negotiated multilevel relations among business, labor and the state have long helped the country to pursue an inclusive transformation strategy.

## The Context before the Crisis

### *Economic Context*

During the decade preceding the financial crisis of late 2000s, all the countries included in this analysis presented continuous economic growth as Figure 1 in the data appendix shows. The first country in reaching a stable path of growth was Slovenia. Following the disintegration of Yugoslavia, Slovenia was hit by economic depression. However, in the subsequent years the country restored a quick recovery reaching 5.3% of growth rate in 1994 while successfully brining inflation down from hyperinflationary levels. Meanwhile, Romania, Estonia, Slovakia and Croatia, succeeded in maintaining stable growth after a period of recession at the end of the 1990s. In this group, Estonia stands with the highest economic growth rates most of the years, even above all the EU countries.

Although all the countries experienced economic prosperity, the sources of this performance differ. To begin with, in comparison with the other countries in the group, international trade has not played a relevant role in the Romanian economy, as Figure 2 shows.  Recovery in Romania was possible thanks to the good performance of domestic consumption and domestic and foreign investment. On the supply side, the main contribution to the outstanding economic performance came from services and construction, which were the only sectors increasing their participation in the GDP in the decade preceding the financial crisis.

By contrast, in Slovakia and Estonia, the role of international trade was prominent on the economy. Slovakia slowly turned from being a net importer country to a net exporter. Between 1996 and 2007, the share of exports in Slovak GDP almost doubled, reaching 86.9% right before the recession. On the contrary, domestic consumption has not been typical of a highly-growing economy. On the supply side, the main source of economic growth was industry. During the previous decade, Slovakia has become a prominent producer and provider of automobiles, as well as other manufactured goods. In Estonia efforts directed to structural change, achieved fostering service sector (particularly through small business) and reducing the share of agriculture. As well as in the other countries of the group; in Estonia, gross capital formation and FDI remained at high levels before the crisis (Figures 3 and 4). However, growth not only relied on capital factors but also on private consumption. Both, private consumption and gross capital formation keep performing as the main sources of growth in a parallel manner. Although, in comparison with the other countries, Estonia exports remained at high levels, its contribution to GDP growth was erratic and, as the trade balance was negative, goes against the cycle. This points out that, at least before 2008, Estonia may have been following 'on paper' an export-led strategy, but the roots of growth were at home.

International trade also played a relevant role on the Slovenian economy. In addition, with growing prospects for EU membership, Slovenia had become a more attractive destination for foreign investors since 2001. FDI continuously grew in the years previous to the crisis. Nonetheless, the record of conservative fiscal stance, together with the successful implementation of macroeconomic policies aimed at stabilization and liberalization are considered the biggest contributors that enabled the Slovenian economy to make a smooth transition from a socialist self-management system to a market economy, following its break-up from the former Yugoslavia in June 1991. Finally, in Croatia, in the years previous to the crisis, industrial sector and its already-dominant services sector grew continually. Exports also rose rapidly year-on-year helping to drive the healthy growth rates. Rising international tourism was the main source of this rise in exports. Moreover, domestic and external investment contributed to strength the economy. Additionally, communist-era macroeconomic policy in Croatia may have rendered the country better prepared than other communist countries to make the transition to liberal capitalism. Unfortunately, war during the 1990s meant Croatia's transition was the roughest and most tumultuous of all the countries in this study (Stojcic, 2012:63-66). In short, sources of economic prosperity in this group of countries are found on structural transformations that increased the participation of services sector and in some cases industrial sector, and decreased agriculture participation. In all the countries, gross capital formation and FDI, played an important role on economic growth. International trade was also important for most of the countries.

Despite outstanding economic performance, the five countries had weaknesses making its economies vulnerable to international economic crisis. Exports and FDI contributed to economic growth but at the same time make the countries more dependent on foreign markets and capitals. As a result, these economies presented wide economic imbalances, as high government deficit, large current account imbalances and growing external debt.

Regarding the labour market, economic growth translated into lower unemployment rates from the early 2000s; particularly in Slovakia, Croatia and Estonia that presented higher rates at the beginning of the period followed by more pronounced declines before 2008, as Figure 7 shows. Nonetheless, only Estonia managed to reach the Romanian and Slovenian levels. Except for Romania, youth unemployment rates also declined in this period (Figure 8). In Romania, labour market mismatches, namely over-supply of highly educated youth labour relative to actual demand, prevented recovery of youth employment. Demographic factors can also contribute to explain persistent youth high unemployment rates in this country, since compared with other countries in the region Romania has a relatively larger youth population (Kolev and Saget 2005). Concerning real wages, its fast improvement in Romania and Estonia allowed private consumption to foster growth hand in hand with domestic capital formation. In comparison, in Slovakia real wages evolved in a relative slow pace. This is consistent with a household expenditure that increases but not deeply.

***Political Context***

The history of countries studied here has in common the beginning of transition towards democracy and capitalist market economy in the early 1990s. Different events brought the end of communist rule giving rise to an era of economic and political transformations. These events were: the end of Nicolae Ceaușescu's autocratic rule in Romani; the independence of Slovakia after the peaceful dissolution of Czechoslovakia; the end of the occupation by the USSR in Estonia; and the independence of Croatia and Slovenia from the Socialist Federal Republic of Yugoslavia.

The constitutions adopted by the new democracies established the foundations of the political system. Nowadays, except for Romania, politics in all the countries takes place in a framework of parliamentary system. Romania adopted a semi-presidential parliamentary system where the President is chief of state and the Prime minister the head of government. In the five countries legislative power is exercised by the parliament, unicameral in Slovakia, Estonia and Croatia, incomplete bicameral in Slovenia and bicameral in Romania, consisting on the Senate and the Chamber of Deputies. Judiciary power is vested in the Supreme Court of Justice which is independent of the executive and legislature.

The five countries have multi-party systems, although with clear differences. In Romania and Slovakia regularly there is between five and seven relevant parties; although, classic cleavages (left-right, nationalist-non, liberal-conservative) are the most relevant in political competition, the key parties have formed themselves around leaders rather than around institutionalized organizations. In Romania, during the period 1990 – 1996, Ion Iliescu former member of the communist party and one of the leaders of the 1989 revolution, served as President. In 1996, the candidate of the Romanian Democratic Convention, representing the largest coalition of opposition parties, won the elections. However, deterioration of economic situation revealed the absence of deep structural reform, needed following the fall of the communist regime. The left returned in 2000 when Ion Iliescu, running as the Social Democratic Party candidate, was re-elected president. The economy recovered the growth path, and the attempts to adhere the EU resulted in the signature in 2005 of the EU accession treaty, paving the way for eventually join the union in January 2007. In 2004, the candidate of the opposition party (Democratic Liberal Party) Traian Băsescu won the presidential elections. Călin Popescu-Tăriceanu from the National Liberal Party (centre-right) was appointed as prime minister. Băsescu has been temporarily suspended twice, the first time in 2007 and the second time in 2012, in both occasions he survived a national recall referendum.

In Slovakia in the early 1990s, Vladimír Mečiar created the HZDS as a mechanism for gaining independence for Slovakia in the newborn democratic Czechoslovakia. The party ruled the country during the 'crony capitalism' years, being the opposition to privatization and deregulation its core policy claim. A move towards conservative rightwing positions consolidated after the party lost its predominant role in the 2000s. Currently, the party leading the country is Robert Fico's SMER. In 2006 this center-left party (Směr translates as "Direction" or as "third way") managed to create a broad coalition including HZDS and the nationalistic SNS. Směr was originally a breakaway (led by Fico) for SDL. This cabinet included both the HZDS and the nationalist SNS, forming a 'big national coalition' that made the process of accession to the EMU. This period was characterized by a broad consensus across all relevant political parties. Overall, the historic conditionals that affect any former communist country as well as the importance of leaders in party formation have made ideological boundaries, relating to economic policy less clear and blurrier, although they do exist and are structured around the role of the state in the economy. This, helped by the virtual lack of territorial cleavages (leaving aside the issues with the Hungarian population), provokes that coalitions and pacts are not particularly difficult to achieve in Slovak politics. This made economic governance relatively feasible and functional, particularly since 1998 and when compared with other Eastern countries.

In the years following the independence in Estonia it was formed a centre-right coalition with a strong focus on liberal, orthodox economic policy that shaped the political economy landscape of the country until nowadays. Hence, the dominating parties fall in the centre-right side of the ideological spectrum. The pivotal actor is the Reform Party, who has been in most coalition governments in either one form or another since 1995. The second relevant party is the Union of Pro Patria and Res Publica, a conservative party that forms coalition with the RP. The Centre Party is the third party in relevance. Centrist, social-liberal and slightly populist, it has been accused to keep links with Vladimir Putin and Russia. In economic policy it tends to defend positions that are relatively at the left of the two other parties, but in European terms it's not a leftist party at all. Given this party structure and a parliamentary democracy with a high threshold to get into the Parliament (5%) and a system that tends to leave only four to five parties inside the National Council, there "politics of coalition" are very common. This locks-in some policies, making them a constant in Estonian economic policy; for instance, balanced budget, conservative monetary policy and relatively low unemployment benefits and employment protection.

Slovenia's political system is characterized by political pluralism and corporatism. Upon independence, a number of political parties emerged and varied from center-left (socialist) to center-right (conservative). Despite prevailing pluralism, the Slovenian party system, with a couple of exceptions, has achieved a high level of consolidation and stability. The main reasons for stability in the early years of independence fell largely on the consistent growth of center-left Liberal Democrats (LDS) and the corporative tradition.

Lastly, in Croatia the leader of the centre-right Croatian Democratic Union (*Hrvatska demokratska zajednica*, HDZ), Franjo Tuđman dominated Croatian politics from the collapse of communism and throughout the war period, until his death in 1999. Following Tuđman's death Croatian politics began to normalise and "Europeanise". In the 2000 Parliamentary elections, the HDZ was defeated by a centre-left coalition and Ivica Račan became Prime Minister, while the Presidential election was won by the independent Stjepan Mesić (BBC, 2013). In the 2003 parliamentary elections, Račan's coalition was defeated by a reformed and rejuvenated HDZ, and Ivo Sanader became Prime Minister, who helped steer the party away from its nationalist and autocratic roots and towards normalisation with other European centre-right Christian Democratic parties (Economist, 2003). After a corruption scandal in 2007, Sanader government survived the general election later that year. In 2008, the government was made up of a coalition led by the HDZ and supported by the conservative Croatian Peasant Party (Hrvatska seljačka stranka, HZS), the Croatian Social Liberal Party (Hrvatska socijalno liberalna stranka, HSLS) and the single-issue Croatian Party of Pensioners (Hrvatska stranka umirovljenika, HSU) (MacDonald, 2008). The largest opposition party was the Social Democratic Party of Croatia (Socijaldemokratska partija Hrvatske, SDP).

As mentioned above Slovenia's political system is characterized by political corporatism. In fact, the corporative tradition has been one of the main reasons for stability of the Slovenian party system. In particular, political corporatism was widely observed in the formation of grand coalition, which involved parties both from the left and right, as well as the liberal and centrist. Another exemplary indicator for corporatism can be found in the Economic Social Council (ESS), a tripartite body which brings together representatives of the governments as well as representatives of social partner including trade unions and employers (Ferfila and Phillips, 2010). Romania also has corporative tradition, is actually the country with the highest trade union density in this group (40% according to Eurofound, 2013). Previous to the 2008 crisis, unions had a relatively high mobilization power. The comprehensive industrial relations system, allowed widespread collective bargaining at national, sectoral and company levels. Moreover, the industrial relations system included a legal system supporting bipartite and tripartite consultation and negotiation between trade unions, employers and the government (Trif, 2013). Trade unions are also relatively strong in Croatia where trade union density is estimated in 35%, although with large differences between density in the private sector (17%) and in the public sector inclusive of state-owned enterprises (70%). Compared to the 1990s, trade union density has decreased, overall among small companies, companies established after 1990 (the socialist time) and among younger workers (Eurofound, 2012). In Slovakia trade unions are also losing support (as in many other European countries, with some exceptions) since the 1990s. Trade density was before the crisis at 17% (2008) while it counted for 67% of the workers in 1993. As a consequence, the coverage rate of collective agreements does not go beyond the 30% of the whole amount of employees. Collective agreements concentrate on industrial sectors, as it happens in several other European countries, mainly automotive and electronic sectors, as well as transportation and construction. Estonia present the lowest trade union density in the group of countries analysed here. Only a 10% of employees belonged in 2009 to a trade union, according to the Estonian Work Life Survey. This percentage is highly diverse among sectors: as 36% for transportation, 31% for healthcare, 23% for education at the top. Only 6% of the companies above five employees have trade union presence. The number increases to 48% when considering big firms (more than 250 employees). Barely one third of employees are covered by a collective agreement, and moreover: only 11% of all of them actually include a wage agreement. Consequently, the increase in wages was not a product of trade union bargaining, but of mere growth and productivity.

***Economic Policy before the crisis***

Regarding economic policy, in the early 1990s the countries set the basic legal framework for a market economy. State companies begun a privatization process along with the creation of private enterprises, and some foreign capitals flowed into the countries. The economies responded positively to the reforms, GDP turned from negative in 1991 to positive in 1993 in Romania and Slovenia and in 1994 in Estonia and Slovakia (see Figure 1). At the same time, inflation presented an astonishing decrease as Figure 6 in the data appendix shows. After 2001, except for Romania, Central Banks managed to control inflation and avoid double-digit figures. Although in the same direction, implementation of market reforms presented differences among countries.

To begin with, in Romania reforms started with the adoption of a new constitution in 1991. This constitution set a basic legal framework for a market economy. State companies begun a privatization process along with the creation of thousands of small and medium size private enterprises, and some foreign capitals flew into the country. Additionally, Iliescu's government achieved improvements on economic and political stability and the country's accession to the NATO. However, in 1996, economy deteriorated fast revealing the absence of deep structural reforms that the country needed following the fall of the communist regime. Reduction in exports marked the beginning of current account deficits and inflation picked in 1997 to 154.8%. The government tried to find a way out from the bad situation, but it became involved in prolonged political feuding that did little or nothing to promote economic reform (BBC 2012). The left returned in 2000 when Ion Iliescu, running as the Social Democratic Party candidate, was re-elected president. The economy recovered the growth path, and the attempts to adhere the EU resulted in the signature in 2005 of the EU accession treaty, paving the way for eventually join the union in January 2007. The possibility of join the EU gave Băsescu's government the necessary incentives for change. The accession of Romania to the EU was obtained in April 2007. Some reform progress was evident in the country; for example, better conditions for foreign investors were created, banking system competition strengthened considerably, and privatization process saw some progress. The financial international market turmoil in 2008 coincided with Parliamentary elections, which occasioned an unprecedented easing of income and fiscal policies (National Bank of Romania 2008, 11). As a result, government deficit offset the external adjustment in the private sector and contributed to the current account deficit. Additionally, the pro-cyclical nature of fiscal policy prevented the adoption of measures aimed at prepare the economy for a possible recession in 2009 (Ibid). Furthermore, full capital liberalization undertook with EU accession Treaty and put into practice in 2006, had the positive effect of contributing to economic growth, but at the same time would later facilitate the spill-over of the global financial crisis.

Slovakia, besides the transition to market economy common to all the countries in the group, experienced the separation of the Czech Republic (that officially happened the 31th of December 1992). During the first five-six years after secession, a period of "crony capitalism" passed until it was overcome by selective privatization. The weight of the public sector in the economy fell from 15.3% in 1997 to 11.8% a decade after. Government expenditure became a 17.1% of GDP, coming from a 25.6% after Slovak's secession. At the same time, public debt was at quite low levels in 2008, coming from higher (but still restrained) values. Additionally, Slovak Central Bank successfully managed to keep inflation low. Overall, the historic conditionals that affect any former communist country as well as the importance of leaders in party formation have made ideological boundaries, relating to economic policy less clear and blurrier, although they do exist and are structured around the role of the state in the economy. As already mentioned this helped by the virtual lack of territorial cleavages makes pacts, coalitions and economic governance easier in Slovak politics when compared with other Eastern countries. The collapse of the Western financial system found the Slovak government occupied by a rather unusual coalition: between 2006 and 2010 Směr governed with the support of the socialnationalist Slovak National Party (SNS) and the HZDS. Considered as a strongly nationalist and socialist party, the SNS does not encourage state-reducing policies as they have a rather conservative and protective view of the economy. Směr has been pursuing what may be defined as a social-liberal or 'third way-like' set of policies, both reducing the weight of the state in the economy also pushing for a clear regulation to ensure the flexible functioning of the different markets. Social-conservative and social-liberal perspectives are irreconcilable in several aspects. These tensions, however, did not prevent the government to articulate a response to the economic shock. Also, the second phase of the crisis (from 2011) has seen two different governments: in 2010, a liberal-conservative coalition formed by four parties took the government over. But the next elections were advanced to 2012 due to political instability, and since then the Směr-SD coalition (formed before the election) enjoys of an absolute majority in the National Council, which allow the social democrats to govern by them. It is noteworthy that corruption played a relevant role in the public opinion dynamics right before the election. The so-called 'Gorilla scandal' consisted on a released (supposed) file from the Slovak Intelligence Service that showed how several public officials were involved in corruption behaviour during the second wave of privatization and deregulation.

Regarding Estonia, following independence in 1990 the country had a 1000% inflation rate and during the first year GDP flew down a 14.6% (Figure 1). Given such figures, as well as a poverty level and an unemployment rate impossible to measure, Estonia decided in 1992 taking the path of reform and stabilization. The first government coming from a centre-right coalition strongly focused on liberal, orthodox economic policy. Prime Minister Mart Laar conducted in three years a large and deep number of reforms that shaped the political economy landscape of the country until nowadays. The keys to track Estonian policy are: (1) macroeconomic stability as a major goal; (2) a marked profile in favour or liberalization in all the aspects of economic and political life: labour market, business creation and competition, public debate, etc. After independence, private property institutions were created, and public assets were quickly privatized. A flat-rate tax system was imposed in hope of generating a friendly environment for business to flourish, which actually happened. Nowadays, Estonia is always in the Top 20 of any ranking of economic freedom. For the World Bank "Ease of Doing Business", Estonia was the number 17 in 2007. It ranked 12 in the Index of Economic Freedom of HF and 14 for FI, and was the 27th most competitive country in the world for the WEF; (3) Implied in the former, a high level of dynamism and adaptation is required from both the private entities and the public realm under new circumstances; (4) a strict control of public spending; privatization and liberalization, allowed government expenditure fall from 25% (1995) to 16.2% (2006) of GDP. This reduction was hand in hand with one of the lowest levels of public debt in the world with a negative tendency and a budget surplus; (5) a "Nordic" aspiration for growth and welfare. In Estonian politics the pivotal actor is the Reform Party, which has been in most coalition governments in either one form or another since 1995.

And since 2005 its leader Andrus Ansip holds the office of the Prime Minister. The free market-oriented character of the party has continued with the tradition initiated by Mart Laar.

Concerning Slovenia after the depression following independence, it restored a quick recover in 1994 reaching 5.3 percent of growth rate in that year while successfully brining inflation down from hyperinflationary levels in the subsequent years (see Figure 1 and 6). The key factors for this economic turnaround are attributable to the successful implementation of macroeconomic policies aimed at stabilization and liberalization (Mrak et al., 2004). During the early transition period, Slovenia was confronted with a wide array of macroeconomic difficulties; two-digit inflation rate, absence of foreign exchange reserves, low confidence in the new Slovenian currency, the Tolar, as well as the lack of credibility of the newly established central bank among others. Against this backdrop, the initial task was disinflation. To this end, the Bank of Slovenia carried out a monetary policy under a floating exchange rate regime instead of an orthodox fixed exchange rate system that prevailed during the pre-independence era. Soon after, Slovenia witnessed a gradual decline in the level of inflation in the subsequent years (see Figure 6). Other essential tasks were seen through various structural reforms including – to name a few, banking restructuring, public expenditure management reform, introduction of a personal income tax as well as the abolition of fiscal "self-management" approach and the centralization of government functions – all of which helped the country maintain stable fiscal balance during the initial stages of the transition (Ibid). Consequently, the general government budget remained virtually balanced during the first five years of independence (1991-1996). Hence, this conservative fiscal stance together with macroeconomic stabilization policies, are considered the biggest contributors that enabled the Slovenian economy to make a smooth transition from a socialist self-management system to a market economy during the first decade of independence. Furthermore, Slovenia's shift from a socialist self-managed system initiated the structural change of the economy. In contrast to a socialist system, which heavily concentrates on industry and production of goods, the country saw an increase in the service-producing sectors as the market economy emerged (Ferfila and Phillips, 2010). The service sector today accounts for the largest part of the economy as a percentage of GDP (see Figure 2). It should be noted however, industry and construction sectors, though altogether comprise the lesser proportion of GDP, account for most employment in the country (Mrak et al., 2004). Most notably, Slovenia's economic recovery continued in parallel with its efforts to re-establish international status. Efforts have been directed to gain membership in the major international financial institutions including the IMF and the World Bank. The milestone of Slovenia's international recognition is undoubtedly the 2004 accession to the European Union, which later followed by membership in the euro area in January 2007. Given the Slovenian "European ideology", the EU accession preparation was met with a political consensus by virtually all major political parties (Lavrac and Majcen, 2006). The low public indebtedness is another key feature of the Slovenian economy. Prior to the EU accession, Slovenia's debt stood far below the threshold of the Maastrict Criteria (60 percent of GDP) and was ranked the second lowest public debtor, only next to Luxembourg, among all other EU member states. From mid-1990s, the level of public debt began to reach above 20 percent of GDP and rose thereafter, though at a slower pace, until early-2000. Debt decreased gradually after 2002, reaching a low of 22 percent in 2008.

Finally, Croatia stands out from the other countries featured in this study due to its experience of war through the first half of the 1990s (Slovenia experienced just 10 days of fighting following its secession from Yugoslavia, while the Croatian war lasted four and a half years). Partly as a result of this, Croatia's transition was slower and its economy took longer to "open-up" than the others in this study, but by the time of the 2008 financial crisis, Croatia is best described as fitting the model of a "small open economy" (Bokan et al, 2009). Although Croatia was not immune to the recession that dogged European communism during the 1980s, communist-era macroeconomic policy in Croatia may have rendered the country better prepared than other communist countries to make the transition to liberal capitalism. Unfortunately, war and authoritarian rule during the 1990s meant Croatia's transition was the roughest and most tumultuous of all the countries in this study (Stojcic, 2012:63-66). The first laws removing restrictions on private enterprise were passed in 1989, while large-scale privatisation took place during the two years' following the passage of the law on the Transformation of Socially Owned Assets in 1991. The Croatian banking sector was liberalised through the 1990s. The Croatian National Bank was given autonomy in 1993. All of the major mechanisms required for a market economy had been implemented by the end of the 1990s. However, these reforms brought only partial success and Croatia's economic performance during this period was behind that of other post-communist European countries. This was in no small part due to the fact that Croatia remained isolated in many respects: the war as well as other political barriers, prevented Croatian accession to various international organisations and trade networks such as the EU, the WTO and the Central European Free Trade Agreement (CEFTA). Following the recession and the political upheavals at the end of the decade, however, Croatia began to integrate into international trade networks, allowing it to catch up with other countries in the region. Croatian accession to the WTO was granted in 2000, while membership of CEFTA was granted in 2003 (Stojcic, 2012: 66-69). At the time of writing, Croatia is due to become a full member of the European Union on 1st July 2013 (European Comission, 2013).

***The crisis and its transmission channels***

Despite the strong economic growth achieved in the last decade by the five countries, economies contracted sharply after the outset of the global financial crisis of 2008. GDP fell first in Estonia in 2008 by 4.2%. In 2009 all the countries had negative variations in GDP: -6.6% in Romania, -4.9% in Slovakia, -14.1% in Estonia, -7.8% in Slovenia and -6.9% in Croatia (see Figure 1). The two main channels through which the crisis affected these economies were trade and investment. In all the countries (except for Romania given its poor export-orientation) exports as percentage of GDP fell in 2009 as figure 2 shows. Given the small size of the domestic market in Slovakia, Estonia, Slovenia and Croatia, export is considered a critical element in economic growth. Particularly in Slovakia, Estonia and Slovenia where by 2008, the dependence of the economy on exports well exceeded 60% (see Figure 2). At the same time FDI as percentage of GDP fell in all the countries especially in Romania (see Figure 4), as a result of the financial market turmoil that caused foreign investors to shift away from East European economies and resulted in massive capital flight. This representation of the crisis as an externality should not permit dismissal of internal problems that after the downturn in worldwide demand exacerbated the effects of the initial shock.

Romanian economy was suffering from serious internal macroeconomic weaknesses before the crisis, as current account and government budget deficits and increasing inflation rate. In addition, economic growth dependence on internal consumption affected the economy via decrease in external private credit lines with adverse effects in private consumption and investment. The problems derived from the pro-cyclical fiscal policy came to the fore with the crisis as well. Public deficit as percentage of GDP reached 9.0% in 2009 the highest in more than one decade; social security and health budgets became unsustainable in terms of relevant revenues. Moreover, in the pre-crisis period the pro-cyclical fiscal policy had contributed to overheat the economy that was already growing due to the massive private capital inflows (National Bank of Romania, 2009:11, 12).

In Slovakia public deficit increased more than in the other countries between 2008 and 2009 (see Figure 9). The recovery has been slow; in 2012 Slovakia presented the higher public deficit as share of GDP in this group of countries. Moreover, household consumption stagnated as a consequence of unemployment and austerity measures. It has also been argued that the incorporation of Slovakia to the Euro area on the same year that the public debt crisis appeared has had a negative effect, rather than positive, on the confidence deposited by investors in their financial future. The fact of pertaining to the same uncertain endeavour may be affecting negatively the image of the country. Finally, as the other countries in the group, Slovakia was also suffering overheating of its economy in the months previous to the crisis.

In Estonia, more tightly loan standards, falling real estate prices and a turnaround of consumer confidence ended the expansion of domestic demand (OECD, 2009). Nonetheless, the economy recovered fast. Estonia arrived to 2010 having done a deep adjustment, with high unemployment but good growth perspectives. Unlike in other countries, for Estonia the recovery phase is not a story of public debt and financial turmoil, but of wages, productivity and uneven recovery. Gross fixed capital formation provided an engine for a growth path. Also exports played a role between 2010 and 2011, although a diminishing one. Even so, in 2012 economic recovery slowed down as a result of a combination of structural problems with a very important labour component, as well as the deterioration of European and worldwide economic situation. On the internal level There are three key dimensions to understand the new (but in part inherited from the past) challenges faced by the labour market in Estonia: (1) the structural change in terms of relevant sectors for the economy; (2) the subsequent distribution of the costs provoked by this change; (3) the maintaining skill mismatch. Structural change the last four years brought about the loss of 41% of employment in construction sector (OECD, 2012). Conversely, employment grew in the field of computers, electronic and optical equipment. However, as this field of activity is not labour intensive, its contribution to employment growth was much smaller than to that of industrial production (Eesti Pank, 2012a). This means that the Estonian economy has deviated resources from domestic demand-based sectors to unemployment, and new labour capital has been directed to new sectors. The wage adjustment was and is necessary if there are no significant gains in productivity due to human capital factors. But Estonian capacity to compete externally and domestically remains doubtful as the labour market is not able to provide at the same time cost-based and education-based gains in productivity. This combined with skill mismatch has caused a sharply uneven distribution of unemployment costs and led to what may be considered now as a new path of structural unemployment.

The economic downturn of Slovenia in 2009 is largely attributed by the effects of international developments. The lower exports and investment activity are seen to be the greatest contributions to the deepening decline of the Slovenian economy at the inception of the crisis. However, in the internal level the accession to the EU in 2007 helped fuel easy credit and construction boom. The access to cheap money increased the vulnerability of the economy and made it more vulnerable to external shocks.

In the years previous to the crisis the most serious internal problem in Croatia was the overheating of the economy. According to the Croatian economist Velimir Šonje, the economy had been overheating for several years, operating beyond its natural capacity. Šonje argues that pre-crisis investment focused too heavily on infrastructure and real estate, while possibilities for investment in technology and processes that may have led to long-term advancements in productivity and competitiveness were neglected, meaning that growth was dependent largely upon demand and cheap debt. Consequently, it would appear that Croatian economic growth prior to the crisis may have been unsustainable; the shocks from abroad may have served to create a particularly "hard landing" for an economy that was already heading for a fall (Šonje , 2012).

***Consequences in the labour market***

The negative economic performance had immediate adverse consequences on the labour market. Unemployment rate that presented decreasing trend in the year previous to the crisis in all the countries, increased in 2009 (see Figure 7). Initially, the share of long-term unemployment went down as an effect of more new unemployed people. But this dynamic sharply reversed in 2010 and currently long-term unemployment is increasing, keeping the pre-crisis levels, except in Croatia where until 2010 this figure had remained in a downward path.

Youth unemployment, already a problem before the crisis, increased faster than adults' unemployment rate during the crisis, widening the gap between these two population groups. However, this is not only a problem in the labour market of these countries. Although high, the levels of youth unemployment in this group are not far from the EU27 average, except in Slovakia and Croatia where they are well above the average. Other vulnerable groups such as the low-skilled population were strongly affected by the crisis as well. Both elements put together (youth and long-term unemployment) speak about a high degree of skill mismatch in the labour market of the five countries. In other words, the qualifications and location of the unemployed do not match the needs of the labour market.

Real wages were also hit by the crisis. In Estonia wage adjustment that started in 2008 was the most important factor driving down internal demand. A significant part of this adjustment was possible thanks to the fact that profit-linked or productivity linked bonuses convey a significant part of Estonian wages. According to a survey of the Estonian Central, in 2008 around 66% of manufacturing, construction, service and trade companies paid various bonuses. The share of these in absolute wages ranged from 14% in manufacturing to 23% in trade (Eesti Pank, 2009b). In Slovakia real wages dropped as well. Since 2008 the moderate increase in nominal wages has been overshadowed by the loss in real terms, in recent years the effect of high inflation is more visible. In Romania real wages stagnated and has also been one of the main factors preventing recovery of internal consumption. By contrast, in Croatia real wages continued to rise throughout the crisis period, but the curve significantly flattens after 2009.

As it always happens with a recession implying a high level of unemployment, consequences for social security funds arise. Demands from new unemployed initially increased public spending, a common pattern in the five countries. Nonetheless, the large public deficits forced soon to the governments to adopt austerity measures, with the expected negative consequences for aggregate demand. Unpopular austerity packages added to frequent corruption scandals has giving rise to general dissatisfaction and social protests.

## Comparative analysis of policy responses

The first obvious variable in post-crisis policymaking in the five studies is the time frame: not only did the crisis hit these countries at different times, but the speed with which governments were able or willing to respond was also variable. Estonia was already in something of a "crisis-mode" before the onset of the global crisis, with austerity measures already in place before the European economy began to struggle. Given that the impact of the crisis was significantly delayed in the Balkans, arriving only in the 4th quarter of 2008 (Arandarenko and Golicin, 2010), the swiftness of the Slovenian government's acknowledgement of the crisis is noteworthy, as a ministerial crisis team to develop policy priorities and first-response measures was set up in November 2008 (Eurofound, 2010). Slovakia's left-of-centre Směr-led coalition government introduced fiscal stimulus measures during 2009, while Romania began introducing cuts and accepted a rescue loan from the EU, IMF and World Bank in the same year, with the most drastic and controversial measures being delayed until after the election period. The slowest response was seen in Croatia, where the government began by merely scaling back its Active Labour Market Policies (ALMPs) as a cost-cutting measure in 2009, having published highly over-optimistic 2009-2011 growth forecasts in July 2008, with substantive crisis-management policies not being introduced in Croatia until April 2010. Like Romania, policy responses in Croatia were partly delayed by the electoral cycle (Arandarenko and Golicin, 2010).

Slovakia was the only country included in the study to introduce substantive fiscal stimulus measures. These measures resembled those introduced in some Western European countries, including the provision of financial incentives for motorists to scrap their old cars and buy new ones. Slovakia's measures also included wage subsidies to protect jobs. Wage subsidisation measures were also seen to varying degrees in the labour market policies of the other countries covered, not as part of fiscal stimulus packages, but as part of moderate attempts to encourage demand in the labour market in the context of wider austerity measures and to protect jobs. Slovakia's wage subsidy policies included the "flexiconto" system, where the government provided subsidies in order for employers to maintain a low-wage for employees "left" at home for temporary periods as an alternative to redundancies. A similar policy was introduced in Slovenia through the "Partial Reimbursment of Payment Compensation Act" of 2009, which provided subsidies on the condition that employers provide training to the employees left at home. Slovenia also introduced the "Partial Subsidising of Full Time Work Act" of the same year, which provided subsidies in cases of reduced working hours (Skledar, 2009). In Estonia, wage subsidies featured as part of the government's "flexicurity" measures, pushed during 2009 and 2010, but scaled back in 2011. The Romanian government provided wage subsidies for vulnerable social groups (such as those over 50 or disabled) who had been unemployed for lengthy periods of time. Croatia provided subsidies by co-financing employment and training alongside employers, and by hiring unemployed people in public works projects (Bejaković et al 2011). In short, Slovak, Slovenian and Estonian subsidies focused primarily on existing-job protection, whereas Croatian and Romanian subsidies were targeted more at reducing unemployment.

All of the countries included in the study turned to austerity measures at some point (with varying degrees of severity). Slovakia switched to austerity following the election of a centre-right government in 2010 (though Směr maintained austerity policies when it returned to power in 2012). As has been mentioned, Estonia stands out because it was already in austerity when the crisis hit in 2008 - these measures were bolstered in 2011. A planned cut to the flat tax was scrapped and social security contributions were raised for both employers and employees, and excise taxes on commodities such as tobacco and alcohol were increased. Many of Estonia's measures were intended to be seen as temporary: plans still exist to cut the flat tax in 2015, and social security contributions will be capped in 2014. There were some lasting institutional changes in Estonia, such as the merger of the Labour Market Board and the Unemployment Insurance Fund, with the new board providing a mechanism for national-level collective bargaining (OECD, 2012). The Estonian government also moved to shift the tax burden away from the labour market, and hiring and firing costs were reduced (Eesti Pank, 2009a). Ultimately, however, Estonia did not pursue policies geared towards long-term changes to the way in which economic and labour market policy is made in the country.

By contrast, Croatian austerity measures were presented as part of a program of structural reforms that aimed to reduce the Croatian government's role in the economy, transfer economic activity from the public sector to the private sector, and to develop a new growth model for the country (Corbanese, 2011:51), though changes to Croatia's collective bargaining systems were modest (Eurofound, 2012). In Romania, the government diminished employment protection and modified workers' rights legislation, and broke-down national-level collective bargaining systems (Lupu and Petrisor 2012, European Industrial Relations Observatory 2012). Similarly, Slovakia reformed its collective bargaining systems, pushing such decision making away from the national level and down to the sector and company levels. Slovenia, on the other hand, not only maintained substantial collective bargaining mechanisms at national level, but directly utilised these decision-making systems in developing labour market reforms in 2010 (Ferfila and Phillips, 2010). The introduction of flexicurity in the Slovenian labour market showed some degree of change in policy practice, but ultimately, post-crisis labour market reforms in Slovenia focused on promoting training and education and not on significant structural changes.

The role and significance of training schemes varied in the policy responses of the different countries covered. In Slovenia, training and education was the most prominent characteristic of all of the country's major post-crisis labour market reforms that are detailed in the study, forming the bedrock of its crisis management policies. In Estonia, where internships were already a significant part of professional training, the government increased the provision of training grants and transport compensation. Estonia also introduced free tuition in universities and reformed vocational education systems. When Croatia scaled back its ALPM measures in 2009, it preserved those that funded vocational training (Bejaković et al 2011). Following the introduction of the Economic Recovery Program in 2010, the Croatian government expanded apprenticeship, internship and work experience schemes (Corbanese, 2011:52). Slovakia's reforms focused more on the principle of flexicurity and changes to general labour market regulations, rather than on policies seeking to introduce long term changes to the types of skills found in the workforce or the sources of economic growth. This is in contrast to Croatia, where training programs were implemented not only to address acute unemployment, but also in the context of a desire to promote a more "high-tech" economy and to address the country's relatively low labour participation rates, which were key priorities of the 2010-2012 fiscal policy guidelines (Republic of Croatia Ministry of Finance, 2009) and the World Bank-funded Economy Recovery Development Policy Loan (ERDPL) (World Bank, 2011). Romania saw some financing of apprenticeship programs, but ultimately, Romania's reforms were heavily focused on market liberalisation and reducing regulatory support for workers, and not on providing new services.

Taking an overview, we can divide the different policy strategies into two paradigms: structural reform in Croatia, Slovakia and Romania and crisis-management in Estonia and Slovenia. Previously national-level collective bargaining systems were pushed down to the sector and company levels in Slovakia and Romania, whereas in Croatia, company-level (in the private sector) and sector-level (in the public sector) bargaining was already the norm. All three of these countries also significantly reduced employment protection, with Slovak and Croatian policy making broadly fitting into a "flexicurity" paradigm, while Romania's followed a much more neoliberal path. Training programs featured significantly in the labour market policies of Croatia, but were less important in those of Romania and Slovakia. If we interpret these changes in the context of Bohle and Greskovits' (2012) "varieties of capitalism", we see Romania moving from a corporatist system to a neo-liberal one. Slovakia appears to have from corporatism to embedded-neoliberalism, as though significant changes were made to collective bargaining systems, the state maintains a role in the labour market, particularly through the provision of policies aimed at protecting jobs. Croatian policy-making remains largely within an embedded-neoliberal paradigm, but with a slight shift in the direction of more neoliberal practices due to the withdrawal of the government from many sectors of the economy and the liberalisation of labour market regulations.

Estonia, on the other hand, promoted national-level collective bargaining, creating a new national labour market institution with government, unions and employers represented on its board, and Slovenia maintained its national-level collective bargaining systems, using them to develop crisis policies. Both countries also placed a significant emphasis on training and education, with training forming the bedrock of Slovenian policy making and Estonia introducing policies to promote both higher and vocational education. Neither country significantly diminished existing employment protection regulations. Consequently, Slovenian policy making is consistent with its pre-crisis corporatist path. By introducing new national-level collective bargaining systems, it could be argued that Estonia appears to have shifted slightly from a neoliberal paradigm and closer to an embedded neo-liberal one, but the changes are not drastic and do not warrant an overall reclassification of the country's labour market policy-making paradigm.

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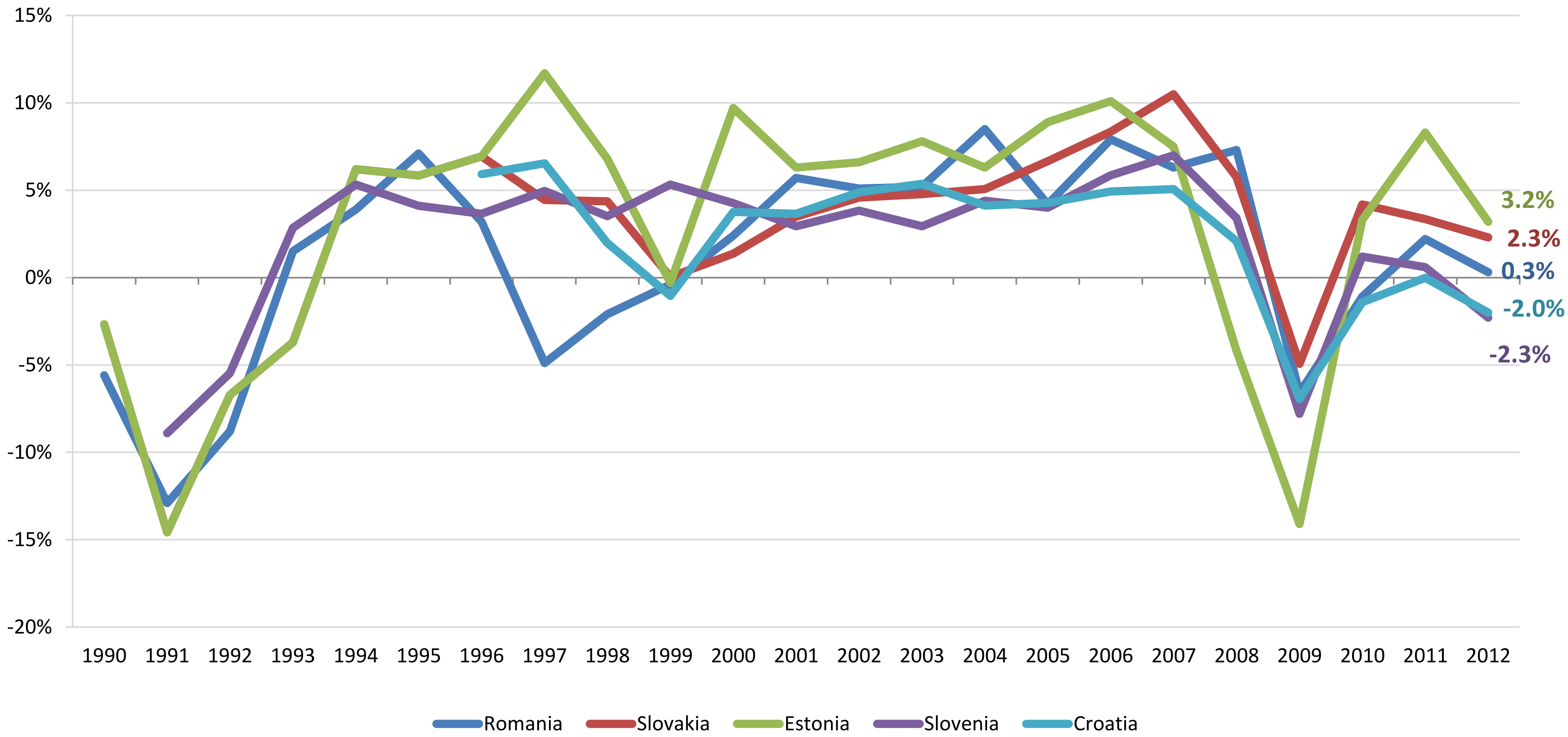
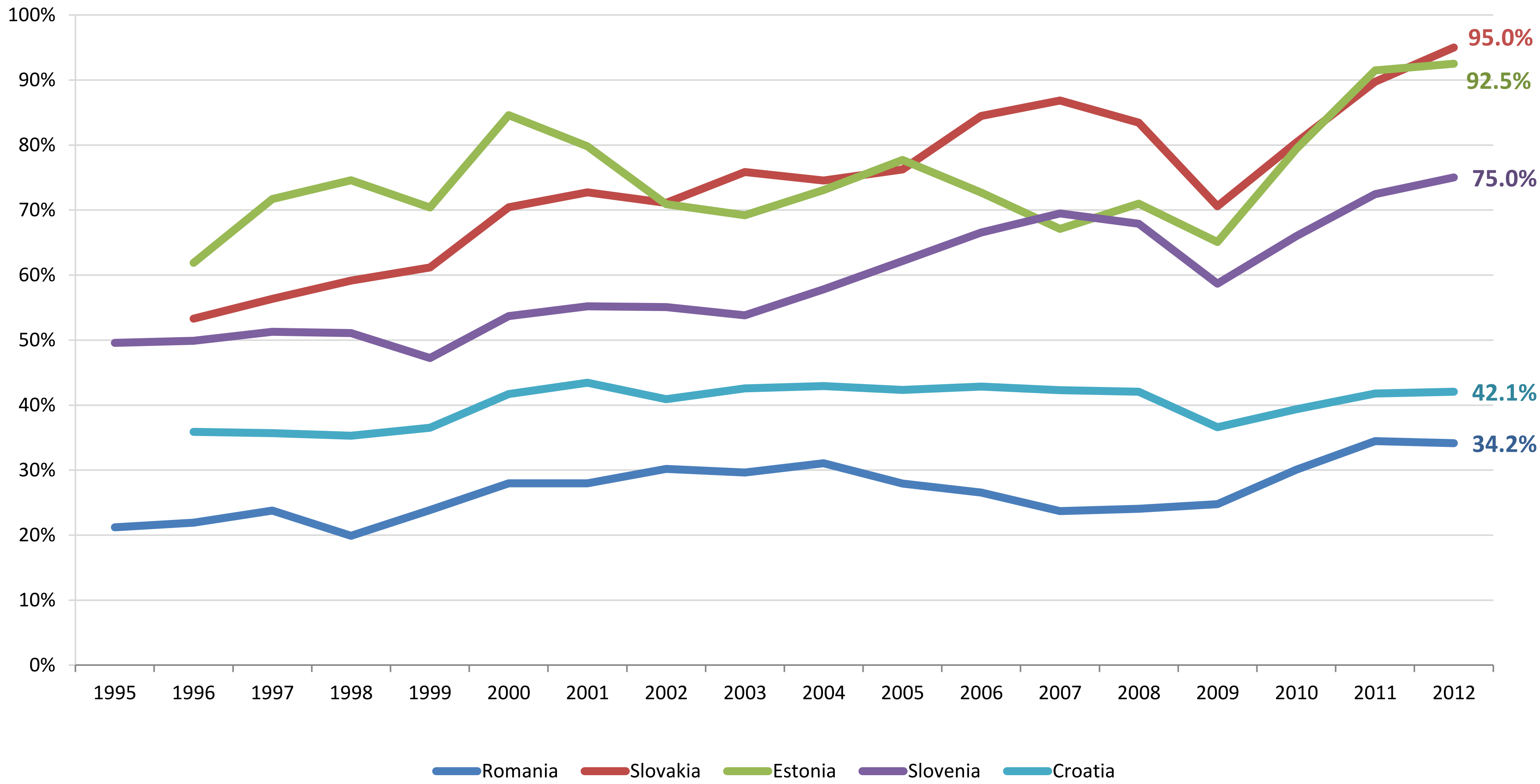
# Data Appendix

## Figure 1: GDP Growth



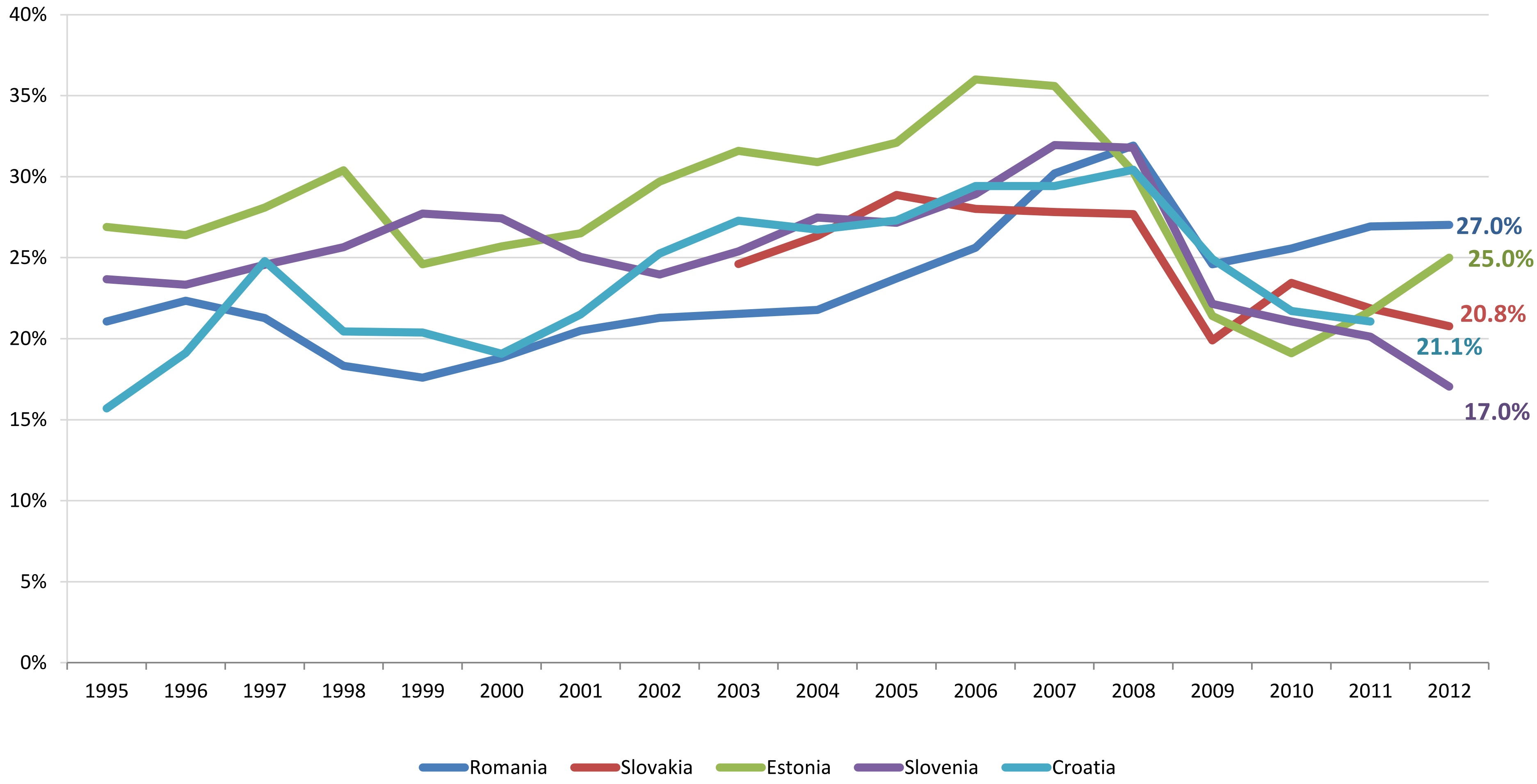

Source: Romania, Romanian National Institute of Statistics; Slovakia, Slovak National Institute for Statistic; Estonia, Statistics Estonia; Slovenia, Statistical Office of the Republic of Slovenia; Croatia, World Bank and Eurostat

## Figure 2: Exports as Percentage of GDP



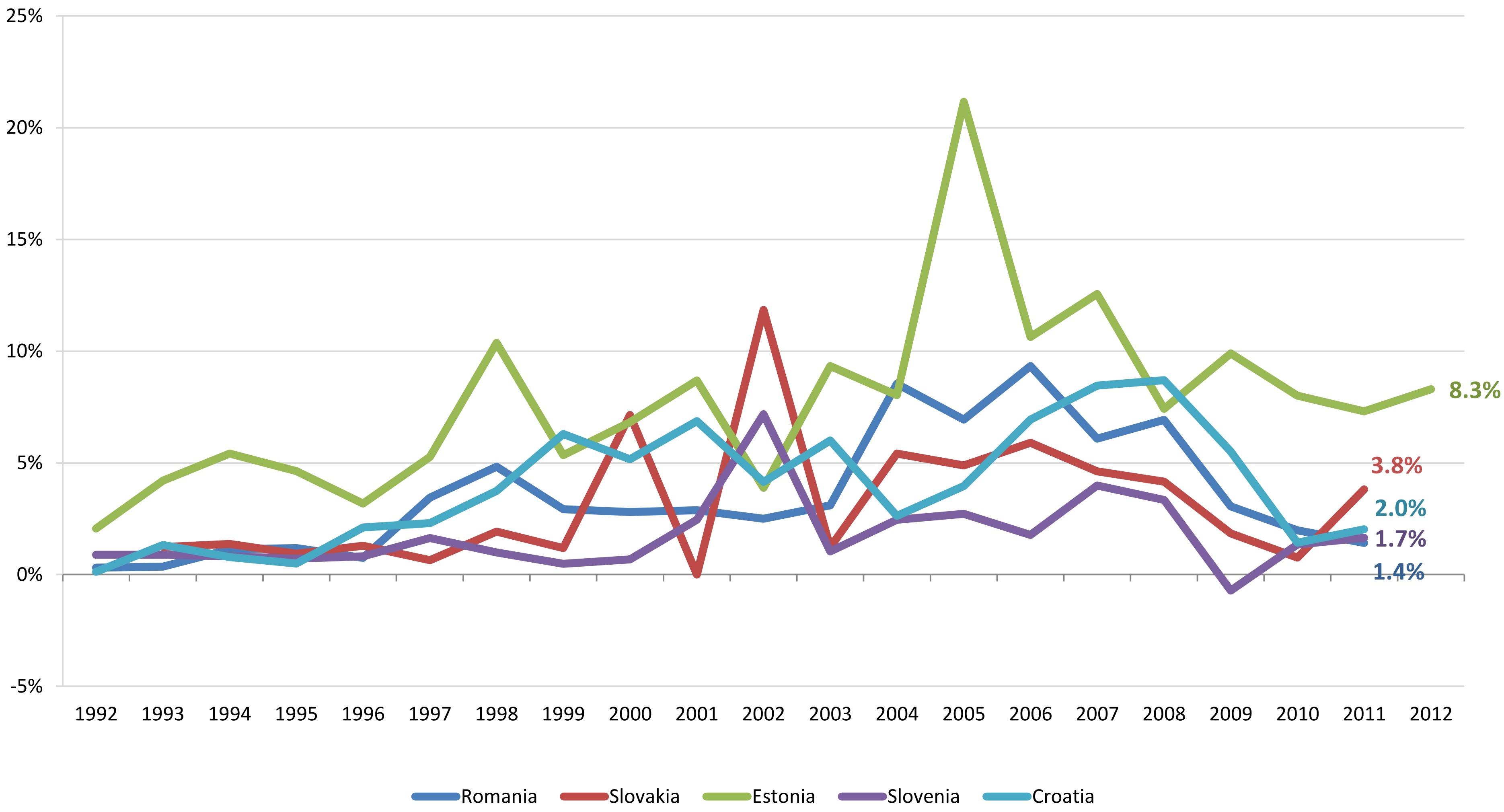

Source: Romania, Romanian National Institute of Statistics; Slovakia, Slovak National Institute for Statistic; Estonia, Statistics Estonia; Slovenia, Statistical Office of the Republic of Slovenia; Croatia, Eurostat

## Figure 3: Gross Capital Formation as Percentage of GDP



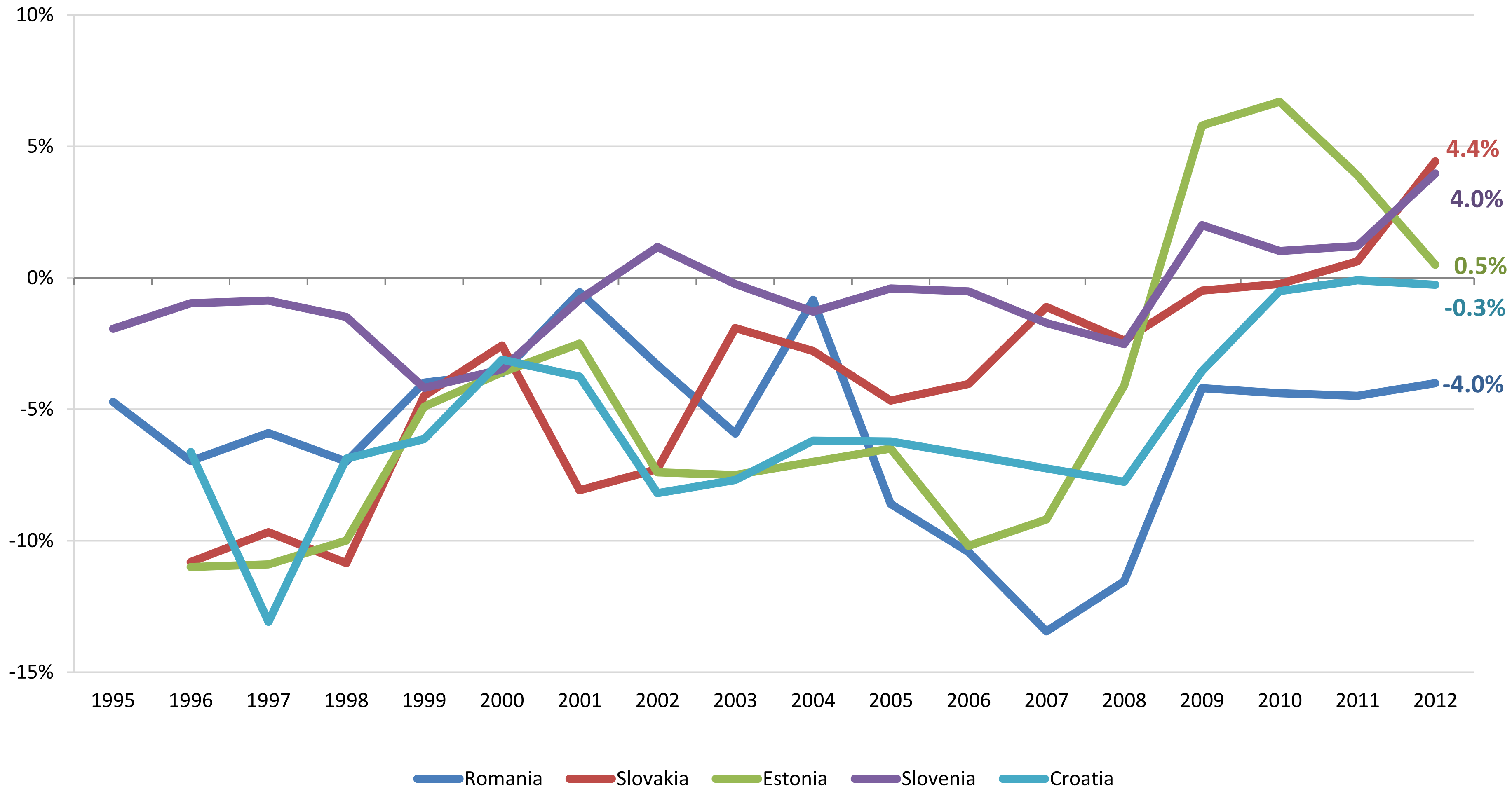

Source: Romania, Romanian National Institute of Statistics; Slovakia, Slovak National Institute for Statistic; Estonia, Statistics Estonia; Slovenia, Statistical Office of the Republic of Slovenia; Croatia, World Bank

**Figure 4: Foreign direct investment as Percentage of GDP**



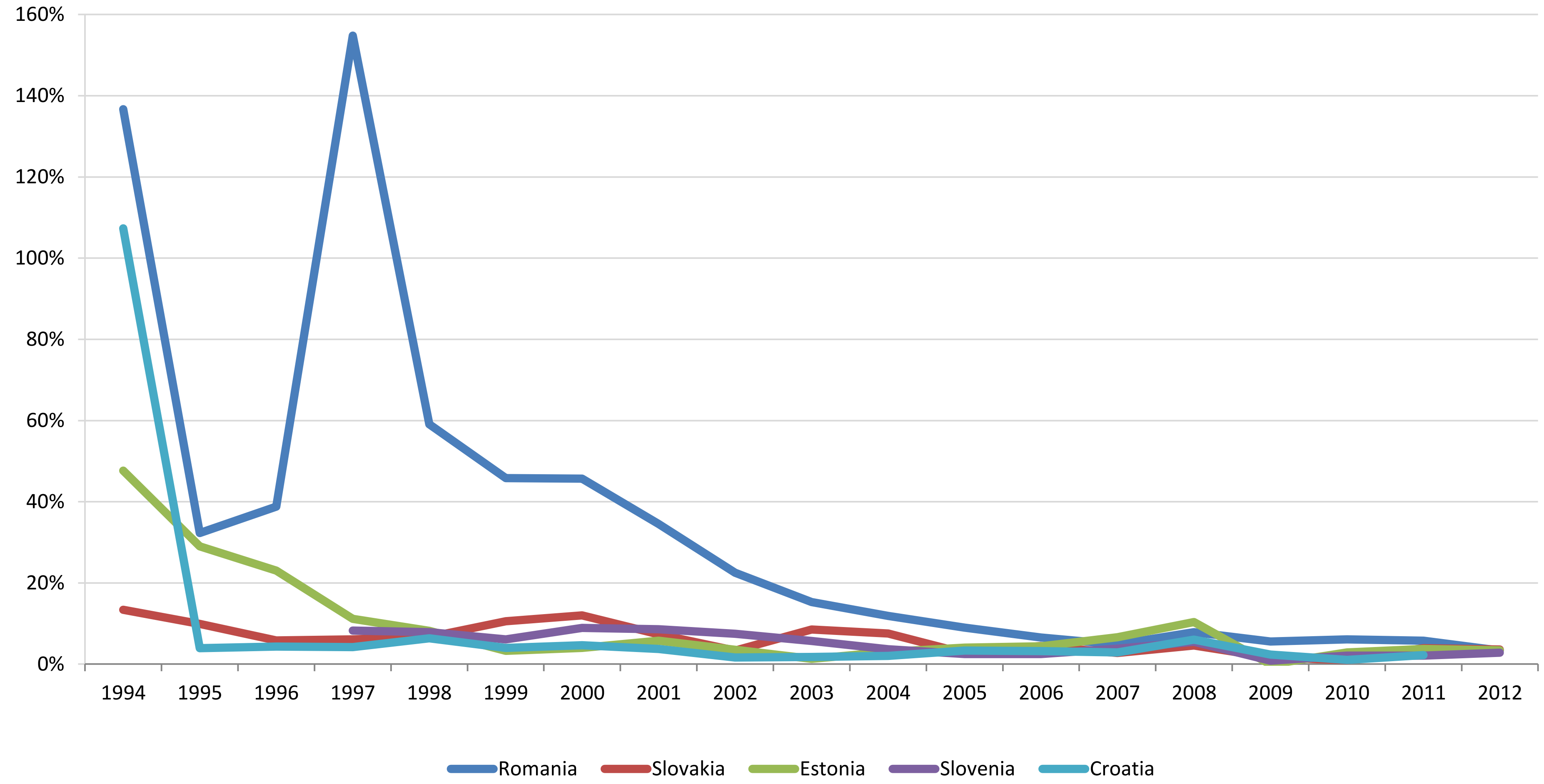

Source: Romania, World Bank; Slovakia, Slovak National Institute for Statistic; Estonia, Statistics Estonia; Slovenia, World Bank; Croatia, World Bank

## Figure 5: Current Account Balance as Percentage of GDP



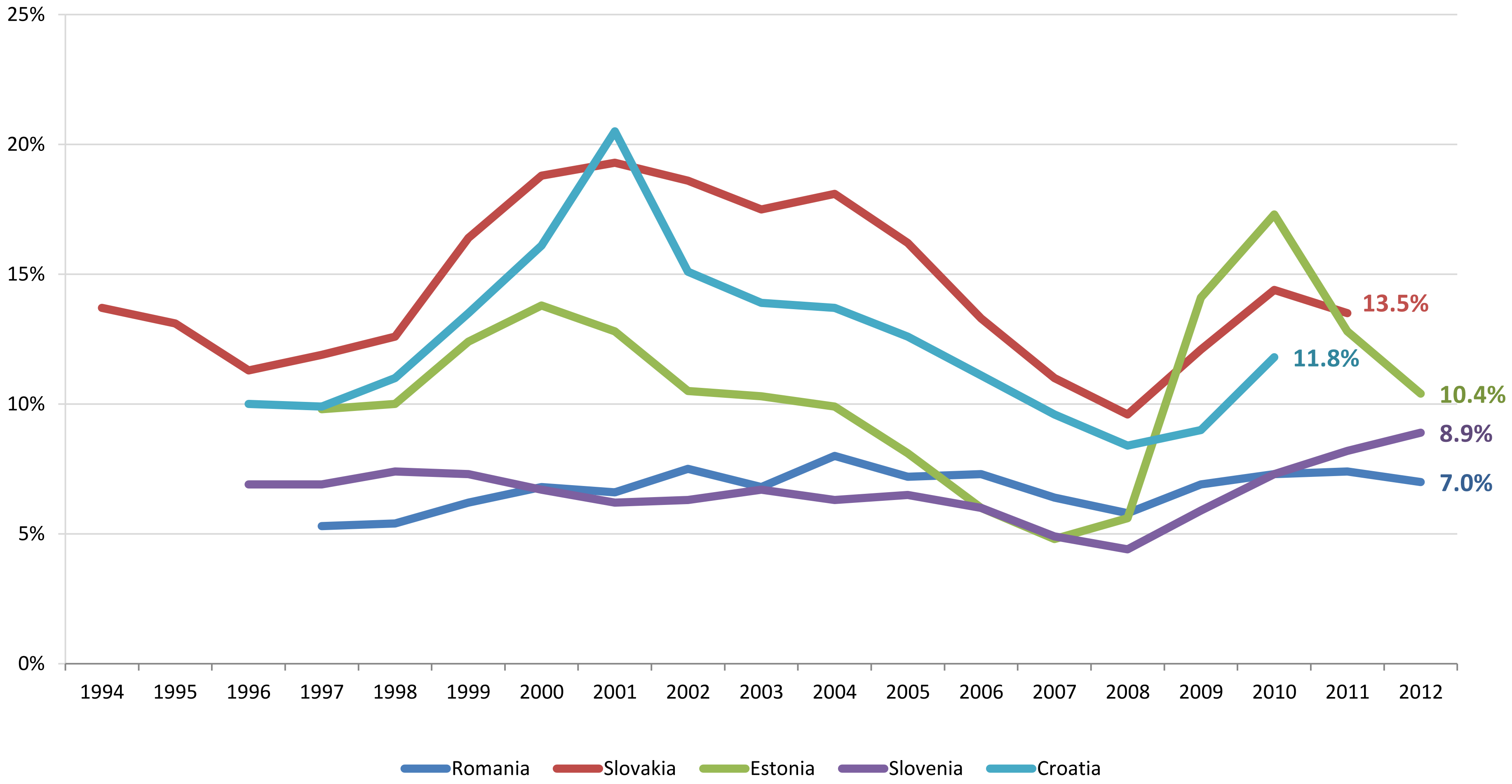

Source: Romania, Romanian National Institute of Statistics for GDP, Eurostat for current account balance; Slovakia, Slovak National Institute for Statistic; Estonia, Statistics Estonia; Slovenia, Statistical Office of the Republic of Slovenia; Croatia, Eurostat

## Figure 6: Inflation Rate



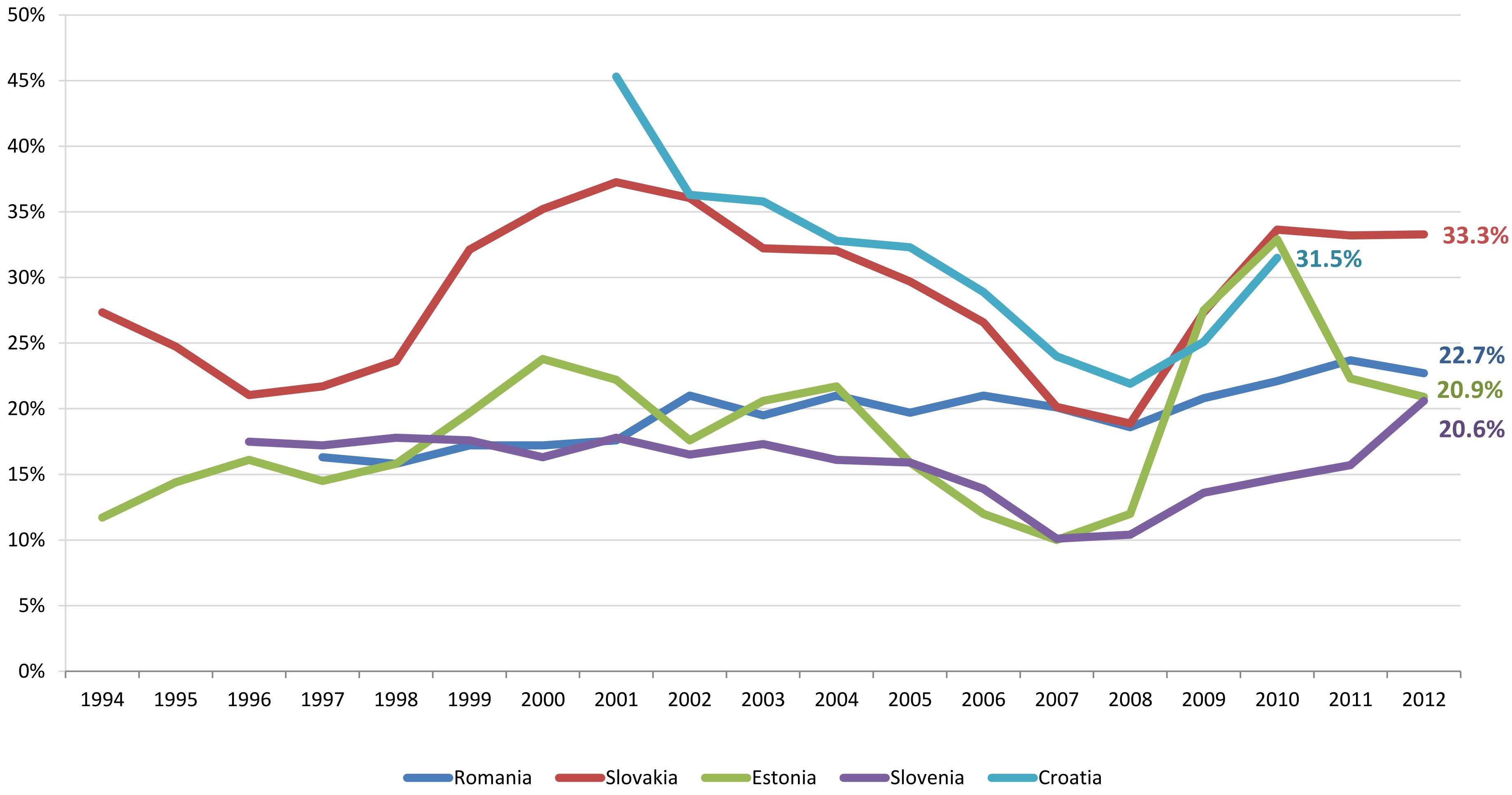

Source: Romania, Romanian National Institute of Statistics; Slovakia, Slovak National Institute for Statistic; Estonia, Statistics Estonia; Slovenia, Eurostat; Croatia, World Bank

## Figure 7: Unemployment Rate



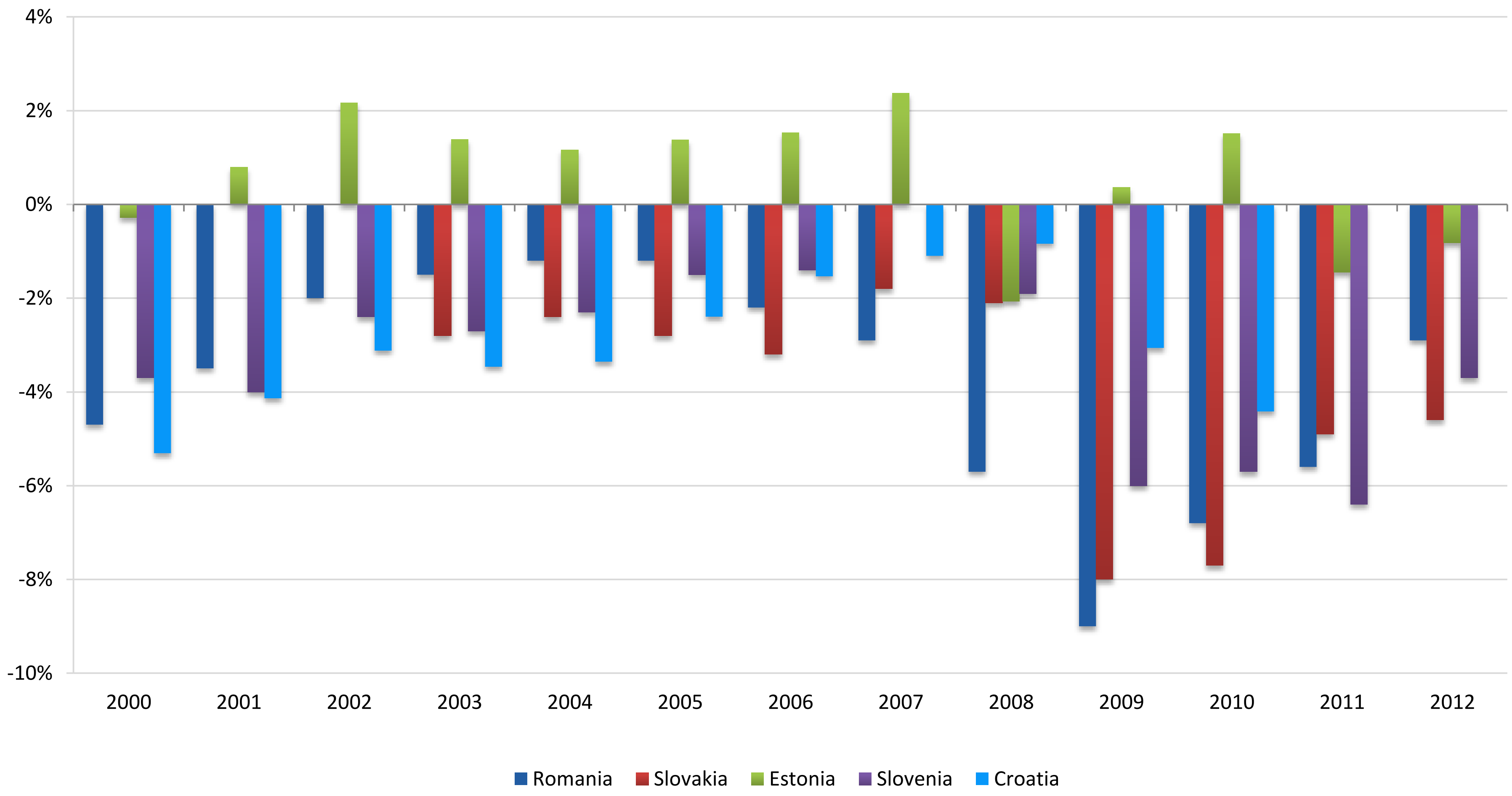

Source: Romania, Eurostat; Slovakia, Slovak National Institute for Statistic; Estonia, Statistics Estonia; Slovenia, Eurostat; Croatia, World Bank

## Figure 8: Youth Unemployment Rate




Source: Romania, Eurostat; Slovakia, Slovak National Institute for Statistic; Estonia, Statistics Estonia; Slovenia, Eurostat; Croatia, World Bank

## Figure 9: Public Deficit as Percentage of GDP




Source: Romania, Eurostat; Slovakia, Slovak National Institute for Statistic; Estonia, Statistics Estonia; Slovenia, Statistical Office of the Republic of Slovenia; Croatia, World Bank