Revisiting the Baltic growth model: From neoliberalism to the social investment welfare state

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Abstract

This article shows that the services-oriented growth model in the Baltic countries—Estonia, Latvia and Lithuania—has been underpinned by a social investment welfare state. Some scholars have portrayed the region’s transition to capitalism as socially ‘disembedded’ and exposed to a more zealous form of ‘neoliberalism’ than the one found in Central and Eastern Europe. These accounts have called attention to the social costs of such a trajectory of capitalist development (Bohle & Greskovits, 2012). Others have praised the exceptional economic growth in the region, and contrasted its high educational performance and labour force participation to Central and Eastern Europe, all the while ascribing these successes to the sound implementation of the Washington consensus (Aslund, 2013). This article provides a more nuanced perspective on the Baltic countries’ approach to growth in order to reconcile these two seemingly contradictory perspectives. To that end, the article reveals higher state investment in human capital, higher generosity of labour market policy and greater expansion of public sector employment in the Baltic states than in Central and Eastern Europe. It argues that these social investment oriented policies have underpinned these countries’ efforts to transform into knowledge-intensive service economies. The article supplies a new type of growth model to the literature on capitalist diversity in Eastern Europe. It also shows that the expansion of a knowledge-intensive service economy can be associated with growth of public sector employment, rather than its reduction.

Keywords: social investment welfare state, growth models, capitalist diversity, knowledge economy, Eastern Europe

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I. Introduction

Transition from socialism to capitalism in Eastern Europe was described as a “great economic experiment of the 20th century” (Stiglitz, 1999, p.3). Following the initial negative impact of transition during the 1990s, Eastern European countries have maintained steady and high growth rates throughout the 2000s, especially prior to the 2008 global economic crisis (Figure 1). Extensive economic restructuring and institutional change which have taken place in the region have been influenced by both international and domestic actors, as well as the countries’ specific historical path dependencies.

These processes have led to the emergence of different trajectories of capitalist development. Literature on capitalist diversity in Eastern Europe has acknowledged a variance between the trajectory of the Baltic countries—Estonia, Latvia and Lithuania—on one hand, and Central and Eastern Europe (CEE)—Czech Republic, Hungary, Poland and Slovakia—on the other. As Stockhammer, Durand, & List (2016) remind us, CEE countries have pursued economic growth by upgrading their industries towards higher value manufacturing products via high dependence on foreign direct investment (FDI) and integration with global value chains (see also Nölke & Vliegenthart, 2009). Instead, the smaller Baltic countries focused on rapid liberalization to attract foreign capital into high value service sectors such as banking and real estate (Bohle & Greskovits, 2012). Both trajectories have, however, been characterized by high dependence on foreign capital as a key driver of growth.
The three Baltic countries saw higher GDP growth rates than CEE countries during the 2000s, which went up to 10% annually (Figure 1). They were also more severely struck by the global economic crisis and experienced a total 20% GDP decline during 2008-2009, due to their high exposure to international markets. While this exceptionally strong impact of the crisis raised important questions about the sustainability of the Baltic growth model (Bohle & Greskovits, 2012), following an internal devaluation and implementation of austerity measures (Som-
mers & Woolfson, 2014), the region swiftly and recovered to again reach higher growth rates than CEE.¹

**Figure 2. Employment rates (20-64)**

The three Baltic states have also seen much better and more dynamic labour market performance than their neighbours in CEE. Their employment rates have been substantially higher than in most CEE countries,² and they generated more new employment during the 2000s than all four CEE countries (Figure 2). The Baltic countries also saw steep declines in their unemployment rates

¹ This sudden negative shock impacted the Baltic countries’ standards of living, as they also experienced drops in their levels of GDP per capita, albeit only temporarily (see Figure A1 in the Appendix).

² With the exception of the Czech Republic which has been at a markedly higher level of economic development than the rest of Eastern Europe since the onset of transition (see Figure A1 in the Appendix).
during the 2000s. By 2008, they had dropped to almost 2%. While the 2008 crisis had a negative impact on the three Baltic countries’ labour markets, they swiftly recovered the employment figures once they restored growth (see Figure A2 in the Appendix).

Such successful economic and labour market performance of the Baltic countries has been hailed by international organizations such as the International Monetary Fund and the World Bank. Much of the countries’ economic success has been ascribed to their rapid and effective market liberalization, macroeconomic stability, simplified tax systems as well as the reduction in the size of their public sectors (Aslund, 2002, 2013).

Political economists also emphasized that there was minimal state involvement in the functioning of the Baltic economies, and they criticized its social cost. Bohle & Greskovits (2007, 2012) underlined the countries’ weak welfarist contracts and low expenditures on social protection, while identifying the Baltic trajectory of economic reform as ‘disembedded neoliberalism’. According to them, the Baltic model of capitalist development has been characterized by a zealous pursuit of macroeconomic stability and economic openness, along with the low provision of social security.

This literature has paid less attention to the fact that since the onset of transition the Baltic countries, and most notably Estonia, have been transforming into information societies and knowledge-intensive economies (Runnel et al., 2009). “When Estonia regained its independence
from the Soviet Union in 1991, less than half of its population had a phone and its only independent link to the outside world was a Finnish mobile phone concealed in the foreign minister's garden. Two decades later, it is a world leader in technology” (“How did Estonia become a leader in technology?,” 2013). All three Baltic countries also boast of very high levels of tertiary educational attainment (Figure 5) and high employment rates of the traditionally disadvantaged groups, especially women (Avlijas, 2016). Furthermore, according to the 2015 Programme for International Student Assessment (PISA), Estonian 15 year olds are ranked third in the world by educational attainment, after Singapore and Japan. Nearly half of the poorest pupils in Estonia score among the top quarter of children across the OECD world, showing the country’s high level of educational inclusiveness (“Must try harder,” 2016). Finally, knowledge intensive service employment in the Baltic countries, and particularly in Estonia, exceeds that found in CEE (Figure 3).4

Despite these trends, scholarship has not accounted for the role of the state and public policy in shaping the Baltic transformation towards knowledge-intensive services. In an initial attempt to analyze capitalist diversity in Eastern Europe, Feldmann (2006) classified Estonia as a liberal market economy, without making specific refer-

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3 Test administered by the Organisation for Economic Co-operation and Development (OECD)
4 The Czech Republic is an exception vis-à-vis Latvia and Lithuania, but the country has been at higher levels of economic development than the rest of the region throughout transition (Figure A1 in the Appendix).
ence to the fact that such economies are considered internationally competitive in high-end services, information and communication technology (ICT) and other sectors that rely on radical innovation and changing market conditions (Hall & Soskice, 2001). Bohle & Greskovits (2012) mention the Baltic countries’ substantial investment into education, ICT and reduction of new social risks, but do not develop the argument further.

**Figure 3. Employment in knowledge-intensive services (% of working age population)**

Source: Author’s calculations based on Eurostat data.
Notes: 1) There is a break in the series in 2008 because Eurostat changed its classification of activities from NACE 1.1 to NACE 2.
2) According to Eurostat, an activity is classified as knowledge intensive if tertiary educated persons employed (according to ISCED97, levels 5+6 or ISCED11, levels 5 to 8) represent more than 33% of the total employment in that activity.
In sum, the economic literature assumes that the state has played a very marginal role in the Baltic and that the region’s labour market and educational performance can be attributed to the supremacy of the market mechanism. On the other hand, by reducing the Baltic growth model to ‘neoliberalism’, the political economists have failed to acknowledge some of the unmistakably positive socio-economic outcomes in the region and identify government policies that can be associated with them.

By showing that state-driven educational reform and public sector employment have played an important role in the emergence of the Baltic growth miracle, this article underlines that the knowledge-intensive services oriented growth model in the region has been underpinned by a social investment welfare state. Previous accounts of capitalist diversity in the region have been based on the traditional definition of the welfare state, while the Baltic countries have been notorious for their low expenditures on passive social welfare programmes. Therefore, earlier contributions have overlooked the emergence of the social investment welfare state which, as defined by Morel et al. (2012), focuses on the creation of human capital (e.g. provision of education), as well as its mobilization (e.g. work-life reconciliation policies) and maintenance (e.g. life-long learning). A lot more that a passive disintegration of the welfare state took place in the Baltic, argues this article, throwing a new light on the Baltic growth model. The article therefore revisits and challenges comparative political economy contributions which have argued that the Baltic countries pursued a ‘disembedded neoliberal’ development trajectory during
their transitions to capitalism (most notably Bohle & Greskovits, 2007, 2012).

The article adheres to the following structure. The next section discusses the literature on the changing role of the welfare state in the ‘new’ economy. From there, theoretical insights from advanced capitalist economies are identified, which are then used to update the existing typology of capitalist diversity in Eastern Europe. Existing accounts of capitalist development in the Baltic are also reviewed in this section, in order to show that they have not yet accounted for this ‘new’ welfare state. Section 3 presents data on education, training and digital literacy, public sector employment and labour market access in the Baltic and CEE spanning from the late 1990s (due to data availability) up to 2014. The section thus uncovers the nature of the social investment welfare state in the Baltic and also discusses its resilience in the aftermath of the 2008 economic crisis. The final section summarizes the article’s contribution and its theoretical and empirical implications.

II. Theoretical framework: A ‘new’ welfare state for the ‘new’ economy

The argument put forward in this article is theoretically embedded in the literature which focuses on the role of the welfare state in the ‘new’ knowledge-intensive service economy. The traditional view is that European welfare states have been shrinking and disappearing over the past few decades (Allan & Scruggs, 2004; Pierson,
2006), driven by neoliberalism that reduces the state to regulation as the main instrument of economic governance (Schmidt & Thatcher, 2013). A number of social policy and political economy scholars have, however, challenged this perspective (Fougner, 2006; Hemerijck, 2012; Jenson, 2010; Morel et al., 2012; Perkins et al., 2004). Instead, they argue that European welfare states have been adapting to new economic circumstances and new social risks which have emerged in response to the changes in demographic, family and labour market structures, as well as growing fiscal pressures. Given the emergence of the ‘new’ ICT-intensive service economy, tapping into the knowledge and skills of the workforce has been recognized as a key driver of economic growth and development across the EU and beyond. These changes have led to the emergence of the so-called social investment welfare state which has focused on creating and enhancing the human capital of the population to support the expansion of the knowledge-intensive economy as a key vehicle of modern era growth (Morel et al., 2012). In that context, Jensen (2008) argues that education should be considered part of the welfare state and that its absence from the literature and welfare state measurements may be more a matter of convention than anything else (p.160). Furthermore, efforts to expand the definition of the welfare state beyond social transfers and also focus on social services have been rife in the more recent literature (e.g. see Schelkle, 2012 for an overview).

The social investment welfare state focuses on the reduction of labour market vulnerability of individuals through investment in their human capital from early
childhood through life rather than via passive social insurance of adults. The logic of social investment is to subsidize disadvantaged citizens in order to improve their marginal productivity, so that they can access higher wages and better quality jobs. It is thus very different from a laissez-faire state which focuses on regulation only and on the creation of any jobs, including the low wage and low quality ones.

These insights have also begun to shift scholarly attention towards the examination of institutional and political factors that underpin the expansion of the knowledge- and ICT-intensive economy and that can maximize its yields (Garritzmann et al., 2017; Häusermann, 2010). Nelson & Stephens (2012) have shown that, contrary to conventional wisdom about liberalization, substantial public sector investment is needed in order to support growth of high productivity service jobs. Thelen (2014) has also shown that liberalization in some countries, most notably in Scandinavia and in the Netherlands, has gone hand in hand with social investment policies delivered by the state. The argument put forward in this article—that a knowledge-intensive services oriented growth model in the Baltic has been underpinned by the social investment welfare state—therefore builds on the insights from this latest generation of comparative political economy research on the trajectories of service liberalization in the ICT-intensive growth era (Nelson & Stephens, 2013; Thelen, 2014; Wren et al., 2013).

Such a redefinition of the welfare state has also had consequences for how political economy scholars view the role of social policies in economic development.
Rather than assuming that the role of the welfare state is to protect the population from market forces, there has been a growing interest in understanding how welfare state reforms are used to support countries’ growth trajectories (Hassel & Palier, 2012; Morel et al., 2012). Specifically, in the context of de-industrialization of the advanced capitalist economies and the concurrent ICT revolution, public investment into human capital has become a key welfare state input for the knowledge-intensive growth model. In that context, social investment can be viewed as a political strategy that transforms the current distributional conflict over cash resources into a future-oriented welfare for all through equitable production, mobilization and maintenance of human capital. In other words, instead of looking at social investment only as a supply side intervention, it can also be seen as an alternative perspective on redistribution, or a government strategy for strengthening the negotiating position of labour vis-à-vis capital by providing them with more education, which then feeds into higher productivity, higher wages, better living standards and economic growth (Midgley, 1999).

These insights about the recent transformations of the welfare state in advanced capitalist economies have not yet been examined in the context of Eastern Europe. Instead, political economy scholarship on the region has retained the traditional notion of the welfare state. For example, Bohle & Greskovits (2012) argue that the rapid transformation and liberalization of the Baltic economies occurred along with little political pressure to compensate the losers of transition. They propose that the Baltic neoliberal model was feasible because of
these countries’ emphasis on identity politics of nation building and alienation from the Soviet Union, which resulted in high social tolerance for inequality. According to them, the perceived threat of Russia united the people politically and made it feasible to impose a high economic and social cost on the population. They go on to argue that, as a result of this high social tolerance for inequality, the Baltic countries were able to focus on economic growth only, rather than also on redistribution and monetary compensation of the losers of transition. The authors contrast this development model to what they refer to as ‘embedded neoliberalism’ in CEE countries—characterized by FDI-led reindustrialization and large welfare state expenditures to compensate the losers of these reforms through passive cash transfers, such as unemployment benefits and pensions, including early retirement schemes (Bohle & Greskovits, 2012).

Furthermore, scholarship on capitalist diversity in Eastern Europe has made an explicit separation between social and educational policies (Bohle & Greskovits, 2012; Cerami & Vanhuysse, 2009; Lendvai, 2009; Martinaitis, 2010; Vanhuysse, 2006). When it comes to CEE, Nölke & Vliegenthart (2009) have pointed out that neither multinational companies nor governments have invested much into the qualifications of their workforce (p. 680). Bohle & Greskovits (2012) argue that educational reform never took place in CEE due to the scarce resources following pressures of international capital for subsidies, as well as EU-imposed tight budgetary constraints. In contrast, Martinaitis (2010) shows that the Baltic countries have developed general skill regimes during transition,
but he does not examine the role of the state in these transformations.

Finally, Vanhuysse (2006) and Cerami & Vanhuysse (2009) connect welfare state reforms in CEE to these countries’ growth strategies. They show that the welfare state restructuring which took place in CEE was part of the rational political strategies geared towards stimulating economic development rather than sheer populism. In other words, they argue that CEE governments intentionally used welfare payments such as unemployment benefits and pensions to ‘divide and pacify’ the losers of transition, and thus reduce political instability so that they can attract FDI.

Building on this literature, this article proposes that the Baltic governments have had an active, state-led approach to welfare state reform. However, it has not been the one suggested by Bohle & Greskovits (2012) and Vanhuysse (2006), according to which these countries’ governments exploited ethnic divisions to shift as many competencies as possible to the market. Instead, the strategy of welfare state reform in the Baltic has been shifted towards social investment, this article argues. The next section empirically examines this proposition.

**III. Empirical analysis: Social investment in the Baltic**

Statistical data and primary literature sources are used in this section to assess whether the Baltic countries have established a social investment welfare state during
transition. To that end, policies and socio-economic outcomes that the political economy and social policy literatures have associated with social investment are examined. Empirical studies have typically focused on educational attainment and digital literacy, public sector employment and labour market access for the traditionally excluded (see Morel et al., 2012 for an overview). While some of the literature has also associated work-family reconciliation policies such as childcare with the social investment state (e.g. Morgan, 2012; Nelson & Stephens, 2012), this article does not examine childcare policy. Formal childcare provision has not become a politically salient topic in Eastern Europe until very recently, perhaps due to the institutional legacy that the countries inherited from the socialist era, nor has it been associated with greater female entry into the labour force. For example, Mills et al. (2014) point out that in Eastern European countries “the level of childcare usage, enrolment and public investment is actually very low”, even though some of them have very high female employment rates (p.42). The following three subsections therefore present policies on education, training and digital literacy that have been implemented in the Baltic countries since the onset of transition, and presents a range of educational and labour market trends that can theoretically be associated with these social investment oriented policies.
3.1 Education, training and digital literacy

3.1.1 Policies
The collapse of the Soviet Union in 1989-1991 led to structural changes in the educational systems of the newly independent Baltic states. OECD reviews of national education policies during the 1990s show that all three Baltic countries started the process of vigorous and all-encompassing education reforms which shared similar concepts and principles (OECD, 2002, p.15). The countries differed in terms of the sequence of implementation of educational reforms, but they nevertheless shared many similarities. All three also saw unprecedented grassroots engagement of educators and drastic increases in tertiary educational enrolment numbers already during the early stages of transition (OECD, 2001a, 2001b, 2002).

Apart from the many legislative changes which served to reform the higher education curricula, strengthen the research infrastructure and create more flexible degree programmes, the Baltic countries’ educational reforms were also characterized by strategic thinking about how education could strengthen their position in the global economy. The Estonian government, most notably, launched the Tiger Leap National Programme in 1997 with the aim to modernize the educational system, and create an inclusive learning environment that is more suited to the needs of “a knowledge-based, information technology-intensive economy” (OECD, 2001a, p.54). The programme equipped schools with ICT, linked them to the internet and offered ICT education and
teaching/learning software to teachers.

Lumiste et al. (2007) also recognize the key role that investment in ICT has played in the stellar economic performance of Estonia. Runnel et al. (2009) argue that the country’s strategic plan to develop into a modern ICT-intensive service economy has contributed to such performance. The reform of the educational system towards a ‘technological revolution’ also had an additional aim to revitalize democracy and bring citizens closer to the state which was rebranding itself as efficient and modern (Runnel et al., 2009). The country also established the Estonian Education Forum, a working group in charge of producing strategic documents on the country’s future education scenarios with the aim to inform education policy making (OECD, 2001a, p.54).

Using a range of indicators to measure skill intensity of the educational systems in Eastern Europe, Martinaitis (2010) shows a stronger orientation towards general skills in all three Baltic countries than in CEE (p. 89-91). Within the Varieties of Capitalism analytical framework, general skills are those which are transferable across firms, and even across sectors. They underpin high-end services, ICT and other sectors that rely on radical innovation and changing market conditions. Martinaitis (2010) also argues that the three countries paid much less attention than CEE to the development of vocational education and specific skills

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5 For example, students at ISCED 5A level as % of youth aged between 18 and 26; students (ISCED 5A) enrolled in social science, business and law fields as % of all students; % of adults engaged in non-formal education and training, that studied social science, business and law.
which are geared towards the manufacturing industry and are not easily transferable across sectors (p.82-83). This further emphasizes the Baltic states’ strategic orientation towards the development of a growth model oriented towards knowledge-intensive services instead of manufacturing.

**Figure 4. Education expenditures (gen. government)**

![Education expenditures graph]

Source: Eurostat.

General government expenditures on education as a share of GDP in the three Baltic countries have been significantly higher than educational expenditures in CEE, especially in comparison to the Czech Republic and Slovakia (Figure 4). Estonia, in particular, has allocated substantial public funds to education, reaching up to 7% of
GDP in some years. This makes it one of the biggest spenders on education in the EU, as well as the OECD.\(^6\) Moreover, since the three Baltic countries had exceptionally high growth rates during the 2000s (Figure 1), their nominal allocations towards education would have been growing even during the periods which saw dropping shares of educational expenditures in GDP.

Furthermore, Hungary and Poland, who have spent higher shares of their GDP on education than the Czech Republic and Slovakia, especially during the mid-2000s, have not had such a clear vision for educational reform as the Baltic states, and their policy was neither entirely focused on the strengthening of manufacturing and specific skills nor on the development of the general ones (Martinaitis, 2010).

High expenditures on education in the Baltic states along with their overall smaller government size also demonstrate that educational spending has been a high political priority for their governments. In other words, education devours a significantly higher share of total public expenditures in the Baltic than in CEE. Overall public revenue/public spending as a share of GDP in 2002 was 36\% in Estonia, and 35\% in Latvia and Lithuania, while it was 51\% and 45\% in Hungary and Poland respectively. Therefore, expenditures on education which amounted to 7\% of the GDP in Estonia in 2002 constituted 20\% of the country’s total public expenditures. In contrast, Hungary

\(^6\) EU-15 average spending on education is around 5\% of GDP.
allocated 11% of its total public expenditures to education in the same year (see Figure A3 in the Appendix).

Investment in ICT in the region may have also spurred further demand for higher education. Skill-biased technological change can, in theory, increase the demand for higher education. “The shift in production technologies causes information technologies to be complementary to employees with higher skill levels since it increases the returns to schooling” (Galor & Moav, 2000 in Castelló-Climent & Hidalgo-Cabrillana 2010, p.2).

EU funds have provided an additional stimulus for social investment in Eastern Europe. The EU began to heavily shape Eastern European growth models and EU co-financing became an essential factor for the development of the region since the countries became members in 2004. For the programmatic period 2007-2013, EU funds have represented 18.5% of Estonia’s GDP, while they have represented 19.4% and 19.6% in Latvia and Lithuania respectively (vs. 16.2% Eastern European average). Thus, the Cohesion Fund, European Social Fund and Horizon 2020 have played an important role in promoting social investment in the region, both as part of the Lisbon Agenda, Europe 2020 and the 2013 Social Investment Package.

Ever since 1993, member states have been determining the types of activities they spend the EU funds on. Therefore, allocation of funds and their structure reflect the countries’ individual growth strategies. In contrast to the other Eastern member states, many of the EU funds in Estonia have been channelled to the development of the
knowledge-intensive economy, such as boosting international competitiveness of enterprises through R&D and technology development. In Latvia and Lithuania the funds have been directed towards training of the unemployed and teachers, as well as increasing knowledge and competences of the workforce, thus indicating a strong social investment oriented component of the EU projects implemented in these countries too (KPMG, 2014).

Finally, Baltic countries have been allocating around 20% of their labour market policy expenditures to training while this category of expenditures has been almost non-existent in CEE (see Figure A9 in the Appendix). While there was a dip in expenditures on training during the period of economic recession, their share has recovered in Estonia and Latvia since, while it has continued to lag in Lithuania. Importantly, these expenditures in the Baltic have not come at the expense of unemployment compensation which guarantees income security to the unemployed. In fact, ever since the early 2000s, the Baltic countries have been at least at the level of CEE if not higher in terms of unemployment assistance coverage and income replacement rates, the standard measures to assess the generosity of the unemployment insurance system (see Figures A4-6 in the Appendix). This implies that a comparatively strong labour market policy has underpinned the Baltic growth model. In addition, Masso & Krillo (2011) show that expenditures on both passive and

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7 A cross-national comparison of labour market policy expenditures as % of GDP would not be very informative, since the Baltic countries have had substantially superior labour market performance than CEE throughout the 2000s and therefore less unemployed persons to spend on.
active measures in the Baltic countries have grown significantly since the onset of the 2008 economic crisis, also thanks to the use of EU funds which compensated for some of the fiscal constraints that the countries faced at the time. These observations indicate a strong response of labour market policy in the Baltic states to the adverse impact that the recession has had on the countries’ labour markets.

3.1.2 Educational attainment and digital literacy

By the end of post-socialist transition, the Baltic countries had a substantially higher share of the population with tertiary education than the CEE ones, which have been at even higher levels of economic development. In 2014, 32.6% of the working age population had tertiary education in Estonia in comparison to 19.1% in the Czech Republic (Figure 5). Latvia and Lithuania also stood out in terms of the higher educational attainment of their populations in comparison to CEE. While the earliest available Eurostat data on tertiary educational attainment shows that the Baltic countries were at higher levels than CEE already in the early 2000s, Terama et al. (2014) underline that enrolment in tertiary education in Estonia increased by 168% between 1994/95 and 2005/2006.

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8 Eurostat groups educational attainment into three categories, following the International Standard Classification of Education (ISCED) 1997 classification: i) pre-primary, primary and lower secondary education (levels 0, 1 and 2); ii) upper secondary and post-secondary non-tertiary education (levels 3 and 4), and iii) first and second stage tertiary education (levels 5 and 6).

9 Measured in terms of GDP per capita and GDP per capita PPP.
which constituted the highest growth rate in the OECD during that period (p.116).

**Figure 5. Working age population with tertiary education**

The cross-national difference in educational attainment has been even starker along gender lines. The Baltic countries saw the steepest gains in tertiary educational attainment among women. By 2014, 40.7% of working age women had tertiary education in Estonia in comparison to 20.1% in the Czech Republic (Figure 6). Therefore, expansion of tertiary education in the Baltic has primarily benefited women, which is consistent with the

**Figure 6. Working age women with tertiary education**

Source: Eurostat.

Finally, quality of education in the Baltic, and particularly in Estonia, has received international recognition. Estonia has become an international leader in educational achievement, according to PISA assessments. Based on the results of the most recent 2015 PISA, Estonia came only after Singapore and Japan in terms of the proficiency of 15-year-old students in science, reading and mathematics. It has also become one of the world’s top performers when it comes to the inclusion and fairness of
secondary education. More than four in ten Estonian students with a disadvantaged background score among the top quarter of students in all PISA participating countries despite the odds against them (OECD, 2016). Latvia was also one of the few countries which saw consistent improvements in their PISA scores from 2000, and its performance is at the level of the OECD average, along with the more developed economies such as the United States, Austria and Sweden. Lithuania, on the other hand, has lagged behind the OECD average.

The level of digital literacy, proxied by internet usage skills, in the Baltic is also higher than in CEE, and Lithuania in particular (Figure 7). It has in fact almost reached that of Sweden, while it is far above the rest of the EU member states.

According to The Web Index, Estonia is ranked very highly in a number of dimensions of the Internet’s contribution to social, economic and political progress in countries across the world. For example, in terms of the Access and affordability of the Internet component of the Index (which includes indicators such as access to internet in schools, cost of broadband per capita income and policies promoting free and low cost internet access), Estonia ranked third in Europe and Central Asia in 2014, right behind Denmark and Finland. While Lithuania and

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10 This index is produced by the World Wide Web Foundation and it is the world’s first measure of its contribution to social, economic and political progress at country level.
Latvia are not included in this survey,\textsuperscript{11} the Czech Republic was in the 17\textsuperscript{th} place, followed by Hungary which was in the 18\textsuperscript{th} and Poland in the 22\textsuperscript{nd}. In terms of the \textit{Education and awareness} component of the index, Estonia was also ranked third, after Iceland and Denmark, while CEE countries lagged substantially.

\textbf{Figure 7. Share of individuals aged 16-74 with proficient internet usage skills}

\begin{figure}[h]
\centering
\includegraphics[width=\textwidth]{figure7.png}
\caption{Share of individuals aged 16-74 with proficient internet usage skills}
\end{figure}

Source: Eurostat.
Note: These individuals can complete 5 or 6 of the following activities: used search engine, sent mail with attachment, posted messages to chatrooms/newsgroups or online discussion forum, made phone calls, done peer-to-peer file sharing or created a web page.

\textsuperscript{11} While this index does not include Lithuania and Latvia, other sources indicate that these two countries, although lagging after Estonia, are aspiring European leaders in ICT.
Estonia also ranked higher than Latvia and Lithuania in terms of its educational and ICT infrastructure already during the early 2000s, as well as its high-technology exports. Latvia appears to have been slightly more advanced than Lithuania in terms of hi-tech exports, but weaker in communication technology and R&D efforts (World Bank, 2003, p.8). Lithuania has also continued its progress in communication technology, and by 2013 the country was ranked 8th in the EU according to usage of electronic government services (KPMG, 2014).

3.2 Public sector employment

Figure 8 shows employment trends in the knowledge-intensive parts of the public sector in the Baltic vs CEE. According to the Eurostat classification, knowledge-intensive public sector activities include the following: i) public administration and defence, including compulsory social security, ii) education, and iii) health and social work. Public sector employees which work in state

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12 Because of the variation in employment rates across the Eastern European countries analysed in this article (see The three Baltic countries saw higher GDP growth rates than CEE countries during the 2000s, which went up to 10% annually (Figure 1). They were also more severely struck by the global economic crisis and experienced a total 20% GDP decline during 2008-2009, due to their high exposure to international markets. While this exceptionally strong impact of the crisis raised important questions about the sustainability of the Baltic growth model (Bohle & Greskovits, 2012), following an internal devaluation and implementation of austerity measures (Sommers & Woolfson, 2014), the region swiftly and recovered to again reach higher growth rates than CEE.
owned public companies are omitted from the analysis, also because of the significant variations in company privatization levels across Eastern European countries.

**Figure 8. Public sector employment (% of working age population)**

![Graph showing public sector employment](image)

Source: Author’s calculations based on Eurostat data.
Note: There is a break in the series in 2008 because Eurostat changed its classification of activities from NACE 1.1 to NACE 2.

Public employment levels in the Baltic have risen steadily during the 2000s, and by 2008 the region had by far the highest share of public sector employment in East-

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**Figure 2**, employees in the public sector are calculated as a share of the total working age population instead of a share in total employment. This is because two countries can have identical shares of employees in the public sector out of all employees, but when the overall employment rate is much lower in one country, that indicator hides the fact that a significantly lower portion of working age people work in the public sector in that country.
ern Europe (Figure 8). This is an unexpected finding, given the ‘neoliberal’ narrative offered by the political economy literature on Eastern Europe. The 2008 economic crisis had an adverse impact on the level of public employment in Latvia only, but the trend had recovered by 2010 and continued going upward. The differences between the Baltic and CEE are even more pronounced for women’s employment, which indicates a larger presence of women in the Baltic public sector than in CEE (see Figure A7 in the Appendix).

**Figure 9. Employment in education (% of working age population)**

Source: Author’s calculations based on Eurostat data.

Notes: 1) There is a break in the series in 2008 because Eurostat changed its classification of activities from NACE 1.1 to NACE 2. 2) Working age refers to the age cohort (15-64).
The education sector in particular has driven the overall higher trends in public sector employment in the Baltic. Figure 9 shows the share of employment in the education sector as a share of total working age population in Eastern Europe. The share is around 2pp higher in the Baltic countries than in CEE by the end of the period of observation. These trends have also been particularly pronounced for women. Around 10% of all working age women worked in the education sector at the end of the period of observation in all three Baltic countries (see Figure A8 in the Appendix).

3.3 Labour market inclusion

The Baltic countries have performed better than CEE when it comes to labour market inclusion of the traditionally marginalized groups such as women. Women have attained very high levels of employment, especially the educated ones, which is characteristic of countries with high levels of social investment (Nelson & Stephens, 2013). This trend stands in stark contrast to CEE countries, which have struggled to effectively incorporate women into their labour force (Avlijas, 2016). Employment rates of women aged 20-64 in 2008 stood at 72.9% in Estonia, 71.9% in Latvia and 68.7% in Lithuania in comparison to 62.5% in the Czech Republic, 60.3% in Slovakia and 54.8% in Hungary (Figure 10). Following the drop in female employment during the 2008-09 recession, these rates recovered to almost pre-crisis levels by 2014.
Employment gap between the two genders has also been substantially lower in the Baltic than in CEE, standing at around 4pp in all three Baltic countries in 2008. The gap ranged between 7-10pp in CEE throughout the period of observation (Figure 11). The 2008 crisis had a “positive effect” on the gender gap in employment rates in the Baltic, which disappeared entirely, predominantly because of a greater loss of male jobs in the region. As the male jobs recovered, the gaps almost returned to their (still very low) pre-crisis levels by 2014. These data indicate that women in the Baltic countries have had much more equal access to the labour market than women in CEE, both before and after the 2008 economic crisis.

**Figure 10. Female employment rates (20-64)**

Source: Eurostat.
Employment rates of youth, defined by Eurostat as those aged 20-29, have been substantially higher in Estonia and Latvia than in other Eastern European countries throughout the 2000s. They rose steadily in the two countries to reach around 70% in 2008, while Lithuania did not see as much progress on that policy front. While the 2008 recession caused a rather substantial drop in youth employment in the two leading performers, the two countries saw a recovery since 2010, but these rates have yet to recover to their pre-crisis levels (Figure 12).
IV. Conclusions and implications for future research

This article shows that a social investment welfare state in the post-socialist Baltic states has played an active role in delivering and shaping the region’s growth model. The article contributes to the literature on capitalist diversity in post-socialist Eastern Europe. It does so by revisiting the account by Bohle & Greskovits (2012) who criticize the Baltic growth model and argue that it has been socially ‘disembedded’ and characterized by very low state involvement. The article also revises the account that the region’s socio-economic successes can be attributed to the sound implementation of the Wash-
ington Consensus, which has put forward by Aslund (2013). It therefore appeases two seemingly contradictory perspectives on the nature of the Baltic transition to capitalism. The article’s findings are also of high political salience, because failing to acknowledge the important role of the state in underpinning economic transformation towards the ‘new’ economy leads us down a perilous path of concluding that market on its own can bring about superior educational and labour market performance. Finally, the article contributes to the emergent comparative political economy literature on growth models and growth strategies of the advanced capitalist economies, which emphasizes the importance of understanding how countries’ growth trajectories are determined by specific political opportunities and constraints, as well as the specific public policies that underpin them (Baccaro & Pontusson, 2016; Hassel & Palier, fcm).

The empirical section of the article shows that the Baltic countries have had higher expenditures on education and ICT literacy, higher generosity of labour market policies, higher levels of public employment and better labour market inclusion than CEE. The section also uncovers cross-national variations in the social investment welfare states across the region. Estonia is identified as the regional leader, Latvia as following closely, while Lithuania has lagged substantially in some dimensions of the social investment agenda.

The article also shows that social investment policies in the Baltic have been resilient to the impact of the 2008 economic crisis. While the three countries were severely
impacted by the recession, both in terms of their GDP decline and employment losses, empirical evidence has shown a pro-active labour market policy during the recession, following which their employment rates recovered to almost pre-crisis levels by 2010. The resilience of social investment policies during a severe recession indicates that they are not auxiliary strategies, but are in fact key pillars which support the region’s growth model.

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Appendix

Figure A1. Economic development, GDP pc PPP

![Economic development, GDP pc PPP](image)


Figure A2. Unemployment rate (% of total pop.)

![Unemployment rate, % total pop.](image)

Source: Eurostat.
Figure A3. Share of education in general government expenditures

Source: Eurostat.
Figure A4. Unemployment assistance coverage rate

Source: Comparative Welfare Entitlements Dataset (CWED).
Note: *Percentage of the labor force insured for unemployment risk.

Figure A5. Unemployment assistance income replacement rate: Single individuals

Source: Comparative Welfare Entitlements Dataset (CWED).
Figure A6. Unemployment insurance income replacement rate: Family (100%)

Source: Comparative Welfare Entitlements Dataset (CWED).
Figure A7. Female public sector employment (% of working age women)

Source: Author’s calculations based on Eurostat data.
Notes: 1) There is a break in the series in 2008 because Eurostat changed its classification of activities from NACE 1.1 to NACE 2. 2) Working age refers to the age cohort (15-64).
Figure A8. Female employment in education (% of working age women)

Source: Author’s calculations based on Eurostat data.
Notes: 1) There is a break in the series in 2008 because Eurostat changed its classification of activities from NACE 1.1 to NACE 2. 2) Working age refers to the age cohort (15-64).
Figure A9. Composition of labour market policy expenditures, 2006-2015

Source: Author’s calculations based on Eurostat data.
Note: 1) Data are not available for Poland. 2) The author includes the following policies into the job creation category: labour market arbitrage, employment incentives, supported employment and rehabilitation, direct job creation and start-up incentives.
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