The end of „buying time“? Capitalism and democracy in East Central Europe before and after the financial crisis*

Dorothee Bohle

1. Introduction

Two decades after the quest of East Central European societies[1] to establish capitalism and democracy on the ruins of communism, democracy has come under attack. In Hungary, a country long considered one of the East European success stories; an increasingly authoritarian regime is taking roots. Other countries have seen their democracies becoming hollow. While these trends towards backsliding and hollowing of democracies in East Central Europe are not new, they have intensified since the outbreak of the Great Recession.[2]

The coincidence of deep economic crises and democratic malaise reopens an old debate, namely that of the compatibility of capitalism with democracy. This had been an important discussion after the breakdown of communism, when a number of scholars have forcefully made the case for the incompatibility of the simultaneous economic and political transformations.[3] These authors argued that while the agendas of creating capitalist market economies and democratic societies were inextricably linked, they were also mutually contradictory. Creating a market society was a political project, which required popular legitimacy in order to succeed. The social dislocation marketization inevitably brings about, would however lead dissatisfied voters use their newly gained democratic rights to obstruct further reforms. In addition, many countries in the region had to cope with another challenge, namely state-building. Most East-Central European countries thus had to traverse three stages of a process which in Western Europe “were mastered over a centuries-long sequence”“.[4] There was a real dan-

* This paper is based on a presentation I gave at the conference of Young Economists, October 12-13, 2017 in Vienna; the Central European University’s “Rethinking Open Societies” Lecture Series in January 2017; and the “Understanding the New Europe” Seminar Series at the Johns Hopkin’s School of Advanced International Studies (SAIS) Bologna, April 27, 2017. A short earlier version of the presentation has been published in: Ignatieff, Michael; Roch, Stefan (eds.), Rethinking Open Society (Budapest 2018). I thank all participants and especially Stefan Roch for helpful comments.

ger, therefore, that the double or triple transformation would either result in economic backsliding to "third ways" between socialism and capitalism, or give rise to authoritarian temptations and upsurges of nationalism and xenophobia.

In this account, it is however unclear, why capitalist democracies could be successfully established in a number of East Central Europe despite deep transformational crises, and why democracy has come under stronger attack after 2009. In order to understand the puzzling trajectories of East Central European capitalist democracies since the breakdown of communism, I will draw on a recent account by Wolfgang Streeck (2014), made for a different context, namely that of advanced capitalist countries. Streeck argues that it was only under the exceptional circumstances of the post- World War II period that the tensions between the market logic with its relentless pursuit of profit and private gains and the collective logic of democracy with its concern for safety and security of citizens could be reconciled. This was because markets were tamed through wide-spread regulations, and democratic polities were including citizens not only as voters but also as producers in corporatist settings. Since the crisis of this model in the 1970s, politicians have however mostly been "buying time". States took up public debt to finance increasing popular demands for welfare services, or enabled citizens to take up private debt, this way allowing them to consume more than their meagre wages would allow. The recent global financial crisis has put an end to this, and it is in this context that nationalism, authoritarianism, and hollowing of democracy has emerged.

My paper explores whether Streeck's arguments travels to East Central Europe. More specifically, I am interested in two questions. First, how could capitalist democracies have been relatively stable in the region despite the tensions that they inevitably faced in the first two decades of the transformation? Second, is there a relationship between the specific form of the 2008 crisis as a debt crisis that can account for the democratic backsliding and hollowing in some of the region? I will argue that while governments in East Central Europe have been successfully "buying time" through welfare states and identity politics, the 2008 crisis has put conflicts between debtors and creditors to a center stage. It is these conflicts that are conducive to an authoritarian-nationalist backlash or hollowing of democracies.

The paper proceeds as follows. The next section briefly summarizes Streeck's argument about crises and time-buying in capitalist democracies. Section 3 and 4 show how these arguments travel to Europe's East. Section 5 hones in on the 2008 crisis. With the examples of Hungary and Latvia, the two countries hardest hit by the crisis, it analyses the role that conflictual creditor-debtor relations had in putting democracy under strain. The final section concludes.

2. Buying time: A series of crises of capitalist democracies

In his 2014 book, Streeck argues that ever since the crisis of Fordism, policy makers in capitalist democracies have been postponing social conflicts in the future and "buying time" through extending credit markets. Each of the solutions policy makers found were however only temporary solving fundamental conflicts, resulting in a sequence of crises. Streeck also sees a sequential displacement of the arena in which social conflicts play out.

Thus, during Fordism, the major location of conflict in capitalist societies was located in labor markets, pitting capital against labor. When the crisis of Fordism hit, the conflict was smoothened through inflation. Labour could still get wage hikes at the expense of asset owners and capitalists. The conflict around inflation was fought in the labor markets, through democratic corporatism, and in the electoral arena.

During the 1980s, the neoliberal "counterrevolution" led to a decline of organized interest representation, and distributional struggles were now increasingly fought in the electoral arena. At the same time, capital started to exert pressure on states to decrease taxes. This background prompted governments to take on public debt to finance large welfare states. Thus the "debt state" was born. In political terms, neoliberalism and the resulting debt state was pushed through mostly by conservative and/or market radical forces.

Public debt however came under increasing scrutiny from the late 1990s onwards, ushering in a first round of consolidation. It is around this time that non-majoritarian institutions such as independent central banks and fiscal rules started to bite, leaving little room for public policies. A significant increase in private debt occurred in this context, a process that Colin Crouch (2009, p. 390) calls the rise of "privatized Keynesianism": "Instead of governments taking on debt to stimulate the economy, individuals did so. In addition to the housing market there was an extraordinary growth in opportunities for bank loans and credit cards." The rise of privatized Keynesianism especially in Anglo-Saxon countries allowed to compensate for stagnating wages and welfare state retrenchment. Citizens this way turned into debtors, homeowners and consumers, and as long as credit was ample, their interests were aligned with those of their creditors. Interestingly, privatized Keynesianism and "financial inclusion" was often endorsed by third way social democratic forces.

The Global Financial Crisis has put an end to this, at least temporarily. Credit market turmoil translated into banking crises, and states amassed new debt when coming to the rescue of their troubled banks. After 2008, a new chapter in the consolidation of public debt was opened, leading to harsh distributional conflicts between private and public creditors and citizens. In Europe, this conflict is being played out at two levels. In national politics, indebted governments have to restore creditors' confidence, while keeping up their citizens' rights. On the European level, international financial diplomacy has installed a system of tight surveillance that ties governments' hands in order to make sure that financial investors are being protected against financial losses. The result is austerity capitalism, and a deep democratic malaise. Table 1 below summarizes Streeck's argument.

Table 1: A series of crises of democratic capitalism

Type of capitalism	Institutional location of tensions	Postponing the crisis between capitalism and democracy ("buying time")	Political formula
Fordism	Labor market (capital vs labor)	Inflation	Democratic corporatism
Neoliberalism	Electoral arena (capital vs voters)	Public Debt	Conservative-market radical
Privatized Keynesianism	Financial markets (alignment of interests of asset owners vs indebted consumers)	Private Debt	3rd way Social Democracy
Austerity capitalism	Within and between states, and between states and markets (creditors vs debtors)		International Financial Diplomacy National Technocracy or Populist-authoritarian backlash

Source: own elaboration based on Streeck (2014).

3. Buying time in Europe's East: from welfarist and nationalist social contracts …

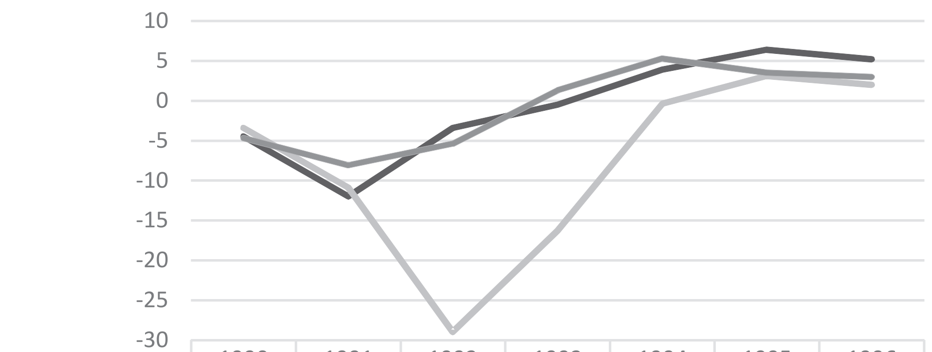
Does Streeck's argument travel east? I submit that we can see similar patterns of capitalist transformations, labor weakening, public debt and private debt, and debt crises in this region as well. This section explores the patterns of time-buying during the 1990s.

As well known, East-Central Europe all had major transformational recessions after the breakdown of state socialism. Figure 1 shows the depth of the crises of the early 1990s.

This was the context in which a number of authors pointed to the difficulties of creating capitalist democracies in the East, and expected authoritarian break-downs.[5] However, the early breakdown theories did not come true, despite the remarkably deep crises. Most countries in the region developed relatively stable democracies and market economies simultaneously. There are two factors that can account for this.

First, similarly to what Streeck argued for the Western democracies since the 1980s, democracies in the East quickly became hollow. Organized labor weakened dramatically. As figure 2 shows, trade union density dropped sharply. In the Baltic States, trade unions became soon

Figure 1: GDP growth/capita 1990-1996

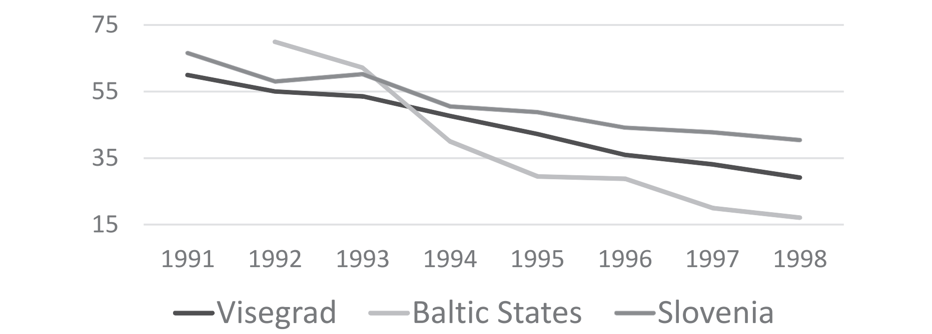


	1990	1991	1992	1993	1994	1995	1996
Visegrad 4	-4,5	-12	-3,4	-0,5	3,9	6,4	5,2
Baltic-3	-3,4	-10,9	-29	-16,3	-0,4	3,1	2
Slovenia	-4,7	-8,1	-5,4	1,3	5,3	3,5	3

Source: EBRD Transition Report.

marginalized. This looked somewhat differently in the Visegrád countries, where during the 1990s trade unions still exhibited some strength. Initially, these countries also had their corporatist moments, which gave trade unions some influence over policy-making. However, corporatism was not strongly institutionalized, and often did little to foster the interests of labor.[6] This distinguishes the Viségrad countries from Slovenia, the only country in the region where democratic corporatism was firmly institutionalized during the 1990s.[7] Labor was also very quiescent during the first decade of the transformation.

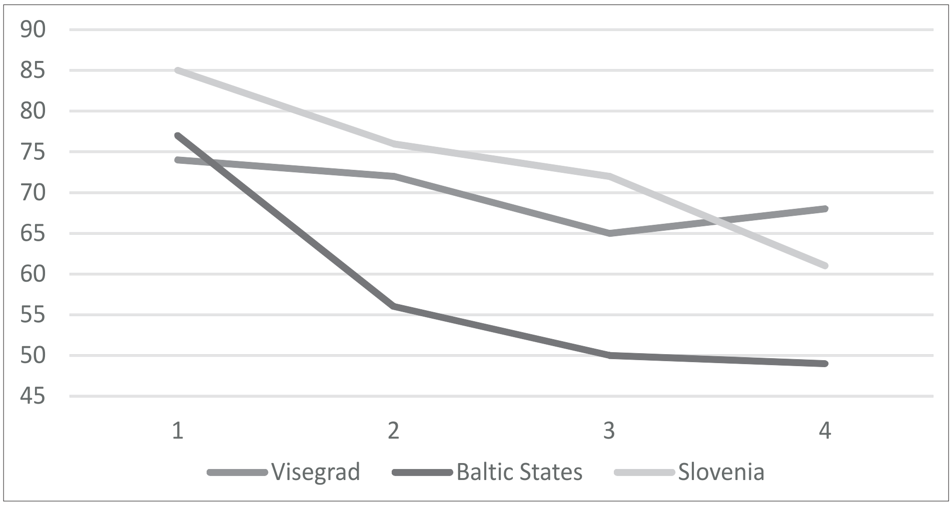
Figure 2: Trade union density 1991-1998



Source: J. Visser, ICTWSS Data base. Version 5.1. Amsterdam: Amsterdam Institute for Advanced Labour Studies (AIAS), University of Amsterdam (September 2016).

A similar trend towards hollow democracies is also visible in voter turnout (figure 3). Once again the decline is most dramatic in the Baltic States. This is because after independence, two Baltic countries, Estonia and Latvia, did not grant citizenship rights to their sizeable Russian speaking minorities. As a consequence, around 30 percent of their resident population did not have a voice in the new democratic polity. But the other countries of the region also registered a decreasing turnout in election. As Greskovits (1998) argues, both organized labor and voters used "exit" rather than "voice" in the first decade of transformation. This allowed the emergence of a "low-level equilibrium" between a hollow democracy and imperfect market economy.

Figure 3: voter turnout (1990s, turnout as percentage of resident population)



Source: http://www.idea.int/advanced-search?th=Voter%20Turnout%20Database.
The numbers on the x axis should be read as 1st (2nd, 3rd, 4th) free election.

But societal demobilization or exit from politics is not the full explanation of the survival of capitalist democracies in the first decade of transition. As I have argued elsewhere,[8] leaders in different parts of the region have offered their populations different forms of compensation for the losses of transformation. In the Visegrád countries and Slovenia a "welfarist social contract" has emerged. Much more than in the Baltic countries, reformers in these countries built on existing welfare state legacies, and offered compensation from above selectively for strategically important social groups. In particular, the better-educated and potentially more vocal social groups were pacified with generous early retirement and disability pensions for their job losses. In contrast, younger workers who were made redundant had to cope with much more meagre unemployment benefits instead. Vanhuysse (2006) calls this a strategy of “divide and pacify”, and sees this at the origin of an “abnormal pensioners boom” in these countries.

In the Baltic States, socialist legacies, including the welfare states were dismantled much more radically than in Slovenia or the Visegrád countries. Here, reformers’ first and foremost priority was to cement their independence from Russia, and they achieved this through ultraliberal market reforms and a firm commitment to Western integration.[9] The Baltic reformers did not have much fiscal room of manoeuvre, and they also had less issues breaking with the previous social contract. This is clearly illustrated in a statement by a Latvian Minister of Welfare, who addressed pensioners in the early 1990s in the following way: “you do not need big pensions, because you worked under the Communist regime, and your work accomplished nothing”.[10] It did help matters that the Russian speaking population was harder hit by the meagre pensions than ethnic Latvians, who were more likely to live in the countryside and thus have access to additional resources (ibid).

Instead through social welfare, ethnic Balts were compensated for the hardship of the transformation through identity politics. The newly independent states were “nationalizing states”, that is, states that are “of and for a particular ethnocultural ‘core nation’ whose language, demographic position, economic welfare and political hegemony must be protected and promoted by the state”.[11] This gave ethnic Balts a sense of belonging, and advantageous political and economic standing in comparison to their Russian speaking fellow residents. The nationalizing states also offered more opportunities in the public sector for ethnic Balts.[12]

Table 2: Pensions in East Central Europe, late 1980s and early 1990s

	Pension recipients as percent of population		Average pension-wage ratio		Real average pension (1987 = 100)	Total real pension spending (1987 = 100)
	87-88	92-93	87-88	92-93	92-93	92-93
Estonia	22.2	24.0	39.0	42.0	50.0	42.0
Latvia	21.9	25.2	39.0	34.0	57.0	74.0
Lithuania	22.0	23.9	35.0	29.0	61.0	52.0
Baltic Average	**22.0**	**24.4**	**38.0**	**35.0**	**56.0**	**56.0**
Czech Republic	27.8	29.4	56.0	49.0	72.0	85.0
Hungary	22.7	27.4	59.0	62.0	84.0	93.0
Poland	17.4	22.4	48.0	64.0	103.0	147.0
Slovak Republic	22.5	25.3	44.0	43.0	76.0	89.0
Visegrad average	**22.6**	**26.1**	**51.8**	**54.5**	**83.8**	**103.5**
Slovenia	**23.8**	**29.8**	**54.0**	**58.0**	**80.0**	**90.0**

Source: Milanovic (1995) 32, based on World Bank Data.

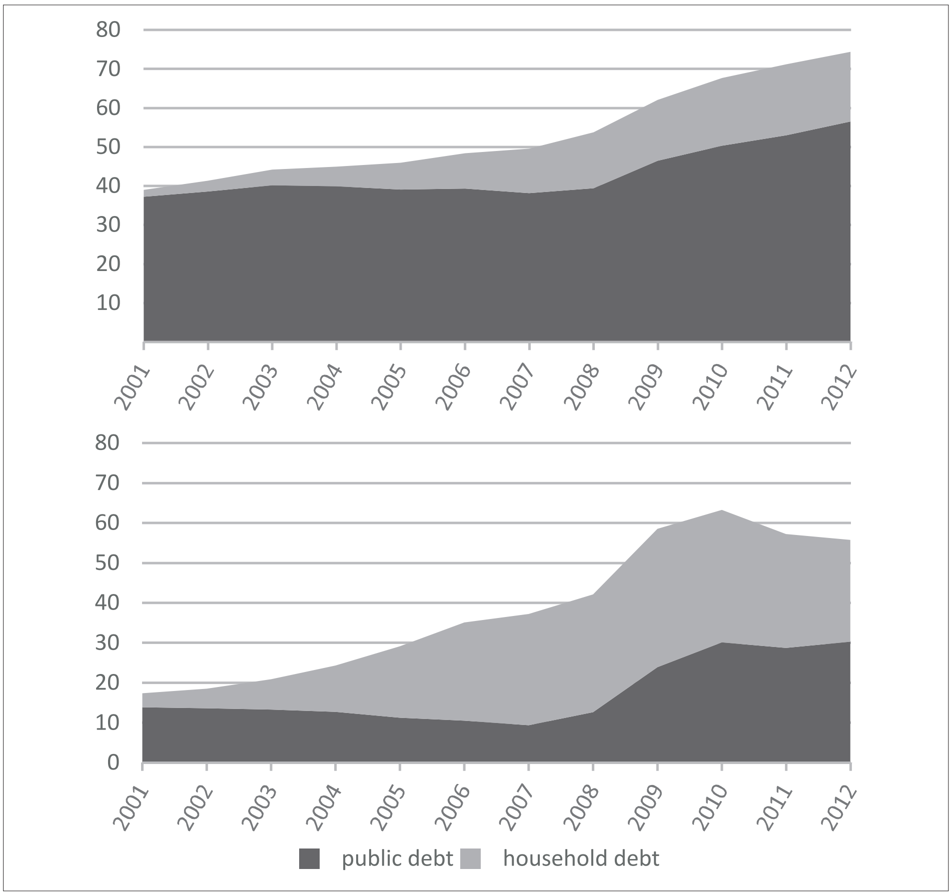
Table 2 above gives an overview over the pensions in the Baltic States and the Visegrád countries during the first years of the transformation. It clearly shows the Baltic exception in terms of their ungenerous pension systems.

4. … to increasing indebtedness

The initial social contracts started to come under strain towards the end of the first decade after transition. In the Viségrad countries, it was the issue of public debt that proved to be the Achilles heel of the welfarist social contracts. In the words of Martin Rhodes (2002, p. 309): "If you want to have a large and sustainable welfare state, you have to be able to pay for it". Low employment rates, an important share of the informal economy and rampant tax evasion made it difficult to finance the welfarist social contract, and the Asian and Russian crisis of 1998 put additional burden on these countries' economies. At various times during the 1990s and early 2000s, the Visegrád countries' social security systems had been at the verge of bankruptcy, and their state budgets were the most imbalanced among the East Central European countries. Attempts at austerity however backfired politically.[13] Arguably, the most extreme example is that of Hungary. Here, as early as 1995, an austerity package was imposed that proved to be hugely unpopular.[14] Ever since, governments increasingly outbid each other in offering financially unsustainable welfare packages, tax exemptions and subsidies to the population. The politics of outbidding was greatly enhanced by the polarization of the party system, and a very real "fear of political annihilation by the other side".[15] Under the socialist-led 2002-2006 government, public finances started to seriously derail. The government postponed necessary adjustment measures, and later attempts at imposing austerity encountered massive resistance. In this situation, the Hungarian government increasingly relied on privatized Keynesianism. Specifically, it delegated to private – and mostly foreign owned – banks the development of mortgage finance. Banks lent generously, and many Hungarian citizens took out mortgage and other consumer loans in Swiss Franc rather than Hungarian Forint, as this significantly reduced interest rates. The government or regulators did nothing to reign in the risky lending practices.[16]

Figure 4 below shows the development of public and private debt in the Visegrád countries and the Baltic States. In the Visegrád countries, there is a tendency towards a decrease of public debt and an increase of private debt as a share of GDP during the 2000s. This pattern is indeed reminiscent of that of the advanced capitalist countries. The Baltic States show the same pattern, but with a very different composition of the debt. Here, the share of public debt in GDP had always been very small, and decreased significantly during the 2000s. At the same time, however, private debt increased at neck breaking speed (figure 4).

Figure 4: Public and household debt in East Central Europe (% of GDP)

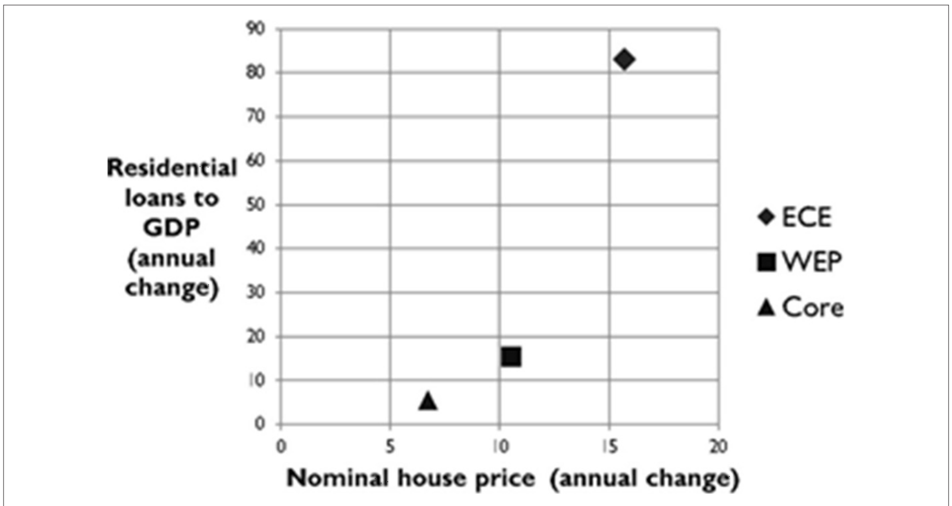


Source: public debt Eurostat, household debt European Mortgage Foundation.

The Baltic pattern is noticeable, because Baltic policy makers had to confront the return of the social question, and managed to do so without increasing their public debt share. While initially politicians could rely on the mobilizing potential of national identity as well as the demobilizing impact of minorities' social and political exclusion, and even put their welfare states in the service of nation-building and nationalizing projects, identity politics lost some of its appeal over the 1990s. At the same time, the social dislocations created by radical reforms and meager welfare states – widespread poverty, high unemployment, high and increasing inequality – increased the potential for social tensions. Although exclusion had an ethnic dimension to it, it did crisscross ethnic lines.[17] In this context, privatized Keynesianism was the way out. Similarly to countries like Ireland or Spain, the Baltic States achieved remarkable growth rates during the 2000s, which were almost entirely based on mortgage lending, construction and housing. Rapid growth also drove up wages. In the Baltic States, it were Scandinavian–owned banks that unleashed mortgage lending boom. They mostly issued mortgage loans in euros rather than in local currencies.[18]

It is interesting to note that the mortgage and housing booms in East-Central Europe outpaced those of advanced capitalist countries. Figure 5 compares the annual change in residential loans to GDP and of nominal house prices in three group of countries. East Central Europe (ECE), the Western European periphery (WEP) advanced capitalist countries (Core).[19] It shows that East-Central Europe had the highest increase in both.

Figure 5: House price and mortgage lending (2002-2006)



Source: Bohle (2018a) 199, based on data from Egert and Mihalik (2007) and the European Mortgage foundation.

The rapid increase of debt made the East-Central European countries particularly vulnerable to the crisis of 2008, and it is no small wonder that a number of countries turned into the first hotspots of the crisis. The next section looks at the political repercussions of the debt crisis in two countries that were hardest hit, namely Hungary and Latvia.

5. The debt crisis and democracy in Hungary and Latvia[20]

Above, I have argued and empirically shown that similar to advanced capitalist democracies, rising debt also played a major role in reconciling capitalism and democracy in East Central Europe. It is therefore no big surprise, that after 2008, conflicts between creditors and debtors as well as the issue of reigning in public or private debt took center stage. This has important implications. If debt has allowed to "buy time", then the crisis can turn out to be a severe challenge for democracy. This is for three reasons. First, the "social lubricant"[21] of credit is in short supply. Second, the hierarchical nature of creditor-debtor relationships severely constrains debtor governments' ability to heed to the preferences of its electorate. As Mair (2011, p. 7) puts it, the austerity imposed by the EU institutions and the IMF equals "government against the people". Third, the debtor-creditor relation is a potentially explosive relation combining morality, identity and distributional struggles.[22] This makes the relation prone to nationalist mobilization and democratic backsliding. Below, I will show how these challenges have played out in two East European countries, Hungary and Latvia.

5.1 Debt, nationalist mobilization and democratic backsliding in Hungary

In their book "European populism in the shadow of the Great Recession" Hanspeter Kriesi and Takis Pappas (2015, p. 8) argue that "[t]he fact the Great Recession manifested itself mainly as a souvereign debt crisis actually provides … populists with a golden (discursive) opportunity to reframe economic conflicts in nationalist terms. Typically, the elites attacked by populists are domestic elites, but given that the sovereign debt crisis has led to a conflict between 'debtor' and 'creditor' countries … the elites that come to be the object of populist attacks may also be supranational elites (e.g. the 'Troika') and/or elites from other nation states." This is exactly what happened in Hungary under the Orbán administration since 2010.

Hungary was the first European country that had to turn to the IMF and EU for a bailout in November 2008. Its banking sector faced a liquidity crisis resulting from the turmoil in the foreign currency swap market.[23] In addition, Hungary had also accumulated massive public debt. In 2008, public debt stood at 71%, and in 2010 at almost 80% of GDP.[24] In November 2008, the IMF approved a 12.5 billion € loan.[25] The IMF-supported economic program had two key objectives: fiscal consolidation and the stabilization of the financial sector. The crisis and austerity destabilized the incumbent socialist government, and swept the right-wing nationalist Fidesz party under Prime Minister Viktor Orbán to power. It became a most central concern for the government to liberate the country from financial dependency on the West, and restore its national sovereignty. While Hungary's crisis was not as severe as that of some of the Eurozone countries or Latvia, two factors prompted the government to put the issue of debt at the center of its economic policies. First, it was elected on an anti-austerity platform and found it hard to reconcile campaign promises with continuous IMF and EU conditionality. Second, the Greek debt spiral and conflicts over bailout conditionality served as a warning of the humiliations that might be in store for heavily indebted countries.

Indeed, the comparison with Greece loomed large in the Hungarian debt discourse. Shortly after coming to power in 2010, a number of Fidesz politicians warned that the Hungarian economy was in a very grave situation, and in danger of suffering a Greek style crisis.[26] The comparison with Greece became a constant in the discourse on debt. For instance, in his 2012 State of the State Address, Prime Minister Orbán declared that had the government not taken action to reduce public debt, Hungary would have "'permanently lost its independence' just as Greece and that 'instead the people's will, creditors would be ruling in place of us'"[27]. Still in 2017, in a speech in front of the European Parliament, a combative Prime Minister reminded the MPs: "In 2008 we started from a point where Greece was. The government of Hungary at the time was the first to turn to the Monetary Fund and the EU for a loan. Since then, we have fully repaid this money, ahead of maturity … We have a number of problems to solve but we have reasons to be proud. I am convinced that the success of Hungary is also a European success, and the EU is in great need of success stories nowadays."[28]

The Orbán administration framed the issue of debt as a relation that enslaves the Hungarian people and robs it of its sovereignty and dignity. In his State of the Union Address of 2011, Orbán declared "war on government debt".[29] For him, debt was not an economic problem, but an enemy to be defeated. Later that year, to justify the nationalization of private pension funds that were used to pay down the public debt, he compared the situation of living in debt to that of the Soviet Occupation. Orbán argued that there were two ways to subjugate a nation: the sword or debt. The government also ordered a detailed investigation in the origin of public and private debt to find those responsible.

A central element of Orbán's debt strategy was the symbolic display of economic sovereignty. A case in point is the government's conflictual relation with the IMF, which was played out in diplomatic backrooms as much as in the public space. While the backroom talks were about the needs for structural adjustment and the benefits and drawbacks of Hungary's "unorthodox" economic policies, the public face of the conflict was all about resistance, respect, independence, and social justice.[30] In October 2012, the government started a big advertisement campaign that appeared in national newspapers and on billboards which displayed slogans like: “We will not give in to the IMF!” The IMF was also accused of impoverishing Hungarian pensioners and families. The highly symbolic conflict with the IMF culminated in the government’s decision to pay back its IMF loans early and close its Budapest office in August 2013.[31]

Next to fighting against public debt and the IMF (and to a lesser degree the EU), the foreign-owned banks and their irresponsible lending behaviour earned the government’s wrath. Foreign banks were an easy target, as they had engaged in risky Swiss Franc lending before the crisis, and had shifted the associated risks on their unsuspecting clients. With the crisis, indebted homeowners saw a massive increase of their debt burden, as the Hungarian forint lost about 60% of its value vis-à-vis the Swiss Franc. Against this background, in autumn 2011 Orbán proclaimed war against “debt slavery”.[32] The government levied special taxes on the banks, tried to impose a financial transaction task and forced banks to take over some of the costs of converting the Swiss Franc loans into Hungarian Forints.[33] These policies were framed in terms of defending the national interests and the people against the foreign banks. Thus in 2013, at the opening day of the fall session of Parliament, Orbán told: “The banks … must get used to the new situation. Now we are the stronger ones and they must adapt to the Hungarian people. Nobody is going to gain extra profit at the expense of the Hungarian people ever again. The era of colonization is over.”[34]

The discourse of the debt crisis was woven into a much broader effort at re-defining the historical memory of Hungary. In this endeavour, Fidesz politicians present themselves “as the primary champion[s] of Hungarian national sovereignty”.[35] In their narrative, Hungary is “portrayed as a nation that has long suffered from the yoke of external oppression in which the Ottomans, the Habsburgs, the Soviets and eventually the Europeans figure as the enemies of the Hungarians”.[36] With its strong focus on national sovereignty, Fidesz aims to create a sense of pride and belonging, while simultaneously attempting at purging all traces of the left and of a pluralistic and multi-ethnic Hungarian society from memory. The debt crisis reinforced this project as it was experienced as a situation of national humiliation and foreign dominance, and the blame could easily be shifted on the left-liberal political forces who were in power when the crisis broke out, and on foreigners. Thus, international conditionality, surveillance and sense of humiliation brought about by the debt crisis gave further ammunition and lent credibility to Fidesz’ right wing nationalist and exclusionary project, with far reaching consequences for Hungarian democracy. The crisis has displaced the belief in the country’s capacity to modernize and catch up with the West. As a reaction, the government has turned the (discursive) table on the West. Increasingly, it portrays liberal democracies as weak und unable to remain globally competitive, and hails authoritarian models such as Russia, China and Turkey.[37]

5.2 Debt compliance, austerity nationalism and hollowing of democracy in Latvia

The Latvian reaction to the crisis epitomizes the exact opposite of the Hungarian. The proximate cause of Latvia's trouble was a run on its biggest domestic bank, PAREX. In response to the run, the government took over the majority control. The costs of recapitalizing and the need for restructuring PAREX pushed the government in the arms of the IMF.[38] At the same time, Latvia's currency came under pressure. Latvia received a loan from the IMF, EU and Nordic countries of 7.5 billion euro, which was equivalent to 40% of its GDP.[39]

A crucial policy decision of the Latvian government was to avoid devaluation of the lats and instead prepare for euro entry. This was a very controversial decision, as a number of internationally renowned economists and also the IMF team suggested that Latvia abandon its currency peg to regain competitiveness.[40] However, Latvian's central bank as well as government were adamant in defending the currency peg. As a result, Latvia's adjustment program was severe even by IMF standards. Then IMF Managing Director Dominique Strauss-Kahn said as much: "It [the program, D.B.] is centered on the authorities' objective of maintaining the current exchange rate peg, recognizing that this calls *for extraordinarily strong domestic policies,* with the support of a broad political and social consensus."[41]

Initially, broad political and economic consensus for the austerity package was lacking. January 2009 witnessed large-scale protests, and in February, the government collapsed. Since then until 2014, there was a rapid succession of governments, none of which lasted longer than a year. While new elections led to somewhat different government coalitions, they did not lead to policy change. Post-crisis governments consistently implemented austerity and harsh structural reforms. This policy response was shaped by Prime Minister Valdis Dombrovskis, who headed three governments before leaving office in 2014. Eihmanis (2018) shows in detail that Dombroviskis instrumentalized external conditionality to foster budget consolidation and structural reforms. Not only did he voluntarily tie the country's hands, but he also "cherry picked" on the conditionality, implementing some of the harsh measures faster and in a more severe manner than asked by the EU or IMF.

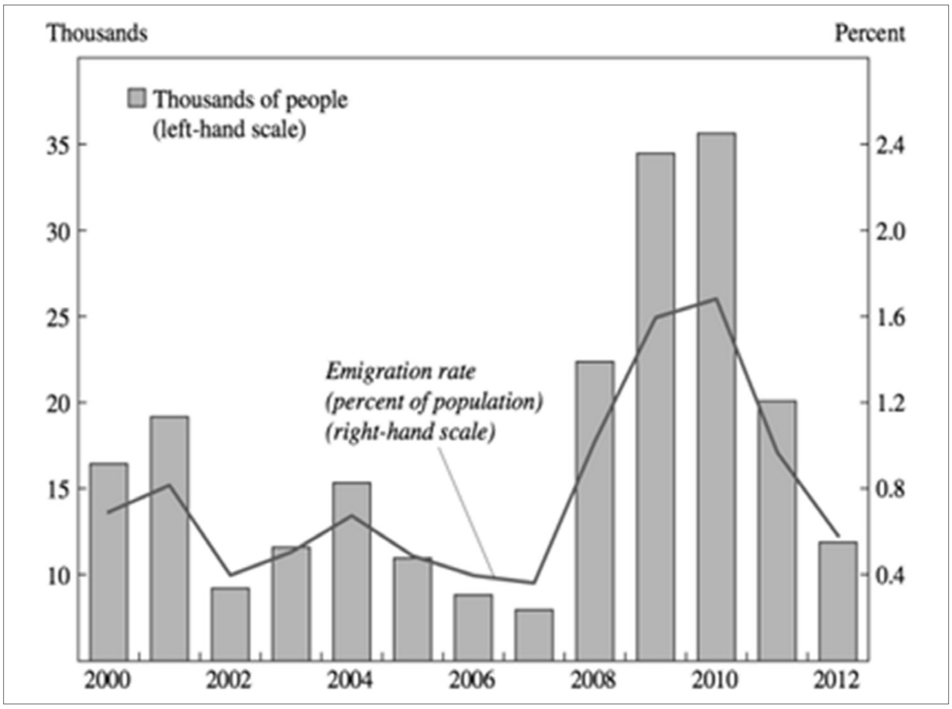
Dombrovskis put the blame for the crisis squarely onto his predecessor Ivan Godsmanis and his People's Party, accusing them of incompetence and fiscal profligacy.[42] Accordingly, the dominant crisis discourse was constructed around the tendency of previous governments to overspend and the need to reign in public spending. Despite the fact that Latvia's budget deficit stayed far below the three percent demanded by the Maastricht criteria, government officials went out of their way to address the country's overspending in the boom years.[43] In this narrative, before the crisis, the country had drifted aimlessly, but the crisis helped to focus the mind. It has taught the lesson that "a country cannot live beyond its means without endangering its future prospects".[44] According to Eihmanis (2018, p. 236, quoting Blyth (2013) 13), the dominant framing of much needed austerity after the crisis was that of "virtuous pain after the immoral party", and "a new ethos was constructed: to avoid spending at any costs".

Austerity and structural reforms had immense social costs, especially in the early years after the crisis. Yet, the country did not experience a political backlash over the reform course. Several factors account for this. First, Latvian policy makers built on the earlier nationalist social contract, and transformed it into a sort of "austerity nationalism". Two examples illustrate this. When Dombrovskis came to power in 2009, he "called on Latvia's residents to express solidarity with the state in the midst of crisis".[45] Dzenovska (2018, p. 61) shows that, in making this appeal, the government "invoked the stories that Latvians tell themselves about themselves, that is, about enduring harsh conditions to ensure the continuity of the nation and achieve political self-determination in the form of their own national state. Thus, the government appealed to Latvia's residents to express solidarity with *their* state, the state that they had so painstakingly restored following the collapse of the Soviet Union, the state that guaranteed their collective existence as a people, that was *them,* as many civil servants emphasized, and that now was in existential danger. The crisis animated renewed efforts to assert moral bonds between the state, the nation, and individuals. From within this moral framework, solidarity was manifested as a 'tightening of belts' for the sake of a collective future."

The second example refers to how, as radical reforms seemingly started to bring some fruits, Latvian policy makers took pride in what they perceived as a successful crisis response and contrasted it with that of Southern Europe. This became particularly pronounced when the drama around the third Greek bailout package unfolded in 2015. Dzenkovska (2018, p. 68f) reports how at the height of this new Greek crisis, the media and political discourse overwhelmingly contrasted the profligate Greek with the virtuous – Northern – Latvians. She quotes at length Inese Vaidere, a Latvian member of the European Parliament, who suggests that the Greek should learn from the Latvians. Vaidare "pointed out that Latvians cannot understand why Greeks refuse to be frugal, because 'we are used to saving and living within our means. Germans, too, are used to spending as much money as is within their means. Similarly, if borrowed, the money has to be returned within a foreseeable period of time. But Greeks want it otherwise: they think they can borrow all the time and not repay … tightening of belts corresponds to European values. Why is it so difficult for Greeks to do it? Perhaps it is lack of information, perhaps it is tradition, perhaps it is the Southern sun, which makes people more relaxed than in Latvia.'"[46] This sense of moral and cultural superiority of the Northern culture of belt-tightening was also shared by parts of the population.

However, appealing to the nationalist social contract was not enough to push through harsh austerity. Two other factors made this possible. On the one hand, there was simply no viable policy alternative. This is because of the ethnic cleavage which dominates the Latvian party system. Thus while the "Russian" party, Harmony, which aimed for somewhat different economic policies, came out strongest in most elections since the crisis, it was always excluded from government.[47] On the other hand, there was large scale exit. Figure 6 below shows the massive wave of emigration that was triggered by the crisis. Thus, during the very hard times, many Latvians chose exit over voice. Both factors: the ethnic cleavage as well as large scale exit attest to a further hollowing of Latvian democracy, at least in respect to the democratic choice of its economic policies.

Figure 6: Net emigration in Latvia, 2000-2012



Source: Blanchard et al. (2013) 358.

6. Conclusions

The aim of the paper was to probe into the relationship between democracy and capitalism in East Central European countries. I was particularly interested in the question why the region has relative successfully manoeuvred the tensions between capitalism and democracy in the first two decades after the breakdown of communism, while developments since the 2008 financial crisis have led to democratic backsliding or hollowing.[48] Building on Wolfgang Streeck's (2014) concept of buying time, I have argued that East Central Europe went through similar phases of bridging tensions between capitalism and democracy, and similar forms of displacement of the political arena where major conflicts take place. Thus, in the 1990s, despite early breakdown prophesies, East European countries could bridge the tensions between capitalism and democracy through offering welfarist or nationalist social contracts. These created their own crises – crises of public debt in the Viségrad countries, and the re-emergence of the social question in the Baltic States. Only Slovenia could escape this crisis, as democratic corporatism allowed for a balanced approach to social and fiscal matters. The 2000s saw the rise of privatized Keynesianism especially in the Baltic States, and to a lesser degree in the Visegrád countries. Overall rising debt levels made these countries vulnerable to the Global Financial Crisis, which triggered a stop and sudden reversal of capital flows from the region. The ensuing credit crunch has put an end to privatized Keynesianism, and tight European surveillance, sometimes joined by the IMF, has made running public deficits much more difficult. It is in this situation that some East European democracies have come under increasing strain.

Based on two extreme cases, Hungary and Latvia, I have elaborated more in detail how the 2008 crisis has put democracy under pressure. In Hungary, the crisis swept a right wing nationalist government to power, that skilfully used the opportunity to push through an increasingly authoritarian and anti-EU agenda. The government could however only advance this agenda because the crisis has brought international hierarchies into the open, and has attested to the failure of the Western oriented path of catching up that the country had pursued since the 1990s. In this context, the governments' narrative of the crisis and IMF-EU surveillance resonates with broader public sentiments. It tells what Arlie Hochschild (2016, p. 135) calls a "deep story". Hochschild defines a deep story as "a feels-as-if story – it's the story feelings tell, in the language of symbols. It removes judgement. It removes fact." The deep story that the government tells Hungarians, and that Hungarians tell themselves is something like this: "We are a small and vulnerable country, and great powers have always taken advantage of us. In the last decades, we have worked hard and sacrificed a lot to become a full and respected member of the European Union. To this aim, we have always played by the EU's rulebook. But we have been – as so often in our history – betrayed. The Socialists have betrayed us by selling our country to foreign companies and accumulating debt. The EU, rather than respecting our achievements and rewarding our sacrifices, has enslaved us with its harsh conditions and treats us as second-class citizens. But we will not take this anymore. We demand and deserve respect. We will free ourselves from debt slavery, restore our sovereignty and regain our dignity. No one will ever meddle with us again." This is the deep story that legitimates an increasingly nationalist and authoritarian turn.

In Latvia, democracy suffered in different ways. Here, the reaction to the crisis was shaped by an elite consensus about the necessity to address Latvia's economic problems in an even more radical fashion than warranted by the international creditors. After a brief period of contestation, the Latvian society patiently put up with the hardship of austerity and structural reforms. This patience can partly be explained by a different "deep story" that resonates with the population. This deep story is about endurance in the face of harsh conditions. As Dace Dzenovska (2018, p. 61) reports from her fieldwork in Latvia during and after the crisis, "the ability to survive and surviving itself – what I refer to in this chapter as endurance – variously appeared as part of a collective habitus formed in relation to a history of multiple foreign dominations. A necessary tactic for living in the present, it increasingly became a normative mode of conduct of living the crisis … Endurance, then, was part of the collective self-narrative of Latvians and a virtue that came to characterize a good national subject." The "stories Latvians tell themselves about themselves" (ibid.) coincided with the Northern virtues that emerged as the dominant narrative of the European debt crisis,[49] and thus allowed Latvian policy makers to present themselves as successful Europeans, as a role model for other (especially Southern) countries to follow. However, as in Hungary, a stronger medicine was needed than appealing to a deep story in order to have the population accept the response to the crisis. Whereas this medicine in Hungary is its increasing authoritarianism, in Latvia it is an increasing hollowing of democracy. The ethnic cleavage that underlies its party system prevents any policy alternative to emerge, whereas large scale exit makes Latvian policy makers increasingly "ruling the void".[50] While developments in Latvia and Hungary have been extreme, these are certainly not the only cases where capitalism thrives, but democracy is now at risk.

Endnotes

[1] For the purpose of this paper, East Central Europe refers to the eight East European countries that joined the EU in 2004: the four Visegrád countries Hungary, Poland, the Czech and Slovak Republics, the three Baltic States Estonia, Latvia and Lithuania, and Slovenia.
[2] Greskovits (2015).
[3] E.g. Offe (1991), Przeworskis (1991).
[4] Offe (1991) 873.
[5] E.g. Offe (1991), Przeworski (1991).
[6] E.g. Ost (2000).
[7] Crowley and Stanojevic (2011).
[8] Bohle and Greskovits (2012).
[9] Bohle and Greskovits (2012).
[10] Quoted in Milanovic (1995) 33.
[11] Brubacker (1996) 105.
[12] Bohle and Greskovits (2012).
[13] Bohle and Greskovits (2012).
[14] Greskovits (2008) 282.
[15] Enyedi (2015) 236.
[16] Bohle (2014).
[17] Aasland (2002).
[18] Bohle (2014).
[19] Due to data availability, only the following countries are covered: ECE countries are the Czech Republic, Estonia, Hungary, Lithuania, Poland and Slovenia. Western European peripheral countries are Greece, Italy, Ireland, Portugal and Spain. Core countries are Austria, Belgium, France, Denmark, Germany, Norway, Sweden and the UK.
[20] This section draws on Bohle (2018b).
[21] Krippner (2017).
[22] E.g. Fourcade et al. (2013).
[23] Aslund and Dombrovksis (2011).
[24] Eurostat http://ec.europa.eu/eurostat/tgm/table.do?tab=table&init=1&language=en&pcode=teina225&plugin=1.
[25] The loan was part of a broader IMF-World Bank and EU administered loan of all in all 20 billion €; Lütz and Kranke (2014).
[26] http://www.nytimes.com/2010/06/07/business/global/07euro.html.
[27] Orange files the war on government debt. Have to find the reference again.
[28] http://www.miniszterelnok.hu/prime-minister-viktor-orbans-speech-in-the-european-parliament/.
[29] The discussion of the issue of public debt and quotations are based on , and the original sources cited in that article.
[30] http://www.thejournal.ie/hungary-government-imf-advertisements-630799-Oct2012/, I might find better sources.
[31] E.g. https://uk.reuters.com/article/uk-hungary-imf-repaid/hungary-repays-2008-imf-loan-in-full-government-idUKBRE97B07720130812
[32] https://www.bloomberg.com/news/articles/2011-10-28/erste-doesn-t-expect-to-make-profits-in-hungary-in-next-years.
[33] Bohle (2014), Johnson and Barnes (2015).
[34] https://theorangefiles.hu/notable-quotes-prime-minister-viktor-orban-by-subject/.
[35] Benazzo (2017) 198.
[36] Ibid.

[37] E. g. https://www.ft.com/content/0574f7f2-17f3-11e4-b842-00144feabdc0. While the West's weakness has been a recurrent topic in Fidesz' rhetoric, it has magnified since the refugee crisis, informed by an ever more racist agenda.
[38] Aslund and Dombrovskis (2011) 35.
[39] European Court of Auditors (2015) 17.
[40] Lütz and Kranke (2014).
[41] Quoted in Hugh (2009).
[42] E.g. http://news.bbc.co.uk/2/hi/europe/8496925.stm.
[43] E.g. Rimsevics (2010), Aslund and Dombrovskis (2011).
[44] Rimsevics (2010).
[45] Dzenovska (2018) 61.
[46] Ibid 69.
[47] Eihmanis (2018) 237.
[48] Greskovits (2015).
[49] Matthijs and McNamara (2015).
[50] Mair (2013).

References

Aasland, Aadne, Citizenship Status and Social Exclusion in Estonia and Latvia, in: Journal of Baltic Studies 33/1 (2002) 57-77.

Aslund, Anders; Dombrovskis, Valdis, How Latvia Came Through the Financial Crisis (Institute of International Economics, Washington, D. C., 2011).

Benazzo, Simone, Not All the Past Needs To Be Used: Features of Fidesz's Politics of Memory, in: Journal of Nationalism, Memory & Language Politics 11/2 (2017) 198-221.

Blanchard, Olivier J.; Griffiths, Mark; Gruss, Bertrand, Boom, Bust, Recovery: Forensics of the Latvia Crisis, in: Brookings Papers on Economic Activity 2 (2013) 325-388.

Blyth, Mark, Austerity: The History of a Dangerous Idea (Oxford, New York 2013).

Bohle, Dorothee, Post-Socialist Housing Meets Transnational Finance: Foreign Banks, Mortgage Lending, and the Privatization of Welfare in Hungary and Estonia, in: Review of International Political Economy 21/4 (2014) 913-948.

Bohle, Dorothee, Mortgaging Europe's Periphery, in: Studies in Comparative International Development 53/2 (2018a) 196-217.

Bohle, Dorothee, To Pay or Not to Pay? Debt Cultures and the Politics of Debt in Europe's Periphery, in: Stato e Mercato 38/1 (2018b) 61-86.

Bohle, Dorothee; Greskovits, Béla, Capitalist Diversity on Europe's Periphery (Ithaca, NY, 2012).

Brubaker, Rogers, Nationalism Reframed: Nationhood and the National Question in the New Europe (Cambridge, New York 1996).

Crouch, Colin, Privatised Keynesianism: An Unacknowledged Policy Regime, in: The British Journal of Politics & International Relations 11/3 (2009) 382-399.

Crowley, Stephen; Stanojevic, Miroslaw, Varieties of Capitalism, Power Resources, and Historical Legacies: Explaining the Slovenian Exception, in: Politics & Society 39/2 (2011) 268-295.

Dzenovska, Dace, Latvians Do Not Understand the Greek People, in: Loftsdóttir, Kristín; Smith, Andrea L.; Hipfl, Brigitte (eds.), Messy Europe: Crisis, Race, and Nation-State in a Postcolonial World (New York, Oxford 2018) 53-76.

Égert, Balázs; Mihaljek, Dubravko, Determinants of House Prices in Central and Eastern Europe, in: Comparative Economic Studies 49/3 (2007) 367-388.

Eihmanis, Edgars, Cherry-Picking External Constraints: Latvia and EU Economic Governance, 2008–2014, in: Journal of European Public Policy 25/2 (2018) 231-249.

Enyedi, Zsolt, Plebeians, Citoyens and Aristocrats or Where Is the Bottom of the Bottom-up? The Case of Hungary, in: Kriesi, Hanspeter; Pappas, Takis S (eds.), European Populism in the Shadow of the Great Recession (Colchester 2015) 235-250.

European Court of Auditors, Special Report No 18/2015: Financial Assistance Provided to Countries in Difficulties (Luxembourg 2015);
http://www.eca.europa.eu/en/Pages/DocItem.aspx?did=35016.

Fourcade, Marion; Steiner, Philippe; Streeck, Wolfgang; Woll, Cornelia, Moral Categories in the Financial Crisis, in: Socio-Economic Review 11/3 (2013) 601-627.

Greskovits, Béla, The Political Economy of Protest and Patience: East European and Latin American Transformations Compared (Budapest 1998).

Greskovits, Béla, Hungary and Slovakia: Compliance and Its Discontents, in: Dyson, Kenneth (ed.), The Euro at 10. Europeanization, Power and Convergence (2008) 274-291.

Greskovits, Béla, The Hollowing and Backsliding of Democracy in East Central Europe, in: Global Policy 6/S1 (2015) 28-37.

Hochschild, Arlie Russell, Strangers in Their Own Land: Anger and Mourning on the American Right (New York 2016).

Hugh, Edward, Why The IMF's Decision To Agree A Latvian Bailout Programme Without Devaluation Is a Mistake, in: A Fistful of Euros (blog) (December 22, 2008);
http://fistfulofeuros.net/afoe/why-the-imfs-decision-to-agree-a-lavian-bailout-programme-without-devaluation-is-a-mistake/.

Johnson, Juliet; Barnes, Andrew, Financial Nationalism and Its International Enablers: The Hungarian Experience, in: Review of International Political Economy 22/3 (2015) 535-569.

Kriesi, Hanspeter; Pappas, Takis S., Populism in Europe during the Crisis: An Introduction, in: Kriesi, Hanspeter; Pappas, Takis S (eds.), European Populism in the Shadow of the Great Recession (Colchester 2015) 1-23.

Krippner, Greta R., Democracy of Credit: Ownership and the Politics of Credit Access in Late Twentieth-Century America, in: American Journal of Sociology 123/1 (2017) 1-47.

Lütz, Susanne; Kranke, Matthias, The European Rescue of the Washington Consensus? EU and IMF Lending to Central and Eastern European Countries, in: Review of International Political Economy 21/2 (2014) 310-338.

Mair, Peter, Bini Smaghi vs. the Parties: Representative Government and Institutional Constraints (2011); online: http://cadmus.eui.eu/handle/1814/16354.

Mair, Peter, Ruling The Void: The Hollowing Of Western Democracy (London 2013).

Matthijs, Matthias; McNamara, Kathleen, The Euro Crisis' Theory Effect: Northern Saints, Southern Sinners, and the Demise of the Eurobond, in: Journal of European Integration 37/2 (2015) 229-245.

Milanovic, Branko, Poverty, Inequality, and Social Policy in Transition Economies (= Policy Research Working Paper 1530, The World Bank, Washington, D. C., 1999).

Offe, Claus, Capitalism by Democratic Design? Democratic Theory Facing the Triple Transition in East Central Europe, in: Social Research 58/2 (1991) 865-892.

Ost, David, Illusory Corporatism in Eastern Europe: Neoliberal Tripartism and Postcommunist Class Identities, Politics & Society 28/4 (2000) 503-530.

Przeworski, Adam, Democracy and the Market: Political and Economic Reforms in Eastern Europe and Latin America (Cambridge 1991).

Rhodes, Martin, Why EMU Is – or May Be – Good for European Welfare States, in: European States and the Euro: Europeanization, Variation, and Convergence (New York 2002) 309.

Rimsevics, Ilmars, Speech by Ilmārs Rimšēvičs, Governor of the Bank of Latvia, at the Baltic Economic Forum 2010 (2010; accessed March 2, 2018); online: https://www.bank.lv/en/about-us/structure/governor/speeches/6607-speech-by-ilmars-rimsevics-governor-of-the-bank-of-latvia-at-the-baltic-economic-forum-2010.

Streeck, Wolfgang, Buying Time: The Delayed Crisis of Democratic Capitalism (New York 2014).

Vanhuysse, Pieter, Divide and Pacify: Strategic Social Policies and Political Protests in Post-Communist Democracies (Budapest, New York 2006).

Abstract

The essay probes into the relationship between democracy and capitalism in East Central European countries. It seeks to understand why the region has relative successfully manoeuvred the tensions between capitalism and democracy in the first two decades after the breakdown of communism, while developments since the 2008 financial crisis have put democracy under increasing strain. Building on Wolfgang Streeck's (2014) concept of buying time, I argue that East Central Europe went through similar phases of bridging tensions between capitalism and democracy, and similar forms of displacement of the political arena where major conflicts take place. The paper traces the welfarist and nationalist social contracts that were offered to the populations in the 1990s, and the rise of private debt in the 2000s. Fast rising debt made many of the countries vulnerable to the Global Financial Crisis, which triggered a stop and sudden reversal of capital flows from the region. The ensuing credit crunch has put an end to privatized Keynesianism, and tight European surveillance, in some cases joined by IMF conditionality, has brought debt consolidation to the center of public policy. It is in this context that some East European democracies have come under increasing strain.

Zusammenfassung

Der Artikel untersucht die konfliktreiche Beziehung zwischen Demokratie und Kapitalismus in ostmitteleuropäischen Ländern. Er fragt, warum diese Länder die Spannungen zwischen Kapitalismus und Demokratie in den ersten zwei Jahrzehnten nach dem Zusammenbruch des Kommunismus relativ erfolgreich bewältigt hat, während seit der Finanzkrise von 2008 Demokratie zunehmend unter Druck gerät. Ausgehend von Wolfgang Streecks (2014) Konzept der gekauften Zeit argumentiere ich, dass Ostmitteleuropa ähnliche Phasen der Überbrückung der Spannungen zwischen Kapitalismus und Demokratie und ähnliche Formen der Verschiebung der politischen Arena, in der große Konflikte stattfinden, durchgemacht hat wie westliche Demokratien. Der Artikel zeichnet die Instrumente der gekauften Zeit in den 1990er und 2000er Jahren nach. In den 1990er Jahren erlaubten wohlfahrsstaatliche und nationalistische Sozialverträge die Verschiebung von gesellschaftlichen Konflikten, und in den 2000er Jahren war es die zunehmende private Verschuldung. Die schnell steigende Verschuldung machte viele Länder anfällig für die globale Finanzkrise, die einen Stopp und eine plötzliche Umkehr der Kapitalströme aus der Region auslöste. Die darauffolgende Kreditkrise hat den „privatisierten Keynesianismus" (Crouch 2009) beendet, und die strenge europäische Überwachung, die in einigen Fällen mit IWF Konditionalität einhergeht, hat die Schuldenkonsolidierung in das Zentrum staatlicher Tätigkeit gerückt. In diesem Kontext geraten einige osteuropäische Demokratien zunehmend unter Druck.

Key words: Eastern Europe, public debt, private debt, democracy, backsliding, IMF.
JEL classifications: O57, P16, P52.