

SOCIAL POLICY PATHWAYS IN THE NEW MEMBER STATES:

THE CASES OF HUNGARY AND ESTONIA

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Abstract

The goal of the thesis is to analyse the changing pathways of social policy within the new member states. The 2008 crisis created a severe shock in the European Union and the thesis sets out to assess the changes in social policy and institutions via the case studies of Estonia and Hungary. The literature on the various welfare state arrangements within the new member states categorizes Estonia as a liberal system, while Hungary is seen as a more social regime. The central question for the thesis is how the different types of welfare systems react to the influence of the European Union. Using historical institutionalism as theoretical framework the thesis maps out the changes in policies and institutions and comes to the conclusion that while internal characteristics of the new member states are still relevant the European Union showed capacity to influence policy formation after the crisis.

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Introduction

The master thesis is aimed at analysing the changes in social policies and institutions in Central Eastern Europe (CEE) after the 2004 European Union enlargement round and the 2008 financial crisis.¹ The research aims to understand the extent and power of the European Union in the post accession period on formulating and promoting social policy in member states as well as how the national institutional environment determines the outcome of this influence. The question of external influence on the region and its effect on transition outcomes has been frequently discussed within the Europeanization literature in addition to the work done by scholars concerned with transition economics. In his excellent review article Jacoby enumerates the various sources of institutional changes in the post-socialist transition with special emphasis on influence from Western-Europe or the United States.² Moreover, discussion on the effects of the various forms of EU governance tools on Member State policies are still relevant today as evidenced by the wide body of literature cited in the review article of De la Porte and Pochet.³ The Open Method of Coordination (OMC) is a particularly interesting governance method of the European Union and it is an important coordination tool of social policy development between the Member States. In addition to the Europeanization and external influence literature there is another key context where the thesis is situated, which is the literature centered on the various welfare state variations within the region. Among this group we can find the Varieties of Capitalism (VoC) literature which tries to categorize the CEE region in line with the framework

¹ In the thesis, the term Central Eastern Europe (CEE) refers to the following countries: Estonia, Latvia, Lithuania, Czech Republic, Poland, Slovak Republic, Hungary, Slovenia, Croatia, Bulgaria and Romania.

² Wade Jacoby, "Inspiration, Coalition, and Substitution: External Influences on Postcommunist Transformations," *World Politics* 58, no. 04 (2006): 623–51.

³ Caroline De la Porte and Philippe Pochet, "Why and How (still) Study the Open Method of Co-Ordination (OMC)?," *Journal of European Social Policy* 22, no. 3 (2012): 336–49.

of Hall and Soskice or tries to modify it to make it fit the new Member States' peculiarities.⁴ In addition to the VoC framework there are influential research published that are centered on creating a typology of welfare states in the region as well as assessing the institutional development.⁵

However, as further evidenced by the in-depth literature review chapter, the above literature has some gaps and areas that can be further developed. First, one identifiable gap is the lack of attention to the Central Eastern European region in the literature dealing with the Open-Method of Coordination. The review article of De la Porte and Pochet clearly displays the attention bias towards the Western-European Member States.⁶ Second, the main body of the works that are concerned with the Central Eastern European welfare states and their development are mainly discussing the developments prior to the financial and European sovereign debt crisis which had profound effects on both European and Member State level.⁷ The goal and the value added of the thesis is to address these shortcomings of the literature by conducting a deeper study of how new Member States reacted to the Open Method of Coordination and how the crisis impacted their institutional and policy development.

⁴ Peter A Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford: Oxford University Press, 2001); Andreas Nölke and Arjan Vliegenthart, "Enlarging the Varieties of Capitalism: The Emergence of Dependent Market Economies in East Central Europe," *World Politics* 61, no. 04 (2009): 670–702; Magnus Feldmann, "Varieties of Capitalism and the Estonian Economy: Institutions, Growth and Crisis in a Liberal Market Economy," *Communist and Post-Communist Studies* 46, no. 4 (December 2013): 493–501.

⁵ Dorothee Bohle and Béla Greskovits, *Capitalist Diversity on Europe's Periphery* (Ithaca and London: Cornell University Press, 2012); Tomasz Inglot, *Welfare States in East Central Europe* (Cambridge: Cambridge University Press, 2008); Alfio Cerami and Pieter Vanhuysse, *Post-Communist Welfare Pathways* (Palgrave Macmillan, 2009).

⁶ De la Porte and Pochet, "Why and How (still) Study the Open Method of Co-Ordination (OMC)?"

⁷For the details of the various effects of the crisis on social policies and Member States see: Patrick Diamond and Roger Liddle, "Aftershock: The Post-Crisis Social Investment Welfare State in Europe," in *Towards a Social Investment Welfare State? Ideas, Policies and Challenges*, ed. Nathalie Morel, Bruno Palier, and Joakim Palme (Bristol: Policy Press, 2012).

In order to achieve this goal the research utilizes the theoretical framework of historical institutionalism which puts emphasis on the importance of various institutions as well as viewing their development in a historical perspective where change is often incremental and path dependent.⁸ Since the format of the thesis does not allow for an all-encompassing study of all new Member States that joined since 2004, Hungary and Estonia are selected as case studies. The case selection was informed by the distinct institutional environment and different policy preferences of the two countries over the transition years. These differences are well documented in the literature, and further elaborated in the literature review and methodological chapter of the thesis. In sum, based on the typology of Bohle and Greskovits and Aslund and Djankov it is clear that the two case studies are viewed as two fundamentally different models which makes them suitable candidates for the study. Based on the literature and theoretical framework, the central research question of the thesis is whether we can observe some convergence in social policy in the new member states or has the financial crisis made individual characteristics more salient?⁹ In connection to the research question a hypothesis is formulated, that the EU is able to influence social policy making and institutional change in the new member states despite their strong inner forces.

The first chapter is concerned with the detailed review of the literature, both on the Open-Method of Coordination and on the welfare state classification and institutional development. The aim of this section is to clearly outline the previous insights and highlight the relevance of certain works. The second chapter is dedicated to overviewing historical institutionalism and how it gives the theoretical background to the case studies. Moreover, the dependent and independent

⁸ Sven Steinmo, "What Is Historical Institutionalism?," in *Approaches and Methodologies in the Social Sciences: A Pluralist Perspective*, ed. Donatella Della Porta and Michael Keating (Cambridge: Cambridge University Press, 2008).

⁹ Convergence here is used in its conventional meaning, that the respective social policies of new member states are converging towards each other.

variables are introduced in this chapter. The main section of the thesis is the fourth chapter with the case study of Hungary and Estonia and the detailed description of the EU policies that are used as the ‘yardsticks’ for the cases. Both cases are contrasted with the main insights from the literature review and each contains a short concluding section. Finally, the thesis is concluded by structuring the main findings and drawing the final conclusions and possible avenues for further research.

The Central Eastern European welfare regimes and Open Method of Coordination nexus

The literature review is grouped into two major sections. The first one is concerned with the different welfare models and sub-regional peculiarities within the CEE region. The second part is focused on the Open Method of Coordination and details the relevant research that investigated the various aspects of EU influence on member state policy formation. Since the 2011 introduction of the European Semester it incorporates the social and employment related Open Method of Coordination policies.¹⁰ The aim of the detailed literature review and this structural separation is to give a clear view on the current state of research and identify the gap in the literature where the thesis can contribute.

There is considerable work done on how to classify the new welfare states of Europe.¹¹ However, as Inglot forcefully demonstrates, it might be better to view the region's development as "permanent construction sites" rather than finished clearly distinguishable units.¹² This sentiment is present in the analysis of Csaba who concludes that since 2004 Hungary did not progressed alongside a master plan rather than followed a path of improvisation.¹³ In addition to the previous works, Szikra and Tomka offers long historical view and reinforces the previous statements: "The merging traditions of pre-war development and state-socialism have made East Central European welfare systems more diverse and mixed than their Western counterparts. This

¹⁰ Jonathan Zeitlin and Bart Vanhercke, *Socializing the European Semester?: Economic Governance and Social Policy Coordination in Europe 2020* (Stockholm: Swedish Institute for European Policy Studies (SIEPS), 2014).

¹¹ Gosta Esping-Andersen, *The Three Worlds of Welfare Capitalism* (Princeton, New Jersey: Princeton University Press, 1990).

¹² Inglot, *Welfare States in East Central Europe*, 307.

¹³ László Csaba, "The Janus Faced Success Story: Hungary," in *Development Success: Historical Accounts from More Advanced Countries*, ed. Augustin K. Fosu (Oxford: Oxford University Press, 2012).

makes it difficult to place them into the categories of ‘conservative-corporatist’, ‘liberal’ and ‘social democratic’.”¹⁴ On the other hand, another approach to categorize the region originates from the Varieties of Capitalism approach which was pioneered by Hall and Soskice who developed the ideal cases of liberal market economies and coordinated market economies.¹⁵ Practitioners of the VoC approach come to the conclusion that countries in the region can be characterized as dependent market economies because of the huge amount of foreign investment inflow.¹⁶ In addition to this, Feldmann tries to fit the original VoC framework to the Estonian case and comes to the conclusion that, with some restrictions, the country might qualify as a liberal market economy.¹⁷ While applying the VoC framework to Estonia is an interesting endeavour the article falls short of establishing Estonia as a liberal market economy. In their recent book Bohle and Greskovits took a different, Polanyian approach to map out a typology for the various welfare arrangements in the region. In their categorization the Baltic countries are purely neoliberal with quick marketization and non-inclusive democracies with dismantled welfare state. The Visegrád group with Hungary is seen as social market economies based on social and political inclusiveness.¹⁸ Their typology offers a middle ground between Inglot, Csaba and the VoC approach. From the above cited works it is shown that while the VoC framework has a clear cut, ideal type categorization, it is not the best available alternative to use as the basis for CEE welfare state typology in the thesis. On the other hand, Bohle and Greskovits create a

¹⁴ Dorottya Szikra and Béla Tomka, “Social Policy in East Central Europe: Major Trends in the Twentieth Century,” in *Post-Communist Welfare Pathways - Theorizing Social Policy Transformations in Central and Eastern Europe*, ed. Alfio Cerami and Pieter Vanhuyse (Basingstoke: Palgrave Macmillan, 2009), 33.

¹⁵ Hall and Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*.

¹⁶ Nölke and Vliegenthart, “Enlarging the Varieties of Capitalism: The Emergence of Dependent Market Economies in East Central Europe.”

¹⁷ Feldmann, “Varieties of Capitalism and the Estonian Economy: Institutions, Growth and Crisis in a Liberal Market Economy.”

¹⁸ Bohle and Greskovits, *Capitalist Diversity on Europe's Periphery*.

typology that can be used as a starting point for the inquiries of the thesis, with the cautionary notes of Inglot, Csaba, Szikra and Tomka.

The regime change that followed the collapse of the Soviet Union and the subsequent adoption of market economy and democratization led policy makers and scholars to expect a successful catching up to the European Union's core members.¹⁹ Indeed there are some indicators where the new member states (NMS) of the European Union outperform other emerging markets or even more established member states. Firstly, in Foreign Direct Investment (FDI) stock per capita, the region is ahead of the other major competitors for foreign capital.²⁰ Secondly, it has been shown that the NMS are generally capable of higher absorption rates of the funds from the European Regional Development Fund than the old Member States.²¹ Unfortunately, these partial successes do not translate into sustained growth in the region that leads to general convergence between the core and the Eastern part of Europe. This prompted a number of academic inquiries into the region's specific attributes. It is clear that the countries in question took different paths to development and, there is "no such thing as common or optimal trajectory."²² These developments and variations can be seen as a result of path dependency as forcefully argued by Andrew Janos in his seminal work.²³ He offers a historic institutional approach to answering the puzzle of sustained backwardness of the region. In a follow-up study

¹⁹ Anders Aslund and Simeon Djankov, *The Great Rebirth: Lessons from the Victory of Capitalism over Communism* (Washington, DC: Peterson Institute for International Economics, 2014).

²⁰ Gergő Medve-Bálint, "The Role of the EU in Shaping FDI Flows to East Central Europe," *Journal of Common Market Studies* 52, no. 1 (2014): 35–51.

²¹ Jale Tosun, "Absorption of Regional Funds: A Comparative Analysis," *Journal of Common Market Studies* 52, no. 2 (2014): 371–87.

²² László Csaba, "The New Political Economy of Emerging Europe," *Budapest: Akadémiai Kiadó*, 2005, 68.

²³ Andrew C Janos, "The Politics of Backwardness in Continental Europe, 1780–1945," *World Politics* 41, no. 03 (1989): 325–58.

Rachel Epstein builds on this theoretical framework in order to provide an explanation for the economic backwardness within the EU.²⁴

Furthermore, in a recent article, Inglot, Szikra and Raţ shows that path-dependency is not only limited to economic processes but to social policies as well. They conclude that in the case of Hungary, Poland and Romania, there is a clear sign of long term path-dependency in maternity insurance and long-term child care leaves.²⁵ In addition to this finding, Inglot demonstrates how institutional legacies in the region contributed to aiding or impeding social policy. In the case of Hungary he founds that one of the major bottleneck in the post-1989 period is a gap between aspiring state ambition and actual administrative capacity.²⁶ The historically informed research overviewed demonstrates that historic institutionalism is a suitable framework that can be used effectively to assess changes in institutions and policies within the region. However, the literature lacks in-depth analysis of social policy changes after the 2008 crisis and its aftermath therefore one of the aims of the thesis is to extend the previous research beyond the crisis and examine the new status quo.

The Open-Method of Coordination as an iterative policy cycle and a new mode of governance in the EU have been widely studied since its introduction. It was termed as the fifth mode of policy making in the EU, next to the Community method, regulatory policy making and intergovernmentalism and distributional policy.²⁷ The main question that is central to this thesis is how the OMC ideas translate into policy outcomes in various institutional settings. In an

²⁴ Rachel A Epstein, “Overcoming ‘Economic Backwardness’ in the European Union,” *Journal of Common Market Studies* 52, no. 1 (2014): 17–34.

²⁵ Tomasz Inglot, Dorottya Szikra, and Cristina Raţ, “Reforming Post-Communist Welfare States: Family Policy in Poland, Hungary, and Romania Since 2000,” *Problems of Post-Communism* 59, no. 6 (November 1, 2012): 27–49.

²⁶ Inglot, *Welfare States in East Central Europe*, 295.

²⁷ Helen Wallace, Mark Pollack, and Alasdair Young, *Policy-Making in the European Union* (Oxford: Oxford University Press, 2010).

encompassing review article on the OMC subfield De la Porte and Pochet list three main ideational transfer mechanisms for the OMC process: socialization, (self) reflexivity and diffusion.²⁸ Moreover, Zeitlin lists additional mechanisms of influence such as external pressure, financial support, and creative appropriation by domestic actors.²⁹ First, socialization refers to the process where different actors are ‘socializing’ within formal or informal institutions, such as the Social Protection Committee (SPC) or the peer-review program. This facilitates the exchange of ideas between various stakeholders in the process and involves member states, the Commission and Council, various NGOs and civil representation.³⁰ This mechanism carries a less than optimistic outlook on its application within the CEE region since civic participation is divided and fragmented.³¹ Second, reflexivity involves evaluating the member states own policies based on others’ experiences and practices. As reported by Zeitlin, “in some cases, such reflexive learning has involved making new connections between hitherto separate policy issues, such as pensions and lifelong learning or women’s employment and childcare provision”,³² which finding demonstrates the potential to better connected policies based on the OMC process. Third, the diffusion of ideas is a broad mechanism, since it can involve “civil servants, parliamentarians,

²⁸ De la Porte and Pochet, “Why and How (still) Study the Open Method of Co-Ordination (OMC)?”

²⁹ Jonathan Zeitlin, “The Open Method of Coordination and National Social and Employment Policy Reforms: Influences, Mechanisms, Effects,” in *Changing European Employment and Welfare Regimes: The Influence of the Open Method of Coordination on National Reforms*, ed. Martin Heidenreich and Jonathan Zeitlin (London: Routledge, 2009), 12–19.

³⁰ The role played by the Social Protection Committee in the OMC process is elaborated in Anna Horvath, “From Policy to Politics? Informal Practices within the Social Protection Committee after the Enlargement,” *European Integration* 30, no. 4 (2008): 545–61; Horvath highlights that the SPC works on the basis of consensuality (p556) which further enhances the socialization mechanism.

In their work on the European Employment Strategy in (Kerstin Jacobsson and Asa Vifell, “New Governance Structures in Employment Policy-Making? Taking Stock of the European Employment Strategy,” in *Economic Government of the EU. A Balance Sheet of New Modes of Policy Coordination*, ed. Ingo Linsenmann, Christoph O. Meyer, and Wessels (Basingstoke: Palgrave Macmillan, 2007). put emphasis on how the different platforms for sharing information and socialization between different actors affected policy making.

³¹ Tanja A Börzel, “Why You Don’t Always Get What You Want: EU Enlargement and Civil Society in Central and Eastern Europe,” *Acta Politica* 45, no. 1 (2010): 1–10.

³² Jonathan Zeitlin, “Conclusion: The Open Method of Co-Ordination in Action: Theoretical Promise, Empirical Realities, Reform Strategy,” in *The Open Method of Co-Ordination in Action: The European Employment and Social Inclusion Strategies*, ed. Philippe Pochet and Lars Magnusson (Brussels: Peter Lang, 2005), 26.

stakeholder organisations and experts, as well as the media.”³³ This mechanism is particularly interesting since it stems from the very nature of the OMC process: involving the relevant stakeholders, both governmental, EU and non-governmental.

Fourth, the term external pressure is used to combine both vertical (from the EU to the member state) and horizontal (between member states) pressure via coaching and guiding or even „naming and shaming” by the Commission and peer pressure by other member states. As with the other mechanisms, external pressure’s effectiveness on policy formation is dependent upon domestic settings, such as the perception of the EU, national visibility of OMC process and so forth.³⁴ In addition to this soft method, an often neglected channel of influence is financial support through Structural Funds. According to Zeitlin this greatly contributed to administrative capacity building in the new member states and to reshaping domestic policy priorities. Finally, creative appropriation, which is argued to be ”the strongest mechanism of OMC influence on national social and employment policies.”³⁵ Member state governments, individual ministries or specialized agencies, NGOs and other non-state actors effectively use OMC ideas and recommendations to further their policy agenda. However, this á la carte selection of suitable policies can result in cherry picking those ideas that are in line with the domestic agenda and paying lip service to those areas where there are differences between the OMC propositions and domestic ideas.³⁶ This literature on the various transmission mechanisms and forms of influences provides valuable points of orientation for the case studies since they allow to better categorise the effects of the OMC governance and other EU strategies.

³³ De la Porte and Pochet, “Why and How (still) Study the Open Method of Co-Ordination (OMC)?,” 341.

³⁴ Zeitlin, “The Open Method of Coordination and National Social and Employment Policy Reforms: Influences, Mechanisms, Effects.”

³⁵ Ibid., 17.

³⁶ Paul Copeland and Beryl ter Haar, “A Toothless Bite? The Effectiveness of the European Employment Strategy as a Governance Tool,” *Journal of European Social Policy* 23, no. 1 (February 1, 2013): 21–36.

As shown, the OMC process has many ways to influence member state policy outcomes and ideas but this influence is a function of domestic institutions, social norms, and historic heritage.³⁷ Since the primary aim of this thesis is to untangle this complex relationship the findings on how OMC affects different welfare models, as listed in De la Porte and Pochet, bears great importance.³⁸ Based on limited research they assess that the OMC process in the CEE region has served as a justification for deregulation and welfare state retrenchment. The main message of social and employment OMC (such as flexicurity, up-skilling, lifelong learning, social inclusion, etc.) resonates well with CEE member states but they mainly used as a scapegoat for liberalization.³⁹ While not directly related to the OMC literature, Sissenich looks at the Polish and Hungarian cases and examines how they fared in EU social policy adoption during their accession. She effectively argues that despite heavy conditionality from the EU both cases display implementation shortcomings which can be traced back to the lack of quality state institution and civic participation. According to Sissenich, effective “rule transfers work if state has strong state institutions and vibrant interest organization.”⁴⁰

³⁷ Zeitlin, “The Open Method of Coordination and National Social and Employment Policy Reforms: Influences, Mechanisms, Effects.”

³⁸ In the cited article the authors derive their typology for the various welfare models from the seminal work of Esping-Andersen, *The Three Worlds of Welfare Capitalism*; Maurizio Ferrera, “The ‘Southern Model’ of Welfare in Social Europe,” *Journal of European Social Policy*, no. 6 (1996): 17–37; Jolanta Aidukaite, “Old Welfare State Theories and New Welfare Regimes in Eastern Europe: Challenges and Implications,” *Communist and Post-Communist Studies* 42, no. 1 (2009): 23–39. Their categories are the following: universal, liberal, post-socialist, conservative and Mediterranean. This approach greatly oversimplifies the variation and distinctive features of the various CEE welfare arrangements.

³⁹ Caroline De la Porte and Kerstin Jacobsson, “Social Investment or Recommodification? Assessing the Employment Policies of the EU Member States,” in *Towards a Social Investment Welfare State? Ideas, Policies and Challenges*, ed. N. Morel, B. Palier, and J. Palme (Bristol: Policy Press, 2012), 117–52.

⁴⁰ Beate Sissenich, *Building States without Society: European Union Enlargement and the Transfer of EU Social Policy to Poland and Hungary* (Plymouth: Lexington Books, 2007), 5.

Although the OMC process generated much interest it is not without critique. One has been already mentioned, as Copeland and ter Haar argue that member states mostly just pay lip service to the process.⁴¹ In addition to this, some view OMC and the other new modes of governance as a ‘red herring’, which does not live up to its promised potential and further undermines the legitimacy of EU policy making.⁴²

While the above detailed literature is helpful in outlining the importance and possible influence of the Open Method of Coordination it speaks little about the specific experiences of the CEE countries. While there is some limited research done on the subject⁴³ it remains largely under investigated. This gap in the existing literature provides an opportunity for contribution by the thesis and its case studies.

⁴¹ Copeland and Haar, “A Toothless Bite?”

⁴² Timo Idema and Daniel R Kelemen, “New Modes of Governance, the Open Method of Co-Ordination and Other Fashionable Red Herring,” *Perspectives on European Politics and Society* 7, no. 1 (2006): 108–23.

⁴³ Anna Gwiazda, “The Europeanization of Flexicurity: The Lisbon Strategy’s Impact on Employment Policies in Italy and Poland,” *Journal of European Public Policy* 18, no. 4 (2011): 546–65; De la Porte and Jacobsson, “Social Investment or Recommodification? Assessing the Employment Policies of the EU Member States.”

Theoretical framework and methodology

The main theoretical backbone of the thesis is historical institutionalism. It is not a theory, in a sense as liberal intergovernmentalism or functionalism is, rather than an approach to study political economy. Sven Steinmo, as one of the influential scholars in the field, puts it, “this approach is distinguished from other social science approaches by its attention to real world empirical questions, its historical orientation and its attention to the ways in which institutions structure and shape political behaviour and outcomes.”⁴⁴ This sentence perfectly summarizes the advantages of this approach: it is driven by empirical questions and backed up by careful analysis of events, policy outcomes and indicators. Moreover, historical institutionalism is not only a method for empirical inquiries but it is a part of the larger institutionalism family, alongside rational-choice, sociological and economic institutionalism.⁴⁵ While different schools of thought may vary on how institutions change and how they interact with different actors, they all agree in the idea that institutions are essential part of development and policy outcomes. This even holds true for economic institutionalism where moving beyond all things quantifiable prominent scholars has demonstrated that institutions can make or break a countries development.⁴⁶ As cited in Sala-I Martin, “the EU was founded not on the calculations of costs and benefits of freer

⁴⁴ Steinmo, “What Is Historical Institutionalism?” 1.

⁴⁵ For a wider literature on various forms of institutionalism see, Douglass North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990); Peter A. Hall, “Historical Institutionalism in Rationalist and Sociological Perspective,” in *Explaining Institutional Change: Ambiguity, Agency, and Power*, ed. James Mahoney and Kathleen Thelen (Cambridge: Cambridge University Press, 2009); Barry R Weingast, “Political Institutions: Rational Choice Perspectives,” in *A New Handbook of Political Science*, ed. Robert E. Goodin and Hans-Dieter Klingemann (Oxford: Oxford University Press, 1996), 167–90; Steinmo, “What Is Historical Institutionalism?”

⁴⁶ North, *Institutions, Institutional Change and Economic Performance*; Daron Acemoglu and James Robinson, *Why Nations Fail: The Origins of Power, Prosperity, and Poverty* (New York: Crown Business, 2012); Dani Rodrik, *One Economics, Many Recipes: Globalization, Institutions, and Economic Growth* (Princeton: Princeton University Press, 2008).

trade or more flexible capital and labour mobility but on the political and institutional gains.”⁴⁷

This further reinforces the choice of theoretical framework since the EU is a dense network of various institutions, both supranational and national, which creates a fertile ground for analysis.

This tie back to the literature review on social policy cooperation within the EU, where both national and EU institutions are at play shaping the outcome.

While historical institutionalism is focused on analysing historical events and process tracing as main tools it stands in a theoretical middle ground between the more strict rational choice institutional theory and the more normative sociological institutionalism. As briefly outlined in Steinmo, this middle ground allows for viewing human beings as rational and norm abiding actors whose preferred action depends on the context and rules that are: institutions.⁴⁸ Moreover, by creating constraints, rules of the game and providing context, institutions actively shape policy outcomes, as referenced in Steinmo.⁴⁹

One major element of this framework is path dependency which means that initial conditions map out an institutional equilibrium which is maintained via self-reinforcement.⁵⁰ Such path dependence is evidenced by a number of historical researches, such as Katzenstein’s Small States or Gerschenkron’s Economic Backwardness.⁵¹ In addition to these studies, Andrew Janos in his seminal work lays down how economic backwardness in Central Eastern Europe can be

⁴⁷ Xavier Sala-i-Martin, “Economic Integration, Growth, and Poverty,” *Integration and Trade Policy Issues Paper*, Inter-American Development Bank, 2007, 10.

⁴⁸ Rationality refers to a certain behavior, where before acting the individuals and organizations carefully weight their costs and benefits and act in order to maximize their benefits. This assumption also implies that information is available to make such calculations.

⁴⁹ Steinmo, “What Is Historical Institutionalism?”

⁵⁰ Path dependency is sometimes referred as „lock in effect” (North, *Institutions, Institutional Change and Economic Performance*.)

⁵¹ See, Peter J Katzenstein, *Small States in World Markets: Industrial Policy in Europe* (Ithaca and London: Cornell University Press, 1985); Alexander Gerschenkron, *Economic Backwardness in Historical Perspective - A Book of Essays* (New York: Praeger Publishers, 1962).

explained by historical institutionalism and how this backwardness is subject to long run path dependency.⁵² In a follow-up study Rachel Epstein builds on this theoretical framework in order to provide an explanation for the economic backwardness within the EU.⁵³ Epstein's study is focused on the disequilibria between savings and consumption in Central Eastern Europe and the high amount of FDI concentrated in the region. She finds that the theory of Janos holds for the current situation as FDI has increased productivity but failed to lead to convergence.

The self-reinforcing path dependency can be interrupted by relatively brief periods of shocks termed critical junctures. During the thesis the following definition will apply: „critical junctures are relatively short periods of time during which there is a substantially heightened probability that agents' choices will affect the outcome of interest.”⁵⁴ To elaborate on this definition, based on the Capoccia and Kelemen article, during the brief period of such critical juncture several new alternatives for change are possible and after the choice has been made a new equilibrium sets in, giving way to renewed path dependency. The authors stress that when trying to establish if an event qualifies as a path breaking event we must keep in mind that institutional change does not equal critical juncture. Moreover, it is entirely possible that, despite the possibility for path departing options, a „re-equilibrium” emerges that is the „the restoration of the pre-critical juncture status quo.”⁵⁵

The thesis utilizes case studies of Hungary and Estonia in order to analyse how social policy evolved in these countries after they joined the European Union. Since the OMC framework has been in place prior to the 2004 enlargement round both countries were faced with a pre-existing

⁵² Janos, “The Politics of Backwardness in Continental Europe, 1780–1945.”

⁵³ Epstein, “Overcoming ‘Economic Backwardness’ in the European Union.”

⁵⁴ Giovanni Capoccia and R Daniel Kelemen, “The Study of Critical Junctures: Theory, Narrative, and Counterfactuals in Historical Institutionalism,” *World Politics* 59, no. 03 (2007): 348.

⁵⁵ Ibid., 352.

policy coordination mechanism that they had to work with. The purpose of the case studies are to shed light to the contextual interpretation of OMC policy recommendations in Central Eastern European new member states and to analyse whether EU influence has yielded results or domestic agendas prevailed. Both case studies are structured into two main parts where the first is dedicated to give context to policy changes by showing how certain indicators and external factors changed. These indicators and statistics are provided by the main database of the Eurostat and if necessary respective national statistical offices, ministries. If not stated otherwise, all data cited as Eurostat are downloaded and compiled from the Eurostat online database (<http://ec.europa.eu/eurostat/data/database>). The second part of the case studies is detailing the changes in the policies and institutions.

The timeframe of the research is from 2004 to 2014 which is divided by the 2008 crisis. This allows for contrasting the pre- and post-crisis assessment of the policy and institutional changes. Based on the above outlined theory the 2008 crisis is used as a critical juncture. The literature provides the initial typology for both cases as well as the independent variables. Bohle and Greskovits categorizes the Baltic states as “champions of neoliberalism”, where Estonia is the trend setter for its regional neighbours.⁵⁶ In their typology Hungary is seen as an embedded neoliberal regime where there is a struggle to balance out marketization and social costs.⁵⁷ The dependent variable is policy change in line with EU recommendations. The independent variables are political parties, the EU OMC influence and the respective welfare model of the country. The political party variable is informed by the research of Gwiazda who found that in Italy and

⁵⁶ Bohle and Greskovits, *Capitalist Diversity on Europe's Periphery*, 96.

⁵⁷ Ibid., 3.

Poland governing party alignment (pro or anti-European or centre-right or centre-left leaning)
had significant influence.⁵⁸

⁵⁸ Gwiazda, “The Europeanization of Flexicurity: The Lisbon Strategy’s Impact on Employment Policies in Italy and Poland.”

The Yardstick – EU social and employment policies

While the main purpose of the thesis is to investigate social policy change and its context in Estonia and Hungary it is nevertheless important to be familiar with the EU proposed social and employment outcomes.

The introduction of the Lisbon Strategy in 2000 was aimed to create sustainable and inclusive growth in the EU but it largely fell short of living up to the formulated sweeping ideas and goals.⁵⁹ While there were a high emphasis on creating a 'knowledge economy' and keeping up with the fast paced changes of the information and communication technology (ICT) boom, there were some structural indicators for measuring convergence to the 2010 targets. Related to employment and social inclusion, the 2010 targets included 70% employment rate, 60% female employment rate, and 50% employment rate of older workers. In addition to the various employment rates the at-risk-of-poverty rate and long term unemployment rates were monitored.⁶⁰

In 2005 the Council re-launched the Lisbon Strategy, stating that “Europe must focus its policies further on growth and employment to achieve the Lisbon goals, against a sound macroeconomic policy background and within a framework aimed at social cohesion and environmental sustainability, which are vital pillars of the Lisbon strategy.”⁶¹ The efforts were focused on growth

⁵⁹This is expressed by the mid-term evaluation report by the Commission. European Commission, “Working Together for Growth and Jobs - A New Start for the Lisbon Strategy; COM(2005) 24 Final” (Brussels: European Commission, 2005).

⁶⁰ “Facing the Challenge: The Lisbon Strategy for Growth and Employment: Report from the High Level Group Chaired by Wim Kok” (Luxembourg: High Level Group, 2004).

⁶¹ European Council, “Communication to the Spring European Council: Working Together for Growth and Jobs: Integrated Guidelines for Growth and Jobs (2005-08)” (Luxembourg, 2005), 9.

and employment without stressing other social policy aspects. The outcome was 24 integrated guidelines, of which 11 were under the 'employment guidelines'. These were the following:

- (17) „Implement **employment policies aiming at achieving full employment**, improving quality and productivity at work, and **strengthening social and territorial cohesion**.
- (18) Promote a life-cycle approach to work.
- (19) Ensure **inclusive labour markets**, enhance work attractiveness, and make work pay for job-seekers, including disadvantaged people, and the inactive.
- (20) Improve matching of labour market needs.
- (21) Promote **flexibility combined with employment security** and reduce labour market segmentation, having due regard to the role of the social partners.
- (22) Ensure employment-friendly labour cost developments and **wage-setting mechanisms**.
- (23) Expand and improve **investment in human capital**.
- (24) **Adapt education and training systems** in response to new competence requirements.”⁶²

The document provides detailed breakdown of each guideline with some target indicators and preferred policy solutions. The original Lisbon employment targets (on female, older population and total employment rate) were formulated under the Integrated Guideline 17 on achieving full employment and social and regional cohesion. To achieve the desired outcome and meet the goals the member states should increase labour supply and modernize social protection systems. Since the goal of the re-launch was to create a more integrated policy guideline framework the above listed seven points should be understood as complementary for each other, where lifelong learning, social protection, flexible yet secure labour market policies are all applied as parts of a

⁶²Direct list is taken from Ibid., 5., as well as the numbering. Highlights are from me.

whole system rather than a patchwork of ad hoc policy measures. Under this renewed commitment, member states were urged to push for reducing the number of early school leavers, build inclusive education systems and enhance gender equality within the labour market. In addition to the limited number of expressed quantitative goals all of the employment and social inclusion guidelines are constrained by macroeconomic considerations that mostly include fiscal prudence and adhering to the Stability and Growth Pact.

The flexicurity approach was further highlighted in a 2007 Commission communication, titled ‘Towards Common Principles of Flexicurity’. The model embraces the “integrated strategy to enhance, at the same time, flexibility and security in the labour market.”⁶³ In their review article Viebrock and Clasen describe both dimension of this strategy.⁶⁴ First, under flexibility, they list the ease of hiring and firing employees and introducing more flexible labour contracts. Second, the flexibility requires the ability to meet market fluctuations by managing over time, part-time work. Finally, employee skills should adapt to the changing environment. On the other side of this strategy, Viebrock and Clasen match each flexibility element with a security one based on the work of Wilthagen and Tros.⁶⁵ First, this includes achieving job security by introducing employment protection legislation. Second, employment security, which ensures that being employed becomes a certainty because of intensive training and education. Finally, they mention income security as the third element.

⁶³ European Commission, “Towards Common Principles of Flexicurity: More and Better Jobs through Flexibility and Security” (Luxembourg, 2007), 10.

⁶⁴ Elke Viebrock and Jochen Clasen, “Flexicurity and Welfare Reform: A Review,” *Socio-Economic Review* 7, no. 2 (2009): 305–31.

⁶⁵ Ton Wilthagen and Frank Tros, “Dealing with the ‘flexibility-Security-Nexus’: Institutions, Strategies, Opportunities and Barriers,” Working Paper (Amsterdam: Amsterdam Institute for Advanced Labour Studies, 2003); Ton Wilthagen and Frank Tros, “The Concept of ‘flexicurity’: A New Approach to Regulating Employment and Labour Markets,” *Transfer: European Review of Labour and Research* 10, no. 2 (2004): 166–86; Viebrock and Clasen, “Flexicurity and Welfare Reform: A Review.”

Besides the life-long learning element there is another cornerstone to flexicurity: active labour market policies (ALMPs).⁶⁶ They can be loosely defined as “making sure that unemployment spells are as short as possible, by proactively helping jobless people re-enter the labour market.”⁶⁷

Bonoli distinguishes between four main types of ALMPs along the dimensions of investment in human capital and pro-market employment orientation, as shown in the figure below.⁶⁸

1. Table: Four types of active labour market policy

Pro market employment orientation	Investment in human capital			
		None	Weak	Strong
	Weak	(passive benefits)	Occupation job creation schemes in the public sector; non-employment related training programmes	(basic education)
	Strong	Incentive reinforcement Tax credits, in-work benefits; time limits on reciprocity; Benefit reductions; Benefit conditionality	Employment assistance Placement services; Job subsidies; Counseling; Job search programmes	Upskilling Job-related vocational training

Source: Bonoli, *Active Labour Market Policy and Social Investment: A Changing Relationship*, 184

According to Bonoli, two out of the four ALMPs can be considered as social investment: upskilling and employment assistance.⁶⁹ While social investment⁷⁰ is not explicitly called for in the

⁶⁶ Gwiazda, “The Europeanization of Flexicurity: The Lisbon Strategy’s Impact on Employment Policies in Italy and Poland.”

⁶⁷ Giuliano Bonoli, “Active Labour Market Policy and Social Investment: A Changing Relationship,” in *Towards a Social Investment Welfare State*, ed. Nathalie Morel, Bruno Palier, and Joakim Palme (Bristol: Policy Press, 2012), 181.

⁶⁸ Bonoli, “Active Labour Market Policy and Social Investment: A Changing Relationship.”

⁶⁹ Ibid.

⁷⁰ Definition from Jane Jenson, “Redesigning Citizenship Regimes after Neoliberalism. Moving towards Social Investment,” in *Towards a Social Investment Welfare State? Ideas, Policies and Challenges*, ed. Nathalie Morel, Bruno Palier,

2007 Commission report on flexicurity, it does highlight the necessity of investing into human resources to keep up with changes and innovation.⁷¹ Moreover, it was shown that there is a positive correlation between ALMPs and employment outcomes. Based on quantitative analysis, Nelson and Stephens claim social investment policies are conducive for more and better quality job creation.⁷²

To sum up, the 2005-2008 periods goals based on the new integrated guidelines that were adapted by the Council we see that there are three main policy goals whose implementation is a function of the macro- and microeconomic guidelines. First, reaching full employment via increasing labour supply and incentivizing the population to enter and stay within the labour market while at the same modernizing the social protection system. Second, improving the adaptability of workers and enterprises by providing the institutional and infrastructural background for lifelong learning, part-time positions, and closing the gender gap in employment. Third, investing heavily into human capital through education.

In 2008 the European Council launched the second three-year cycle of the Lisbon strategy with “the focus of the new cycle will be on implementation.”⁷³ The objectives and means of the previous cycle were largely unchanged. Most importantly the integrated guidelines remained as well as the call for a move to a “knowledge-based economy” in order to create more and better

and Joakim Palme (Bristol: Policy Press, 2012), 61–62. : „Proponents of the social investment perspective assign the state a key role in fostering [...] outcomes. In policy terms this implies increased to and investment in human capital, making work pay and early childhood, bringing new or different patterns of social spending: focused on education, particularly early childhood education; stressing support for labour market participation [...]”

⁷¹ European Commission, “Towards Common Principles of Flexicurity,” 12.

⁷² Moira Nelson and John D Stephens, “Do Social Investment Policies Produce More and Better Jobs,” in *Towards a Social Investment Welfare State*, ed. Nathalie Morel, Bruno Palier, and Joakim Palme (Bristol, Policy Press, 2012), 226–227.

⁷³ Council of the European Union, “Presidency Conclusions – Brussels, 13/14 March 2008” (Brussels, 2008), 2.

jobs. In the Presidency Conclusions the European Council called on the member states to take definite action on the following points:

- “substantially **reduce the number of young people who cannot read properly** and the **number of early school leavers**, and improve the achievement levels of learners with a migrant background or from disadvantaged groups;
- attract more adults, particularly **low-skilled and older workers, into education and training** and further facilitate geographic and occupational mobility;
- **promote higher overall labour force participation** and tackle segmentation in order to ensure **active social inclusion**;
- **improve policy consistency and coordination** of economic, employment and social policies in order to enhance social cohesion”⁷⁴

In 2010 the Lisbon Strategy was relieved by Europe 2020 in order to mark a post-crisis agenda in the life of the European Union. According to Commission President José Manuel Barroso, “the crisis is a wake-up call, the moment where we recognize that “business as usual” would consign us to a gradual decline.”⁷⁵ New headline targets were specified in the domain of employment and social policies; First, **75% of the population aged 20-64 should be employed**; second, **share of early school leavers should be below 10% and 40% of the younger generation should have a tertiary degree**; third, (compared to 2010) **20 million less people should be at risk of poverty**.⁷⁶ In addition to these targets the new strategy introduced seven flagship initiatives as well. There are two which are particularly important for the subject of this thesis: “An agenda for

⁷⁴ Ibid., 10., highlights are from me.

⁷⁵ European Commission, “Europe 2020 A Strategy for Smart, Sustainable and Inclusive Growth (COM(2010) 2020 Final),” Communication from the Commission (Brussels: European Commission, 2010), 2.

⁷⁶ Ibid., 5.

new skills and jobs” and the “European platform against poverty.” As a result, flexicurity remained high on the agenda as a useful approach to higher employment ratios and to a pathway to creating a beneficial work-life balance. In addition to flexicurity social investment became one of the new key areas promoted by the Commission.⁷⁷

In 2011 the EU introduced the European Semester as its most recent attempt to push the member states towards concerted action by implementing an annual policy cycle. While the European Semester’s main goal is to harmonize economic rules and policy making it is a vital process for achieving the Europe 2020 goals in the individual Member States. Moreover, Zeitlin and Vanhercke argued that despite the fiscal focus of the Semester it does not neglect the social aspect.⁷⁸

2. Table: The national targets for Hungary and Estonia

Selected targets	Hungarian national targets	Estonian national targets	EU targets
Employment rate	75 % of the population aged 20-64 to be employed	76 % of the population aged 20-64 to be employed	75 % of the population aged 20-64 to be employed
Early leavers from education and training	less than 10%	less than 9.5% of children should leave school at an early age	less than 10%
Tertiary education attainment	at least 30.3% of 30-34-year-olds should complete third level education	at least 40% of 30-34-year-olds should complete third level education	The percentage of those aged 30-34 who have successfully completed tertiary education (ISCED levels 5 and 6)
People at-risk-of-poverty or social exclusion	450.000 less people should be at risk of poverty or exclusion	49.500 less people should be at risk of poverty or exclusion	20 million less people should be at risk of poverty or exclusion

Source: Europe 2020 in your country, web: http://ec.europa.eu/europe2020/europe-2020-in-your-country/index_en.htm

⁷⁷ European Commission, “Towards Social Investment for Growth and Cohesion – Including Implementing the European Social Fund 2014-2020 (COM(2013) 83 Final),” Communication From The Commission (Brussels, 2013).

⁷⁸ Zeitlin and Vanhercke, *Socializing the European Semester?*.

Hungary – gradual curtailing of social policies

2004-2008: Policy and institutional environment before the crisis

The adoption of EU social and employment policy within Hungary has gone down in a top down fashion. As Sissenich notes, Hungary and other new Member States chosen the formal adoption of the EU rules but deferred their behavioural adoption. In addition this top down process was further reinforced by the lack of participation from labour and employer organizations. The insightful analysis of Sissenich comes to the conclusion that successful rule transfer to the Member States is dependent on strong state institutions and participating interest organization.⁷⁹

Against this critical backdrop we should examine key indicators in the period of 2004-2008. One of the key Lisbon target in this area was the employment rate, which was targeted to reach 70%. As evidenced by the data compiled by the Eurostat Hungary battled a stagnant employment rate despite enjoying favourable economic climate.⁸⁰

⁷⁹ Sissenich, *Building States without Society: European Union Enlargement and the Transfer of EU Social Policy to Poland and Hungary*.

⁸⁰ According to the Eurostat database, Hungary enjoyed an average of 3,48% real GDP growth in the period of 2003-2007 (this period illustrated the run up to the EU accession and the year preceding the crisis)

3. Table: Employment rate by sex and age, and in total, Hungary and EU28, 2004-2008

	Hungary EU28		Hungary EU28		Hungary EU28	
	Employment rate, total, %		Female employment rate, %		Employment rate of older people, %	
2004	62,1	67,4	55,3	59,4	31,1	40,6
2005	62,2	67,9	55,6	60	33	42,2
2006	62,6	68,9	55,6	61,1	33,2	43,3
2007	62,3	69,8	55,2	62,1	32,2	44,5
2008	61,5	70,3	54,8	62,8	30,9	45,5

Source: Eurostat

If employment rate is decomposed by age and gender group we can observe a similar pattern. Female employment rate never increased above 55,6% in the period. The employment rate of older people stably remained in the vicinity of 31% despite the 50% target of the Lisbon Agenda. This performance cannot be written down as ignorance towards EU goals prior to the accession, since in the 2001 Joint Assessment of the Employment Policy Priorities of Hungary both the Commission and the Hungarian government recognized key labour market policy and outcome priorities. The four main identified goals were increasing employment levels with policies aimed at reducing the cost of labour. Furthermore, the parties stressed the importance of ALMPs (especially training) in decreasing unemployment, as well as creating a more flexible labour market.⁸¹

While the intentions were clear and well-articulated Eurostat data show the share of LMP spending in Hungary hovered around 0,7% of the GDP, while the EU averaged between 1,5-2%. This is a stark difference, given the above described employment problems. Furthermore, the

⁸¹ Government of Hungary and European Commission, "Joint Assessment of the Employment Policy Priorities of Hungary," 2001.

share of early school leavers was stuck in the 11-12% range without any positive development. Similarly, at-risk of poverty levels were fluctuating between 12-13,5% with the exception of the 2006 spike to above 15%. This data gives a rather bleak picture of the situation with employment and social indicators stagnating or worsening. Unemployment is a nice example of this process with its slowly but steadily climbing rate from 6,1% in 2004 to 7,8% in 2008. While this was below the EU average it should be considered an alarming sign given the favourable economic conditions and the positive association between economic growth and decline in unemployment.

4. Table: Unemployment rate , Early leavers from education and at-risk-of-poverty rate in Hungary and in the EU28, 2004-2008

	Hungary EU28		Hungary EU28		Hungary EU28	
	Unemployment rate, total %		Early leavers from education and training, age group 18-24, %		At-risk-of-poverty rate, total, %	
2004	6,1	9,3	12,6	16	n.a	n.a
2005	7,2	9	12,5	15,7	13,5	16,4
2006	7,5	8,2	12,5	15,3	15,9	16,5
2007	7,4	7,2	11,4	14,9	12,3	16,5
2008	7,8	7	11,7	14,6	12,4	16,6

Source: Eurostat

According to the Labour Market Report produced yearly by the Institute of Economics of the Hungarian Academy of Sciences, there were four main factors for the low participation rate: low demand for low-skilled workers and positions, the wide coverage of social assistance programs, serious regional backwardness in the labour market, and the sizeable informal economy.⁸² This

⁸² Károly Fazekas, "The Current Situation on the Labour Market and Labour Market Policy in Hungary," in *The Hungarian Labour Market - Review and Analysis 2004*, ed. Károly Fazekas, Jenő Koltay, and Zsombor Cseres-Gergely (Budapest: Institute of Economics, HAS, 2004).

final factor corresponds with another report where the researchers observed participation in the informal economy in rural Hungary. This process is exacerbated by the fact that the public work scheme did not provide enough positions, and this was often used as a basis of denial of social assistance.⁸³ Further findings of the 2004 report include the persistent segregation in housing and education between Roma and non-Roma families and the lack of enough kindergarten and nursery places.

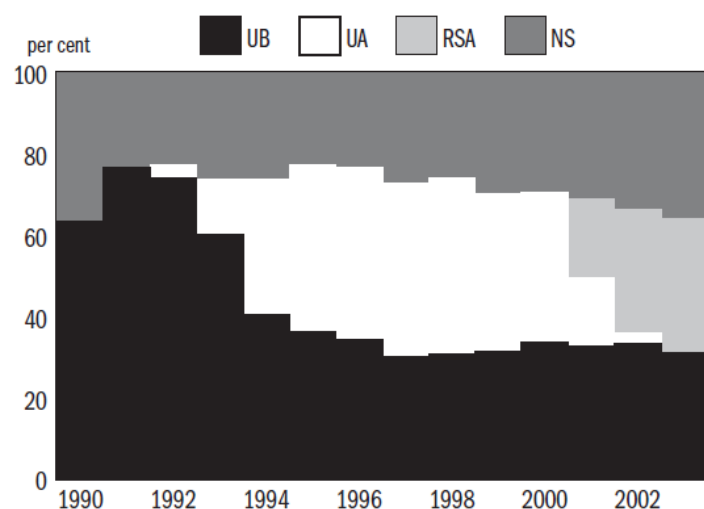
⁸³ Zsuzsa Ferge, "Report on the Regional and Local Implementation of the First Hungarian National Action Plan on Social Inclusion (NAP/incl) 2004-2006," Third Report of 2005, (2005).

The main financial instrument for financing active and passive labour market policies was the Labour Market Fund (LMF). It was supported by both employee and employer contributions and was governed by the Governing Board of the Labour Market Fund tripartite body. In addition to the various labour market policies the Public Employment Service (PES) is financed by the LMF as well. It was set up in 1990 and during the years changed considerably. In 2002, under the Ministry of Employment and Labour, the PES was responsible for the “9 National Employment Office, 20 County Labour Centres, 134 Local Labour Offices and 20 Human Resource Development and Training Centres constitute the institutional framework of labour market administration in Hungary.”⁸⁴ In 1 May 2004, the government introduced the Central Employment Register with the aim of reducing informal employment. While it was mainly supported by National Interest Reconciliation Council there were some criticism claiming that the Register is creating additional administrative burden for firms. As Fazekas notes, during 2000-2001 the unemployment benefit system got overhauled which resulted in a stricter arrangement where the maximum period for the benefit were reduced from 12 months to 9 months. In addition there were a move away from insurance based unemployment benefits to means-tested regular social assistance, as demonstrated by the below figure.⁸⁵

⁸⁴ Fazekas, “The Current Situation on the Labour Market and Labour Market Policy in Hungary,” 32.

⁸⁵ Fazekas, “The Current Situation on the Labour Market and Labour Market Policy in Hungary.”

1. Figure: Composition of registered unemployed by form of assistance, 1990-2002



UB: Unemployment benefit recipients; UA: Unemployment assistance recipients; RSA: Regular Social Assistance recipients; NS: do not receive cash assistance.

Source: Fazekas, *The Current Situation on the Labour Market and Labour Market Policy in Hungary*, 33)

Furthermore, active labour market policies consisted of providing cash payments to people attending trainings who were below a certain income threshold. To increase the employability of disadvantaged people⁸⁶ the government introduced the “job search incentive” and “job finding incentive” schemes, both of which were positively discriminating for older people. In 2002 the previous strict regulation were eased and people from the most disadvantaged groups were able to combine participation in multiple ALMP programmes. The exact breakdown of the active policies is shown in the table below.⁸⁷

⁸⁶ In the report, disadvantaged groups are identified as Roma minorities, disadvantaged young people and older workers.

⁸⁷ Fazekas, “The Current Situation on the Labour Market and Labour Market Policy in Hungary.”

2. Figure: Active Employment Policy Programmes, Hungary, 2002

Active Employment Policy Programmes	Inflow in 2002		Previous year = 100%
	Persons	%	
Training	48,296	29.5	78.9
Wage support schemes	18,035	11.0	82.8
Public works	67,860	41.4	100.4
Job creation support schemes	285	0.2	38.8
Small business start-up schemes	2,989	1.8	82.6
Mobility schemes	6,764	4.1	109.2
Support for school leavers	8,780	5.4	90.5
Job keeping support schemes	2,894	1.8	-
Wage related tax support schemes	7,882	4.3	90.3
Self-employment support schemes	1,080	0.5	70.1
Intensive job search support schemes	54	0.0	-
Total	163,829	100.0	91.1

Source: *National Employment Office*.

Source: Fazekas, *The Current Situation on the Labour Market and Labour Market Policy in Hungary*, 36), highlights are from me.

As the table illustrates training and Public works were the two biggest ALMP in the year of 2002, with other important key Lisbon areas received negligible inflow of persons. In the following years the Ministry of Employment and Labour were pushing for increasing employment via non-standard forms, such as Telework and seasonal work. A grant program was launched to provide wage subsidies for firms creating new tele work positions. According to the report compiled by the Institute of Economics, the main advantages of such non-standard working arrangement are the possibility to balance private life and work; and a better access to employment for people with disabilities.⁸⁸ The report identifies people on parental leave as a short-run labour supply. Despite child care allowance and support allow for a part time job (4 hours per day) most people on parental leave do not take part in such positions. This finding corresponds with research

⁸⁸ Mária Frey, "Changes in the Legal and Institutional Environment of the Labour Market," in *The Hungarian Labour Market - Review and Analysis 2005*, ed. Károly Fazekas and Júlia Varga (Budapest: Institute of Economics, HAS, 2005).

claiming that although lavish child care support might seem to be a positive policy in reality it excludes women out of the labour market.⁸⁹ Moreover, Bálint and Köllő points to the fact that the family support system is a legacy from the Kádár system and subsequent administrations are reluctant to bring any substantial changes even in the face of OECD policy advice. Another problem that Hungarian employees face when returning to the labour market after child care that „returning after Gyes⁹⁰ [they] receive significantly lower wages than other workers with similar observable characteristics.”⁹¹

One of the new main initiatives of the period was the Start program that targeted the youth exiting from education, whose employers were eligible for a subsidy (in the form of reduced contributions) for 2 years.⁹² After the introduction the Start program it got expanded with additional funding from the European Social Fund in 2007. The expansion was twofold: first, the Start Plus was aimed for people returning to the labour market from child care. It provided a subsidy for employers by partly covering the payable statutory contributions. Second, the Start Extra was geared towards those who return to the labour market from long-term unemployment

⁸⁹see, Ágnes Szabó-Morvai, “Who Benefits from Child Benefits? The Labor Supply Effects of Maternal Cash Benefit,” *CERGE-EI*, 2013, and Eva Fodor and Erika Kispeter, “Making the ‘reserve Army’ invisible: Lengthy Parental Leave and Women’s Economic Marginalisation in Hungary,” *European Journal of Women’s Studies* 21, no. 4 (2014): 382–98.

⁹⁰ Within the Hungarian family support policy nomenclature Gyes is the flat rate benefit, while Gyed is insurance based benefit and Gyet is extended paid leave.

⁹¹ Mónika Bálint and János Köllő, “The Labour Supply Effects of Maternity Benefits,” in *The Hungarian Labour Market - Review and Analysis 2008*, ed. Károly Fazekas, Zsombor Cseres-Gergely, and Ágota Scharle (Budapest: Institute of Economics, HAS, 2008).

⁹² Mária Frey, “Changes in the Legal and Institutional Environment of the Labour Market,” in *The Hungarian Labour Market - Review and Analysis 2006*, ed. Károly Fazekas and Jenő Koltay (Budapest: Institute of Economics, HAS, 2006), 222.

due to age or living in deprived areas. Similarly to the core concept of the Start Programme, it fully subsidizes the employers' contributions via the Labour Market Fund.⁹³

In her evaluation, Frey identifies four main ALMPs in Hungary: labour market training, public work, wage subsidy and support of young entrants. She finds that training is largely ineffective since the job finding rates of people leaving the programs never went above 50% in the period of 2001-2005.⁹⁴ Another weak point of training programs for the unemployed that one-fifth of the participants found positions where the training was not relevant. Public work is the main active labour market policy both in terms of funding and participation. Despite its weight, its effects are at best controversial and at worst has insignificant effects on further employment. Frey shows that public workers are “trapped by local interests and conflicts” and in addition to this fragile and harmful environment only a fraction of them continue their work in the same position after the subsidies lapsed.⁹⁵ The table below shows that continued employment never exceeded 2% and most of the positions were community infrastructure maintenance, which did not require sophisticated skills.

⁹³ Mária Frey, “Legal and Institutional Environment of the Hungarian Labour Market,” in *The Hungarian Labour Market - Review and Analysis 2007*, ed. Károly Fazekas and Gábor Kézdi (Budapest: Institute of Economics, HAS, 2007).

⁹⁴ Mária Frey, “Evaluation of Active Labour Market Programmes between 2001–2006 and the Main Changes in 2007,” in *The Hungarian Labour Market - Review and Analysis 2008*, ed. Károly Fazekas, Zsombor Cseres-Gergely, and Ágota Scharle (Budapest: Institute of Economics, HAS, 2008), 146–152.

⁹⁵ *Ibid.*, 148.

3. Figure The distribution of public workers according to types of activities and rate of continued employment (%)

Type of activity	2001	2002	2003	2004	2005	2006
Community infrastructure	77.7	77.6	78.9	77.3	80.4	76.6
Health and social care	7.1	6.9	6.9	7.6	6.1	7.2
Culture and education	4.4	4.6	4.3	4.7	4.1	5.3
Other	10.8	10.9	9.9	10.4	9.4	10.9
Total	100.0	100.0	100.0	100.0	100.0	100.0
Continued employment	1.5	1.8	1.4	1.3	0.9	1.1

Source: Frey, *Evaluation of Active Labour Market Programmes between 2001–2006 and the Main Changes in 2007*, 149, highlights are from me.

While wage subsidies did enhance hiring it contributed to increasing the relative disadvantage of the already disadvantaged unemployed by letting employers cherry pick the best skilled from the Register instead of the actual difficult-to-place target group. In 2007 the Public Employment Service underwent an organizational change and new regional job centres were creating in the place of the previous county level offices. In addition to this change the Employment and Social Office was created that was tasked by managing the new structures and, in addition to their portfolio, oversee certain social issues, such as child welfare and child protection.⁹⁶

In conclusion, within this period Hungary struggled with low employment ratios (total, female and old persons) and gradually increasing unemployment, while the active labour market policy funding were below 1% of the GDP. The statistical data is in stark contrast with the Lisbon Agenda and while the government did push policies aimed at employment and social investment they were insufficient, either in funding or in efficiency. This is particularly true for the public work programme which, while providing short term employment, gave no real opportunity for further employment once subsidies run out. In their article, Inglot Szikra and Rat looks at the

⁹⁶ Ibid., 150.

family policies in the period and that while gender equality and eradication of poverty were main goals the subsequent Hungarian governments did not manage to make a forceful and concerted action partly due to political infighting.⁹⁷

Despite the changes in the Ministerial system, reworking the Public Employment Service, creating a centralized Register and additional funding and policy coordination from the EU, Hungary did not manage to deliver on the goals formalized in the Lisbon Agenda and then subsequently in the 2005 re-launch.

2008-2014: Crisis and its aftermath

In the second period the activity rate started its slow-paced incremental increase from 61% in 2008 to 67,4% in 2014. A similar trend can be observed with the total employment rate in the population aged 20-64: the indicator increased from 62,3% in 2008 to 66,7% in 2014. It would be an overstatement to call a 4,4% gain over 6 years a dynamic boom, especially with keeping in mind the Europe 2020 target of 75% employment rate by 2020. While the EU2020 targets do not include female employment rate directly it should be noted that that in the period in question there were little to no change since it climbed from the 2008 45,6% to 46% in 2014. This signals that the policy and institutional framework promoting female employment is struggling to bring any meaningful results. This is consistent with the analysis of the previous time period where there were numerous mentions of bringing the female population back to labour market with little to no effect. On the other hand however, the employment rate of older workers shows signs of serious improvements over the 6 year period, growing from 30,9% to 41,7%. Another positive development is the steady increase of the tertiary attainment that stood at 34,1% in 2014 after the

⁹⁷ Inglot, Szikra, and Raţ, "Reforming Post-Communist Welfare States."

22,8% in 2008. With this indicator Hungary has met its EU2020 goal of 30,4% for tertiary education attainment in the population aged 30-34. Unfortunately the same cannot be observed in the rate of the early school leavers that sits steadily around the 11% region, 1+ percentage point above the minimum target of at least 10%.

5. Table: Tertiary education attainment, early leavers from education, total employment rate, Hungary and EU28, 2009-2014

	Hungary EU28		Hungary EU28		Hungary EU28	
	Tertiary educational attainment, total, age group 30-34		Early leavers from education and training, age group 18-24		Employment rate of the total population, age group 20-64	
2009	24	32,3	11,5	14,2	60,1	68,9
2010	26,1	33,8	10,8	13,9	59,9	68,6
2011	28,2	34,8	11,4	13,4	60,4	68,6
2012	29,8	36	11,8	12,6	61,6	68,4
2013	32,3	37,1	11,9	11,9	63	68,4
2014	34,1	37,9	11,4	11,1	66,7	69,2

Source: Eurostat

One key external factor is the global financial crisis that turned into the European sovereign debt crisis and claimed Hungary as one of its earliest victims. This resulted in an IMF standby agreement in the end of 2008 which meant more focus on fiscal prudence and scaling back government spending. In addition to the economic crisis a political crisis unfolded at the time, which resulted in the 1-year term of a crisis-managing government. This added severe political constraints on decision making and implementation for the period. Furthermore after the 2010 elections the new government was facing similarly strict fiscal expectations from the EU as part

of the main effort of crisis management.⁹⁸ This austerity not only impacted the budget deficit but the spending priorities as well. As Csaba notes, faced with fiscal constraints the government started “severing social transfers of various sorts, creating strong incentives to work, strengthening employer positions and turning industrial relations generally more flexible.”⁹⁹

In 2008 the Hungarian government¹⁰⁰ prepared the National Action Programme for Growth and Employment for the period of 2008-2010. Its main elements remained the Start Programme and its already mentioned extensions, Start Plus and Start Extra, aimed at older employees and women, respectively.¹⁰¹ The NAP highlights that the gradual increase of the retirement age contributed to raises in both the activity and employment rates of the older people. This gradual increase was phased in during 2007 and 2008 and aimed at tightening the employment duration and age-related conditions to retiring as well as promoting later retirement. The document identifies four legs of the flexicurity approach and matches them with national measures as shown in the table in the annex. This table clearly shows that on the level of discourse the Hungarian government clearly set its agenda with the flexicurity approach in mind. From the previous period, the Start, Start Plus and Start Extra got included in the strategy as well as a new initiative started from 2009 named Start Region with the goal of reaching the most disadvantaged micro-regions.¹⁰² However, in the comprehensive report on the Hungarian Labour Market, Frey cites an EU evaluation of the 2008-2010 National Reform Programme as lacking a coherent

⁹⁸For an in-depth analysis of the period see: László Csaba, “Growth, Crisis Management and the EU: The Hungarian Trilemma,” *Südosteuropa Mitteilungen*, no. 03–04 (2013): 154–69.

⁹⁹ Ibid., 21.

¹⁰⁰The governmental cycle during these periods is the following: 2002-2006: Socialist-Social Democrat coalition; 2006-2010: Socialist-Social Democrat coalition, with the Social Democratic party breaking off the coalition in from May 1 2008, 2010-2014 Fidesz-KDNP supermajority, 2014- Fidesz-KDNP supermajority (the ruling coalitions supermajority ended in 2015) “Elections in Hungary,” *Wikipedia*, 2015, http://en.wikipedia.org/w/index.php?title=Elections_in_Hungary&oldid=655398921. last accessed: 05/24/2015

¹⁰¹ “National Action Programme for Growth and Employment - 2008-2010,” 2008.

¹⁰² “National Strategy Report on Social Protection and Social Inclusion 2008-2010,” 2008.

strategy and missing political ownership, which results in a rather technical approach to the Lisbon strategy. In relation to the flexicurity approach put forward by Hungary (see the Annex) Frey points out the fact that “the existence of an integrated flexicurity strategy is not evident. Many active labour market programmes are in place, but their effectiveness needs to be improved.”¹⁰³ Nonetheless, by curbing early retirement and increasing the retirement age as a response to the Commission proposals Hungary managed to increase its employment ratio of older people.

Facing the backlashes of the financial crisis required the Hungarian government to put forward measures not outlined in the NAP 2008-2010. The prevailing problems of low activity and employment rates had been exacerbated by the crisis. In her report, Frey highlights that in order to meet the 2008 IMF criteria the government made the following measures relating to the labour market and social policy:

- Reduced parental leave (from 3 years to 2 years)
- Taxing the family allowance
- Freezing the family allowance for 2 years and upper age limit of eligibility was reduced from 23 to 20 years
- Eliminating the 13th month pension
- Rising retirement age gradually to 65 years
- Lowering sick pay by 10 percentage point

¹⁰³ Mária Frey, “The Legal and Institutional Environment of the Hungarian Labour Market,” in *The Hungarian Labour Market - Review and Analysis 2010*, ed. Károly Fazekas, Anna Lovász, and Álmos Telegdy (Budapest: Institute of Economics, HAS, 2010), 198.

To counterbalance the cuts decision were made to extend the nursery and kindergarten network. In the comprehensive and exhaustive chapter in the Hungarian Labour Market report, Frey compiles a list of policy changes that were prompted by the crisis. The new amendments of Labour Code, introduced in 2009, were creating a more flexible labour market by making both overtime and working time limit more flexible, preferring the employers. In addition to this, the Ministry of Social Affairs and Labour and the National Employment Foundation and the Public Employment Service adapted job protection schemes, from a budget of 17.9 billion Forints.¹⁰⁴ To combat the employment and activity problem a new scheme was introduced in January 1 2009, 'Pathway to Work'. It was divided into two parts, each targeting a different segment. The first was dealing with severely disadvantaged people who continued to receive Regular Social Assistance. The second group was made up of people who were capable to work and was guided into the labour market or public work scheme.¹⁰⁵ Along with this new scheme the importance of PES in public work organizing declined rapidly while in concert the municipalities' increased. In addition to this development, a case study of Hungarian public work schemes showed that they were inefficient in creating employment and "the new scheme introduced in 2009 did not differ much from its predecessors, but entailed a large increase in the resources available to municipalities for public works schemes."¹⁰⁶

From 2010 and the change in government we can observe a change in policy directions. Following the path of the German Hartz reforms the length and amount of unemployment benefits were further curbed. The new Labour Code adopted in 2011 had the main aim of further

¹⁰⁴ Ibid., 181–223.

¹⁰⁵ Frey, "The Legal and Institutional Environment of the Hungarian Labour Market."

¹⁰⁶ Ágota Scharle, "The Efficiency of Municipal Public Works Programmes" (Budapest: Budapest Institute, 2011), 2.

liberalizing the Hungarian labour market. With the introduction of the new Code, the scope for individual agreements widened as well as a number of flexicurity measures:

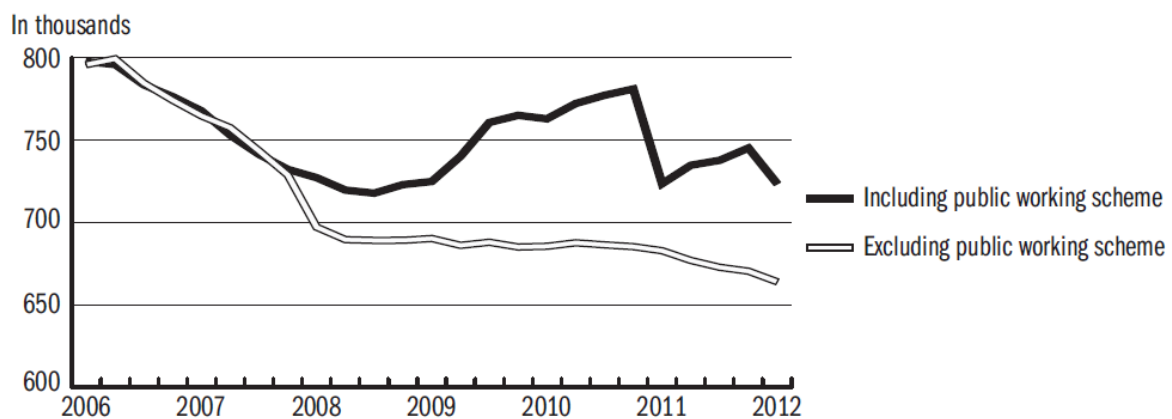
- it is easier to change quantities of labour
- the extension of the probationary period where both the employers and employees can terminate the contract without justification
- employers can more flexibly adjust working time and with collective bargaining the compulsory overtime can be extended up to 300 hours.¹⁰⁷
- Maximum duration of unemployment insurance reduced from 9 months to 3 months
- reducing the amount of social assistance (after expired unemployment insurance), from 20 to 15% of the average wage (nominally).
- participation in the social assistant system is largely dependent upon enrolment into the public work scheme.¹⁰⁸

In terms of ALMPs, a new, extended public work scheme was introduced in 2011 with increased funding. This meant that the focus of ALMPs were on public work schemes with increasing participating rates.

¹⁰⁷ Irén Busch, Zsombor Cseres-Gergely, and László Neumann, “Institutional Environment of the Labour Market between September 2011 and August 2012,” in *The Hungarian Labour Market - Review and Analysis 2013*, ed. Károly Fazekas, Péter Benczúr, and Álmos Telegdy (Budapest: Centre for Economic and Regional Studies, HAS, 2013), 290–293.

¹⁰⁸ Dorottya Szikra, “Democracy and Welfare in Hard Times: The Social Policy of the Orban Government in Hungary between 2010 and 2014,” *Journal of European Social Policy* 24, no. 5 (December 1, 2014): 486–500.

4. Figure: Employment in the public sector in Hungary, 2006-2012



Source: Cseres-Gergely, Kátay, and Szörfi, *The Hungarian Labour Market in 2011–2012*, 24¹⁰⁹

Characterizing the reforms, Szikra assess that “post-2010 Hungarian reforms have been distinct [from the Hartz reform in Germany], however, due to the inordinate scale of cuts, the nearly total replacement of active labour market policies with a punitive public works programme.”¹¹⁰ In addition to putting a large public work scheme in the centre of the ALMPs the government made

Another key element is missing in Hungary that is central to a successful flexicurity approach: education. Education spending has been declining in the country since 2004 and there are no signs of any reversal in that trend.

Main findings

The Hungarian case shows that while official policy documents were receptive to the EU’s concepts implementation often did not succeed. One of the key examples is the persistent decline

¹⁰⁹ Zsombor Cseres-Gergely, Gábor Kátay, and Béla Szörfi, “The Hungarian Labour Market in 2011–2012,” in *The Hungarian Labour Market - Review and Analysis 2013* (Budapest: Centre for Economic and Regional Studies, HAS, 2013).

¹¹⁰ Szikra, “Democracy and Welfare in Hard Times,” 412.

in education spending which clearly signals that over the 2004-2014 period governments did view the sector as a priority, but rather a source of budgetary reallocation. Moreover, the improvements in the labour market indicators, such as unemployment and employment ratio were a result of a public work scheme. These programs had been present in the Hungarian ALMP mix throughout the observed period but their capacity to have long-term effects on re-employment is marginal. Another indicator of inefficient social policies is that while social spending and economic growth increases at-risk-of-poverty is increasing as well. This is a clear sign that successive governments were unable to develop inclusive social policies and the institutions such as the Public Employment Service and the Ministry of Human Resources are incapable of tackling these problems. Furthermore, from the new laws and policies it seems that the governments were reluctant to substantively follow the EU advice and took advantage of the non-binding nature of the OMC by ignoring actual social investment and flexicurity proposals.

Estonia – incremental changes toward a new, more social system

Estonia has been regarded as one of the new Member States that is dedicated to pursue liberal market policies with large scale privatization, flexible labour market arrangements and minimal social safety net as part of a small state. This intention is widely documented in the literature.¹¹¹

One of the most salient features of the Estonian model is the transition into a more particularistic social policy from the universalist system that was present in the Soviet Union.¹¹²

As both Bohle and Greskovits and Medve-Bálint point out this is a result of a nation building process where Estonia had to create a new national identity and cherish independence.¹¹³ The main inspiration for Estonian policy makers was the Reagan and Thatcher administrations with the added benefit of the radical privatization process “clearing the place.”¹¹⁴

2004-2008 Policy and institutional environment

The main targets set by the EU in this period were the Lisbon strategy targets, that are 70% total employment rate, 60% female employment rate and 50% employment rate of older people. In this regard the Estonian case shows a strong performance. In the period in question the employment rate of the age group 20-64 grew continuously from 70,3% in 2004 to its peak at

¹¹¹For a more in depth analysis, see: Bohle and Greskovits, *Capitalist Diversity on Europe's Periphery*; Medve-Bálint, “The Role of the EU in Shaping FDI Flows to East Central Europe”; Aslund and Djankov, *The Great Rebirth: Lessons from the Victory of Capitalism over Communism*; Feldmann, “Varieties of Capitalism and the Estonian Economy: Institutions, Growth and Crisis in a Liberal Market Economy”; Jolanta Aidukaite, “From Universal System of Social Policy to Particularistic? The Case of the Baltic States,” *Communist and Post-Communist Studies* 36, no. 4 (2003): 405–26.

¹¹² Aidukaite, “From Universal System of Social Policy to Particularistic? The Case of the Baltic States.”

¹¹³ Bohle and Greskovits, *Capitalist Diversity on Europe's Periphery*; Medve-Bálint, “The Role of the EU in Shaping FDI Flows to East Central Europe.”

¹¹⁴ Aslund and Djankov, *The Great Rebirth: Lessons from the Victory of Capitalism over Communism*, 79.

77,1% in 2008. The female employment rate of the same age group displays a similar trajectory with growing well above the 60% Lisbon target by 2008. It peaked in 2008 at 72,3% from the starting point 67,3% in 2004. The third target was also met by the country as the employment rate of older people stood at 53% in 2004 and climbed to 62,3% by 2008. According to the Labour Market report of the Eesti Pank these labour market indicators, alongside with the decreasing unemployment, is closely tied to the robust economic growth in the period.¹¹⁵ Unemployment fell from its 2004 10,1% to the 4,6% low point in 2007.

6. Table: Unemployment, employment rates by sex and age group and total employment, Estonia and EU28, 2004-2008

	Estonia EU28		Estonia EU28		Estonia EU28		Estonia EU28	
	Unemployment rate, total %		Female employment rate, %		Employment rate of older people		Employment rate, total %	
2004	10,1	9,3	67,3	59,4	53	40,6	70,3	67,4
2005	8	9	69,7	60	55,7	42,2	72	67,9
2006	5,9	8,2	72,5	61,1	58,4	43,3	75,9	68,9
2007	4,6	7,2	72,6	62,1	59,9	44,5	76,9	69,8
2008	5,5	7	72,9	62,8	62,3	45,5	77,1	70,3

Source: Eurostat

While labour market enjoyed favourable developments its must be noted that in line with the agenda described in the introductory section, the Estonian government did not follow active labour market policies. The government expenditure on labour market policies was among the lowest in the EU with around 0,28-0,15% of the GDP. This figure is well below the EU average of 2-1,6%. Furthermore, the share of the population at-risk-poverty has fluctuated between 20,2% to 19,7% from 2004-2008. The dedication of the government to pursue (neo)liberal

¹¹⁵ Diana Tur, Natalja Viilmann, and Andres Saarniit, "Labour Market Review 2007/1" (Tallin: Economic Policy Office, Eesti Pank, April 2007).

policies is once again reflected in the total government expenditure on social protection that, similarly to the LMP spending, lags behind EU average and stayed in the near vicinity of 10% during 2004-2008 and even declining in the wake of the crisis. While from the data it seems that in the given period the security aspect of the flexicurity was not a decisive factor in government spending, education received above EU funding. With the exception of a dip in 2007 the share of government expenditure on education exceeded 6%, peaking at 7,1% in 2009. Despite this relatively high-level funding the share of early school leavers did not drop below 13% and even reached 14% in 2008.

7. Table: LMP expenditure, government expenditure on education and on social protection, % of GDP, Estonia and EU28, 2004-2008

	Estonia EU28		Estonia EU28		Estonia EU28	
	LMP expenditure, % of GDP		Government expenditure on education, % of GDP		Government expenditure on social protection, % of GDP	
2004	0,234	n.a	6,3	5,2	10,2	18,3
2005	0,187	2,014	6,0	5,2	9,8	18,2
2006	0,152	1,809	6,0	5,2	9,4	17,9
2007	0,149	1,591	5,9	5,1	9,3	17,5
2008	0,280	1,601	6,7	5,2	11,6	18,0

Source: Eurostat

After examining the data we should turn to the declared policy goals of the Estonian government and examine the how social and employment policies were shaped by the EU targets, proposals and the domestic institutional arrangements. The Estonian Action Plan for Growth and Jobs 2005–2007 calls for the strengthening of active labour market policies in order to efficiently reach

different risk groups.¹¹⁶ The Action Plan outlines measures aiming to strengthen the education system with special regards to vocational training and decreasing drop-out rates in all age groups and increasing enrolment ratios.¹¹⁷ The document identifies unemployment in Estonia as inherently structural and proposes targeted active labour market policies to counter this phenomenon. Among these policies, the Action Plan names development of new labour market services for risk groups, increased monitoring, integrating labour market and social policies. Furthermore, to combat unemployment more flexible labour market is needed.

These goals were reflected in the Labour Market Services and Benefits Act, which entered into force on 1 January 2006. Its main priorities were achieving the highest possible employment rate of the working population and to create client-friendly labour market supply services. There are a total of 13 labour market services offered in the Act, including work based training, community placement (temporary public work), business start-up subsidies, job mediation, labour market training, career guidance and wage subsidies.¹¹⁸ While this non-exhaustive list tackles the actions proposed by the EU and the National Action plan it seems that its implementation did not receive much fiscal consideration. In addition the labour market services the Act provides the possibility to apply for three different employment benefits:

- “Entitled to labour market benefit are people who during 12 months prior to registration as unemployed have been employed with work or other activity equalized with work for at least 180 days,

¹¹⁶ “Action Plan for Growth and Jobs 2005-2007” (Tallin, 2005), 41.

¹¹⁷ The measures on the labour market and employment cited in this paragraph are detailed in Ibid., 43–53.

¹¹⁸ Mare Viies, “Trends, Recent Developments, Active Inclusion and Minimum Resources,” Peer Review and Assessment in Social Inclusion, 2006, 12–13.

- Grants are paid to the unemployed who participate in employment training, practical training or work exercises during 40 hours,
- Travel and accommodation benefits are paid to the unemployed who participate in employment training or in practical training.”¹¹⁹

This showcases the conditionality of employment benefits on the use of employment services. Another feature of the new Labour Market Services and Employment Benefits Act is that it requires job-seekers to draw up an individual action plan upon registering themselves as unemployed. This is a further testament to the findings of Aidukaite who emphasizes the emerging particularistic approach of social policy in Estonia.¹²⁰ This stipulation in the Act shows that despite the long list of services and dedication to the active labour market policies the government and policy makers still views active job-searching the responsibility of the individual, rather than the state institutions.

In their assessment of the Estonian labour market Kerem and Randveer highlights two main domains for active labour market policies: training programs and cash allowance for business start-ups.¹²¹ While they note that due to availability of EU funding through the European Social Fund the labour market policies are expanding but they call for a more efficient use of them. It seems that there were steps taken towards the flexicurity approach and ALMPs (for instance the

¹¹⁹ Ibid., 13.

¹²⁰ Aidukaite, “From Universal System of Social Policy to Particularistic? The Case of the Baltic States.”

¹²¹ Kaie Kerem and Mare Randveer, “Assessment Of The Estonian Labor Market Development,” *International Business & Economics Research Journal* 7, no. 2 (2008).

2006 legislation) but according to Brixova and Égert due to the marginal expenditure on them “ALMPs played a minimal role in facilitating workers’ employment.”¹²²

2008-2014 Institutional and policy environment after the crisis

Since Estonian policy makers fully embraced the idea that radical reforms¹²³ in the face of the global financial crisis that hit the EU in 2008 the country experienced severe downturns in employment and unemployment rates.¹²⁴ Total employment rate dropped by 7% point to 70% in 2009 with corresponding changes in female and older people employment rates. Female employment fell from its 2008 peak value of 72,9% to 69% in the following year. While the amount of negative change was bigger than the change in the EU average the three employment indicators were above the EU average even in the midst of the crisis.¹²⁵ The most dramatic change was the explosion of unemployment from the 2007 low-point of 4,6% to 16,7% in 2010. This peak was followed by a rather fast paced and stable trend of reduction in unemployment which resulted in sub-EU average of 10% unemployment in 2010 and with further decline reaching 7,4% in 2014. On the other hand, a World Bank study highlights the rise in long-term unemployment that started in 2007 and continued due to the crisis. The researchers show that

¹²² Zuzana Brixiova and Balázs Égert, “Labour Market Reforms and Outcomes in Estonia,” *Comparative Economic Studies* 54, no. 1 (2012): 4.

¹²³ In the literature dealing with the regions transformation this approach is often termed as ‘shock therapy’ by its critiques. For more details on the various concepts and their respective policy mixes see: Joseph E. Stiglitz and Sergio Godoy, “Growth, Initial Conditions, Law and Speed of Privatization in Transition Countries: 11 Years Later,” in *Transition and beyond*, ed. Saul Estrin, Grzegorz W Kolodko, and Milica Uvalic (Palgrave Macmillan, 2007).

¹²⁴ For a detailed account of policy maker insider vantage point see the corresponding chapter in: Aslund and Djankov, *The Great Rebirth: Lessons from the Victory of Capitalism over Communism*.

¹²⁵ With the sole exception in the year 2010 when total employment rate dipped slightly below the EU average.

this puts additional burden on household and government finances as well as adversely affecting long-term health status.¹²⁶

One of the most important policy decisions of this time period was turning to fiscal austerity and internal devaluation¹²⁷ instead of using stimulus and devaluing the national currency. The 2014 Article IV. report¹²⁸ of the International Monetary Fund notes that “while this near-balanced budget policy has kept public debt low, it has also added a pro-cyclical bias to fiscal policy.”¹²⁹ In addition, nominal wage growth fell sharply, alongside with real unit labour cost growth as demonstrated by the IMF’s data compilation below.

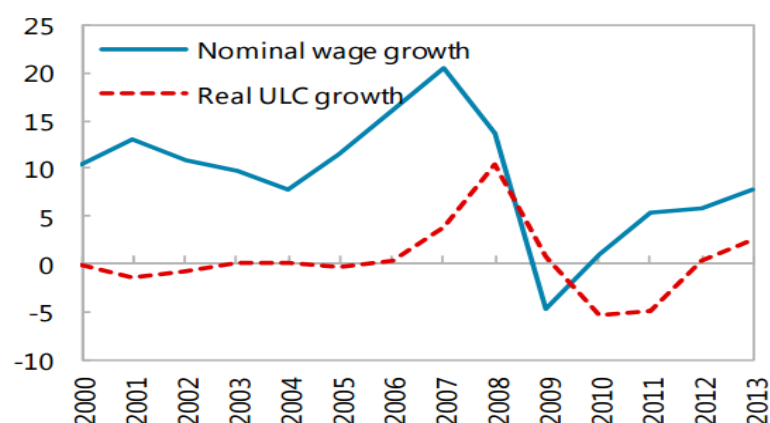
¹²⁶ Ramya Sundaram et al., “Portraits of Labor Market Exclusion” (Washington, DC: The World Bank, 2014).

¹²⁷ The term refers to one of the crisis management approaches within the EU, where instead of regaining competitiveness by devaluating one’s currency, administrations push for downward wage changes. More on this issue and on European Union crisis management issues see Barry Eichengreen, “Implications of the Euro’s Crisis for International Monetary Reform,” *Journal of Policy Modeling* 34, no. 4 (2012): 541–48; László Csaba, “Unintended Consequences of Crisis Management,” *Zeitschrift Für Staats-Und Europawissenschaften* 7, no. 3–4 (2009): 450–70.

¹²⁸ „Country surveillance is an ongoing process that culminates in regular (usually annual) comprehensive consultations with individual member countries, with discussions in between as needed. The consultations are known as “Article IV consultations” because they are required by Article IV of the IMF’s Articles of Agreement.” (<https://www.imf.org/external/about/econsurv.htm>, accessed: 25/05/2015)

¹²⁹ International Monetary Fund, “2014 Article IV Consultation—Staff Report; Press Release; And Statement By The Executive Director For The Republic Of Estonia,” IMF Country Report No. 14/112 (Washington, DC: International Monetary Fund, 2014), 5.

5. Figure: Growth of wages and labour costs, Estonia, 2000-2013



Source: IMF, 2014 *Article IV Consultation*, 4

While Estonia was one of the frontrunners of austerity politics there are some peculiar developments to be observed. Most notably, as unemployment skyrocketed labour market policy expenditures followed by increasing to 1,6% of the GDP which is a marked departure from the approach of previous years. In addition, spending on education started to grow and after some decline it stood slightly below its 2008 level of 6,7%.

8. Table: LMP expenditure, government expenditure on education, % of GDP and unemployment rate, %, Estonia and EU28, 2009-2014

	Estonia EU28		Estonia EU28		Estonia EU28	
	LMP expenditure, % of GDP		Government expenditure on education, % of GDP		Unemployment rate, %	
2009	1,603	2,153	7,1	5,5	13,5	9,0
2010	1,097	2,137	6,7	5,5	16,7	9,6
2011	0,720	1,884	6,3	5,3	12,3	9,7
2012	0,728	n.a	6,4	5,3	10,0	10,5
2013	0,686	n.a	n.a	n.a	8,6	10,9
2014	n.a	n.a	n.a	n.a	7,4	10,2

Source: Eurostat

The country performed rather well in the EU2020 indicators given the crisis and the pro-cyclical fiscal policy of the governments. As it was noted, employment rate dropped initially but bounced back after 2010 and by 2011 exceeded the EU average and in 2013 it stood at 73,3%. This is not far from the national target of 76%. Moreover, the share of early leavers from education declined in the observed period, from 14% in 2009 to 9,7% in 2013. Similarly to the employment ratio, this 9,7% means close proximity to the national target of 9,5%. Tertiary education attainment continued to grow in the population aged 30-34. By 2013 it reached 43,7% which is already above the 40% national target. On the other hand, Estonia failed to reduce the meaningfully reduce the share of the population at-risk-of-poverty over the whole 2004-2014 period. In the timeframe of 2008-2014 the financial crisis and fiscal rigor was creating an unfavourable environment for large scale poverty reduction. This resulted in a 23,5% at-risk-of-poverty rate in 2013.

The financial crisis had a very direct effect on social policy in Estonia, since the government opted for cutting a number of planned extensions of social benefits at the beginning of 2009. This included cancelling the 200 kroons raise in child care allowance and the increase the amount of benefits after for the third and every next child. Furthermore, raises in unemployment benefit from 1000 to 1700 kroons got cancelled, as well as the once-a-year school allowance. On the other hand, parental benefits increased.¹³⁰ According to Flèche and Radziwill the crisis hit the young, low skilled workers the hardest. Their weak attachment to the social safety net and income volatility due to non-standard work contracts contributed to this vulnerability. In contrast, households with children fared better than the average because of family support

¹³⁰ Diana Tur and Natalja Viilmann, "Labour Market Review 2008/2" (Tallin: Economics Department, Eesti Pank, October 2008).

policies.¹³¹ Their policy paper points out that at-risk-of poverty remained high in the country and a better targeted, integrated social policy approach is needed.

In contrast, in her analysis Viies reports that the social perspective is strengthening which is visible in the National Reform Programme for the 2008-2011 periods. In addition, in the preparation and monitoring processes of the NRP the government systemically involved different stakeholders. On the other hand, in-work poverty is not considered as a problem and the rise in prices and other impacts of the crisis on the people at-risk-of-poverty are not taken into consideration.¹³²

The new Employment Contract Act, adopted in 2008 December by the parliament and coming into effect in 2009, introduced comprehensive deregulation as well as changing the institutional setting by merging the Labour Market Board with the Unemployment Insurance Board. In order to balance the more flexible labour market the Act eased the eligibility for unemployment benefit. On the other hand, several studies have found that prior to a 2008 reform, the employment protection legislation was actually quite protective but employers usually disregarded its provisions. However, as Brixiova shows the main institutional settings remained unchanged by the end of 2008: ALMPs are marginal; wage setting is decentralized within the private sector (which translates into low minimal wages).¹³³ Despite this assessment, the Labour Market Report of the Eesti Pank claims that this change in labour market flexibility was essential.¹³⁴ In addition, Brixiova and Égert noted that while labour market flexibility was indeed greatly enhanced by the

¹³¹ Sarah Flèche and Artur Radziwill, “Reducing Poverty in Estonia Through Activation and Better Targeting,” OECD Economics Department Working Papers, (2012).

¹³² Mare Viies, “Assessment of the 2008-2010 National Reform Programmes for Growth and Jobs from a Social Inclusion Perspective: The Extent of Synergies between Growth and Jobs Policies and Social Inclusion Policies,” Peer Review and Assessment in Social Inclusion, 2008.

¹³³ Zuzana Brixiova, “Labour Market Flexibility in Estonia: What Can Be Done?,” *OECD Economics Department Working Paper* 2009, no. 38 (2009).

¹³⁴ Natalja Viilmann, “Labour Market Review 2010/2” (Tallin: Economics Department, Eesti Pank, 2010).

new legislation security measures lag behind considerably. Despite this mismatch between the flexibility and security elements they do highlight the fact that ALMPs are gaining more attention and a higher share of spending.¹³⁵ This development is noted by the European Social Policy Network's (ESPN) assessment of the country's social policies and the ESPN report terms the changes „remarkable.”¹³⁶

The main ALMPs, listed in the previous section, are still regulated by the Labour Market Benefits and Services Act. In 2012 the government introduced the first Employment Programme for 2012-2013. With this and the subsequent program for 2014-2015 the number of different active labour market policies rose to 20.¹³⁷ These Employment Programmes represent an extension of previous policies. In the 2014-2015 programme, the changes (non-exhaustively) included the following:

- expanding the range of people who can continue to participate in labour market services, with special emphasis on older people;
- similarly, employers who provide training for employees will be compensated for 50% of the cost of the training as opposed to the previous 25%;
- the number of people eligible for longer (up to 6 months) work exercises will expand, including the long-term unemployed, those with special needs, unemployed people with disabilities.¹³⁸

¹³⁵ Brixiova and Égert, “Labour Market Reforms and Outcomes in Estonia.”

¹³⁶ Andres Võrk et al., “ESPN Thematic Report on Social Investment” (Brussels: Directorate-General for Employment, Social Affairs and Inclusion, 2015), 12.

¹³⁷ Võrk et al., “ESPN Thematic Report on Social Investment.”

¹³⁸ “National Social Report 2014 - Estonia,” 2014, 5–6.

In addition to the Employment Programmes, from January 2013 the monthly unemployment benefit (paid for a maximum of 270 days for those who are not eligible for unemployment insurance) rose to half of the minimum wage.¹³⁹ Another new development was the establishment of the Gender Equality Council in 2013 with the aim of reducing gender segmentation in the labour market and promoting female labour market participation. This advisory body to the government is last step of a process initiated by the 2004 Gender Equality Act.¹⁴⁰

Main findings

The trajectory of the Estonian case is very intriguing since prior to the financial crisis the country maintained a very low level of social spending and attention to flexicurity and ALMPs in particular. This resulted in marginal spending on social policy and a sustained high level of people at-risk-of-poverty. The favourable labour market developments (rising employment rate, declining unemployment) were accompanied by robust economic growth provided a context where, given the radical liberal policy approach of the country's political elite, the low spending on ALMPs were justified. It must be noted that institutional development did happen in the pre-crisis period as well since the 2006 Labour Market Services and Benefits Act together with the Labour Market Board put more emphasis on flexicurity measures advocated by the Lisbon Agenda.

The crisis upset much of the previous picture by causing contraction in economic growth which was accompanied by a rapid rise in unemployment. The pro-cyclical fiscal policy of the government coupled with the downward mobility of wages meant that the share of population at-

¹³⁹ Natalja Viilmann and Orsolya Soosaar, "Labour Market Review 2012/2" (Tallin: Economics Department, Eesti Pank, 2012).

¹⁴⁰ "Estonian National Review of the Implementation of the Beijing Declaration and Platform for Action, 2009 – 2014," National Review (United Nations Economic Commission for Europe, 2009).

risk-of-poverty was experiencing further vulnerability. Against this backdrop came the Action Programme for 2008-2010 which put heavy emphasis on labour market security and flexibility. This changing focus is reflected in the upswing of labour market policy spending and in social spending overall. Furthermore, the increasing spending on education signals the strong dedication for creating a “knowledge economy” in Estonia. However positive these developments might seem, formulating an overly optimistic conclusion might not be in order. The at-risk-of-poverty ratio is remaining high, despite increased social spending and the increase in labour market policy spending did not prove to be a lasting phenomenon, however it did not return to the previous lows.

In summary it seems that institutional and policy changes paved the way for the more social crisis management although the main tools were similar to those applied in the 1990s and termed shock therapy. In official government documents and in their evaluations the concept of flexicurity and social investment is being increasingly present and it seems that the crisis facilitated a turn to the EU “best practice” policies in addition to the previous domestic policy mix of liberal market policies.

Conclusion

The results of the in-depth analysis shows that there is an observable convergence between the cases, where Estonia is moving towards a more social post-crisis status quo and Hungary following liberalization and dismantling previous policies and institutions. This finding answers the initially set out research question. Moreover, the hypothesis on the EU's influence has been proved true since we can observe changes based on the OMC documents and there is a clear sign that both countries have been influenced by EU agendas in the post-crisis period. These findings together contribute to the value added of the thesis since the result of the follow-up study is that the previous typology that was described by Bohle and Greskovits and Aslund and Djankov should be revisited in light of the crisis and the profound changes it inspired.¹⁴¹ Furthermore, the thesis showed that the sceptical assessment De la Porte and Jacobsson on the OMC's impact on new member state social policies is overly pessimistic and is not sufficiently supported based on the empirical evidence of the post-crisis period.¹⁴²

The two case studies revealed interesting and perhaps some counter-intuitive findings. One of the findings is that the political alignment of the governing parties does not seem to have a lasting and meaningful impact on employment and social policies in Estonia and Hungary. In Hungary the retrenchment of the generous welfare state and the liberalization of the labour market started under a socialist, centre-left government and continued under the conservative, centre-right government. While the labour market liberalization and the revisions of various early retirement schemes and disability pensions led to increasing employment rate in Hungary it still

¹⁴¹ Bohle and Greskovits, *Capitalist Diversity on Europe's Periphery*; Aslund and Djankov, *The Great Rebirth: Lessons from the Victory of Capitalism over Communism*.

¹⁴² De la Porte and Jacobsson, "Social Investment or Recommodification? Assessing the Employment Policies of the EU Member States."

relies on large scale public work programmes that has been proved largely ineffective as opposed to other active labour market policies. The examination of policy and institutional change revealed that public work schemes enjoy priorities over other active labour market policies in Hungary, irrespective of governments or European Union recommendations. However, we can observe that in official documents the flexicurity and social inclusion ideas of the EU are present and constant mentioning signals government awareness to these policies that unfortunately does not lead to government willingness. Moreover, a further discouraging trend in Hungary is underinvestment in education by successive governments which again reveal how skewed the flexicurity adaptation is. The continued labour market liberalization and welfare state retrenchment opens the possibility to revisit the Bohle-Greskovits typology since Hungary shows signs of moving away from embedded liberalism towards liberalism. This dynamism is not outside the realm of their model since they conclude that “even if the new regimes so far have been able to preserve many of their features, their future survival is not more guaranteed than their emergence has been.”¹⁴³

In terms of the political variable we can observe the same in Estonia with broad political support for liberalization. On the other hand, the Estonian case demonstrated that there was a definite shift towards a more social model with increased social and labour market policy spending. Moreover, the policy and institutional changes shows a convergence towards the flexicurity model with increased active labour market policies and increasing expenditure on education. Unfortunately, this positive development is yet to reduce considerably the long-term unemployment and the number of people at-risk-of-poverty. The Estonian case, however, shows that while liberalization is still a main component of the labour market policies it is now coupled

¹⁴³ Bohle and Greskovits, *Capitalist Diversity on Europe's Periphery*, 139.

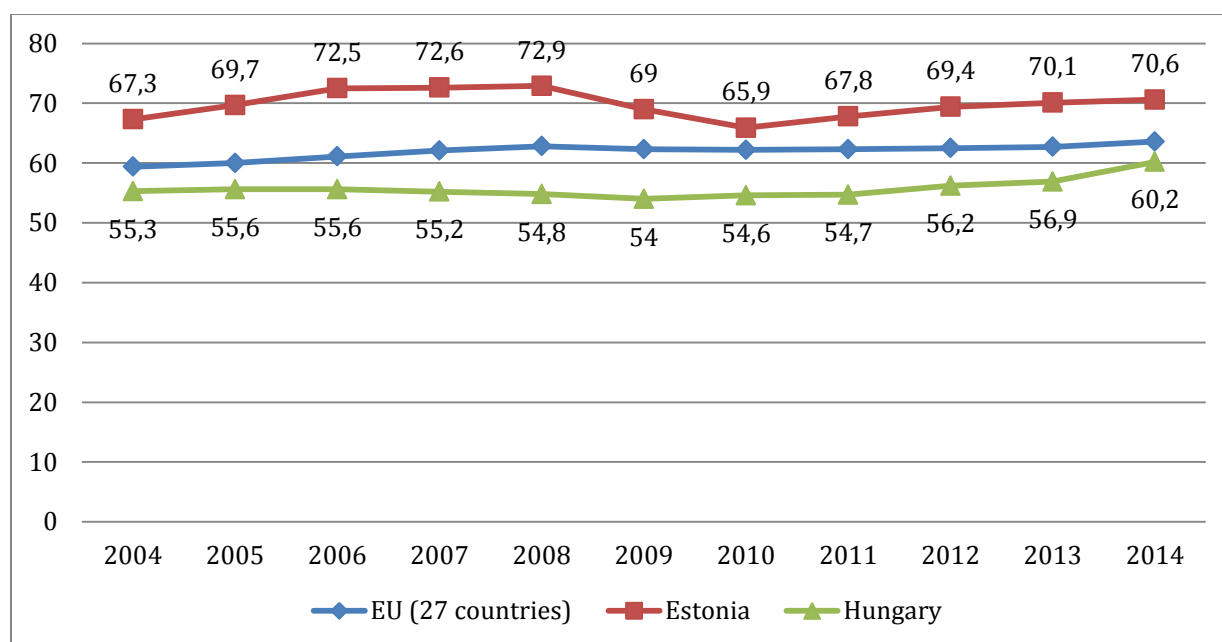
with increased social dimension that can be traced back to the EU. The emphasis on targeting and various labour market services (such as training, career guidance, etc.) signals that unlike Hungary the Estonian governments are willing to adapt policies in line with EU best-practice when faced with a crisis situation. This finding goes against the De la Porte-Jacobsson assessment since besides advocating flexibility Estonia did make meaningful steps towards security as well. While Estonia remains a predominantly liberal economy this shift in policy might mean that the country is moving towards a more embedded form of liberalism. This development also questions the high praises that the Estonian liberal development model receives in the volume of Aslund and Djankov.¹⁴⁴

The limitations of the thesis might warrant caution since drawing region wide conclusions from two case studies is not possible. However, Estonia is a trend setter among the Baltic countries which makes the finding of the Estonian case more generalizable. While Hungary is part of the Visegrád group there is no strong signal that it has the same regional influence as Estonia does, which limits the findings on how far the Hungarian case travels. Given all this, further research could include more cases to see if a recognizable pattern emerges within the Central Eastern European region or these post crisis developments are just the manifestations of the permanent construction site effect.

¹⁴⁴ Aslund and Djankov, *The Great Rebirth: Lessons from the Victory of Capitalism over Communism*.

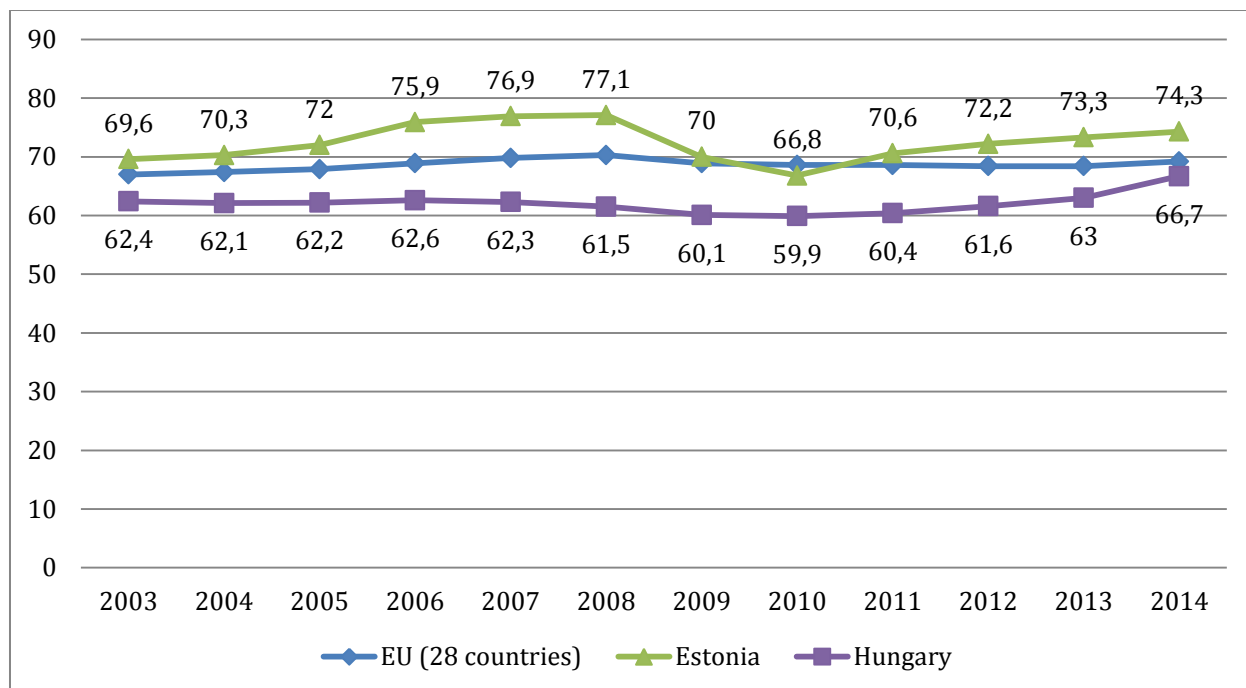
Appendices¹⁴⁵

9. Table: Female employment rate, age group 20-64,%, Hungary, Estonia, EU28, 2004-2014

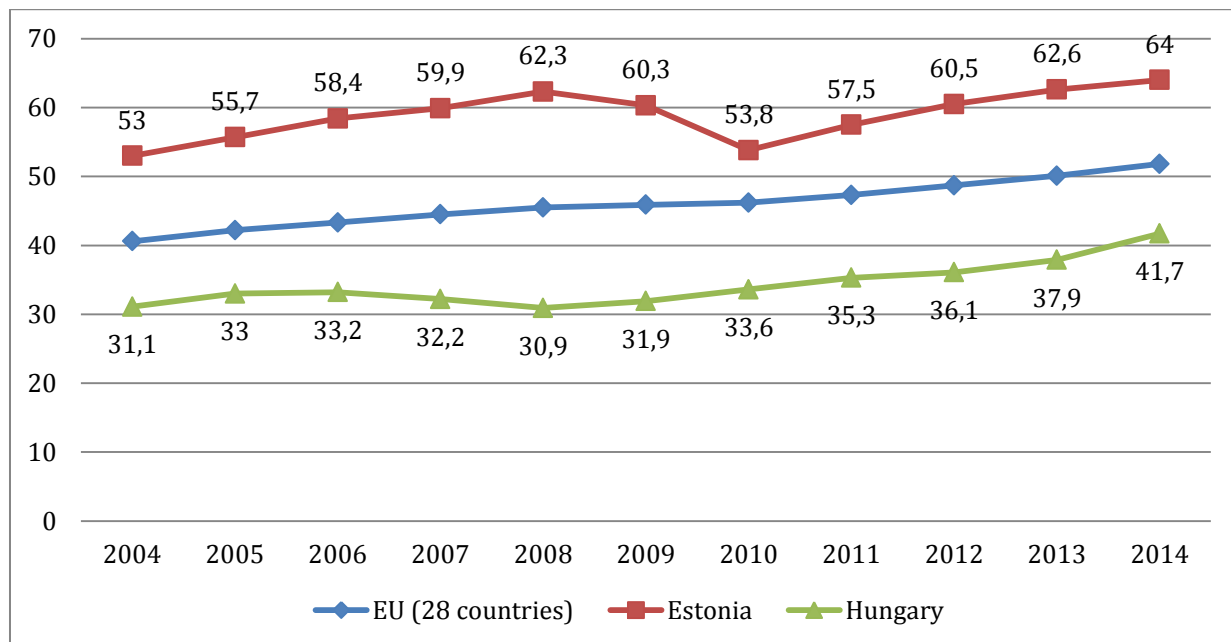


¹⁴⁵ If not stated otherwise, all data are downloaded and compiled from the Eurostat online database (<http://ec.europa.eu/eurostat/data/database>), last accessed:20/05/2015

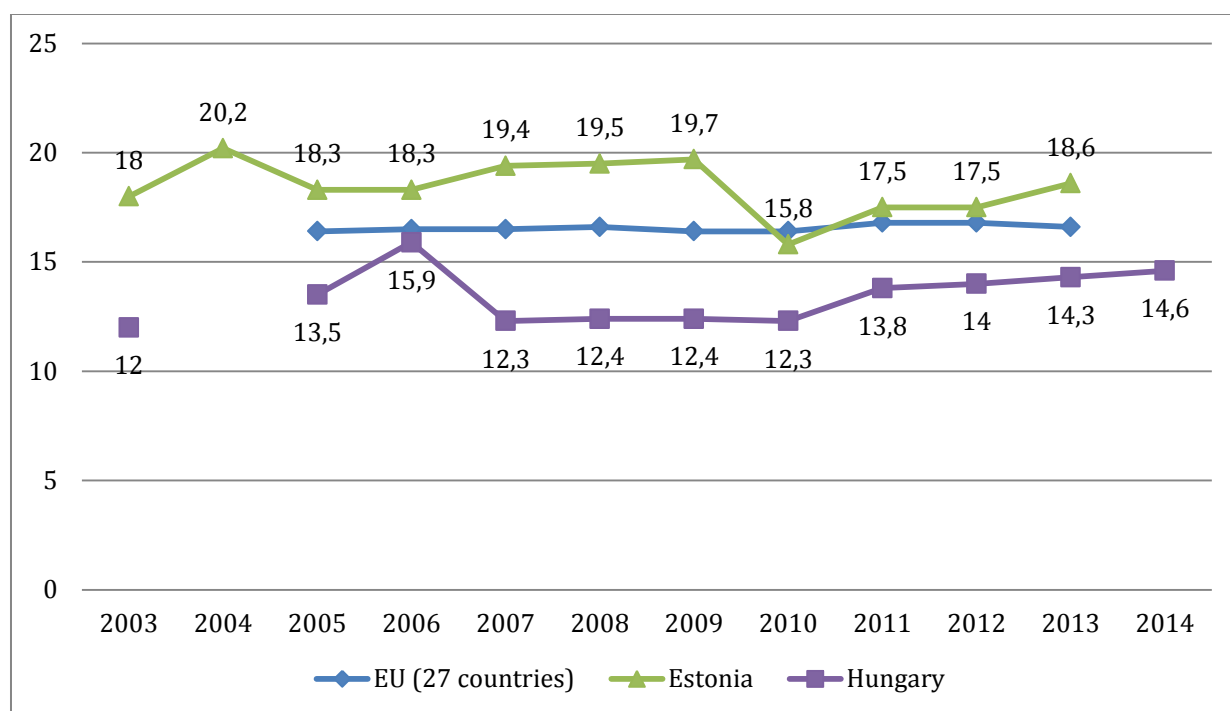
10. Table: Employment rate of the total population, age group 20-64, %, Hungary, Estonia, EU28, 2003-2014



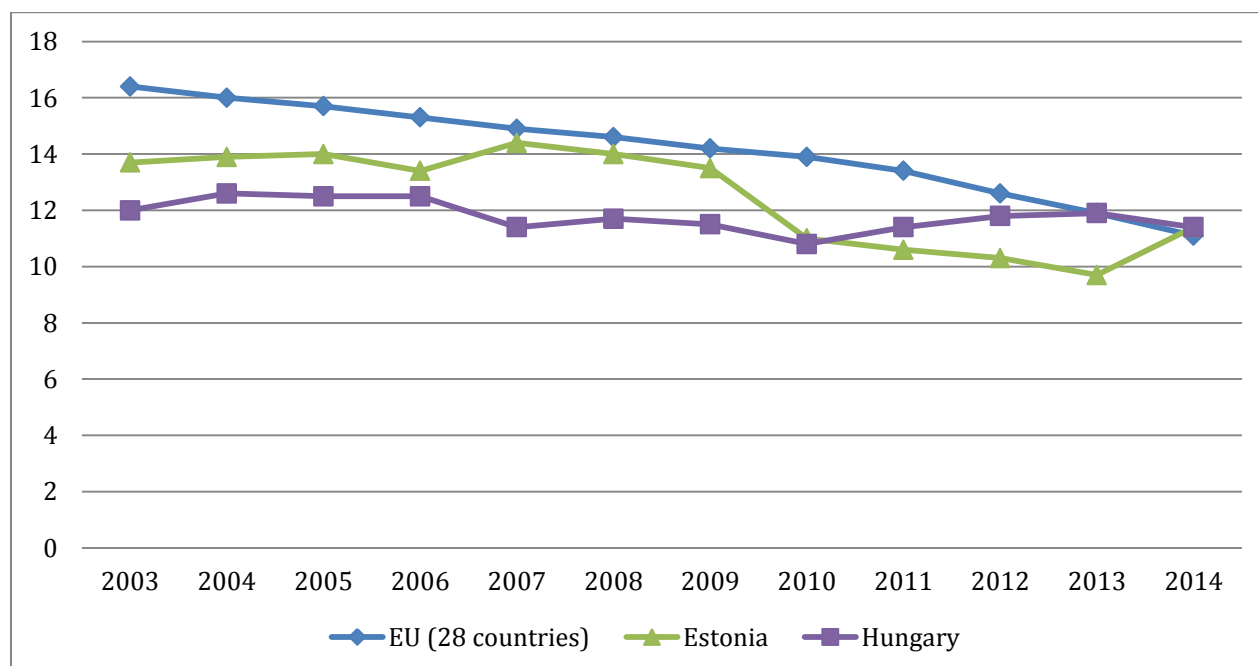
11. Table: Employment rate of older workers, %, Hungary, Estonia, EU28, 2004-2014



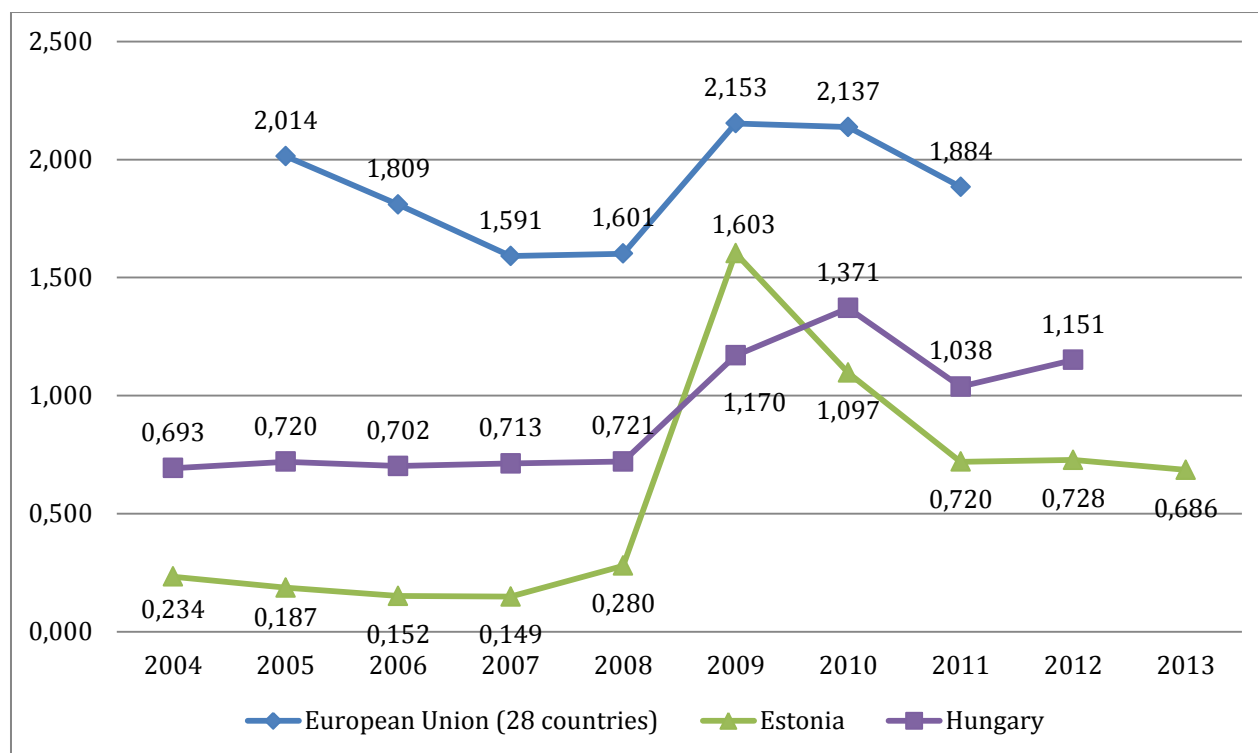
12. Table: At-risk-of-poverty rate, Total, %, Hungary, Estonia, EU27, 2003-2014



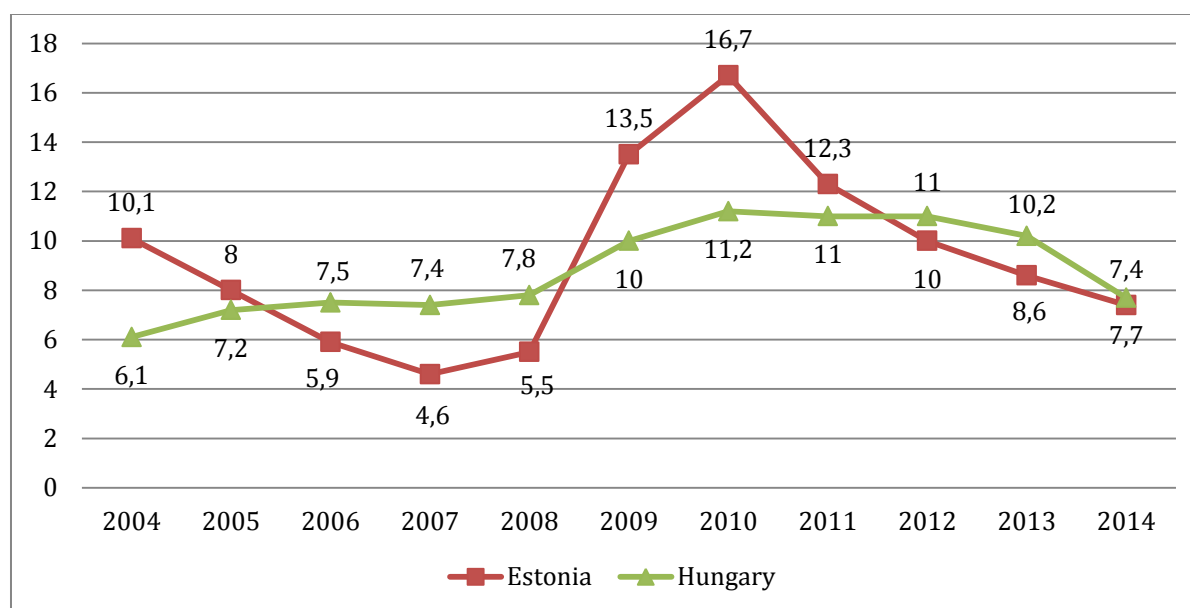
13. Table: Early leavers from education and training, age group 18-24, %, Hungary, Estonia, EU28, 2003-2014



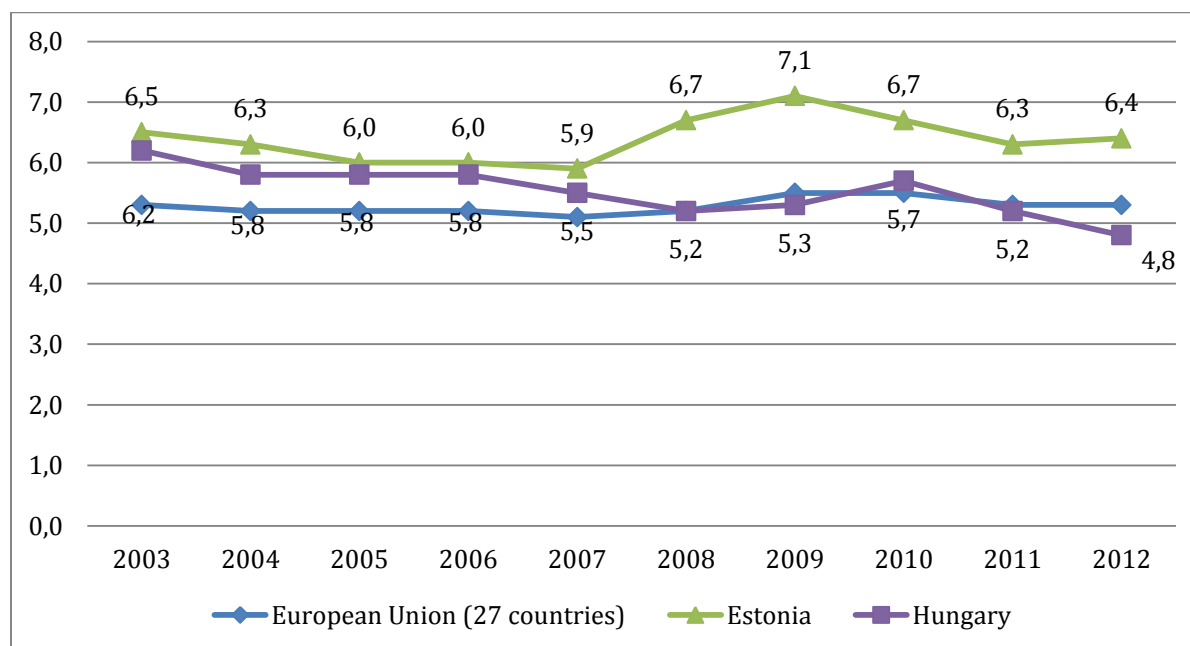
14. Table: LMP expenditure, total, % GDP, Hungary, Estonia, EU28, 2004-2013



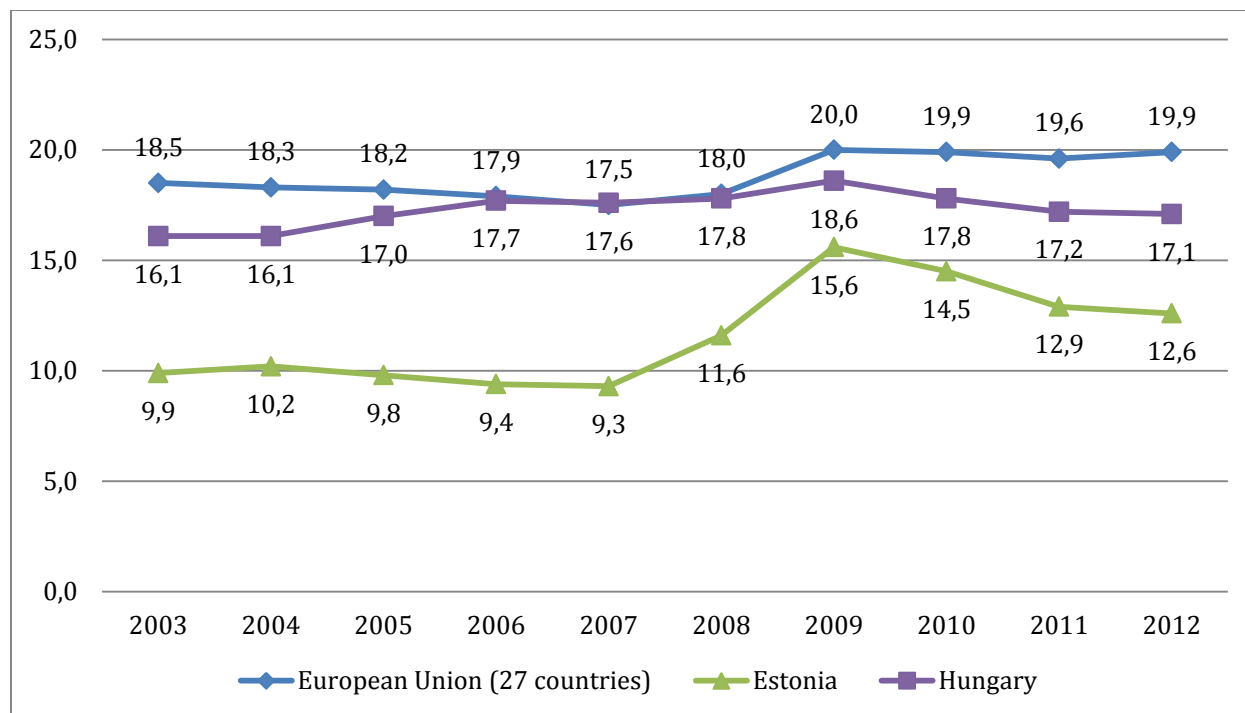
15. Table: Unemployment rate, total, Hungary, Estonia, EU27, 2004-2014



16. Table: Total general government expenditure on education, , % of GDP, Hungary, Estonia, EU27, 2003-2012



17. Table: Government expenditure on Social protection, % of GDP, Hungary, Estonia, EU27,
2003-2012



18. Table: Elements of the flexicurity concept in the Hungarian National Action Plan 2008-2010

Pillars	Measures
Strategy for Life-long Learning	„One Step Forward!” programme
	Development of key labour market competencies
	Continuing the development of the Regional Integrated Vocational Training Centre network
	Development of a career guidance system
	New Career programme
	Supporting in job training
	Quality, methodological and curriculum development of the training system
Active labour market policies	Integration of non-state organisations in the employment services network
	Supporting the rehabilitation and employment of persons with disabilities
	Improving the labour market situation in the most disadvantaged microregions
	Employment of disadvantaged persons at infrastructure investments funded by the EU
	Programmes promoting the employment of Roma population
Labour law environment; reducing the level of undeclared employment and labour market segmentation	Reducing social security contribution in the case of employment of people with labour market disadvantages
	Strengthening labour inspection
	Raising employer awareness
	Package of measures aimed at reducing the informal economy
Developing a modern social protection system	Transformation of the pension system
	Improving access to child day-care services
	Transformation of the disability pension system
	Setting up an integrated employment and social services system
	Strengthening the promotion of employment in the social protection system

Source: “*National Action Programme for Growth and Employment - 2008-2010*,” 121

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