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From transition crisis to the global crisis: Twenty years of capitalism and labour in the Central and Eastern EU new member states

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Abstract

This paper analyses the developments in wages, employment and income distribution in the Central and Eastern European new member states twenty years after transition to capitalism, divided into three periods: 1) the transition crisis; 2) post-transition growth; and 3) the crisis episode of 2008-9. Total employment has at best stagnated or slightly decreased. Modest wage increases have fallen behind productivity increases. Furthermore, the global crisis has led to employment losses in all countries, and real wages have already started to decrease in several countries.

Keywords

Central and Eastern Europe, wage, employment, wage share, crisis

Introduction

It has been now twenty years since the transformation of the Central and Eastern European Countries (CEECs) from planned economies to capitalism. After the initial shock of transition, towards the end of 1990s, these countries were being praised as success stories. However, this evaluation did not incorporate the deviation between the

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performances in terms of GDP growth vs. the outcomes for the working class. This paper analyses the consequences of this policy framework on wages, employment, unemployment and income distribution in the CEECs after twenty years of capitalism, divided into three periods: 1) the transition crisis; 2) post-transition growth; and 3) the crisis episode of 2008-09.

The integration of the CEECs to the Western European market, and later Eastern enlargement of the EU, was expected to bring about the catching-up of these countries in terms of GDP per capita in the foreseeable future. This very optimism soon turned into an unquestionable dogma, particularly since any critique of the process was also perceived wrongly as constituting praise for the old, anti-democratic regimes of the region. The neoliberal economic policy framework maintained an uncontested hegemony under these historical conditions. The Eastern enlargement of the EU has also been designed as part of the neoliberal economic model, which perceives integration as being the extension of markets and the creation of new secure and profitable areas for capital mobility, with little concern for social cohesion. The official policy line of the EU was legitimised by the mainstream optimistic expectations from free trade and private capital flows, based on traditional trade theory. Different from the previous enlargement phases, during Eastern enlargement, the EU budget and the amount of structural funds have been very limited; and consistent with the neoliberal policy framework, the EU has abandoned the task of convergence to private capital flows and international trade. These are the objective conditions under which the Central and Eastern European new member states (CEENMSs) find themselves obliged to get involved in wage as well as tax competition in order to attract capital.

The global crisis of 2009 and its consequences for the region have now laid bare the major shortcomings of this policy package, which has few instruments to counter the shock. The effects of the neoliberal policy framework on macroeconomic performance proved to be far from sustainable during the global crisis, which made it clear that the dependence of the region on private capital inflows is a major source of risk. After the initial transition shock and a decade of restructuring, all the NMSs are now facing the costs of integration to unregulated capital markets, despite differences in their development trajectory.

The rest of this paper is organised as follows: the second section analyses the trends in labour market outcomes and institutions in the CEENMSs since the transition era. The third section discusses the expected consequences of the crisis both at a macro level and for labour; and the fourth derives the conclusions and policy implications.

Labour from transition to European enlargement

Labour market outcomes

The 1990s started with a severe transition crisis in the CEECs, with the cumulative loss in GDP ranging from 13.2 per cent in the Czech Republic to 22.1 per cent in Slovakia, and reaching up to 45 per cent in Latvia and Lithuania. Table 1 shows the period averages for annual growth rates in GDP, employment, productivity, and real wages. The transition crisis was replaced by a recovery in output starting in 1993-4 in the Visegard countries and Slovenia, in 1995-6 in the Baltic states, and in 1998-2000 in Bulgaria and Romania; but as the market transition matured, dramatic changes in the sectoral employment structure and wages emerged in the CEECs (Havlik and Landesmann, 2005; Boeri and Terrell, 2002). In general, compared to the pre-transition era there has been a sharp contraction in employment, an increase in open unemployment, a massive exit from the labour market, and only moderate job creation. In particular, industrial employment has decreased in all the countries, not only in the first period of transition recession, but also in the post-recession period, at least until 2004-6. There have been some modest increases in Poland and Bulgaria after 2004, and in Czech Republic and Slovakia after 2006. In general, the jobs created in services have offset the negative effects of the major downsizing in the industry, but even during the uninterrupted growth years of the 2000s, new service jobs have just sufficed to generate stagnation in total employment (Hungary, Czech Republic, Romania), or modest increases in employment in the late-2000s (see Table 1). As a result of disappointing employment performance, employment rates (employment to population ratio) remained quite low – lower than 60 per cent in Hungary, Poland and Romania, as of 2008 (EUROSTAT, 2010). Only in Slovenia, Latvia and Estonia were employment rates slightly higher than the EU15 average of 67.4 per cent, and even when compared to the already low Western EU levels (let alone the higher rates of 74.3 per cent in Sweden), this is far from being a success story. However, a more striking comparison would be to the full employment performance of the pre-transition era. The fall in unemployment rates in Poland, Slovakia, Bulgaria and Romania in the 2000s seem far less spectacular, when the low employment rates are considered.

There is also an important difference between the male vs. female unemployment rates, with the latter being higher in all countries other than in the Baltic countries and Romania (ILO, 2009). As of 2008, the difference is particularly high in Slovakia, the Czech Republic and Poland. The female unemployment rates are higher despite the lower female labour-force participation rates, which range between 54.8 per cent in Hungary and 63.4 per cent in Bulgaria, as of 2008, for the total working-age female population (ILO, 2010). Only the Baltic countries and Slovenia have female labour-force participation rates higher than 65 per cent. The massive withdrawal from the labour market at the early stage of transition was stronger among women. The participation rates for the prime-age population (in the age group 25-54) are higher for both men and women, and the difference between women and men is lower. This is an improvement, which indicates that once the wave of withdrawal from the labour markets after the transition crisis is over, the gender gap in participation has also narrowed for the new generation in the prime-age cohort.

The youth unemployment rate (covering persons aged 15-24) is also strikingly higher than the total unemployment rate (ILO, 2009), reaching up to 19.9 per cent in Hungary, 19.0 per cent in Slovakia, and 18.6 per cent in Romania. The ratio of youth unemployment rate to adult unemployment rate is particularly high in Romania, followed by Hungary, Poland, and Slovenia.

Boeri and Garibaldi (2006) show that in the aftermath of 1996, recession periods led to significant job destruction, whereas expansions in GDP did not lead to statistically significant job creation in the CEE-10. Indeed, high rates of output growth in the CEECs in the post-recession era generated fewer jobs than did stagnation in the other countries of the EU (Boeri and Garibaldi, 2006). Izyumov and Vahaly (2002) find a

Table 1. Average annual growth in GDP, employment, productivity and real wage, 1989-2009 and sub-periods, Eastern EU MS

	1989*–1994				1994–2000				2000–2007			
	GDP	Employment	Productivty	Real wage	GDP	Employment	Productivty	Real wage	GDP	Employment	Productivity	Real wage
Czech Republic	–2,3	–2,0	–	–3,0	2,2	–0,8	3,2	3,2	4,5	0,8	3,8	4,7
Hungary	–3,2	–4,2	3,7	–1,9	3,3	0,5	2,1	–1,9	3,7	1,1	2,0	4,3
Poland	–1,6	–3,6	2,0	–3,5	5,7	–0,2	5,0	4,8	4,1	0,6	2,6	1,1
Slovenia	–2,3	–4,6	3,8	–6,0	4,3	–0,3	4,7	2,9	4,4	0,9	3,3	3,0
Slovakia	–2,4	–	12,6	–5,6	3,8	–0,6	4,8	5,3	6,2	1,0	5,9	3,3
Estonia	–1,6	–4,3	2,7	–17,3	6,0	–2,7	8,9	8,0	8,1	1,7	6,4	8,6
Latvia	–11,2	–5,1	19,0	8,2	4,3	–2,3	2,7	3,4	9,0	2,4	5,7	9,9
Lithuania	–11,5	–2,0	0,0	–19,8	4,5	–1,2	8,3	6,9	8,1	1,3	5,6	8,5
Bulgaria	–5,7	–5,8	8,5	–13,4	–0,2	0,0	0,0	–4,4	5,6	2,0	3,2	4,0
Romania	–4,6	–1,8	1,6	–6,7	0,1	–2,4	5,0	6,5	6,1	-0,8	5,5	9,3

Table 1. *(Continued)*

	2008				2009				1989*–2009			
	GDP	Employment	Productivty	Real wage	GDP	Employment	Productivty	Real wage	GDP	Employment	Productivity	Real wage
Czech Republic	2,5	1,2	1,1	1,3	–4,2	–1,2	–2,3	–1,1	1,5	0,1	2,9	2,1
Hungary	0,6	–1,3	1,6	0,9	–6,3	–3,6	–3,4	–4,5	1,2	–0,2	1,9	0,2
Poland	5,0	3,8	0,5	3,8	1,7	0,4	1,0	1,0	3,0	0,3	3,0	1,1
Slovenia	3,5	2,8	0,5	1,5	–7,8	–2,2	–5,4	4,0	2,0	0,3	3,2	0,6
Slovakia	6,2	2,8	4,1	1,3	–4,7	–2,4	–0,5	3,6	2,7	0,3	5,4	1,5
Estonia	–3,6	0,2	–5,1	0,6	–14,1	–9,9	–4,2	–2,2	4,4	–0,5	5,6	1,4
Latvia	–4,6	0,9	–6,2	–1,0	–18,0	–13,6	–3,7	–14,6	0,1	0,0	4,8	5,0
Lithuania	2,8	–0,5	0,7	2,9	–15,0	–6,9	–8,1	–11,5	0,3	–0,2	5,0	–1,1
Bulgaria	6,0	3,3	2,3	7,4	–5,0	–2,9	–0,9	6,9	0,4	0,6	3,2	–2,9
Romania	7,3	–0,2	6,7	13,5	–7,1	–1,0	–6,1	–0,1	0,9	–0,8	3,9	4,0

Notes
The starting date differs with respect to data availability. GDP data for Estonia only starts in 1993; the employment data for Slovakia starts in 1994, and for Hungary in 1992. The employee data for the Czech Republic starts in 1995; in 1992 for Hungary and Latvia; in 1993 for Slovakia, Estonia, and Lithuania; and in 1990 for Romania. The wage data for Latvia starts in 1993, and for Estonia in 1990.
GDP is in 2000 prices in national currencies. Employment is total economy. Productivity is real GDP/employee. Real wage is labour compensation deflated by private consumption deflator, index 2000=100.
Period averages are geometric averages. The data for 2009 is the AMECO forecast as of April 2010.

Source: Own calculation based on AMECO (Economic and Financial affairs, Annual Macroeconomic Indicators online database). In the case of the missing values for 1989-1991, growth rates of the variables in WIIW (The Vienna Institute for International Economic Studies), Handbook of Statistics, online database is used.

lower Okun's coefficient of -0.526 (the effect of GDP growth on the change in unemployment) in the 10 CEECs in the post-recession era of 1995-2000, compared to the coefficient for EU15 (-0.799).

Another important concern is that of the quality of the jobs created in the service sector. One major problem of the neoliberal pattern of European integration continues to be that jobless growth and deindustrialisation go hand in hand. Although the shift in employment from industry towards services is a pattern, which goes along with improvements in productivity and can be observed in developed countries as well, Reinert and Kattel (2004) point out that the type of deindustrialisation in the CEECs is qualitatively very different from the slow 'de-industrialisation' of high-income countries, which upgrade into a knowledge-intensive service sector. In contrast, the service jobs created in the CEECs are mostly low–skilled and low-paid jobs.

An indicator about the quality of employment is the share of vulnerable employment, calculated as the sum of contributing family workers and own-account workers as a percentage of total employment (ILO, 2009). As of 2008, this share is quite high in Romania (31.2 per cent), which is particularly due to the high share of agricultural sector, which has a higher share of self-employment and unpaid family workers. Poland follows with an 18.9 per cent share of vulnerable employment. In the Czech Republic, Slovenia and Slovakia, the share is slightly higher than 10 per cent; however in Slovakia, further data about informal employment reveals a very high and increasing share of informal employment in total employment in the non-agricultural economy (23 per cent as of 2008: ILO, 2009).

This disappointing employment performance took place despite massive wage cuts in the early stage of transition, which was then followed by moderate wage growth compared to productivity. The transition shock came with a sharp real wage cut in the first two to three years: of 39 per cent in Slovenia; 30 per cent in Czech Republic and Slovakia; 15 per cent in Hungary during 1989-1991/92; more than 60 per cent in the Baltic countries during 1990-1992/93; and a prolonged decline of 70 per cent during the period 1990-97 in Bulgaria. Table 1 shows the period average for annual growth in real wage and productivity (GDP/employee). Although wages started to recover in the second half of the 1990s, real wages significantly lagged behind productivity in seven out of ten countries during 1994-2000, despite strong growth in GDP and the opening up to Western Europe through trade and FDI. Slovakia, Latvia and Romania are the exceptions in this period. During the period 2000-7, wage growth was still lower than productivity growth in Poland, Slovakia, and Slovenia. In manufacturing, this gap is more pronounced (Onaran, 2008). Thus the CEECs have also followed the wage moderation policy of Western European countries, and wage convergence between Eastern and Western Europe remained weak despite the phenomenal improvements in productivity in the periphery of Europe. Indeed, with the onset of the global crisis, real wage growth slowed in 2008 in the Czech Republic, Slovenia, Hungary, Estonia and Latvia. Even before the crisis, despite the strong wage growth in the 2000s, in Bulgaria and Lithuania real wages were as of 2008 lower than in 1989, and in Hungary and Slovenia, there has been negligible improvement. In 2009, the figures point at already declining real wages in the Baltic states, Hungary, Romania and the Czech Republic, as will be discussed in more detail below.

As a consequence of this moderate wage growth, which lags behind productivity, and low employment, the labour share has been declining in Slovenia, Poland, Bulgaria and Romania, and stagnant in Hungary and Slovakia (Figure 1). The only exception to this are the last years in the Baltic countries and Czech Republic, when the labour share is back to the former peaks at the start of the transition; however data does not allow us to compare their current situation with the pre-transition phase. Moreover, as the forecasts indicate, this recovery will be reversed during the current crisis, as will be discussed in more detail below.

In the meantime, the GINI coefficients have increased in all 10 CEECs (AMECO database). The low GINI coefficients of the early 1990s, ranging from 19.4 in the Czech Republic to 25.2 in Poland, increased to a range of 25.4 in the Czech Republic and 34.9 in Poland. The Baltic countries have the highest GINI coefficients of the region, reaching 36. In Poland, Slovenia, Slovakia and Romania, the increase in inequality was continuous, while in Hungary and Lithuania, the improvement in equality in the late-1990s was reversed again later.

The mode of accumulation in the CEENMSs has been very dependent on foreign capital inflows from Western Europe in key sectors, with the exception of Slovenia. Nölke and Vliegenthart (2009) define this regime as dependent market economies, and emphasise the role of multinational enterprises (MNEs). However, within this common framework of dependent development, further differences emerged. Becker and Jaeger (2010) distinguish between a regime of accumulation based on dependent industrialisation in Visegrad countries (Hungary, Czech Republic, Slovakia, Poland) and Slovenia, as opposed to a regime based on dependent financialisation in the Baltic countries and the South Eastern member states (Bulgaria and Romania).[1] In the countries with dependent industrialisation, the industrial export sector has been the driving force of accumulation; however the dependency on imports as well as repatriation of profits have been high, leading to current-account deficits beyond 5 per cent of GDP, with the exception of the Czech Republic. The countries with dependent financialisation are marked by highly appreciated domestic currencies, which hindered international competitiveness and industrial development, and capital inflows, which have mostly financed real estate bubbles (Becker and Jaeger, 2010). In these countries, with the exception of Romania, the appreciation of the domestic currency was determined by fixed exchange-rate regimes, which aimed at establishing stable domestic currencies. The end result was dramatic current account deficits exceeding 10 per cent of GDP, or even 20 per cent of GDP in the case of Latvia and Bulgaria. The decline in industrial employment was particularly strong in the countries with dependent financialisation; nevertheless the decline in total employment has been among the highest also in Poland and Slovenia, along with the countries with dependent financialisation. However, the actual divergence in the employment and growth performance of these two regimes and the fragilities associated with dependent financialisation became more evident after the global crisis, as will be discussed below. A controversial fact about this dependent development, for the mainstream economists, is that rapid improvements in exports and FDI have not generated a stronger boost to employment. It is true that transition economies of Central Asia, which have attracted significantly lower FDI inflows, performed much more poorly than did the Eastern European countries in terms of employment and growth. However, the shooting stars of the East, which have been the most attractive destinations of the Western European

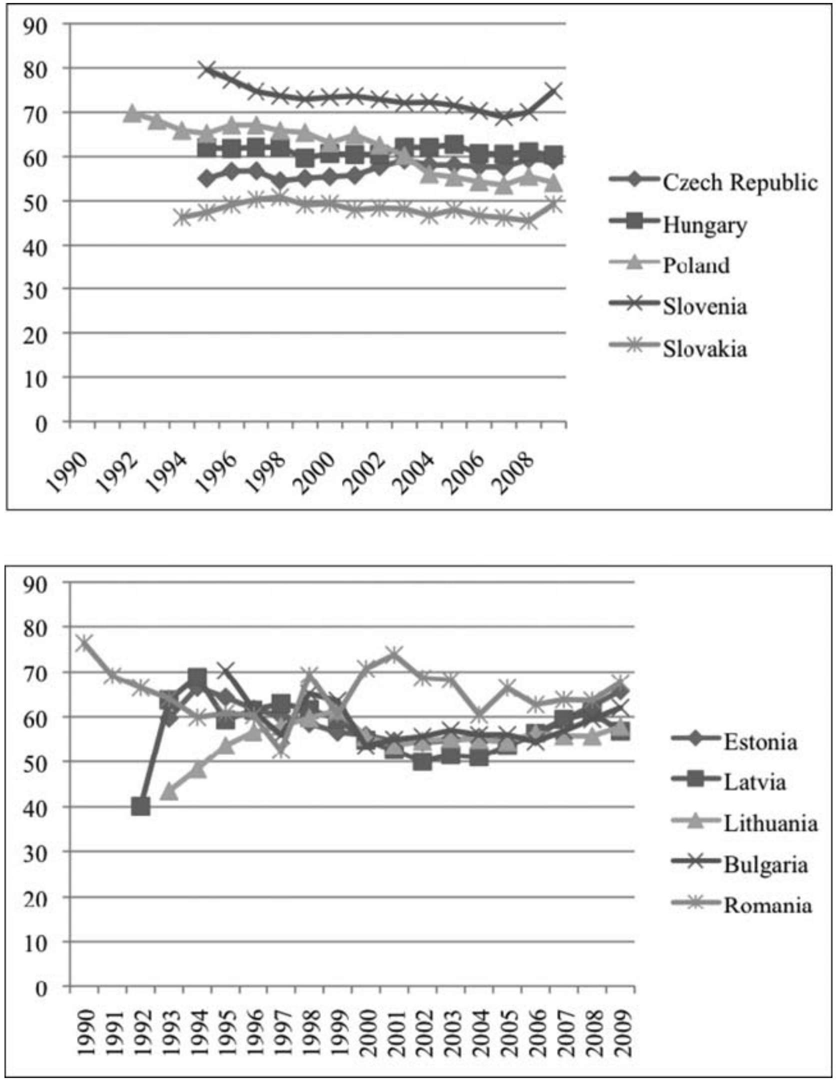

Figure 1. Adjusted wage share, Eastern EU MS*
*Compensation per employee as percentage of GDP at factor cost per person employed.
Source: AMECO (Economic and Financial affairs, Annual Macroeconomic Indicators online database), April 2010.

MNEs, have not been star performers in terms of labour-market outcomes. Onaran (2008) finds that exports (to EU15), imports (from EU15) and FDI have had no significant positive effect on employment in manufacturing in the post-transition period in most CEECs. Onaran and Stockhammer (2008) estimate the effects of FDI and trade

on wages in the manufacturing industries during the period 2000-4 in five CEE countries, and find that only in the capital-intensive and skilled sectors has FDI had a positive effect on wages, and that international trade has had no significant effect. Interestingly, in the long run, the effect of FDI becomes negative, exports also have a negative effect on wages, and imports have a positive one. Thus in the long run, neither FDI nor international trade has the expected effect according to the traditional trade theory. Although MNEs tend to pay higher wages than local firms in most developing countries as well as in the CEECs, there are also many anecdotal stories for other countries concerning threats by companies to move to sites with even lower wages, if workers try to unionise or raise their wages (Burke and Epstein, 2001).

These results could come as a surprise to neoclassical economists, who would expect an increase in employment and wages thanks to trade liberalisation and FDI inflows in countries that are relatively capital scarce compared to Western Europe. A close look at the nature of FDI flows can account for this adverse development. About half of the FDI in the new member states between 1990 and 1998 was in the form of privatisation-related acquisitions, and the restructuring of the former state-owned enterprises led to massive labour shedding (Hunya and Geishecker, 2005). In later years, especially in manufacturing, most of the new FDI has been investment in new assets; however even then, although new capacities usually increased employment, technological progress also led to lay-offs simultaneously. Moreover, most of the greenfield jobs have been created in the service sector such as banking, retail and real estate. Irrespective of the initial method of entry, FDI is now increasingly taking the form of reinvestment of profits, the results of which are yet to be seen. Apart from the direct effects, indirect negative effects of FDI are also observed (Hunya and Geishecker, 2005): jobs were destroyed through negative spillovers as foreign investors replaced traditional domestic suppliers by imports, or domestic firms disappeared or downsized due to intensified competition from larger and technologically more advanced foreign subsidiaries of multinational enterprises. Thus productivity spillovers of FDI to domestic firms have been very limited, and in turn, employment effects have been weak or negative. Mencinger (2003) points at several reasons that may explain the absence of positive productivity spillovers in the CEECs: 1) the extent of imitation is limited because of the small size of the countries (except Poland), where often a single company represents the whole industrial sector; 2) the restructuring of a privatised firm acquired by a MNE most certainly may be associated with specialisation within production or the business chain of the MNE, which implies purchasing raw materials and spare parts within MNEs, rather than local suppliers. Thus, while the microeconomic efficiency of the MNE increases, its forward and backward linkages might shrink, and this might increase current account deficits. Then 3) due to the concentration of FDI in trade and finance, multinational companies contributed more to imports than to exports of host countries; and 4) large MNEs often force small domestic firms out of business, and thus reduce potential competition and create monopolistic or oligopolistic structures.

Furthermore, profit repatriation by the MNEs creates long-term current-account problems, as discussed above. Finally, capital flows, even if in the form of FDI, create macroeconomic instability due to the appreciation of the local currency and fragility with respect to sudden capital flow reversals. This last point was demonstrated after the deepening of the global crisis in autumn 2008. These findings do not mean that FDI is to blame for the jobless growth pattern of the CEE NMS, but they indicate that in the absence of a systematic industrial policy for structural change and public investments, which could have been financed by domestic states as well as the EU, transition based on private FDI inflows do not generate strong domestic spillovers, and fail to compensate for the job losses of the early transition period.

Labour market institutions and industrial relations

At the beginning of transition, not even the actors for wage negotiations were present. With the exception of Poland, none of these countries had independent unions, nor were employers organised in associations. Privatisation, foreign direct investment and EU accession have shaped the transition of industrial relations (Aquilera and Dabu, 2005). EU accession processes affected in particular the states' role in establishing industrial relations through the adoption of modern labour laws, the right of workers to form unions, and collective bargaining.

Boeri and Garibaldi (2006) report that wage floors in the new member states (NMS) are often not binding, and are rarely enforced in the private sector: the ratio of minimum wage to the average wage is around 30-40 per cent compared to a ratio of 50 per cent on average in EU15. Schroeder (2002) reports that the minimum wage to average income ratio as of 2001 is ranging from 33 per cent in the Czech Republic to 42 per cent in Lithuania – Slovenia is an exception, with a ratio of 52 per cent. Kohl and Platzer (2007) argue that minimum wage increases serve as benchmark for wage contracts. States often encouraged tripartite meetings, which among other things, are involved in setting minimum wages.

Former official trade unions had strong membership, although they had little practical influence. After transition, the numbers declined dramatically. Kohl and Platzer (2007) argue that the private sector is characterised by large 'union-free' spheres; and Aguilera and Dabur (2005) argue that this is also the case for the multinational enterprises. Galgoczi (2003) reports that the multinational enterprises match their wage and welfare policies solely to the local conditions; even some big firms are 'union free'; and cases of trade union presidents' being threatened have been observed. Regarding the power of unions, collective bargaining coverage rates are very low compared to EU-15, although union density rates are more comparable (Boeri and Garibaldi, 2006). Viser (2009) provides data on union density, collective bargaining and dominant levels of bargaining. With the exception of Slovenia, only a minority of the workers is covered by collective bargaining. The adjusted rate of collective bargaining coverage is 44 per cent in the Czech Republic, and 35 per cent in Hungary, Slovakia and Poland. Bulgaria, Latvia and Estonia have even lower rates, at around 20-25 per cent, and Lithuania has the lowest collective bargaining coverage at 12 per cent. Union density varies substantially, being highest in Slovenia (at 41.3 per cent) and Romania (33.7 per cent), followed by Slovakia (23.6 per cent), with the other countries ranging between 16 and 21 per cent. The early transition period also witnessed the foundation of independent unions and conflict between old and new unions (Schroeder, 2004). Strong rivalry persists in Poland and Hungary, while other countries typically have one dominant union federation and several smaller ones.

The targets of the trade unions were rather far from a productivity-oriented wage policy: Stasek (2005:588) reports that a Czech union president writes, 'the collective bargaining process … was successful and worked well … and generally respected the principle of maintaining the real wage'.

According to Viser's (2009) index of wage coordination, most countries have firm-level wage negotiations; only in Slovenia and Slovakia is there economy-wide coordination, with central elements or pattern bargaining similar to Austria or the Scandinavian countries. Slovenia is a clear outlier, whereas Slovakia has more sectoral elements in bargaining. Romania fits into the category of industry bargaining, with no or irregular pattern setting. Hungary, the Czech Republic and Bulgaria represent intermediate cases of mixed industry- and firm-level bargaining. All the Baltic countries as well as Poland have the most market-oriented industrial relations, with fragmented bargaining, mostly at company level.

Many indicators show that the newly formed labour markets in the CEECs are rather flexible. Based on panel data estimation of wage bargaining equations for the sub-sectors of manufacturing in the CEECs, Onaran and Stockhammer (2008) find that wages are highly flexible with respect to unemployment. Regarding employment flexibility, Hungary, the Czech Republic and Slovakia are ranked in the more flexible half of the OECD countries, according to the Index of Rigidity of Employment Protection Legislation of OECD (2004). The Employment Rigidity Index in the World Bank's Doing Business Report (2006) ranks the four OECD members in CEE (Czech Republic, Poland, Hungary, and Slovakia, the first being the most flexible) at a level between fifth to ninth among 20 countries, where Ireland is ranked the sixth. Thus wage or employment rigidity does not seem to be the reason behind the disappointing employment performance.

Crisis and the consequences for labour

CEENMS are being severely affected by the credit crash and capital outflows, and possible currency crises accompanying the banking crisis, although the recent problems in the old periphery countries of Europe removed the focus on these countries as Europe's 'sub-prime'. After the initial transition shock and a decade of restructuring, these countries will once again face the costs of integration to unregulated global markets. The early optimism about the decoupling of the East from the West proved to be wrong. The hopes for a soft landing were replaced by fears of a hard landing in 2008 autumn; the conventional wisdom of the markets shifted from optimism to pessimism; and the EU anchor seems to be helping only to a limited extent. The fundamental problem of the region was an excessive dependency on foreign capital flows, and as a typical consequence of this, a bust period following the boom was an unavoidable outcome of capital flow reversals. Many authors, including myself, were pointing at these risks, and a bust did happen again (Onaran, 2007; Becker, 2007; Goldstein, 2005). If it had not been due to the global crisis, it could have been triggered through traditional channels of expectations regarding the sustainability of the overvalued exchange rate and high current-account deficits. Ignoring the possibility of capital outflow was a gamble in policy making. This behaviour is like ignoring a gas leak in your house, and choosing a 'wait and see' strategy rather than trying to fix the leak. Markets in the last instance could not prevent the systemic risk, but only postponed it and made it bigger.

The difference of this crisis compared to the former boom-and-bust cycles in the periphery is that it is a global and not a regional crisis. It has originated from the core, but the consequences for the periphery of Europe are heavier. The credit crunch has a global dimension, which makes the usual capital inflows after the bust phase unlikely. Again, due to the global character of the crisis, the export markets have severely contracted, and depreciation, which is a usual outcome of boom-bust cycles, now only has the negative balance-sheet effects, and no positive demand effect. The austerity packages in Western Europe further threaten recovery. The extent of debt-led growth and household and private-sector debt, most of all in foreign currency, is also increasing the risks more than did the former crises, with wider social implications of depreciation.

The slowdown in global demand, the decline in FDI inflows, portfolio investment outflows, the contraction in remittances, and the credit crash are affecting all the Eastern European countries; but the degree of accumulated imbalances including current-account deficits, exchange-rate appreciation, the housing-market boom and foreign-currency-denominated private debt determine the differences in the depth of the effects among these countries. The Baltic countries, Hungary, Romania and Bulgaria are more exposed than Poland, Czech Republic, Slovenia and Slovakia. The sudden reversal of capital flows had disastrous effects in the countries with dependent financialisation. Latvia and Estonia entered a recession already in 2008. Hungary has some features similar to those of the countries with dependent financialisation, which made the effects of the crisis heavier, compared to the other Visegrad countries. In Hungary, the public sector, households and firms are in debt, and the current-account deficit has been high for a long time. In particular, government bond auctions made the country a target of speculations and capital outflows early on, and it became one of the first countries to depend on the IMF programme, along with Latvia. Hungary is now affected by the sovereign debt crisis in Greece and other peripheral countries in the Eurozone; but even Poland, Czech Republic, Slovenia and Slovakia are suffering from those effects, and from the slowdown in global demand and the decline in FDI inflows. Excessive dependence on export markets and a dangerous specialisation in the automobile industry, as in the case of Slovakia in particular, but also in the Czech Republic and Slovenia, turn out to be major risks. Poland is experiencing only stagnation rather than a recession, thanks to its more diversified market and large domestic economy, with a lower trade volume as a ratio to GDP. However, growth rates in Poland only accelerated in 2006; and thus the boom had not yet created all the associated fragilities. Both Slovakia and Slovenia have escaped turbulence in the currency markets by adopting the Euro; but their problem will be a permanent loss of international competitiveness relative to their Eastern European competitors, whose currencies depreciate. To avoid speculation, Estonia is also willing to opt for the lesser evil, i.e. to adopt the Euro.

The myth that these countries would not experience bottlenecks regarding the current-account deficits, thanks to FDI's being a major source of finance of the deficit, also proved to be wrong. It is true that FDI is still more robust than the other capital flows, but FDI inflows have also fallen significantly, reaching the level, of 2001-2 (Hunya, 2009). Although the current-account deficits are also falling because of lower imports, FDI is now financing a declining part of the deficits. Furthermore, FDI not only finances but also creates current-account deficits; average repatriation rates of profits have been 70 per cent in the region; and FDI inflows are either only as large as or even less than the repatriated profits in Hungary, Slovakia and Czech Republic (Hunya, 2009).

Nine Eastern European economies in the EU have had a recession in 2009, Poland being the only exception (see Table 1). Employment has declined and unemployment

increased significantly in all countries, with the sharpest increases taking place in the Baltic countries. Real wages have fallen in the Czech Republic, Hungary, the Baltic countries and Romania. The austerity programmes in Hungary, Romania and Latvia will further reinforce the pressures of the crisis. The wage share has already fallen in Latvia, Hungary, Poland and the Czech Republic (see Figure 1). Moreover, a long-lasting recession cannot be ruled out, which would certainly have negative effects on the real wage and labour share.

In the last part of Table 1, we calculate the long-term average annual growth in GDP, employment and real wages in the last twenty years of transition to a market economy: with first a transition recession and then a global crisis, the gains in terms of growth and wages are far from spectacular. Employment has at best stagnated, and it has decreased in Romania, Estonia, Lithuania and Hungary, compared to 1989. Real wages have stagnated in Hungary and Slovenia, and have even fallen in Lithuania and Bulgaria. Real wage growth has, overall, lagged behind productivity growth. The only significant real wage growth has taken place in Romania, but even then only equal to improvements in productivity. This does not look like a politically and socially viable balance sheet of integration.

The current global crisis has created no change in the policy stance regarding European enlargement. The concerns of the EU for the NMS are shaped by the interests of the MNEs, in particular Western banks, and are limited to maintaining the stability of the currency rather than employment and income. The EU did not have the political will to create the institutions and tools for a unified counter-cyclical stimulus plan, but rather delegated the issue of the NMS to the IMF, albeit with some financial support to prevent a big meltdown of the Western European MNEs in the region. The IMF's injured credibility after the Asian crisis was restored at the G20 via an increase in the available funds to the IMF, but not much has changed in the policy framework, despite the seemingly different discourse. Faced with the pressure of capital outflows, Hungary, Latvia and Romania have resorted to the IMF. The EU connection, thanks to the interests of the MNEs, and in particular West European banks in the region, has determined the size of the packages rather than the genuine content. As it was in the case of the crises in the developing countries in the 1990s and 2000s, the IMF's policies are again far more restrictive than those the IMF deems appropriate for the Western European countries. The credit line to Poland without conditionality is the only new tool the IMF has used. Otherwise, Hungary, Romania and Latvia have strongly pro-cyclical fiscal policies; fiscal discipline is still the norm; and cuts in public-sector wages and pensions are part of the recipes. In the fixed-exchange-rate countries, the prevention of devaluation was the major aim to protect the foreign banks, which had extended the majority of the loans in foreign currency. The governments of these countries were also not willing to push domestic firms and households indebted in foreign currency into bankruptcy through devaluation. Thus nominal devaluation was replaced by a brutal internal real devaluation via wage suppression. In Latvia as of the fourth quarter of 2009, average salaries fell by 12.1 per cent. Public-sector wages were down by 23.7 per cent compared to a year ago; and pensions have been cut by 10 per cent. Together with increases in the VAT rate from 18 per cent to 21 per cent, these were the conditions to which the Latvian government had to agree in order to get the second tranche of the IMF package (Gligorov et al., 2009). The government has forced through spending cuts and tax rises worth a tenth of

GDP (Ward, 2010). The cost of this internal devaluation has been a 25 per cent loss of GDP in two years, and 22.9 per cent unemployment in 2009. It also translated eventually into a political crisis, as the biggest party, the People's Party, broke from the ruling coalition because of its support for the tax cuts. In Estonia and Lithuania too, cuts of at least 20 per cent in public wages and a reduction in social benefits have been decided (Gligorov et al., 2009). Thus the current-account imbalances are being corrected not through nominal but real devaluation, and deep recession.

One difference during this crisis is that the IMF is now trying to bail in the banks in order to maintain the level of credits in the countries that have an IMF financial programme. The major difference compared to East Asia and Latin America was the reliance on parent banks in the mature markets with a longer-term strategy of expansion in the region, rather than market finance via foreign capital flows. The parent banks' loyalty to the region did not happen automatically, though. For example, initially the Austrian government has said that it would only support its troubled Erste Bank, which was overexposed to risky loans in foreign currency in Eastern Europe, if the money went to loans inside Austria, rather than to the further expansion of loans in the East (*The Economist*, March 2010c). This approach would have led to each individual bank's reducing its exposure by calling in loans and dumping assets, and a major currency crisis, which would have hurt the banks themselves as well. The small number of large international players with a long-term strategic investment in the unsaturated new banking markets of the region facilitated coordination, and the European Bank for Reconstruction and Development led the 'Vienna Initiative'. The ECB's liquidity provision to foreign banks in Eastern Europe encouraged them to keep financing the subsidiaries outside the Euro area. The IMF support helped the central banks of Eastern Europe to provide liquidity to foreign-owned banks as well as to the minority domestic-owned banks. However, given the global crisis and the crunch in the wholesale credit markets, the ability of parent banks to maintain the credit booms in the region is exhausted, and even without further capital outflows, the region suffers from a deeper recession than in the West in the absence of former capital inflows. The speculation about the Greek sovereign debt is creating particular liquidity restraints for the Greek banks and their affiliates in Bulgaria and Romania; and the funding problems of other European parent banks are also rising. The currency depreciation or the recession will lead to increases in non-performing loans and further affect the parent banks' approach to the Eastern affiliates. In Latvia, even without devaluation one fifth of debt is non-performing due to the recession (*The Economist*, 2010). Although the non-performing loans will not lead to a collapse of the Western banks, they will erode their capital buffers, and contribute to stagnation in credit and economic activity in the region.

Another difference in this crisis in the Eastern MS compared to the former crises in the developing countries was the moderate scale and pace of depreciation. In the countries with the floating exchange-rate regime, there has been some contagion even in countries like Poland, but not a total breakdown until now: the exchange rate only depreciated by 20-30 per cent in Hungary, Poland and Romania, with some recovery afterwards, and the fixed pegs are still holding in the Baltic states and Bulgaria. The maintenance of the problematic pegs required rather large international rescue packages in comparison to the size of the economy. The Western European banks operating in the region (such as the Swedish in the Baltic states and the Austrian in Bulgaria) and their home country governments have applied pressure to avoid devaluation for fear of high non-performing loan rates, which would erode their profitability. The local governments also stand behind the pegs. However, preserving this overvalued fixed exchange rate under the current policy framework came at the cost of a very deep recession and deflation to create a real devaluation, and the mechanism for that was massive wage cuts, as can be seen in Latvia.

On the other hand, the consequences of an unmanaged devaluation following a market-made currency crisis would also lead to very severe distributional effects, as was the case during the Asian or Latin American crises. The reason for that are the inflationary effects of high devaluation rates following a currency crisis. In import-dependent developing countries, devaluation has a high pass-through effect to domestic prices due to the rise in the imported input costs, and during a severe recession and high unemployment, it is impossible for workers to index their wages to past inflation rates (Onaran, 2009). So far during the recent global crisis, not only has the depreciation rate been moderate, but also the pass-through effect to inflation has been restrained by the global deflationary environment and the falling commodity prices. However, any problem in the periphery in Eastern or Western Europe or other developing countries regarding speculative attacks on sovereign debt and capital outflows can easily trigger contagion effects and pressures on currencies in Eastern Europe again.

Capital controls on outflows or a managed devaluation are not even mentioned in the IMF or EU debates. The only recent revision has been a recent 'IMF Staff Position Note' about capital controls on inflows to moderate the effects on the exchange rate (Ostry et al, 2010); however, this does not help at this moment, when the boom has already been followed by a bust.

Conclusions and policy implications

FDI inflows to the CEECs have been the channels around which most of the optimistic expectations about catching-up have been built. However, FDI without a systematic industrial policy does not seem to deliver what mainstream economic policy expects from it. As opposed to the common wisdom, FDI and trade have not necessarily brought positive aspects for labour in the Eastern European countries. Total employment has stagnated or even slightly decreased, along with significant job losses in industry. Modest wage increases have fallen way behind phenomenal productivity increases. Simple reliance on private capital flows has proved unable to lead to an egalitarian income distribution. Similarly shocking to many economists will be the finding that international trade does not deliver an increase in wage shares in the more labour-abundant economies of the CEECs. Furthermore, the global crisis has led to employment losses in all countries, and real wages have already started to decrease in Hungary, the Baltic countries, Romania and the Czech Republic.

In spite of these adverse developments, the lack of a serious policy about EU-wide social cohesion is still dominating the enlargement process. As the wage growth in the CEENMSs lag behind productivity, the convergence of wages to Western levels proceeds at a rather slow pace. The depth of the crisis in some CEENMSs will not only slow down convergence, but also create a further divergence in wages. The current global crisis has also created no change in the policy stance. The concerns of the EU for the CEECs are shaped by the interests of the MNEs, and are limited to maintaining the stability of the currency, rather than employment and income. How or whether the West supports the East in weathering the current global crisis will be critical in the political credibility of the EU.

In the European context, labour in the old and new member states has more common ground than it is currently exploiting. The coordination of collective bargaining activities is vital in order to avoid beggar-thy–neighbour policies and the relocation threats of the employers to suppress union demands. Coordinating the institutional setting of wage bargaining, a fundamental correction of the wages in both the periphery and the core to reflect the productivity gains of the past three decades fully, and designing a European framework for minimum wages and shorter working hours is the only alternative to readjust the playground back to conditions that are fairer to labour. Understandably, labour in the East can only be convinced to stop seeing lower wages as an advantage and the only way to attract private FDI from the West, if there is a systematic EU policy on regional convergence and social cohesion. Regional convergence should be supported by fiscal transfers and public investments to boost productivity in poorer regions. Industrial and technology policy should set investment priorities and recognise the significance of public investment to achieve these ends. The regional and cross-country distribution of these investment programmes should be based on dynamic long-term targets, instead of static competitive advantages. Furthermore, a European unemployment benefit system should be developed to redistribute from low to high unemployment regions. This requires a significant EU budget financed by EU-level progressive taxes.

The most important obstacle today to initiate any progressive economic policy in Europe is the speculation on public debt and the governments' commitment to satisfy the financiers. Public finance has to be unchained via debt default in both the periphery and the core. This has to be coordinated at the EU level as part of a broader public finance policy to make the responsible pay for the costs of crisis and to reverse the origin of the crisis, i.e. pro-capital redistribution. This involves a highly progressive system of taxes, coordinated at the EU level, not only on income but also on wealth, higher corporate tax rates, inheritance tax, and tax on financial transactions.

Another important fact that became clearer after the global crisis is that capital account openness creates turbulences and structural imbalances, and that capital controls and financial regulations are vital. They are not, however, enough. The crisis has shown us that large private banks are exploiting their advantage of being 'too big to fail'. Yet the challenge is the finance of socially desirable large new investments, e.g. in the energy sector. What needs to be done is to build a public banking sector with the participation of the workers and other stakeholders in decision making, and transparency of the accounts.

A similar managed approach is required with regards to the exchange-rate policy. In Eastern Europe, a direct transition from the pegged exchange rate to the Euro as is planned in Estonia, or insistence on preserving the overvalued pegged exchange rate as in the case of Latvia, Lithuania and Bulgaria, ignores the need for a major adjustment in the exchange rate. Devaluation pushed by market forces would be devastating, but this can be overcome with capital controls, debt restructuring and a managed devaluation with price controls. To avoid the negative effects of devaluation on indebted households and firms, the foreign-currency denominated debt must be converted to local currency at the current exchange rate, and the burden of devaluation must be shifted to the private banks of the core countries. Similarly, to avoid the inflationary effect of devaluation on the purchasing power of people, price controls could be introduced.

Last but not least, after twenty years of capitalism in the Eastern European countries and amidst the global crisis of the neoliberal model, it is time to discuss efficient as well as socially desirable alternatives for the mechanisms of economic decision-making, and to derive positive lessons from the negative experiences of anti-democratic plans as well as unstable market mechanisms. This crisis calls for a major shift in decision-making to facilitate the economy-wide coordination of important decisions. This in turn requires public ownership and the participation and control of the stakeholders (the workers in the firms, consumers, regional representatives, etc.) in critical sectors for society, such as banking, housing, energy, infrastructure, pension system, education and health. Bringing democracy, participation and planning together to avoid short-termism, instability and inequality will require the mobilisation of our collective creativity to bridge the current urgent problems with a democratic socialist alternative for the 21st century.

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Endnote

1. In a more detailed divide, Drahokoupil and Myant (2010) distinguish between different modes of integration through MNCs, exports in complex sectors, exports in simple manufacturing, commodity exports and financialised growth. Looking from the perspective of welfare regimes, Bohle and Greskovits (2007) distinguish between a neoliberal type in the Baltic states, an embedded neoliberal type in the Visegrad states, and a neo-corporatist type in Slovenia.

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