Poverty, Inequality, and Democracy

EAST-CENTRAL EUROPE'S QUANDARY

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Since socialism collapsed two decades ago, the fragility of the new market-based order that replaced it has raised problems for social cohesion, political stability, and general welfare in Central and East European (CEE) societies. The capitalist system there was born amid crisis in the early 1990s, remained vulnerable for a disconcertingly long time after the initial emergency passed, and recently has proven crisis-prone again. The "transformational recession" that gripped the region after socialism entered its death throes was long and deep enough to merit comparison with the local impact of the worldwide Great Depression of the 1930s. Neither frontrunners nor laggards were spared.

The recovery had just gotten underway when the late 1990s brought a fresh wave of economic and financial shocks that laid bare the weakness of the partially transformed CEE economies and paved the way for deeper transnational integration. That seemed to be going very well—living standards, investment, and exports were rising—until the global financial crisis and economic downturn hit in the second half of 2008. Suddenly, many CEE countries found themselves awash in speculative attacks against their national currencies, runs on their banks, massive capital flight, contraction in their foreign-dominated industrial sectors, rising unemployment, and crushing external debts.

How well prepared are these small, ex-socialist states—particularly the ten that belong to the European Union[1] (the "ECE 10")—to weather current hard times while combatting poverty and inequality? During the difficult days of the early 1990s, when real wages were plunging to half or less of what they had been in 1989, unemployment was running

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rampant, and the massive state-run enterprises that once doled out benefits were vanishing, CEE governments turned to ad hoc and temporary measures to ease the pain of adjustment and lay the basis for new investment.

After the mid-1990s, governments began taking more systematic steps, including the establishment of export-processing zones and investment-promotion agencies, with the aim of luring the foreign capital and transnational corporations (TNCs) that the "latecomer" CEE region would need in order to achieve economic modernization and entry into world markets. Within a decade, varied forms of transnational control had become the norm in all major CEE export industries and many strategic utilities and services. Nowhere was this more true than in the banking sector, where foreign penetration went far beyond its usual extent in Europe or other parts of the world.

The rapid shift of development strategy toward a model based on foreign investment and exports had an impact on poverty and inequality. Foreign direct investment (FDI) brought much that was new, but this did not include jobs in the needed quantity and quality. As of the mid-2000s, only a third of the region's working-age population had found regular employment in the private sector. With steady work scarce, the risk of impoverishment rose. The small and medium-sized domestic firms that might have taken up some of the job-creation slack were struggling because foreign-bank subsidiaries viewed them as poor lending risks, while state policies favored larger and foreign concerns. Meanwhile, low wages threatened even the lucky minority that held secure private-sector jobs with consignment to the ranks of the "working poor." Even during the period of rapid growth before and right after EU accession, the new market order kept reproducing significant risks of poverty in most of the CEE economies. Nevertheless, within this overall pattern there prevailed a number of intraregional differences with roots in (among other things) the differing degrees to which various countries had embraced the demands of transnational economic integration.

FDI poured into the capital- and skill-intensive industries of the Visegrád countries (the Czech Republic, Hungary, Poland, and Slovakia, also known as the V4), and to a lesser extent Slovenia. From their factories in turn poured such advanced-economy staples as cars, machinery and equipment, electronics, and chemicals. Bulgaria, Romania, and the Baltic states, meanwhile, became favored low-wage relocation sites ("sweatshops" may not be too strong a word) for West European light industries making clothes, shoes, and furniture, or assembling small electrical goods.

These divergent industrial paths have led to divergent social outcomes. Not surprisingly, wages and working conditions are better in the more highly skilled V4 and Slovenian economies. Yet certain features of complex industrial specialization tended to exacerbate inequalities. First, complex industries may have paid their core workers relatively well, but this was not necessarily a status enjoyed by those who worked for suppliers, or for small firms competing on the domestic market. Second, the tight clustering of TNCs in already well-developed areas maintained or even increased regional disparities within countries. Finally, while firms in complex industries tended to be on friendlier terms with their own employees, the generous incentives offered to such enterprises laid heavy burdens on national budgets and thus indirectly drew resources away from the marginalized.

The small countries along the Baltic coast or down in Europe's southeastern corner faced their own social challenges. Light-industrial TNCs typically preferred working through local subcontractors. While less demanding of overt incentives, the highly mobile outside firms expected their host governments to keep labor markets flexible, workers docile, and wages, taxes, and social-security contributions low. Whenever a TNC moved its operations to a lower-cost location, government had to step in to help the town or region left behind cope with job losses. Overall, the CEE states' record of maintaining social cohesion despite destabilizing market forces is not bad. Whether one looks at poverty rates, relative income, or other indicators of social stress, the newcomers do not seem to differ much from many older EU member states. What strategies have the CEE states adopted to combat the social costs attached to their varied paths toward economic transformation and transnational integration? And to what extent have these countries been able to mitigate poverty and inequality?

A Variety of Strategies

Numerous studies have been devoted to the CEE welfare states—their origins, their varying levels of generosity, and the methods by which they are balanced against considerations of growth and macroeconomic stability.[2] These studies most often point to policy traditions, transnational influences, and degrees of democratization to explain how these welfare states have come to be what they are.[3] All the explanations offered have power, but each also poses puzzles and so invites further inquiry into the intricate relations among welfare-state development, social cohesion, and democracy.

The beginning of wisdom in thinking about the topic is to recall that all is mediated by perceptions. How do those who decide welfare policy see their country's welfare-policy legacy? Do they find it a hindrance to development, or a help? At the same time, problems of recession, public indebtedness, or inflation—whatever their actual seriousness—must first be *perceived* as critical before they can prompt extraordinary measures such as drastic cuts in welfare provisions or sweeping public-sector reforms. And as for democratization, whom does it empower most—the poor or the middle classes?

It is often said that the neoliberal consensus among international financial institutions narrows the room available for local differences in welfare policy among countries beholden to those institutions. But if that is so—if local agency is so constrained—how can we explain the continuing diversity that we see among the various welfare states of the CEE region?

How do they differ from one another? Let us count the ways. First, there is the matter of size relative to the scale of the national economy. In commensurate terms, total public spending on social protection including health care, pensions, labor-market policies, family and child care, and public housing (but leaving out education) is nearly twice as high in the V4 and Slovenia as it is in Bulgaria, Romania, and the Baltic states. The *volume* of social benefits (as measured in euros per capita at comparable purchasing-parity standards [PPS]) that citizens of the former countries enjoy is also double what the populations of the latter countries receive. This is so even though the three Baltic republics employ significantly larger shares of their respective working-age populations in public service than any other CEE state, and also match the V4 in per capita spending on education.

Second, there is the matter of performance. The V4 and Slovenia appear to be far more successful in mitigating the risk of impoverishment than Romania or the Baltic states, which are in fact the EU leaders when it comes to social disparity.

Third, these states differ as to how they structure their social spending and target specific social groups for benefits. The Baltic states favor the young, the educated, and the middle classes (whether in public or private jobs) rather than the elderly. The V4's welfare states tend to tilt in favor of those who may be "nonproductive" (meaning permanently or temporarily un- or underemployed) but who are nevertheless seen as having earned a respected status through their work history or role in society. Thus Hungary and Poland have large numbes of pensioners in early retirement, while the former extends many benefits to middle-class mothers and their children.

Finally, the particular groups most threatened by marginalization differ across the two sets of countries in terms of ethnic origin as well as recent social status. To see how this is so—and to explore the impact of socialist legacies, the role of perceptions in the making of social policy, and the influence of international and domestic constraints, risks, and opportunities—it will be helpful to consider a pair of countries in greater detail. Hungary and Latvia respectively represent the Visegrád and Baltic "worlds" of welfare capitalism, and thus offer good material for such a comparison.

Socialism left both Hungary and Latvia with complex and diversified but inefficient economies that had numerous experienced and skilled workers but also an urgent need for modernization. Living standards had been relatively high, with social benefits provided not only via fiscal means but also through the state-run enterprises that employed so much of each country's populace. When socialism fell, each country embraced a "return to Europe." Yet Hungary's elites proposed what we might call a "welfarist" path toward this goal, while Latvia's preferred a more "nationalist" route. Thereby hangs much of the tale of how social policy and the politics of social policy have played out in each country over the last two decades (see Table on the facing page).

Hungary's welfarist option had its roots in the "goulash communism" that János Kádár had devised to pacify society after Soviet tanks suppressed the Hungarian Revolution in late 1956. In return for political quiescence, the regime offered citizens economic reform, some freedoms of travel and private life, and modest social-protection and welfare measures. The price tag in terms of macroeconomic stability was high, however, and Hungary struggled with inflation, crippling foreign debt, and runaway budget deficits right up until the crumbling of communist rule in 1989.

When Hungary's first democratic government tried to solve the problem by, among other things, allowing a sharp rise in fuel prices, the turbulence that this unleashed roused old fears of unrest. After cab drivers mounted a days-long blockade of Budapest streets in October 1990, the conservative government backed down and opted for a continuity in welfare policies that János Kornai says "can be aptly called 'goulash post-communism.'"[4]

Latvia's situation was different. The revolutionary process there had begun with identity politics.[5] More than in Hungary, whose national survival was less threatened under socialism, the cause of sovereignty remained important throughout the whole period of Latvia's transformation. The questions of how Latvia was to relate to its own ethnic-Russian minority, to Russia itself, and to the West were central and had deep effects on social policy. Unlike Hungary, Latvia had been forcibly joined not only to the Soviet sphere, but to the Soviet Union itself. When it came to the socialist past, Latvia's postcommunist leaders differed from Hungary's in stressing not continuity but rather its opposite. Looking east at forces hostile to Baltic independence, Latvian politicians saw the new democratic-capitalist order as a sharp break with the past. They emphasized the need to quit the East and its dangerous Soviet legacy as quickly as possible, and saw the social losses produced by radical economic restructuring as unavoidable costs of independence.

Hungarian politicians were convinced that long experimentation with cautious economic liberalization under "goulash communism" had left their economy in relatively good shape. Once the initial hard times were over, they believed, Hungary's skilled labor force would begin attracting large inflows of FDI. Latvia's leaders felt no such confidence.

Table—Combating Poverty and Inequality in Hungary, Latvia, ECE-10, and EU-15

	Hungary	Latvia	ECE-10	EU-15
Public spending on social protection (current prices, % of GDP)	21.7	12.5	16.8	27.6
Social benefits per head of population (in PPS euros annually)	3,063	1,347	2,227	7,020
At-risk-of-poverty rate before social transfers (%)	29	27	24	26
At-risk-of-poverty rate after social transfers (%)	14	21	16	16
Income-quintile share ratio	4.8	7.2	5.0	4.8
Spending on pensions (current prices, % of GDP)	9.7	6.4	8.2	12.2
Spending on education (current prices, % of GDP)	5.6	5.2	4.9	5.0
Spending on education per spending on pensions	58	81	60	41
Regular employment in private sector (% of 15+ years old)	24.7	31.3	33.1	n.a.
Regular employment in public sector (% of 15+ years old)	11.3	16.1	12.7	n.a.

Instead, they associated their country's socialist-era legacy industries with profound value destruction, whether in the form of unwanted goods or depreciated human capital. Officials in Riga thus felt less willing than their counterparts in Budapest to extend special help and protection to their highly vulnerable complex industries.

In time, Hungary would emerge as the most and Latvia as the least complex manufacturing economy in the CEE region. Export-oriented automotive, electronics, and chemical concerns thrived in Hungary and atrophied in Latvia, which found a new niche as an exporter of wood and unprocessed wood products, food, and apparel. While both countries' industrial trajectories were threatened by rising unemployment, poverty, and inequality, the need for public remedies was viewed through the lenses of distinct social contracts.

Marginalizing the Vulnerable

Hungary's welfarist contract envisaged protection above all for those groups that in socialist times had acquired social status through work. In practice, such groups' losses were mitigated in proportion to their demonstrated or anticipated abilities to resist—whether via voting or street protests—changes that would make them vulnerable. Accordingly, several administrations tried to "divide and pacify" opposition to market reforms by offering liberalized access to disability and early retirement, benefits for the unemployed and families, and broad schemes of public health care and education.[6]

Among the groups left without sufficient protection against a slide into underclass status was Hungary's substantial Roma population. Under communism, the integration of the Roma had never gone far beyond temporary employment in low-skilled occupations that brought little respect. As Júlia Szalai has shown, after socialism broke down the Roma (and other vulnerable groups) were effectively shoved aside by politically more vocal beneficiaries of the welfare state. Roma poverty is above all to be traced to extremely high rates of long-term unemployment.[7]

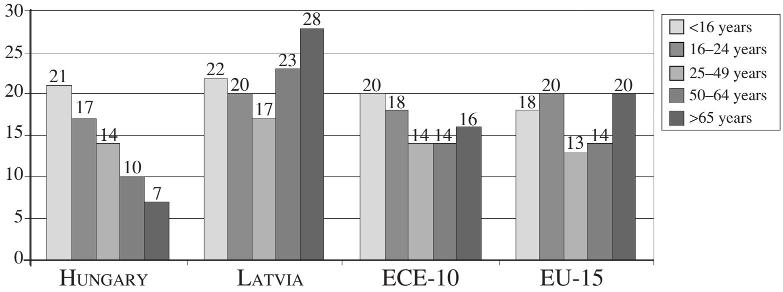
The politics of social inclusion and exclusion followed a different logic in Latvia. There, the rejection of the Soviet legacy and the agenda of nation-building under threat supported radical economic restructuring and a meager welfare regime that identified some beneficiaries on grounds of citizenship and language and operated through selective deprivations of democratic rights. Free-market radicalism seemed a sharp sword for defending national autonomy by cutting ties with the Russian economy. The resulting dislocations put disproportionate burdens on Latvia's largely Russian-speaking manufacturing workers, whose privileged status under Soviet rule had brought them higher pay and easier access to enterprise-based social provisions and public housing.[8]

Russian-speaking workers in Latvia found little support for their grievances among politicians or the ethnic-Latvian majority, however. Unlike the Roma in Hungary, the ethnic Russians in Latvia have not suffered massive and long-term unemployment. But the switch from the huge but not notably efficient industrial concerns of the Soviet era to the postcommunist sweatshop economy made skilled ethnic-Russian workers downwardly mobile and crippled much of their capacity for collective bargaining.

In the early 1990s, Latvia passed a highly restrictive citizenship law that excluded all Russians who had arrived during the Soviet era, or about 32 percent of the population. Moreover, the law made it difficult to acquire citizenship. Even after EU pressure brought about a relaxation of this law, about 22 percent of all those officially living in Latvia as of 2003 were noncitizens, most of them ethnic Russians.[9] Both the political and the social inclusion of the Russian-speaking population continue to lag.[10]

To Latvian nationalists, the republic's Soviet-era industrial base and the ethnic Russians who ran it stood for a species of colonial subordination from which marketization (even at the cost of deindustrialization) offered an escape. Moreover, introducing and stabilizing the new national currency, the lat (an important means and symbol of independent statehood), required strict fiscal and monetary policies that left little room

FIGURE—AT-RISK-OF-POVERTY RATE AFTER SOCIAL TRANSFERS, BY AGE GROUP (2004–2006 AVERAGE %)



Source: EUROSTAT, *http://epp.eurostat.ec.europa.eu.* At-risk-of-poverty rate refers to the share of persons with an equivalized disposable income below the risk-of-poverty threshold, which is set at 60 percent of the national median equivalised disposable income after social transfers. "EU-15" refers to the EU membership before the 2004 enlargement.

for public spending anyway. In these circumstances we can trace some of the reasons for the large differences in the amounts of social benefits provided in Hungary and Latvia, respectively, and the degrees to which impoverishment and inequality have been kept at bay in each country.

Hungary and Latvia also differ as to how their respective welfare systems redistribute poverty risks across age groups (see Figure above). While children and the young adults run high risks of becoming poor in both countries, the Hungarian at-risk-of-poverty rate gradually declines with age, and reaches its bottom in the oldest generation. In Latvia, by contrast, older people run a dramatically higher risk of being poor. Hungary's pensions are not especially generous, but they are available starting at an early age, and many people are able to pad them out and save for old age by running family businesses, moonlighting, and the like.

In Latvia, spending on benefits that are accessible to citizens and noncitizens alike—health care, pensions, or active and passive labor-market policies—is subject to strict controls. In the few areas where Latvian welfare generosity approximates or exceeds Hungarian standards (public spending on higher education and certain kinds of state employment), access is controlled via citizenship requirements or language-proficiency tests administered in Latvian.

It is hardly surprising that the new state's public sector became increasingly "Latvianized" as the 1990s wore on. As the decade began, 31 percent of employed ethnic Latvians and 32 percent of ethnic Russians had jobs in state-funded entities. By 2000, that figure had slipped to 21 percent for ethnic Russians while rising to 35 percent for ethnic Latvians. Conversely, the private economy became "Russified," and by 2000 fully 57 percent of all ethnic Russians with jobs worked for privatized state enterprises or newly founded private firms.[11]

To summarize, in welfarist Hungary the better-off and more vocal have often pushed their poor, powerless, and (partly but not exclusively) Roma compatriots away from the public-welfare tap. Yet by saving large swaths of the middle class from poverty, the Hungarian welfare state has in its own inefficient way managed to keep a lid on social disintegration. In nationalist Latvia, governments representing the newly empowered titular majority adopted a peculiar mix of economic and social policies in order to reverse the inherited pattern of social hierarchy and turn the Russian minority into a new "lower class."[12] Thus, the Latvian welfare state's performance also should be judged against the yardstick of the "nationalizing project" in which Latvian elites have been engaged—that is, the project of building a state for the core (ethnic-Latvian) nation.[13]

Do All Roads Lead to Crisis?

Different as they are, both Hungary's and Latvia's financial systems were among the first "hot spots" to be hit hard by the global financial crisis in October 2008. In order to understand what happened, it is necessary to look at the novel mix of macroeconomic and distributive policies that politicians used around and after the time of EU accession to boost the living standards of the middle and upper classes. In Hungary, such policies evolved in tandem with increased welfare spending. In Latvia, they acted as privatized functional substitutes for more generous public-welfare provisions.[14]

Hungary's brief "Golden Age" (from the late 1990s to 2006) was a time of cut-throat party competition over the support of a rather "materialist" constituency. Short-term politics drove policy decisions. Parties on both the left and right promised to observe the welfarist contract and, once in power, tried to implement measures consistent with their respective social agendas.

Thus, in 2001 Viktor Orbán's right-of-center coalition government launched a policy package designed partly to counter a drop in exports, partly to pave Hungary's way to EU accession, and partly to secure the prospects of Orbán's party in the 2002 elections. The government passed a pair of minimum-wage hikes totaling 80 percent—with a predictable upward pull on wages throughout the economy—and used fiscal expedients to boost domestic output and consumption. Large-scale transport, tourism, and public-works projects were begun. Most significantly, those Hungarians who wished to build or improve homes could get generously subsidized loans, while the "Széchenyi plan" gave grants to medium-sized businesses, local communities, and individuals.

After Orbán's party narrowly lost the 2002 elections to the left-liberal coalition led by the Socialists, new prime minister Péter Medgyessy left the middle class alone to enjoy the consumption bonanza financed by government-generated pay hikes, easy credit, and the boom in house prices that it made possible. From 2003 to 2008, public-welfare spending remained high and "house-price Keynesianism"[15] was rampant. Moreover, a series of left-liberal governments turned a blind eye to the rapidly rising foreign-currency indebtedness of Hungarian households and private firms. By the end of 2007, roughly half of all mortgage and personal loans were in Swiss francs; in 2006–2007 alone, 80 percent of all new-home loans and half of all small-business and household lines of credit were taken out in Swiss francs, with Hungarian subsidiaries of Austrian banks doing much of the actual lending.[16]

The foreign-currency loans had become popular because the National Bank of Hungary, anxious to prepare for Eurozone entry, had kept interest rates on the Hungarian forint prohibitively high in order to fight inflation and the growing fiscal deficit. The much lower interest rates on loans taken out in Swiss francs (plus the ensuing house-price hikes) shielded middle-class Hungarian consumers from both their government's encouragement of inflation through legislated pay raises and their central bank's efforts to fight that inflation through tight-money policies. Housing prices kept rising through 2006, and the high rate of interest commanded by the forint made foreign-currency borrowing look ever more advantageous. Few stopped to reflect, however, that private consumers were taking on major exchange-rate risks by engaging in what amounted to a form of currency speculation.[17]

To be sure, officials from the National Bank of Hungary as well as independent experts tried to warn that speculative attacks might cause the forint to collapse and suddenly saddle credit-happy firms and households with drastically higher debt-service costs. But most consumers and financiers alike remained content to rely on Hungary's expected Eurozone entry to keep a lid on exchange-rate risks.

What went wrong in Latvia? Unlike Hungarian authorities, Latvian governments tried to stay committed to prudent fiscal policies and refused to jack up social spending or minimum wages and public-sector salaries. Yet in Latvia, too, there were changes. Once the new millennium arrived and the popular appeal of nation-building began inevitably to fade from its vivid first flush, policy makers' resolve to be cautious about domestic macroeconomic fundamentals came under challenge from the country's rapid economic expansion. With GDP increasing at an annual average rate of 8.5 percent from 2000 to 2006, Latvia had the EU's fastest-growing economy. Growth brought down unemployment and released pent-up demands for higher standards of living. Moreover, unlike Hungarians, masses of Latvians made use of the newly acquired right to exit after their country joined the EU. In 2006, between 6 and 8 percent of the country's labor force found employment abroad, mostly in the United Kingdom and Ireland.[18] The resulting shortage of workers back home led to exceptional wage growth.

Amid fast growth and abundant international finance, Latvian conservatives opted for a mortgage and housing boom—one that far outstripped Hungary's—in order to push middle-class living standards even higher. As the Austrian banks had done in Hungary, the Swedish-owned Hansabanka touched things off by vastly expanding foreign-currency–denominated credits to households and domestic enterprises. In May 2002, Hansabanka submitted a proposal to facilitate mortgage lending, which the center-right government of Premier Andris Berzīns duly embraced. Residential construction took off and housing prices soared. Between 2001 and 2006, the price of a square meter in a standard house in Riga increased by 42 percent annually, while by 2006 more than 70 percent of the construction loans were being issued in foreign currencies, mainly the euro.[19]

By the late 2000s, it was becoming clear that the partial privatization of both the Hungarian and the Latvian social contracts was built on shaky global foundations. The two countries' export competitiveness was plummeting while their current-account deficits and external debts were soaring. Hungary was the first to fall from international grace, although its macroeconomic and financial imbalances were by no means worse than those of Latvia. Nonetheless, its twin fiscal and current-account deficits plus persistent exchange-rate instability landed it on the radar screen of several international actors simultaneously.

Under pressure from the EU and its rules against excessive deficits, the newly reelected Socialist prime minister Ferenc Gyurcsány announced in June 2006 that drastic social- and economic-policy changes would be needed to bring the budget deficit under control and prepare for rapprochement with the Eurozone. Although the European Commission accepted Hungary's new convergence program, international rating agencies judged the premier's efforts unsatisfactory. By late summer 2006, all the major agencies had cut Hungary's ratings. While the Gyurcsány package began to remedy the problem of the twin deficits, it had sharply negative repercussions for growth, real wages, public-sector employment, and consumption.

In the Shadow of the Bailouts

The shock of the austerity package had barely struck when Hungary became one of the prime victims of the global financial crisis. In October 2008, its currency and stock markets plunged, and foreign finance dried up. In order to escape bankruptcy, stem savage speculative attacks, restore confidence in the forint, and ease the credit crunch, the Hungarian government had to rely on a coordinated rescue package crafted by the IMF, the World Bank, and the EU. The size of the bailout—20 billion euros—is huge by local standards, and its attached conditions threaten a grim future for many Hungarians. Hungary's harsh adjustment program this time must focus on the public-expenditure side.

Latvia's more prudent fiscal policies allowed that country to fly below the radar of international scrutiny for a longer time. The first signs of strain occurred in 2005, when the inflation rate began creeping suspiciously high. In 2006, the IMF published one of the first critical analyses of Latvia's growing macroeconomic imbalances, including its rising current-account deficit and limited capacity to close the gap through exports. The report also pointed out the problem of rapidly growing private-household debt, warning that "[a]s numerous cross-country studies have documented, rapid credit growth is the single best predictor of banking crises."[20]

In the first half of 2007, the Latvian government endorsed a plan to fight inflation, but it was too little and too late for an economy that was spiraling out of control. Already in the first quarter of 2007, the current-account deficit had come to exceed a fourth of GDP, while wage and price inflation was racing ahead along with the real exchange rate. When the global financial crisis broke in the third quarter of 2008, the major domestically owned bank ran into grave liquidity problems, and official reserves fell by almost 20 percent due to the Bank of Latvia's attempt to defend the national currency. Despite the huge effort, moreover, pressure on the lat remained strong. With national bankruptcy looming, Premier Ivars Godmanis's center-right government turned to the IMF for support in December 2008. Latvia received an IMF loan worth 1.7 billion euros, with additional funds from the EU, the World Bank, and several bilateral creditors totaling nearly 5.8 billion euros for a country of only about 2.2 million people. As described by IMF managing director Dominique Strauss-Kahn, the unusually harsh adjustment program that Latvia must swallow "calls for extraordinarily strong domestic policies, with the support of a broad political and social consensus."[21]

Support and consensus, however, seem to be in short supply—not only in Latvia but in Hungary and other CEE countries as well.[22] Massive protests, strikes, and riots have become regular occurrences in once-patient Hungary, and have begun to break out in Latvia for the first time since the early years of independence. On 13 January 2009, citizens fearing the consequences of a hard landing gathered in front of the Latvian Parliament and demanded the government's resignation (it came about five weeks later). Hungary's prime minister resigned at the end of March. With popular dissatisfaction growing, and governments strapped for resources to mitigate the pains to come, the future of democratic capitalism in these and other similarly hard-hit CEE countries is once again uncertain.

We can only speculate about the consequences for social policies. Without a doubt, the global crisis has set in motion unusually fierce domestic distributional struggles. Their foreboding nature is clearly reflected in a dramatic shift on the plane of discourse. In a new outburst of neoliberal reform rhetoric, the CEE welfare states—once appreciated for their importance in fighting social disintegration and political instability—are today portrayed as major causes of macroeconomic instability and recession.

If the conclusions drawn for social policies follow entrenched logics, then the outcome will be the same as it ever was. Spearheaded by large private banks that gained the most from the mismanaged consumption boom, the vocal middle classes have ample incentives and resources to press for policies that spread the costs of their private debts. Since cornered and unpopular governments may not have many alternatives to embracing such demands, the implied fiscal burden will put already hard-pressed budgets under even more strain. Resources crucial to mitigating poverty and inequality will go instead to the better-off in ways that, as scholars long ago observed, may even lead to "reverse" forms of income redistribution from lower to higher on the household scale and from labor and small businesses to corporate giants.[23] When the banks are "too big to fail" and the aggrieved-feeling middle classes are too loud to be ignored, it is all too easy to turn the marginalized and stigmatized poor into scapegoats and cut their benefits or sentence them to workfare.

Across Central and Eastern Europe, radicalizing political forces and desperate constituencies alike seem ready to complete the scapegoating of their neighbors on ethnic or other grounds—or at least to stand by without much protest while others do the dirty work. As to the fate of the region's fragile polities, grave economic and political instability is likely to speed up the already-rolling processes of massive disenchantment with centrist solutions, dramatic declines in popular participation, and rising radical voices.

NOTES

1. The ten ex-socialist EU members are the Baltic states of Estonia, Latvia, and Lithuania; the Visegrád group made up of the Czech and Slovak Republics as well as Hungary and Poland; and Bulgaria, Romania, and Slovenia.

2. See for example János Kornai, "The Postsocialist Transition and the State: Reflections in the Light of Hungarian Fiscal Problems," in his *Highway and Byways: Studies on Reform and Postcommunist Transition* (Cambridge: MIT Press, 1995), 107–39; Branko Milanovic, *Income, Inequality and Poverty during the Transition from Planned to Market Economy* (Washington, D.C.: World Bank, 1998); Linda J. Cook, *Postcommunist Welfare States: Reform Politics in Russia and Eastern Europe* (Ithaca: Cornell University Press, 2007); Tomasz Inglot, *Welfare States in East Central Europe, 1919–2004* (Cambridge: Cambridge University Press, 2008); and Stephan Haggard and Robert R. Kaufman, *Development, Democracy, and Welfare States: Latin America, East Asia, and Eastern Europe* (Princeton: Princeton University Press, 2008).

3. For a recent review and summary of these arguments, see Mitchell A. Orenstein, "Poverty, Inequality, and Democracy: Postcommunist Welfare States," *Journal of Democracy* 19 (October 2008): 81–94.

4. János Kornai, "Paying the Bill for Goulash-Communism: Hungarian Development and Macro Stabilization in a Political-Economy Perspective," Discussion Paper 23, Collegium Budapest, Institute for Advanced Study, March 1996, 1.

5. Sten Berglund, Joakim Ekman, and Frank H. Aarebrot, eds., *Handbook of Political Change in Eastern Europe* (Cheltenham, England: Edward Elgar, 2004).

6. Pieter Vanhuysse, *Divide and Pacify: Strategic Social Policies and Political Protests in Post-Communist Democracies* (Budapest: Central European University Press, 2006).

7. Júlia Szalai, *Nincs két ország . . . ? Társadalmi küzdelmek az állami túlelosztásért a rendszerváltás utáni Magyarországon* (Are there not two Hungaries? Redistributive struggles in Hungary after the systemic change) (Budapest: Osiris Kiadó, 2007).

8. Richard Rose and William Maley, *Nationalities in the Baltic States: A Survey Study* (Glasgow: University of Strathclyde Centre for the Study of Public Policy, 1994).

9. Hermann Smith-Sivertsen, "Latvia," in Berglund, Ekman, and Aarebrot, *Handbook of Political Change.*

10. Aadne Aasland and Tone Fløtten, "Ethnicity and Social Exclusion in Estonia and Latvia," *Europe-Asia Studies* 53 (November 2001): 1046.

11. For these and other data on the social consequences of the ethnic divide, see Richard Rose, *New Baltic Barometer IV: A Survey Study* (Glasgow: University of Strathclyde Centre for the Study of Public Policy, 2000), 5, 14.

12. Juris Dreifelds, *Latvia in Transition* (Cambridge: Cambridge University Press, 1996), 164.

13. Rogers Brubaker, *Nationalism Reframed: Nationhood and the National Question in the New Europe* (Cambridge: Cambridge University Press, 1996), 105.

14. The following analysis draws on Dorothee Bohle, "East European Capitalism: What Went Wrong?" *Intervention: European Journal of Economics and Economic Policies* 6, no. 1 (2009): 1.

15. The term comes from Colin Hay, N.J. Smith, and M. Watson, "Ireland: The Outlier Inside," in Kenneth Dyson, ed., *The Euro at Ten: Europeanization, Power, and Convergence* (Oxford: Oxford University Press, 2008).

16. Edward Hugh, "And So It Ends," 27 October 2008, available at *www.rgemonitor.com/euromonitor/254139/and_so_it_ends.*

17. Joachim Becker, "Dollarisation in Latin America and Euroisation in Eastern Europe: Parallels and Differences," in Joachim Becker and Rudy Weissenbacher, eds., *Dollarization, Euroization and Financial Instability* (Marburg: Metropolis, 2007).

18. See *http://edwardhughtoo.blogspot.com/2007/06/latvian-economy.html.*

19. Data on the real-estate market in Riga and its environs are available at *www.latio.lv/files/novembris_en-1.pdf.*

20. See the October 2006 report on Latvia of the International Monetary Fund, available at *www.imf.org/external/pubs/ft/scr/2006/cr06354.pdf.*

21. Attachment 1 to the IMF's January 2009 Report on Latvia, 60; available at *www.imf.org/external/pubs/ft/scr/2009/cr0903.pdf.*

22. On the events and logic of Central and Eastern Europe's growing political turbulence since EU accession, see Béla Greskovits, "Is East-Central Europe Backsliding? Economic Woes and Political Disaffection," *Journal of Democracy* 18 (October 2007): 40–46; plus the other contributions to the *Journal*'s special forum on the question stated in the article's main title.

23. James Kurth, "The Political Consequences of the Product Cycle: Industrial History and Political Outcomes," *International Organization* 33 (Winter 1979): 1–34.