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The Political Economy of Crisis Management in East–Central European Countries

MARTIN MYANT, JAN DRAHOKOUPIL & IVAN LESAY

Abstract

The financial and economic crisis in the Central and East European countries raised the profile of economic policy themes that relate to the role of taxation and state spending. The key policy differences related to public budgets and support for a demand stimulus. Responses fall broadly into two categories that we link to a social-democratic and a neo-liberal response. The distinction indicates that the policy responses were linked to the party affiliation of the government on the left–right spectrum. There were some remarkable common trends that cannot be explained by the logical requirements of the economic situation alone. There are differences in timing and in severity, but every country has at some point moved towards a policy of balancing the budget by making cuts. In all cases there were cuts in benefits for marginal groups in society and a switch towards indirect rather than direct taxes. These carry clear distributional implications.

THIS ESSAY ANALYSES POLICY RESPONSES TO THE FINANCIAL and economic crisis in the Central and East European countries (the Czech Republic, Hungary, Poland and Slovakia), a group of countries with broadly similar economic and political backgrounds that were affected by the crisis slightly differently. Thus Hungary was hit much harder by the financial side of the crisis while the Polish economy was overall less vulnerable to external shocks. However, there was a wide variety of, often contradictory, policy reactions, with important differences both between countries and between periods in individual countries. The aim of this essay is to explain the differences in policy reactions as linked to the differences in interpretations of the causes and nature of the crisis by key actors.

We start by looking at the economic impacts of the crisis in terms of GDP, finance, export performance, state spending and state debt. This follows the framework set out in an earlier article (Myant & Drahokoupil 2012) which was designed for analysing the impact of the crisis on economic performance in 2009. An analysis of political responses needs a different, and more flexible, framework because of the complex and varied interactions between economic and political phenomena. Indeed, some of the indicators referred to

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above relate to the direct impact of external shocks—governments had very little short-term control over exports—but some are also partly indicators of policy responses. Only two types of economic problems, as argued in the second section, constituted hard constraints that limited the room for governments to manoeuvre: problems in the financial sectors invariably led to implementation of support measures for domestic banks; problems with financing government debt then made countries dependent on the IMF and other institutional lenders, preventing the governments from pursuing anti-cyclical policies.

The key policy differences relate to state budgets and, amid the huge number of individual measures that were adopted, responses fall broadly into two categories that we link to a social-democratic and a neo-liberal response. The terms are imprecise. Government policies were not guided by strict adherence to theories, either political or economic. However, as we argue in the third section, the division proves applicable and helpful for all of these four countries. The distinction indicates that the policy responses were linked to the party affiliation of the government on the left–right spectrum. Political contexts—type of ruling parties and their electoral strategies—shaped the interpretation of the crisis and the nature of policy reactions. The remaining sections thus analyse the politics of crisis management in individual countries in detail.

The varied responses demonstrate the extent to which conflicts depended on conditions and past histories specific to individual countries. Debates took different forms in each one, but the following three points summarise the general features of Central and East European countries when compared with other groups of countries.

First, governments did need to take account of public opinion and that set limits to any neo-liberal strategy. The Baltic recipe would lead to electoral defeat. However, quite substantial cuts in public-sector pay and state benefits could be implemented and this marks Central and East European countries out from Western European countries where the level of social acceptability seemed to be reached more quickly.

Second, fears over the level of state debt were easy to arouse and that set limits to any social-democratic strategy. That is not obviously justified by figures on government debt as a percentage of GDP, but reflects the reality of international constraints imposed on Hungary and fears in other countries that they could easily lose the confidence of financial institutions, and also perhaps that their electorates are easier to frighten than those of Western Europe.

Third, there was little concern over long-term economic weaknesses that might be revealed by the crisis. Indeed, issues such as the desirability of greater emphasis on research and high technology played only peripheral roles in government rhetoric. Essentially, the assumption was that the crisis would be weathered without any new economic thinking.

The conclusion is that the crisis did not lead to a uniform pattern of policy responses, but similar policy issues were brought to the fore. However, there were both similarities and differences in policy responses that cannot be explained by the logical requirements of the economic situation alone. The crisis, partly through its real and partly through its imagined effects, raised the profile of debates over levels of taxation and state spending, over levels of provision for pensions, health and education services and, above all, over measures affecting the distribution of income. It did not determine which side would triumph, or in what particular form, but political divisions, even when masked by other rhetoric, resembled much more the classic division between left and right than had been common in the region. There was very little change in thinking on longer-term economic policy making so this political change may prove to be the most important outcome in policy terms of the financial and economic crisis of 2008.

The economic impacts of the crisis

An analysis of all transition economies shows that the variations in GDP decline from 2008 to 2009 can largely be explained by falling financial inflows, falling exports and reductions in state spending.[1] First came a sharp halt to credits which affected most severely those countries that had been dependent on financialised growth, but also led to increased caution from banks in all countries. Next came a fall in demand for exports from those countries exporting products that were sold with the help of credits, meaning motor vehicles and other high-value consumer goods. The reductions in incomes through lower profits and wage payments led to a further reduction in domestic demand and to lower tax revenues and this, plus any additional spending undertaken in the context of the crisis, led to deepening state-budget deficits.

Differences between Central and East European countries followed from differing levels of past dependence on financial inflows, that being an important factor only in the case of Hungary, differing levels of dependence on exports, that being lowest in the case of Poland, and differing levels of willingness to incur state-budget deficits. That was the most constraining in Hungary owing to pressure to comply with terms from the IMF, given the country's dependence on IMF financing from November 2008. The responses of economic actors—enterprises, banks and households—were broadly consistent and predictable but, particularly after 2009, governments' reactions were more complex and varied. The course of economic development therefore reflected partly the continuing influence of external economic events and partly the choices made by governments which can therefore be seen both as a response to economic developments and as a factor shaping the course of those developments.

Table 1 shows changes in key economic indicators that were the least subject to government influence and could therefore be considered as creating the conditions from which policy choices had to be made. GDP declined in 2009 in all cases apart from Poland, where the previous rate of growth declined markedly, and then recovered across all countries in 2010. The major stimulus was the renewed growth in exports. There was also some recovery in the volume of credits, following restriction in all countries in 2009, but there was no return to the very rapid expansions of the pre-2008 period. Hungary was hardest hit here, because of the country's previous dependence on financial inflows, but recovery was also hampered in other countries because banks, following concerns with the world financial situation, became more cautious. In no case was there a recovery to the levels of lending of the mid-2000s.

These indicators point to areas of possible policy response. Declining exports led immediately to falling industrial output and hence a threat of rising unemployment. Governments could react passively or could respond with measures to maintain employment, to create new employment opportunities or to raise demand levels to compensate for the fall in export demand. Lower levels of credit caused particular problems

[1]The impacts of the crisis on individual countries up to the end of 2009 are discussed elsewhere (Myant & Drahokoupil 2011, 2012).

TABLE 1

ANNUAL PERCENTAGE GROWTH IN GDP, EXPORTS AND VOLUME OF CREDITS, 2008–2011.

	GDP				*Exports*				*Credit to enterprises and households*			
	2008	*2009*	*2010*	*2011*	*2008*	*2009*	*2010*	*2011*	*2008*	*2009*	*2010*	*2011*
Czech Republic	3.1	−4.7	2.7	1.7	6	−10.2	17.6	11	16	1.5	4.1	5.9
Hungary	0.9	−6.8	1.3	1.7	4.2	−12.7	16.9	10.2	10.5	−4.6	−1.4	1.3
Poland	5.1	1.6	3.9	4.4	7.1	−6.7	10.1	7.5	36.7	7.2	8.8	14
Slovakia	5.8	−4.9	4.2	3.3	3.2	−14.8	10.6	16.9	18.2	3.1	6	8.6

Notes: The figures are December values.
Sources: For GDP and exports, IMF database, available at: http://www.imf.org/external/pubs/ft/weo/2012/01/weodata/weoselgr.aspx, accessed 16 August 2012. For Credits, December to December annual growth, from central banks, available at: http://www.cnb.cz/cnb/STAT.ARADY_PKG.PARAMETRY_SESTAVY?p_sestuid=1148&p_strid=AACA&p_lang=CS; http://www.nbp.pl/home.aspx?f=/statystyka/pieniezna_i_bankowa/nal_zobow.html; http://www.nbs.sk/sk/statisticke-udaje/menova-a-bankova-statistika/zdrojove-statisticke-udaje-penaznych-financnych-institucii/uvery, all accessed 16 August 2012.

for the construction sector and governments could, again, respond passively or by substituting state spending for previously credit-financed activities. These differences are pursued in discussion of individual countries.

Table 2 gives a broad indication of the nature of government responses. Government spending increased in 2009 in all cases covered here apart from Hungary. Growth was particularly marked in Slovakia. There was then rapid retrenchment in 2010, albeit with Poland continuing the upward trend. Figures for 2011 suggest a continuing, albeit not universal or consistent, trend for government spending to switch from countering depression into a factor holding back the pace of economic recovery. Differences between countries are also clear from the fiscal deficits, which grew somewhat more rapidly in Poland. The constraint on budget deficits was fear over growing state debt. The figures in Table 2 suggest that the high level of public debt in Hungary was an exception, while in general the region was characterised by low debt levels in international terms.

As already argued, changes in the economy were partly a consequence of government policies. However, the changes outlined above also set an agenda for governments and for political parties and representatives of particular interests. There were likely to be pressures from particular groups: those suffering declining living standards, those hit by the reduction in credits, those seeking to combine security in employment with flexibility in the face of economic fluctuations and those threatened by cuts in public spending.

Governments in all countries interpreted the nature of the crisis and adopted policies in response. However, it is not sufficient to take at face value government presentations of their anti-crisis policies. They often presented packages of measures which included steps, some of which had been decided beforehand and some of which were never implemented. Governments came under pressure to appear to be doing something and responded, at least in part, by dissembling.

Moreover, measures adopted under an ‘anti-crisis’ heading were arguably often irrelevant to the crisis. It is therefore very difficult to separate out clear cut, anti-crisis policy measures from continuity with past policies or from new policies that were adopted at the time of the crisis, often using economic difficulties as a pretext. The two sections that follow set out the basis for a framework that makes sense of policies adopted, starting with a consideration of external and internal constraints. The key point is the linking of economic theories and political ideologies to actual policy responses and this points towards a re-emphasis of an underlying, but often blurred, left–right distinction.

External and internal constraints

There were hard constraints, both economic and political, that limited the room for manoeuvre for governments regardless of their ideological affiliation. The centrality of the financial sector for the rest of the economy meant that all governments were under pressure to ensure stability of banking systems, but that was generally done by government guarantees without any direct expenditure. Banks were largely under foreign ownership and enjoyed a degree of security thanks to international agreements, as discussed by Kudrna and Gabor (this issue), so that stability of the financial system, a major issue for the crisis at the global level, was an issue that in Central and East European countries required an active response only in Hungary where the financial sector was in a more difficult situation.

TABLE 2

Annual Percentage Growth in Government Spending, Fiscal Balance as Percent of GDP and Government Debt as Percent of GDP, 2008–2011.

	Government spending growth				*Fiscal balance*				*Government debt*			
	2008	*2009*	*2010*	*2011*	*2008*	*2009*	*2010*	*2011*	*2008*	*2009*	*2010*	*2011*
Czech Republic	3.4	4.0	0.9	0.9	−2.2	−5.8	−4.8	−3.1	28.7	34.4	38.1	41.2
Hungary	−2.0	−2.7	−2.5	0.6	−3.7	−4.5	−4.2	4.3	74.0	79.8	80.2	80.6
Poland	7.6	4.7	5.9	1.6	−3.7	−7.4	−7.8	−5.1	47.1	50.9	54.85	56.3
Slovakia	8.3	13.1	2.7	−1.3	−2.1	−8	−7.7	−4.8	27.9	35.6	41.1	43.3

Source: Eurostat, available at: http://epp.eurostat.ec.europa.eu/portal/page/portal/statistics/search_database/, accessed 16 August 2012.

Financing external debt could become a major constraint on policy, but this was an issue only in Hungary which, unable to finance its government debt in October 2008, was forced into seeking external financing from the IMF and EU under terms that implied budgetary restriction. That was not an absolute determinant of policies as governments could interpret external conditions with some flexibility. Nevertheless, it rather sets Hungary apart from the other Central and East European countries.

The EU had some influence over all Central and East European countries' fiscal policies. Having joined the EU in 2004, they were committed to joining the euro at some time in the future. Slovakia joined in 2009 and was thereby formally tied to the Maastricht criteria, meaning that the budget deficit should not exceed 3% of GDP and public debt should not exceed 60% of GDP. In practice, these were not hard constraints in the first years after 2008 when many EU members failed to meet the targets. The other countries were expected to abide by timetables, negotiated and embodied in Convergence Programmes, which set target dates for fulfilling the criteria. For Hungary this was overshadowed by conditions set out in agreements with the IMF. For Poland it was significant as a factor reinforcing internal pressures for austerity which led to the dramatic fall in the budget deficit in 2011. In Slovakia, the pressure from the European Commission was a factor that contributed to the commitment to bring down the deficit. For the Czech Republic its significance varied as governments changed with the oddity that the main political force advocating austerity was the least eager for early accession to the euro and the least interested in following EU directives and guidelines.

Apart from this, the EU did impose an important constraint through its competition rules which effectively ruled out help to individual enterprises or sectors. Any government assistance could not discriminate between EU member countries and that marked a striking difference from Russia and Ukraine, where much of the anti-crisis policy took the form of help to particular firms (as well as from the USA). Policy making in Central and East European countries therefore took the form of more general measures which appeared less susceptible to individual lobbying.

Finally, the most important internal constraint on a government was the possibility of defeat in an election. However, that was not a universal determinant of particular policies. It is clear that no government can ignore all opinions and pressures and pursue a course based on pure ideology. All make some compromises so as to win elections that give them the power to pursue their priority objectives. All listen to some extent to social interests even if, as indicated for individual countries, the influence of formal tripartite structures varied greatly, depending in fact on the willingness of particular governments to listen which, in turn, varied with the ideological complexion of governments.

Economic theories and political ideologies

The crisis of 2008 brought back memories of the depression of the 1930s and with that, thoughts of a solution true to Keynesian theory. If the problem originated in the failure of the banking system to provide credits, then that implied a case for states to substitute for private-sector failure and to stimulate demand. This implied running a budget deficit, and trying to prevent that by cutting spending was, in the Keynesian view, a mistaken approach. Cutting spending would further depress demand and hence national income and tax revenues, leading to long-term depression if not a downward spiral of decline. The aim of a countercyclical policy was to prevent not only an immediate economic decline but also a permanent loss of potential output that the latter was likely to cause. It thus made more sense to endure a period of rising government debt which could be reduced when economic growth was restored.

The alternative perspective of fiscal prudence put all the emphasis on preventing an escalation in the level of government debt. In this view the crisis was a crisis of the state budget and the solution was to restore balance. Within such a perspective the fear was not of lasting depression but of state bankruptcy. That was a live issue in Hungary, leading to the need to seek IMF help, and the fear could be evoked across Central and East European countries as a number of other EU member countries experienced extreme difficulties with continued borrowing.

However, the key division in policy choices is closest to an ideological divide between what can loosely be termed social-democratic and neo-liberal responses. That differs from dividing policy responses by the attitude towards the state budget alone for four reasons. The first is that the budget can be balanced by a number of different methods. Both raising taxes and cutting spending are options and the ways in which they are done can have very different distributional impacts. The second is that spending and tax policies can have quite specific effects, such as maintaining employment in a particular sector or demand for a particular product, that are not captured by a distinction between stimulus and depression. The third is that governments used further measures that related only indirectly to the state budget, such as labour-market policies. The fourth is that crisis management was often used as an opportunity to implement policies that the parties in power wanted to implement regardless of the crisis.

The interpretation of the nature of the crisis and the respective policy response pursued was conditional upon the party-ideological affiliation on the left–right dimension. There had been an inexact fit between political parties and easily definable economic thinking (Tavits & Letki 2009), such that the division between left and right in Central and East European countries, with the exception of the Czech Republic, was blurred by the nationalist–populist (right) compared to the modernising (left) dimension (Kitschelt 1995; Kitschelt *et al.* 1999). The crisis raised the profile of economic policy in general and the role of the state in providing social security and services and in affecting the distribution of income in particular. The left–right dimension thus started to play a more prominent structuring role. At the same time, in the context of unstable party systems where social constituencies are not clearly defined, it is difficult to assign policy positions to political parties *a priori*. Specific crisis narratives used by party leaders in voter mobilisation played a key role in shaping the party agenda (Hanley *et al.* 2008). The policy of individual governments thus has to be linked to the specific electoral strategies of the parties that compose the governments.

In general, the left subscribed to the social-democratic response, including acceptance of Keynesian thinking alongside responsiveness to pressure from employee representatives and support for progressive taxation. There was no presumption in favour of a reduction in the weight of the public sector in the economy. The neo-liberal response of the right was likely to ignore Keynesian thinking and to centre on the dangers of a budget deficit. This was to be solved by cutting public spending, especially benefits for the unemployed and those on lower incomes, and any increases in taxes should not be progressive. The neo-liberal approach cannot be defined simply as giving priority to budget balance. Indeed, evidence is clear from many countries, including Central and East European countries, that over preceding years governments with a social-democratic complexion had been the more determined and successful at reducing budget deficits (Tavits & Letki 2009). Thus the neo-liberal approach should be seen as primarily concerned with cutting back on state activity in total, and particularly on any role it plays in reducing the extent of inequality created by a free-market system.

This highlights one of the difficulties in interpreting responses to the economic crisis. It has been claimed that every successful politician is aware of the possibility of using a crisis to implement otherwise unpopular policies. All political trends could theoretically act in such a way, including those advocating Keynesian or nationalist approaches. However, in the context of the post-2008 situation, advocates of the neo-liberal approach appeared the most adept in this. The slogan of reducing the budget deficit, so as to avoid state bankruptcy was used to justify moves towards lower levels of state benefits and also of taxes and towards overall less progressive tax systems, steps which have the primary effect of shifting the pattern of income distribution.

Table 3 indicates the broad differences in starting points and in the policy reactions to the crisis that relate to public spending. In the Czech Republic, the first reaction of a

TABLE 3
Government Spending, % of GDP.

Czech Republic	*2007*	*2008*	*2009*	*2010*	*2011*
Total government expenditure	41	41.1	44.9	44.1	43.4
Gross capital formation	4.1	4.6	5.1	4.3	3.7
Compensation of employees	7.3	7.3	7.8	7.6	7.3
Social benefits	17.6	17.6	19.5	19.7	20
Poland	*2007*	*2008*	*2009*	*2010*	*2011*
Total government expenditure	42.2	43.2	44.5	45.4	43.6
Gross capital formation	4.3	4.6	5.3	5.7	5.9
Compensation of employees	9.6	10	10.3	10.2	9.8
Social benefits	19.3	19.2	20.6	20.7	20.1
Hungary	*2007*	*2008*	*2009*	*2010*	*2011*
Total government expenditure	50.7	49.2	51.4	49.5	48.7
Gross capital formation	3.7	2.9	3.1	3.4	2.9
Compensation of employees	11.7	11.6	11.5	10.9	10.1
Social benefits	18.4	18.6	19.4	18.5	17.9
Slovakia	*2007*	*2008*	*2009*	*2010*	*2011*
Total government expenditure	34.2	34.9	41.5	40	37.4
Gross capital formation	2	2	2.3	2.6	2.3
Compensation of employees	6.6	6.8	7.7	7.7	7.1
Social benefits	16.1	16.1	19	19.5	18.5

Note: Government spending on social benefits differs from total expenditure on social protection.
Sources: Eurostat, Government Finance Statistics, available at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/introduction, accessed 16 August 2012.

right-wing government was limited: continuation of past policies led to continued growth in the weight of public spending in GDP, affecting all its main elements. A caretaker government that ruled from May 2009 led to reductions in some areas alongside increases in others as it listened to diverse inputs from political parties and society. Elections in May 2010 gave a strong mandate to a right-wing government that then pursued a neo-liberal approach, reflected in the declining share of state spending.

In Poland, the policy of the right-wing government that pursued a careful strategy of re-election—which was ultimately proven successful in March 2011—can be seen as partially Keynesian oriented, with continued growth in public-sector pay and capital spending. It changed in 2011 with more evidence of retrenchment.

Hungary, in contrast, started from the position of the highest level of state spending, but dependence on financing from the IMF led to the imposition of pro-cyclical policies on the then left-wing government. The arrival of the conservative-right government in March 2010 changed the situation. It was able to gain more independence through unorthodox one-off revenue-raising measures, but a radical neo-liberal agenda, albeit with a specific nationalist–populist colouring, led to the reductions in capital formation, public-sector pay and social benefits shown in Table 3.

In Slovakia, state involvement in the economy and in social protection was lowest in the Central and East European countries. The social-democratic government implemented an anti-crisis policy, but the data in this table show powerful effects from elements that were not explicitly part of the anti-cyclical package. Increases in spending in 2009, including social benefits, public-sector pay and capital spending—an element made up largely of infrastructure expenditure—were part of the government's broader policy of increasing public spending after the period of cuts by the right-wing government before 2006. The approach was reversed by the neo-liberal approach of the new right-wing government from June 2010.

Table 4 sets out matching data on government revenues as a percent of GDP. It is noteworthy that only Hungary consolidated its budget through revenue increases in 2011. In the rest of the Central and East European countries, the apparent urgency of balancing budgets did not lead to a significant increase in tax and insurance contributions as a percent of GDP after 2007. A further striking feature is the common switch from direct towards indirect taxes, although the former had already been relatively low by international standards. The latter tend to be less progressive, falling on the whole population, while direct taxes are more likely to fall more heavily on higher earners,[2] and on businesses. Social contributions are less clear cut, with part nominally paid by employers and part nominally paid by employees. Reductions in this period frequently followed from reductions in business contributions. The data in Table 4 are therefore consistent with the crisis leading to a strengthening of the neo-liberal relative to the social-democratic approach.

The aggregate data are indicative of important differences, but the complexity of the politics and policy of crisis management requires a detailed analysis of developments in individual countries. That is provided in the sections that follow.

[2]This is true even where so-called flat tax systems have been introduced as they contain significant allowances before tax is levied.

TABLE 4
Government Revenue, % of GDP.

Czech Republic	*2007*	*2008*	*2009*	*2010*	*2011*
Total revenue	40.3	38.9	39.1	39.3	40.3
Indirect taxes	10.8	10.6	11.1	11.2	11.5
Direct taxes	9	8	7.3	7	7.5
Social contributions	15.7	15.6	15	15.3	15.5
Hungary	*2007*	*2008*	*2009*	*2010*	*2011*
Total revenue	45.6	45.5	46.9	45.2	52.9
Indirect taxes	15.9	15.6	16.6	16.9	16.6
Direct taxes	10.3	10.6	9.9	8	6.4
Social contributions	13.9	13.8	13.3	12.1	13
Poland	*2007*	*2008*	*2009*	*2010*	*2011*
Total revenue	40.3	39.5	37.2	37.5	38.5
Indirect taxes	14.1	14.2	12.9	13.6	13.7
Direct taxes	8.6	8.6	7.4	6.9	7
Social contributions	12	11.3	11.3	11.1	11.4
Slovakia	*2007*	*2008*	*2009*	*2010*	*2011*
Total revenue	32.4	32.8	33.5	32.3	32.6
Indirect taxes	11.1	10.4	10.3	10.1	10.4
Direct taxes	6.2	6.5	5.5	5.4	5.6
Social contributions	11.9	12.2	12.9	12.6	12.5

Source: Eurostat, Government Finance Statistics, available at: http://epp.eurostat.ec.europa.eu/portal/page/portal/government_finance_statistics/introduction, accessed 16 August 2012.

The Czech Republic

Czech politics were characterised by a reasonably clear division between left and right. Governments broadly of the right dominated up to 1998 and were in power again from 2006. Social Democrats were dominant in the intervening period. Thus the right was in power in 2008 and had been able to implement neo-liberal policies of a flat tax, some reductions in welfare benefits and initial charges for health treatment. Its parliamentary majority was very tight, but it showed no desire to compromise with the opposition or to listen to representatives of social interests. The first reactions to reports from outside of a developing economic crisis were dismissive: this would not affect the Czech economy in view of its stable financial system and policies of low taxes, low state spending and low budget deficits. The state budget for 2009 was therefore approved with the assumption of real GDP growth of 4.8%.

Changes came in early 2009, following pressure from inside the country. Both employers and trade unions pointed to the collapse in manufacturing output and, following thinking in other EU member countries and advice from the EU as a whole, formulated their anti-crisis measures. The EU was of special significance as the Czech Republic held the presidency of the union for the first half of the year and it was not desirable to ignore calls for anti-crisis strategies embodying a fiscal stimulus. However, the dominant party in the Czech government, the *Občanská demokratická strana* (ODS, Civic Democratic Party), had a record of Euroscepticism that, combined with ideological aversion to any economic policies associated with Keynesian theories, ruled out full compliance with EU thinking.

Thus the first Czech reaction was essentially to give some appearance of complying with pressures from the EU for an anti-crisis policy, but to complement this with a defiant pronouncement that no significant rethinking was required, irrespective of the external or internal pressures. The crisis was seen as a minor, short-term phenomenon which should not be allowed to disrupt the neo-liberal direction of its policies.

In February 2009 the government published its National Anti-Crisis Plan *(Národní protikrizový plán vlády)*. Prime Minister Topolánek introduced the programme with the words: 'It is a plan which, unlike those of many other countries, is free from the populism and bribery which we could smuggle in under the cloak of a crisis situation'.[3] It was a plan 'of which we would not need to be ashamed even in a time of growth' (Vláda ČR 2009, p. 5). There were some nods of recognition towards EU pressure for a stimulus package, but dangers were not seen as very great and the main one was not seen as coming from the crisis at all. A key statement in the programme was that 'taking note of the fact that the cyclical slow-down of the economy is a lesser threat than long-term indebtedness', the package of measures was aimed at 'maintaining employment and the stability of the public finances' (Vláda ČR 2009, p. 32). The aim was not to create a demand stimulus, in line with Keynesian thinking, but to 'make labour cheaper' (Vláda ČR 2009, p. 3), keeping people in employment, preventing unemployment from rising at all, and enabling firms to invest and grow (Vláda ČR 2009, p. 32).

The plan was presented as stimulating the economy to the extent of 2.9% of GDP, adding a cost equivalent to 1.9% of GDP to the state budget. In fact, almost half of the package was from measures already decided and approved (such as the annual pay increase for state-sector employees which had been agreed following strong pressure from trade unions and opposition parties) so that the new fiscal stimulus, introduced after acknowledging the crisis, amounted to only 1.1% of the GDP that was actually achieved in 2009. Fully 74% of the stimulus was to come from reductions in taxes and social insurance obligations on businesses, thereby continuing with the previous neo-liberal policy direction. There was no commitment to major infrastructure investment, no serious thought of a demand stimulus either by raising the lowest incomes or by supporting particular sectors and a reversal rather than expansion of measures for direct employment creation, which had been financed out of the company social insurance contributions that were being cut as a measure apparently to help overcome the crisis.

The only new form of policy discussion was cosmetic. The government established the National Economic Council of the Government (*Národní ekonomická rada vlády*, NERV), on 8 January 2009 as an advisory body. It had a strong representation from business and only two of its nine members were academics, in the limited sense of being employed by academic institutions. Although not all clear and active supporters of the government, none were known as its opponents. It produced three reports, with a final one in September 2009, and broadly supported the government's approach, concluding that 'the main priority should not be growth in GDP but rather reducing indebtedness' (NERV 2009, p. 66).

[3]Addressing parliament on 18 February 2009 (PSP 2009).

The outcome in practice is clear from the 267-page report on the results of the 2009 state budget (MFČR 2010). There were only seven references to anti-crisis measures, one very general, four relating to easier tax conditions for businesses and two relating to export guarantees which were a relatively small item. Indeed, the only noteworthy consequence of the anti-crisis plan was the introduction of additional tax relief on small businesses, which were the only social interest that visibly affected government decisions.

Changes on the expenditure side largely reflected previously planned cuts in some state benefits, reduced spending on anti-unemployment measures, presented, as indicated above, as part of an anti-unemployment measure, and higher unemployment benefit payments, reflecting higher levels of unemployment, up from an average of 5.4% in 2008 to 8.0% in 2009 and 9.0% in 2010. The increase was small in relation to the state budget as a whole, amounting to only 1.3% of total expenditure, against 0.66% in 2008.

A change in approach in the Czech Republic was brought about by the defeat of the Topolánek government in a vote of no-confidence in March 2009—over issues not related to the anti-crisis policy—and its replacement by a caretaker government, given support by the main parties of the right and left. It was intended that the new government would not take any major political decisions and just tide things over until new parliamentary elections. Those were delayed until 28–29 May 2010. This interlude therefore gave some voice to the Social Democratic Party, which supported following the advice coming at the time from the EU and IMF for a fiscal stimulus. It succeeded in winning approval for reversal of some previous state benefit reductions. The new government was also more willing to consult through tripartite structures, even agreeing with unions and employers on 2 February 2010 to a 38-point plan (RHSD 2010).

This was a government that acknowledged the presence of a crisis and the need to take measures. A number were even approved, such as a car-scrap scheme, lobbied for by the motor industry and supported by the Social Democrats, which was approved by parliament in September 2009. However, very little was actually done. The 38-point plan remained at the level of points for consideration, despite pressure from both employers and unions for decisive action. Indeed, both employers and trade unions were openly frustrated by the government's approach, preferring a shorter list of measures that would be treated as priorities. A prime example was support for implementation of the German *Kurzarbeit* system, whereby an employee could work shorter hours while partially supported from state benefits. That was not possible under existing Czech law, so the call was for some simple amendments. The government's response was to discuss and consider rather than to implement.

Reluctance over spending measures reflected one clear decision that the government did take: the budget deficit for 2009 was not to exceed 5% of GDP and the same was to apply for 2010. The background to this was the desire of the government—more sympathetic to the EU than its predecessor—to engage fully with the process of joining the eurozone. This required compliance with the Convergence Programme, negotiated with the European Commission, which set the timetable for reaching the Maastricht criteria. Terms were renegotiated in early 2010, with the prediction that the budget deficit target of 3% of GDP could be met in 2013. Despite a lack of enthusiasm for early entry to the Euro, the ODS were quick to approve. The Social Democrats were more sceptical.

The clear deficit target, alongside opposition to significant tax increases, inevitably pointed to spending cuts. With Social Democrat support for public services, the immediate blow fell on new infrastructure projects and on areas such as the government's commitment to R&D spending. Thus stimulus and retrenchment met in one contradictory programme and the stimulus measures were the ones to face delay.

This, then, was neither an explicitly neo-liberal nor an explicitly social-democratic response. There was a willingness to listen to the views and interests that pointed in the social-democratic direction, but little action was taken. It rather marked a period of indecision and waiting in which the course of economic development was left unaffected by government policies, despite the crisis being a major theme in economic policy discussions. It differed from the approach of the Topolánek government in that social-democratic measures were held in check by inaction rather than outright rejection.

The Czech political situation was transformed by parliamentary elections in May 2010 which led to a right-wing government with a clear majority, effectively the first time since 1996 that a government had not had to struggle to maintain a parliamentary majority. A major factor in the electoral outcome was undoubtedly the situation in the eurozone at the time. Parties of the right used this in the last weeks of campaigning and the outcome of the elections deviated markedly from previous opinion polls which had pointed to a decisive victory for the left. Evidently, with continued public-sector pay rises and with recovery in export-oriented industries meaning that real wages for those still in work were rising, the threat of falling living standards and rising unemployment appeared less serious to much of the population than the fear of possible state bankruptcy following rising debt levels. Thus, at this point the most important political effect of the economic crisis appeared to be a decisive move to the right, opening the way for a clearly neo-liberal policy direction.

The new government came with a reinterpretation of the crisis. The only issue of concern, to judge from its rhetoric, was the budget deficit and state debt, mixed with a more general neo-liberal agenda. They were going beyond just exploiting a crisis as an opportunity to implement unpopular policies. The outcome can be seen from the results of the 2010 state budget (MFČR 2011). The 'crisis' was presented as an external constraint, not as a reason for adopting any particular policies. Anti-crisis measures were mentioned only in relation to some reductions in business tax obligations. The important changes from the previous year included reduced unemployment benefit payments, following stricter rules that reduced the numbers eligible, and a 2.5% reduction in spending on pay throughout state administration. Research institutes and universities also experienced significant cuts.

Spending in 2011 (MFČR 2012) was further reduced by cuts in state benefits and public-sector pay but, as confirmed by the data in Table 3, the impact on public spending was relatively small. Thus a 22.5% cut in spending on unemployment benefits and an 11.7% cut in social benefits in 2011 were equivalent to only 0.2% of GDP, as these items were already quite small. All of these savings were outweighed by a 6.3% increase in pension payments, due to an increasing number of retired people and to the government's compliance with the existing law on indexation of pensions, equivalent to 0.6% of GDP.

In fact, the government appeared to be motivated as much by a clear neo-liberal agenda as by restoring budget balance and when the two came into conflict it faced a difficult dilemma. In contrast to the initial reaction in 2008 of denying that there was a crisis, the new approach seemed to be to magnify its scale so as to provide a pretext for a broader policy agenda. The government's programme included greater private roles in the pension system and the employment service, a two-tier health system allowing additional payments for better services and fees for students in higher education. The state budget deficit was set to increase with the transition to a partly private pension system and this was to be held in check by increases in VAT while taxation on business and personal incomes were to remain unchanged.[4] Results for 2011 showed revenue from indirect taxes increasing by 3.9% while revenue from direct taxes fell very slightly, up 3.6% from personal incomes and down 4.6% from companies.

Not surprisingly, government policies met with opposition in the form of large and persistent public protests and demonstrations, particularly from trade unions and universities, and other informal groups also took some forms of action. This of itself need not influence government decisions, but the overall political effect of the economic crisis appeared to be a reassertion of a classic left–right division, with high-profile disputes over policies that directly affect the distribution of income. Parliamentary elections, due in 2014, could be expected to reveal which side in that divide could command more public support.

Poland

The left–right division was less prominent in Poland than in the Czech Republic or Slovakia. The left had suffered a resounding defeat in 2005 and the main political division was between the *Platforma Obywatelska* (PO, Civic Platform) and *Prawo i Sprawedliwość* (PiS, Law and Justice). The former brought together politicians from neo-liberal backgrounds, but they had repeatedly failed with some of their favoured policies, notably the flat tax, advocacy of which contributed to electoral defeat in 2005. PiS was more nationalist than neo-liberal and had a continuing association with the Solidarity trade union. PO won the 2007 election, albeit on a more cautiously neo-liberal policy than in the past and set about governing, in coalition with the party representing farmers, with an approach aimed at winning a second term in power. That had not been achieved by any Polish government since 1989.

When contrasted with the experience of other Central and East European countries, Poland differed in three respects. The first was that one government remained in power for some years after the start of the crisis and that was associated with more stability in policy making. The second, marking it out from other governments of the right, was that it was a pragmatic right-wing government, listening to social interests and influenced by fears over the social costs of its policies. The third was that it was concerned over budget deficits and rising debt, ultimately placing these considerations ahead of a narrower neo-liberal agenda that would place all the emphasis on a small state and privatisation.

The Polish government responded to the crisis slightly more quickly than its Czech counterpart, following reports of reduced exports from foreign- and domestically-owned firms and as banks cut lending in the autumn of 2008. The response was to reduce the growth forecast for 2009 from 4.8% to 3.7% and to set out the Stability and Development Plan (*Plan stabilności i rozwoju*) on 30 November 2008. The underlying assumption was that Poland

[4]The actual costs of the reform were uncertain as the entry into the private pillar was made voluntary. There was thus uncertainty about the number of people who would divert part of their insurance contributions to the private pillar and thus reduce revenues of the budget. Costs for a compulsory private pillar were expected to peak at 1.1% of GDP by 2040. The reform thus involved substantially lower costs than was common in the earlier reforms in other Central and East European countries (see Drahokoupil & Domonkos 2012).

was unlikely to be severely affected by the crisis owing to the relative stability of its banking system. The plan was billed as costing zł 91.3 billion (0.7% of GDP), but most of this was in guarantees to keep the finance system functioning. It was intended to balance reduced revenue from the lower level of GDP by reduced spending. The effect of the plan was to allow the budget deficit to rise when growth was even lower than expected.

However, in early 2009 the Polish government came under pressure to take more positive action from opposition parties and the Solidarity union which argued that the country was ideally placed to implement a Keynesian policy of fiscal stimulus. This position was neither explicitly accepted nor explicitly rejected. Instead, negotiations through the tripartite commission led to a 13-point anti-crisis package which came into force on 22 August 2009 with the intention that it should operate for two years with the possibility of further extension (MPiPS 2009).

The measures included a number of proposals for changes in employment legislation to make it easier for enterprises to maintain employment by temporary layoffs and short-term working and proposals to ease financial difficulties for businesses suffering from the immediate effects of the crisis, largely by reducing tax burdens. Much of the necessary legislation was passed fairly quickly. Some longer-term measures, such as an agreement to raise the minimum wage to the level of half the average wage, were set aside for further discussion. This, then, was largely a programme for immediate relief rather than a significant economic stimulus. The main help to investment was to be from helping co-financing for EU-funded projects.

Overall the impact of newly adopted government policies on economic development was very small. However, the continuation of government spending decided in the past, including increases in public-sector pay and pensions significantly above the increases in private-sector pay, helped to maintain consumption-led growth through 2009 and 2010 (MFRP 2011, p. 7). Government spending also continued on road building and the output of the construction sector continued to rise every year while it moved into decline in all other Central and East European countries as they cut public capital spending.

Polish government policy underwent a shift in 2011 towards much greater concern over the budget deficit. The stimulus was partly external, as the European Commission called on the government to take steps to get back in line with its programme for joining the eurozone. The stimulus was also internal, partly in the sense that complying with eurozone rules did matter to this government but primarily because a previous right-wing Polish government had set strict rules on the level of state debt. Should this reach 55% of GDP, the government was required to cut spending and freeze the indexation of pensions. The constitution set 60% as an absolute maximum and that was also the level set by the Maastricht criteria. As indicated in Table 2, these levels were looming large and the government was embarrassed by criticisms from outside its ranks that it was on course for a debt crisis. The response was a programme of changes on the expenditure and revenue sides.

The main spending-side measures were a freeze on public-sector pay (saving 0.46% of GDP in 2011), pension reductions achieved by limiting early retirement (saving 0.30% of GDP in 2011) and cuts in employment creation measures (saving 0.28% of GDP in 2011). On the revenue side the biggest changes were an increase in VAT (0.41% of GDP) and a change in the system of financing pensions which increased state revenue by the equivalent of 0.64% of GDP. The effect on the state budget was quite significant as the deficit fell in 2011 to little over half its 2010 level (based on nine months of 2011 (MFRP 2012)). This also brought a shift in the driving forces for Poland's economic growth. In 2011, pensions and pay in both public and private sectors stagnated in nominal terms and fell in real terms. Public investment projects continued but, as in other Central and East European countries, the main stimulus to growth had become rising exports.

There were still important differences from the Czech experience both in the rhetoric surrounding, and in the content of, policies. In terms of rhetoric, the fiscal deficit was only 'one of the serious threats to Poland's development' (MFRP 2011, p. 11), rather than the biggest and most pressing. In content too the reform of the pension system indicated a significant difference. Under the system established in 1998, a proportion of pension contributions went into private funds while a proportion went into a smaller state pension system. Changes from May 2011 reduced the share going to private funds to less than a third of its previous level, increasing revenue that flowed through the state budget. This was therefore a significant reversal of a key neo-liberal reform measure, arousing some wrath from free-market purists. It reflected both the desire to reduce state debt and a more realistic assessment of the costs and performance of the private pension system (Drahokoupil & Domonkos 2012). However, the pragmatic approach appeared to work in that the PO government triumphed in parliamentary elections in October 2011, returning for a second spell in power.

Slovakia

The Slovak government in 2008 was dominated by the *Smer—sociálna demokracia* party (Direction—Social Democracy) under Prime Minister Robert Fico. It had come to power after elections in 2006 following a period of right-wing dominance during which standard neo-liberal policies, including a flat tax and partial privatisation of the pension system, had been introduced with vigour and considerable consistency. The share of public spending in GDP was the lowest among all Central and East European countries and among the lowest in the EU. The *Smer* government had been committed to reintroducing more progressive elements in the personal income tax system but, at a time of rapid economic growth and rising living standards, did little to reverse those previous neo-liberal policies.

However, the Slovak government reacted to the economic crisis in a clearly Keynesian, and also social democratic, manner. As indicated in Table 3, it produced the largest rise in state spending in 2009 of any Central and East European country. This primarily reflected continuation of expenditure planned before under a budget based on the assumption of 4.6% growth in GDP. This included increases in public-sector pay, higher social spending and increased capital spending, all contrasting with the previous government's approach of reducing the role of the state and all to be financed out of continuing rapid economic growth. This outweighed the impact of a formal anti-crisis package which was nevertheless of some significance when set against those of neighbouring countries. Between November 2008 and February 2009 the government adopted 62 explicit anti-crisis measures, plus a series of further steps targeted at a number of levels and sectors, covering macroeconomic policy, the financial sector, the business environment and the labour market.

Slovakia went further than other countries in systematic formal consultation with representatives of particular interests, building from the established tripartite structure. An Economic Crisis Committee was established in January 2009 as an advisory body with responsibility for approving all anti-crisis measures. It brought together representatives of trade unions, employers' organisations, regions and municipalities, the central bank, the banking sector and ministers. The enormous number of measures approved reflected the number of interests represented and some measures were adopted explicitly after consultations with interest groups, such as the Motor Industry Association or the Slovak Banking Association.

There was an element of confusion as discussion of policies was rather informal and episodic. The prime minister, ministers or their advisors were pressing for speed, leading to a substantial amount of stress, confusion, political direction and improvisation. Indeed, as has been pointed out (Filadelfiová 2010, p. 52), anti-crisis measures were often copied from the concepts of other countries or the EU rather than being based on an analysis of local contexts. The government's approach to consultation meant that the 'economy' was understood rather narrowly. The perspectives of economic actors took centre stage and economic tools and employment measures were prioritised. The public sector and social services were not considered under the anti-crisis heading (Kusá & Gerbery 2009, p. 17).

In the field of macroeconomic policy, the stated rationale, in line with accepted Keynesian thinking and with the first pressures from the EU, was to raise aggregate demand, and thus consumption and production. Besides the passive anti-crisis policy of continuing with past plans for higher spending, the government also actively decided to provide liquidity to citizens and firms by various tax measures, including a higher basic tax allowance on personal income tax and higher employee tax credit, in effect a negative income tax. These changes were therefore very unusual for the time in that they increased the progressiveness of the tax system. This tax cut stimulus amounted to €455 million (approximately 0.7% of GDP).

There were also a number of measures benefiting particular sectors. A refundable aid package of €236 million (0.36% GDP) was provided to the railway companies and later reclassified as a non-refundable capital transfer. The registered capital of the Slovak Guarantee and Development Bank (SZRB) was increased by €32.4 million (0.05% GDP), and that of Eximbanka (Export–Import Bank) by €11.4 million (0.018% GDP). These additional sources were aimed at the development of small and medium-sized enterprises and at promoting their exports. Car producers enjoyed the €55 million (0.085% GDP) subsidy supporting the purchase of new cars conditioned by liquidation of old cars (the car-scrap scheme). Interest-free subsidies for house insulation, amounting to €71 million (0.11% GDP), were beneficial for the construction sector.

Given the relatively good shape of the financial sector, the Fico government did not need to intervene and spend any money on saving banks. However, the Bank Stabilisation Assistance Act adopted in June 2009 provided a legal basis for state aid to banks, should they be hit by the global crisis. Another preventive measure was adopted in November 2008, a Bank Deposit Protection Act. Another set of anti-crisis measures related to the business environment. They were intended to boost the competitiveness of companies, to support applied research and innovation, explicitly at the cost of basic research, and to target energy-related sectors. However, these measures were not allocated significant budgetary resources and had minimal impact.

Labour-market measures included a contribution to support the maintenance of employment, along the lines of the German *Kurzarbeit* scheme that could make little progress in the Czech Republic. This policy required a public subsidy for short-time working schemes. Employers who wanted to prevent or minimise layoffs, and were willing temporarily to limit companies' operating activities by reducing their employees' weekly working time by at least 4%, were eligible for this subsidy. Government documents were also presented supporting the creation and maintenance of social enterprises and raising the work commuting allowance as anti-crisis measures, although they were launched or planned before the crisis. Taken together, all the labour-market anti-crisis measures had approximately 126,000 beneficiaries, but accounted for only €52 million (or 0.08% of GDP) from the state budget and EU funds.

The difference in approach from that of Czech governments is clear. It was recognised from early on that there was a crisis and the government took steps to counter its effects. Other steps, such as short-time working and the car-scrap scheme, indicate the influence of business and employee interests. However, the actual impact of all these measures over the period 2009–2010 was rather small. Changes in GDP depended much more on continuity in past spending plans and on export performance, including the decline in 2009 and renewed growth in 2010. Indeed, not only were planned measures set to have a relatively small effect, but only about half of the promised resources were actually disbursed. Whereas the expenditures were planned on the level of €2.02 billion (3.14% of GDP), the real sum represented only €1.03 billion (1.6% of GDP).

A detailed breakdown also shows wide variations between measures (Lesay & Bujňáková 2011, p. 216). Implementation was effectively full for tax reductions, but much less reliable where non-state actors were expected to apply for support. Thus, implementation of planned expenditure was minimal in support for social enterprises, subsidies for employment and programmes aimed at improving energy efficiency. The car-scrap scheme was fully subscribed, but measures to help research, using subsidies and tax allowances, were grossly undersubscribed.

Parliamentary elections in June 2010 led to a right-wing coalition government. That did not imply electoral punishment for the social-democratic *Smer* party. The party won more votes than in the previous elections in 2006, but failure by its previous coalition allies meant that the right succeeded thanks to its ability to lead a viable coalition.

The newly formed government of Prime Minister Iveta Radičová openly resigned from anti-crisis policies. In a government report dated October 2010, it was claimed that anti-crisis measures 'had mostly a formal character and the impact of their implementation to mitigate the negative crisis impacts on the Slovak economy is questionable'. The text further reads that 'at the moment it is not necessary to prepare further measures to mitigate the impacts of the global economic crisis' (MHaV 2010, pp. 3, 5).

In many ways, the Radičová government acted in the opposite way to the government of Prime Minister Fico. The new administration was active in trying to balance the budget deficit and consolidate public finances, and was reluctant to promote deliberate stimulus policies. It has to be stated though that after the initial fiscal stimulus for the period 2009–2010, Social Democrats planned to launch fiscal consolidation in 2010, too. Pressure from the European Commission on this eurozone member arguably contributed to the commitment to fiscal consolidation. The budget deficit was clearly going well over the 3% limit already in 2009. This was judged to be acceptable by the European Commission in view of the economic crisis and of the fact that Slovakia had followed advice in adopting a stimulus package, but the recommendation was to eliminate the excessive deficit (i.e. above

3%) by 2013.[5] The Social Democrats responded by adopting a budget for 2010 aimed at eliminating the excessive deficit by 2012 (MFSR 2009). It is difficult to estimate to what extent things would have been different had *Smer* formed the government again.

Unlike its predecessor, the right-wing government did not enact any sector-specific anti-crisis measures. It was also relatively inactive towards the financial sector, partly because the banks did not need state aid, and partly because the deposit guarantee scheme enacted by the previous government was still effective. Somewhat surprisingly, however, the Radičová administration did introduce a bank levy, amounting to 0.4% of selected banks' liabilities, with an expected yearly contribution of €80 million, to go into a special reserve fund for handling a potential future banking crisis. Such a proposal was not raised during the Fico government, but when back in opposition *Smer* proposed a higher rate of 0.7%. The initial opposition of the Slovak right-wing Minister of Finance Ivan Mikloš to a bank levy probably changed due to pressing budgetary problems and to the influence of the EU.

However, much more than in introducing progressive measures, the Radičová government was active in further implementation of neo-liberal reforms. On the revenue side, the VAT rate increased from 19% to 20% and excise duties were also increased. On the expenditure side, two focal areas for cuts were core expenditures of the state and public-sector wages, leading to a contraction by almost 16% in 2011–2012 in real terms. A constitutional debt threshold for public finances at 60% of GDP, to be lowered gradually to 50% after 2017, was also enacted in 2011. It has to be stated that all the parliamentary parties, including Social Democrats, supported this proposal. The overall trend by the right-wing government was to cut expenditures to match the level of revenues, although the latter, measured as a share of GDP, were among the lowest in Europe. The anti-crisis measures introduced by Social Democrats in the labour market were set to be temporary, running only to the end of 2010. The right-wing government did not prolong their operation. It is obviously an open question whether the Social Democrats would have acted differently.

The Radičová government's policies inevitably generated opposition and hostility from part of the population. This came to the fore when, albeit for reasons not directly related to the economic crisis, her government fell and was forced into early elections in March 2012. This time *Smer* won a clear overall majority in parliament and Fico returned as prime minister. In view of past promises, his government could be expected to move back to social-democratic policies. In view of the tight budget situation, higher spending could not be achieved without some tax increases and that implies a re-emphasis on progressive taxation of personal incomes.

Hungary

Hungarian politics have not fitted easily into a left–right divide. The main parties from both of these sides competed in the past through promises of spending increases before elections and both shared responsibility for the continuing budget and current account deficits of the years up to 2008 (Ohnsorge-Szabó & Romhányi 2007). A number of policies which had the effect of stimulating domestic demand, including a mortgage subsidy for households, were introduced by the right-wing government in 2000. The Socialist Party (*Magyar Szocialista*

[5]An IMF mission reported on 19 July 2010 indicating that significant cuts would be needed to reduce the deficit to below 3% by 2013 (IMF 2010).

Párt) came to power after the 2002 election and accentuated the trend of unfunded spending increases, introducing a 13th-month pension[6] and continuing with public-sector wage increases (amounting to 37% in real terms in 2002 and 2003). This is the background to Hungary's high level of public spending relative to GDP and to its persistent current account deficits that made it more vulnerable than any other Central and East European country to the effects of the financial crisis.

The Socialists, re-elected in 2006, were obliged to pursue a policy of fiscal consolidation given the aim of joining the eurozone and the problems in financing debt. Approximately half of this was to be achieved by revenue increases, higher VAT in particular. Expenditure reductions were to include lower investment spending and reduced public-sector employment. There were no plans for cutting public-sector pay or pensions, although the extensive early retirement system was to be tightened. Thus, in contrast to other Central and East European countries, Hungary entered the crisis in a period of fiscal stabilisation and low growth while both the public and private sectors were heavily indebted and reliant on financing from abroad.

The Hungarian situation was specific also as far as the vulnerability of the financial sector was concerned. Banks had relied heavily on external financing. The drop in cross-border loans was unlikely to lead to liquidity problems for foreign-owned banks, but it put pressure on domestic banks that experienced difficulties in accessing funding and they had to rely on government support. Moreover, a large part of loans in Hungary were in foreign currencies. Devaluation made repayment more difficult for borrowers. The risk of a growing share of non-performing loans was an issue for all banks and all governments involved in crisis management, both left and right, were prepared to work with the banks on resolving this issue (OECD 2012, pp. 64–65).

The crisis hit the country directly in the early stages of the 'credit crunch'. The government bond market had already experienced problems in the first half of 2008, with several undersubscribed bond issuances. The collapse of Lehman Brothers led to a sell-off of government securities, a failed bond auction, and a sharp currency depreciation in early October 2008 leading the government to seek a stand-by arrangement with the IMF and the EU which was agreed on 28 October 2008 (IMF 2011). Conditions included limits on government deficits and the establishment of a Fiscal Council, an independent watchdog that was to ensure that the fiscal rules were followed and to evaluate the effects on the state budget of legislative changes.

Thus in this first period, and in contrast to other Central and East European countries, the Hungarian government was pursuing a pro-cyclical fiscal policy. The measures followed agreement with, and were formally approved by, the IMF, but the latter did not intervene in the policy process. This followed the resignation of Prime Minister Ferenc Gyurcsány, who lost credibility to pursue reforms in a series of political scandals that followed his confession to having lied in the run up to the 2006 elections.

The new, reconstructed government relied extensively on policy input from the Reform Alliance, an organisation consisting of representatives of all major Hungarian business associations, the president of the Hungarian Chamber of Commerce and Industry, and a number of economists. Its proposals were also supported by representatives from multinational companies. The new finance minister was an important Reform Alliance

[6]The pensioners thus received an additional monthly pension in a calendar year.

figure. Trade unions were formally consulted through a tripartite body where they expressed their disagreement with policies pursued, but they did not have a significant influence on policy.

In 2008, the reduction of expenditures had been achieved by not using reserves that had been built into the budget. The stand-by agreement with the IMF envisaged a general government deficit of 2.6% of GDP for 2009, implying a fiscal adjustment of about 2.5% of GDP, 2% more than envisaged earlier in 2008. The focus was on the expenditure side, including pay cuts for public-sector employees, equivalent to 1% of GDP, the elimination of the 13th monthly pension for early retirees and a cap on the 13th monthly pension for other pensioners, equivalent to 0.2% of GDP. The indexation of selected social benefits was to be postponed or eliminated (0.2% of GDP), and other spending was to suffer a general reduction (0.5% of GDP).

The budget for 2009 was consistent with the goals in the stand-by agreement, with the exception of a smaller cut in public-sector wages. With the 2009 recession larger than foreseen, the IMF was prepared to agree to a revised deficit target of 3.9% of GDP in May 2009, a figure that was, in practice, surpassed although, as indicated in Table 2, Hungary's deficit was by then relatively low by Central and East European standards. In 2009 and 2010 expenditures were reduced by the equivalent of 1.6% and 3.6% of GDP, respectively (NM 2011a). This included cuts in pensions, by various means, and cuts in various social benefits. Public-sector pay was frozen for 2010 and 2011 and cut through abolition of the 13th-month salary from 2009.

The reconstructed government also pursued a tax reform, presented as revenue neutral, that can be directly linked to Reform Alliance proposals, shifting taxation to consumption and cutting the burdens on business and high earners. In 2009, there was a minor reduction in the lowest bracket of personal income tax while VAT was increased from 20% to 25%, albeit with a preferential rate of 18% for food. In 2010, employers' insurance contributions were reduced by 5% and personal income tax was cut. A 3% increase in the corporation tax rate went in parallel with the cancellation of a 4% solidarity tax, a levy on most businesses and high-income individuals that had been introduced as a part of the 2006 package. Finally, a property tax was introduced.

There was also a package of anti-crisis measures to help the private sector suffering from funding problems, a fall in the value of the currency and the collapse in export demand. In contrast to the other Central and East European countries, measures relating to banking and finance were very prominent. Thus the government introduced a foreclosure moratorium for mortgage loans, about two-thirds of which were denominated in foreign currency, mostly Swiss francs. There was also a bank support package that had an important role in reducing funding pressures at three domestically-owned banks.

A number of measures were introduced to support non-financial enterprises, including credit guarantee programmes, direct lending through the development bank, interest subsidies and participation in venture companies to address the deteriorating credit market conditions. As in other countries, uptake was low (OECD 2010, p. 13). The employers, most notably the multinationals in the automobile industry as in other Central and East European countries, pressed for more employment flexibility to deal with the drop in demand. Negotiations involving trade unions led to a reduced-working-hours scheme allowing workers on a four-day schedule to receive 80% of pay for the fifth day, provided that they met a number of conditions, including the use of training. However, this, unlike the Germanstyle *Kurzarbeit* scheme, did not involve a state wage subsidy. Take up was low and the law remained little more than a gesture towards protecting employment places as employers were in a powerful enough position to adjust labour inputs through wage cuts and layoffs.

The situation was transformed after elections in May 2010 when the right-wing *Fidesz* party came to power, gaining a constitutional majority, meaning that it had the power to do as it liked. It took a firm approach on the country's international standing and, in July 2010, negotiations with the IMF and EU about future funding collapsed. The IMF was most concerned with a lack of 'commitment on the 2011 budget to preserve the … fiscal target of below 3 percent of GDP' and referred to a disagreement about taxation policies (IMF 2011, p. 23). The government cited disagreements about previous commitments based on a growth forecast that was 'too optimistic'.[7] It preferred to implement reforms without consulting the IMF or EU and to rely on market-based funding in the future.

Fidesz represented a conservative right that mobilised through a nationalistic and populist agenda. It had vehemently opposed spending cuts during its period in opposition and argued that a large reduction in the tax burden was needed to stimulate growth and employment. Its economic ideology incorporated some nationalist elements and there was rhetoric about overcoming the failure of standard, neo-classical economics, as apparently exposed by the world crisis. Nominally, then, this was a new approach to economic policy but, once the rhetoric is stripped away, much actually fitted with the neo-liberal thinking the government claimed not to accept. Indeed, elements that appeared novel were largely unsustainable or far less effective than the government claimed. The dominant features were therefore to remain a shift towards a less progressive tax system, cuts in redistributive state spending, most notably on the unemployed, and attacks on employee and union rights.

Tax reforms implemented from mid-2010 included a 'flat tax' on personal income,[8] and other tax reductions, most notably for SMEs, resulting in revenue loss estimated at around 1.8% of GDP (EC 2011). Revenue increases were achieved through a temporary bank levy and one-off 'crisis taxes' on energy, retail and telecommunications companies. That played on nationalist rhetoric as these were sectors controlled primarily by multinational corporations. These measures raised revenue of 0.7% and 1.3% of GDP, respectively (EC 2011; OECD 2012). Importantly, the private pension pillar was effectively nationalised, switching the budget balance into the sizeable surplus shown in Table 2, due to the one-off transfer amounting to 10% of GDP. *Fidesz* traditionally opposed pension privatisation, but the decision, similar to that made in Poland, reflected a realisation of its high costs and a negative evaluation of the performance of private funds that was widely shared across the spectrum (Drahokoupil & Domonkos 2012).

The new government showed no interest in wider social consultation. It reduced external control over its own activities and it severely constrained policies of future governments through constitutional changes. In 2010, it effectively abolished institutionalised social dialogue by replacing the tripartite National Interest Reconciliation Council (*Országos Érdekegyeztető Tanács*, OÉT) with the much more symbolic National Economic and Social

[7]Comments on the stand-by arrangement programme submitted to the IMF by the Hungarian Ministry for National Economy, the Central Bank and the Hungarian Financial Supervisory Authority (IMF 2011, pp. 37–38).

[8]A so-called 'flat tax' on the personal income implied a real rate of 20.3% for those on the average wage, a level comparable with that in Slovakia and the Czech Republic (Myant & Drahokoupil 2011, p. 180). It included a substantial allowance for families with children and the latter, together with the high-income earners, therefore benefited. In contrast, lower-income workers without children could lose almost 10% of their net income (Szabó 2013).

Council (*Nemzeti Gazdasági és Társadalmi Tanács*, NGTT). The latter was an advisory body with no government representatives and incorporating various civil society organisations, such as churches, universities and consumer protection groups (Szabó 2013). In late 2010, the government downgraded the Fiscal Council, removing its staff and replacing independent economists elected by parliament by the central bank governor, the head of the State Audit Office—both government appointees—and an economist to be appointed by the president. However, the new constitution, approved in 2011, gave the Council the power to veto fiscal laws, meaning that, at least nominally, it had the power to bring down the government. The new constitution, taking effect from 2012, also stipulated that public debt be capped at 50% of GDP, albeit at some unspecified point in the future. A debt rule, adopted in December 2011, taking effect from 2016, stipulated that until that level of debt-to-GDP ratio is reached, the public debt can increase only by expected inflation minus half of expected real GDP growth.

Fiscal consolidation was set out in a plan of structural reforms for 2011–2015 introduced in March 2011 and to come into effect from January 2012. It was given the nationally inspiring title of the Széll Kálmán Plan, after the fiscally prudent prime minister of 1899–1903. The programme aimed at keeping deficits below 3% of GDP, thereby reducing indebtedness from 80% to 65% of GDP by 2015. About three-quarters of this consolidation was to come from expenditure cuts, equivalent to 1.8% of GDP in 2012 and 2.8% in 2013. The major focus was savings in employment and labour-market policy, advertised as pushing people into the labour market (estimated at 0.7% GDP/year). The measures included reducing support in unemployment, disability pensions and sick pay. Disability pension eligibility cuts and early retirement revision were intended to save 0.4% of GDP per annum. The plan also included a reform of drug subsidies, stimulating price competition and favouring generics (0.4% of GDP), and savings in public administration (0.4% of GDP).

There were some implementation delays in 2011. More seriously, the spending side of the plan was not clearly specified, as exemplified by the vague estimates of savings and promises of efficiency savings in the public sector. Moreover, many of the measures, such as the freeze in public-sector wages and cuts in benefits, could not fail to arouse political opposition. June 2011 saw large demonstrations against the scrapping of early retirement benefits. In September 2011, the government confirmed its commitment to follow the deficit targets in the Kálmán Széll plan even after a downward revision of the growth outlook. The deteriorating growth prospects led to the adoption of additional fiscal measures on the revenue side: there was an increase in employer's social security contributions and various excise taxes. Moreover, VAT was increased to 27%, the highest level in the EU.[9] On the spending side, there was a 2.5% reduction in public-sector employment in 2011, excluding public employment schemes.

In the labour market, the new labour code undermined employee rights and allowed for flexibilisation of employment relations (Szabó 2013). The government also pursued reforms and policies ostensibly aimed at increasing labour-market participation. These included mainly punitive measures with little economic rationality, most notably the public employment schemes (OECD 2012, pp. 87–118).[10] They seemed driven by a populist

[9]By 2011, the government expected the contribution of expenditure-side adjustment to 2012 consolidation to drop below 60% (NM 2011b).

[10]Subsidised public-sector employment programmes are widely considered to be the least effective form of active labour-market policies (Card *et al.* 2010). Public-works scheme experiments in the past had failed to improve the employability of participants and to provide a foothold in the open labour market (Fleck & Messing 2010; Budapest Institute 2011).

agenda, rewarding those in low-paid jobs by increasing wages at the bottom of the labour market while punishing the unemployed. Public employment schemes had been launched in early 2009 to bring down long-term unemployment. The *Fidesz* government introduced a new public employment scheme, managed by the Ministry of the Interior. Aimed also at the long-term unemployed, the schemes provided higher income than social assistance but lower than the minimum wage. More than 100,000 were enrolled in 2009 and 2010 and 220,000 people—100,000 full-time equivalents—participated in 2011. At the same time, the duration of unemployment benefits was cut from 270 days to only 90 days and capped at the level of the minimum wage. Moreover, an additional job-search benefit, previously available for 90 days, was abolished in 2011, except for workers close to retirement. The government also attempted to raise the lowest wages—compensating low-income workers for the possible losses from the new tax regime—and increased the minimum wage in 2012 by 19%. Public institutions received subsidies to finance the increases. Firms that did not implement the low-wage increases were to be excluded from public procurement, but this sanction mechanism was not in use by 2012. Many employers, particularly in the private sector, thus did not implement any compensatory wage increases at all (Szabó 2013).

The austerity course, combined with large one-off revenue boosts, stabilised the budget in the mid-term, but a downgrading of the sovereign rating to non-investment grade—first by Moody's on 25 November 2011 followed by other major agencies in December 2011 and January 2012—precipitated the failure of several debt auctions. The government thus went back to the IMF and the EU to request financial assistance from the end of 2011.[11]

Conclusion

The initial impact of the crisis, measurable by the fall in GDP in 2009, can be broadly explained by factors external to the four countries considered here. However, the crisis did not end with the recovery in exports from their low point in early 2009. It continued to dominate economic performance in the following years and differences between countries became less explicable in terms of external economic shocks. Domestic policy making became a more important determinant and the policies chosen differed between countries and over time.

Thinking was not very imaginative. In no case was there an attempt to rethink the basis of past strategies, for example by trying to switch to a 'knowledge-based economy', relying more on innovation, research and higher education. Controversies and choices centred rather on a limited range of themes that fit quite well into a social-democrat as opposed to a neo-liberal framework. Increasingly, the state budget became the key arena and the key conflict was over the priority to be ascribed to, and the distributional consequences of, reducing deficits. The choices depended primarily on internal politics—the ideologies of ruling parties, the interests they listened to and their ability to weather public opposition and win elections—but external pressures also played a role. This was clearest in the case of Hungary, reflecting that country's sorry financial position, but even there a government could try to defy the demands of the IMF and EU. In other cases external pressures were less direct and played a role essentially by giving greater backing and political credibility to political forces favouring austerity.

[11]No agreement was concluded by November 2012, but further discussions were anticipated for early 2013.

One effect of economic crisis was to increase political volatility, with some dramatic changes in parties' electoral fortunes. However, that was not the case everywhere—Poland stands out as an exception—and, when detailed policies are examined, there are striking similarities in the ideas that came forward in all countries. In all cases there were cuts in benefits for marginal groups in society and a switch towards indirect rather than direct taxes: these carry clear distributional implications. The unemployed were penalised with varying degrees of determination and business was typically given help through reduced taxes. Again, the distributional implications would appear to be that support was given to those already on higher incomes. Differences include varying levels of support for a demand stimulus, maintained the longest in Poland through infrastructure spending, and for a private pension scheme. This is an important difference as it represented an additional cost to the state budget. It was pursued most enthusiastically in the Czech Republic, the one country yet to introduce such a scheme, even at the cost of increasing the budget deficit. The implication is that an ideologically driven quest for a small state and bigger role for private enterprise could take priority over the quest for a balanced budget.

Thus the link from economic difficulties to these economic policy changes is not direct. To some extent politicians were using the crisis as a pretext for pursuing polices they had always wanted to impose. Nevertheless, the fact of rising budget deficits at a time of low growth forced governments into choices with clear distributional implications and these led in some countries to powerful social protests. It can therefore be hypothesised that the crisis is reasserting the distinction between left and right as a central dividing line in Central and East European politics. We conclude with the question of which 'side' will prove the more influential in a constantly changing political scene. There are differences in timing and in severity, but every country has opted for balancing the budget by cuts at some point. The legacy of the crisis so far looks like being a move towards a smaller state and more unequal society.

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