https://association-radar.org/spip.php?article1797

Economic crisis

Global crisis and the policy reaction in Western and Eastern European Union

- Features - Economic and debt crisis -

Publication date: Monday 18 January 2010

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1. Introduction

The neoliberal policies and the deterioration in labor share have created an important fertile ground to bury the seeds of a major global crisis together with debt accumulation, and the risky developments in the credit, housing, and security markets. Thus what we are going through is a crisis of high exploitation rates and extreme inequality in distribution; and similarly the policy reactions to the crisis are part of a distributional struggle.

This also explains why the international as well as national institutions reacted to the accumulating risks only after they turned into a full-fledged crisis. The policy reaction of the ruling elite, shaped by the existing pro-capital power structures, are mere efforts to preserve the high profit shares via massive state intervention with an aim of going back to the "business as usual" strategy of neoliberalism. As can be expected, without the pressure of mass mobilizations, there is a clear unwillingness to alter the distribution of income and wealth in their efforts to save capitalism from itself. However the wishful thinking of the ruling elite to go back to "business as usual" is ignoring the multiple dimensions of the crisis.

First, on the economic dimension, capitalism is facing a major realization crisis. Neoliberalism tried to solve the crisis of the Keynesian consensus of the golden age of capitalism via a major attack on labor; profit rates eventually recovered in the major capitalist economies in the 1990s; however this created a potential realization crisis due to low wages as well as investment. Thus it only replaced the profit squeeze and over-accumulation problems of the 1970s with the realization problem. The potential negative effects of the dramatic deterioration in the income of the working people and financialization on consumption and investment demand in the last two decades was overcome via debt-led consumption of the US at the global level. Now since summer 2007 this solution has also collapsed and the capitalist economy is faced with a major systemic crisis. The depth of the crisis is comparable to the Great Depression; it is only the unprecedented policy intervention that makes the visible dimension more moderate. Now that the financial mechanisms that made the accumulation of debt collapsed, it is unclear how the realization crisis can be overcome with this strategy.

Second, on the ecological dimension, recovery efforts are all centered on maintaining growth and employment via high consumption, and it is simply hoped that we can go on consuming as before via some magical technological change in energy efficiency. However, different from the last systemic crisis in the 1970s today the ecological limits to growth are scientifically firmly established, which provides a strong basis to the idea that any economic recovery plan must not imply a return to business as usual in ecological as well as in economic terms. If the use of environmental resources is to maintain a certain â€˜sustainable' level, economic growth, in the long term, has to be zero or low, i.e. equal to the growth rate of â€˜environmental productivity'. However, for such a regime to be socially desirable it has to guarantee a high level of employment and an equitable distribution of income. It is this last point that is at odds with capitalism, as long as there is no major technological revolution.

Third, on the political legitimacy dimension, the depth of the present crisis has torn holes in the hegemony of neoliberalism. Rising unemployment and inequality after the crisis in Western Europe and returning to the days of initial transition crisis after 20 years of capitalism in Eastern Europe, will lead to serious political discontent. Thus there is space for radicalization, but the left is yet to challenge the ideological hegemony of capitalism.

Given this multiple dimensions of the crisis, it is debatable where the recovery will come from, even if the bottom of the recession were reached. "Business as usual" is not feasible in the long run, so the question is whether capitalism can create new institutional structures, a new locomotive sector, overcome the limits of ecological sustainability and

political legitimacy, and come out of this crisis with a new wave. The destructive creative capacity of capitalism cannot be excluded; however the hardness of this process is opening space for radical systemic change.

The following section discusses the distributional background of the crisis. Section three presents briefly the recent evidence about the depth of the crisis in the West and the East and discusses the consequences of the crisis for labor. Section four evaluates the policy reactions. Section five concludes with policies that could connect the urgent needs and discontent of the people to an alternative socialist economic model.

2. The crisis of the neoliberal era of capitalism

Neoliberal economic policies have been the answer of the capitalists to the crisis of the 1970s. Since the 1980s, the world economy has been guided by deregulation in labor, goods and financial markets at the domestic and international level. Since the 1990s, the transformation of the Soviet Union and Eastern Europe opened up new markets for consumption and a wide global reserve army of cheap labor and relieved the pressure on the welfare states of the West to maintain a certain living standard for the working masses. The outcome was a dramatic decline in labor's bargaining power, and a secular deterioration in the share of labor in national income since the early 1980s in major capitalist economies (Figure 1). There is a secular decline in the labor share across the globe ranging from developed countries to major emerging economies of Latin America, Asia, as well as Eastern Europe, who have all shared similar neoliberal policy guidelines. Although this global trend is very striking, these numbers are hiding another important fact: the very high wages of the CEOs or other top managerial income earners are also part of labor income, and the share of these high income groups in total labor income has increased dramatically at the expense of the rest of the wage earners in the last two decades (ILO, 2008). Thanks to increased rates of exploitation, profit rates already recovered by late 1990s or early 2000s in the US and in most EU countries back to the levels of early 1970s (Figure 2). The profit rate has indeed recovered not only in the aggregate economy but also in non-financial sector as well as in manufacturing, albeit at a lower degree in the latter due to the intensive intra-capitalist competition. The recovery in the profit rate has borrowed itself to both the decline in the wage share, i.e. higher rates of exploitation, and a lower investment rate out of profits in both the EU countries and the US.

[https://association-radar.org/IMG/jpg/Onaran_Figure1.jpg]
Figure 1: Adjusted wage share, total economy, EU & US (1960-2008)*
Source: AMECO, online macro-economic database of the European Commission's Directorate General for Economic and Financial Affairs,
*Compensation per employee/ GDP at factor cost per person employed, %
[https://association-radar.org/IMG/jpg/Onaran_Figure2.jpg]
Figure 2: Profit rate in different sectors (Net returns on net capital stock)
Source: Bureau of Economic Affairs for US, and EUKLEMS for Europe

Here lie the two important long term contradictions of the neoliberal era of capitalism. Firstly, neoliberal era has generated higher profits for multinational firms, and especially for the financial sector. However, the high financial returns have replaced profits from real activity in many cases. As the finance dominated regime rose, the investment behavior of the firms were significantly affected by the rising shareholder value orientation. Lazonick and O'Sullivan (2000) argue that a shift in management behavior from â€˜retain and reinvest' to â€˜downsize and distribute' has occurred. Financial market-oriented remuneration schemes based on short-term profitability increased the orientation of management towards shareholders' objectives. The unregulated financial markets and the pressure of financial market investors have created a bias in favor of asset purchases as opposed to asset creation. At the same time most of the effort of macroeconomic policy makers has been going to policies to retain the confidence of volatile financial markets. Markets have been deregulated mainly to support the interests of the rentier-capitalists. The same process has limited the demands of workers. In a way, the loss in labor's share has prevented the profits in the real sector from being eroded by increased interest payments. Consequently the relationship between profits and

investment has changed; thus higher profits do not automatically lead to higher investment. The share of dividends and interest payments in profits increased substantially in the last two decades; thus retained profits for investment declined. In spite of higher profit rates and a boom-euphoric business environment, not only in the USA, but also in the major advanced capitalist economies (Germany, France and the UK), as well as some developing countries (e.g. Latin America, Turkey), economic growth rates have been well below their historical trends. In a deregulated financial environment, it would be irrational for the capitalists to give up the short term high profit options in financial speculation and engage in long term irreversible and uncertain physical investment. At this point it has to be emphasized that the reference point for the capitalists in the post 1980s was not the profit rates of the early 1960s in manufacturing, which might be higher than currently, but was the short term and high return of the financial assets. Thus, it is unconvincing to see this crisis as an outcome of long-term declining trend in the profit rates due to an unavoidable rise in the organic composition of capital (as in Choonara, 2009; Harman, 2009; Kliman, 2009) or increased international competition (Brenner 2009).

Secondly the decline in the labor share has been a potential source of realization crisis for the system. Profits can only be realized, if there is sufficient effective demand for the goods and services. But the decline in the purchasing power of labor has a negative effect on consumption, given that the marginal propensity to consume out of profits is lower than that out of wages. This affects investments negatively, which are already under the pressure of share holder value orientation.

Exactly at this point the financial innovations seemed to have offered a short-term solution to the crisis of neoliberalism in the 1990s: debt-led consumption growth. It is important to note that without the unequal income distribution the debt-led growth model would not have been necessary or possible. Particularly in the US, but also in UK, Ireland or even some continental European countries like Netherlands and Denmark the household debt increased dramatically in the last decade. The increase in housing credits and house prices fuelled each other; then the increased housing wealth thanks to the housing bubble served as collateral for further credit, and fuelled consumption and growth and maintained high profit rates. This phase, despite with growth rates lower than in the 1960s, deserves to be named as a new expansionary long wave with the peculiarity of profits without investment and growth without jobs and with an increased financial fragility. Financialization leads to a debt-led growth by fueling consumption in the short-run, but debt has to be serviced in the future. Because of high debt levels, the fragility of the economy to the possible shocks in the credit market also increases.

The deregulation in the financial markets and the consequent innovations in mortgage backed securities, collateralized debt obligations and credit default swaps facilitated the debt-led growth model. These innovations and the “originate and distribute” model of banking have multiplied the amount of the credit that the banks could extent given the limits of their capital. The premiums earned by the bankers, the commissions of the banks, the high CEO incomes thanks to high bank profits, the commissions of the rating agencies all created a perverse mechanism of investments that led to short-termism and ignorance about the risks of this banking model. In the short-run in the sub-prime credit segment, even if the risk of default were known, this was not perceived as a major issue: first, most of these credits were anyway sold to other investors in the form of mortgage backed securities with high ratings. Second, when there is a credit default, the houses, which serve as collateral, could be taken over and as long as the house prices kept increasing this was a profitable business for the creditor. However this banking model led to a very risky economic model and a time bomb, which was destined to explode eventually. The bad news from the sub-prime markets triggered the explosion eventually, and first the market for CDOs and then the interbank market, and finally the whole credit market collapsed at a global scale.

It is interesting to ask, why it took so long for the time bomb to explode. The reason is the endogenous evolution of the expectations: as the debt-led growth model produced high short-term growth and profits, optimism was stimulated via self-fulfilling prophecy, and risks were more and more underestimated even by those who were more conservative at the beginning. In a world of coerced competition (Crotty, 1993) even those who see the risks are forced to take risky positions, if they are to keep their jobs as dealers, bankers, or CEOs, since the burst of the

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bubble is a matter of time, and it can take longer than the short-term evaluation of the profits by the share holders, who fail to value more secure investment behavior. Just a couple of weeks before the big collapse in July 2007, the ex-CEO of Citibank, Chuck Prince, had said "when the music stops, in terms of liquidity, things will be complicated. But as long as the music is playing, you've got to get up and dance" (Elliott, 2007). When the shock came, credit crunch and the collapse of the debt-led growth model was inevitable.

A more important explanation is the distributional aspect behind this risky model: the prevention of the crisis required the solution of the distributional problems behind the debt-led growth model, i.e. redistribution of income and wealth; however the powerful global elite, who have influence over global policy making through their nation states would not agree with this solution. Therefore the policy institutes hoped for a "soft-lending" that would correct the bubbles without effectively touching the distributional conflict.

This debt-led consumption model created a current account deficit in the US that exceeded 6% of the GDP. This deficit was financed by the surpluses of some other developed countries like Germany and Japan, developing countries like China and South Korea, and the oil rich Middle Eastern countries. In Germany and Japan current account surpluses and the consequent capital outflows to the US were made possible by wage moderation, which has suppressed domestic consumption and fuelled exports. Thus this is again an outcome of the crisis of distribution. On the side of the developing countries like China and South Korea, the experience of the Asian and Latin American crises stimulated a policy of accumulation of foreign reserves as a bail-out guarantee against the speculative capital outflows. Here the international dimension of inequality plays an important role: these countries, threatened by the free mobility and volatility of short term international financial flows, invested their current account surpluses in US government bonds instead of stimulating their domestic development plans. In the European context strong wage moderation in Germany created further imbalances within the West as well as between the East and the West: within the West, the lack of a systematic industrial policy and public investments created a rise in the costs of production (unit labor costs, i.e. wage/productivity) in countries like Spain, Greece, Portugal, Italy, Ireland. Thus the high current account surpluses of the neo-mercantilists of the EU, i.e. Germany along with Austria, Netherlands, and Finland came along with widening trade deficits in the other EU countries. The low level of wages in Eastern Europe also did not save them from running high current account deficits thanks to the high amount of imports from the international supplier networks of the European multinational companies as well as the high profits of these foreign investors (repatriated as well as reinvested).

3. Crisis in the Western and Eastern EU Countries

The crisis is unfolding the divergences and particular fragilities of the different countries within Western Europe as well as the periphery of Europe.

3.1 Western Europe

Although the crisis originated in the US, the impact is heavier in Europe partially due to the larger size of the fiscal stimulus plans as well as the speed of reaction in the US. According to the OECD Economic Outlook revised forecasts of September, US GDP will contract by 2.8% in 2009, whereas Euro area (12 countries) is expected to contract by 3.9% and UK by 4.7% (See Table 1). The UK is having a deeper recession due to dependence on financial sector, deleverage in the banking sector, the burst of the housing bubble, and household debt. The prospects within the old Euro area (12 old member states) are also rather diverse: while the size of the recession in Germany reaches up to a decline of 4.8% and in Italy to 5.2%, France is expected to contract by 2.1%. There are also diverging sources of fragility in different Western EU countries. As the export markets are shrinking, Germany is particularly suffering from the curse of its neo-mercantilist strategy, i.e. growth based on export markets via wage

dumping, which had led to decades of stagnant domestic demand. The chronic current account deficits of Italy, Spain, Greece, Portugal as an outcome of the historical failure of the EU and the single currency without any policy for regional convergence is now proving to be detrimental: the financial investors are asking for much higher interest rates in return for the government bonds of these deficit countries in the EU compared to Germany since 2007. These countries' ability to respond to the shocks is also constrained by their fiscal capacity. Austria is also following this camp in terms of the high interest rate spreads due to the excessive expansion of its banks in Eastern Europe. Ireland with its disproportionally large banking sector and the bust of the housing bubble will not only go into a deeper recession with a contraction of 9.8% (OECD Economic Outlook June 2009 forecast, not revised) in 2009 but also continue to contract in 2010. In Spain the burst of the housing bubble and the consequent contraction in construction is also expected to lead to a continuous recession in 2010.

[https://association-radar.org/IMG/jpg/Onaran_Table1.jpg]

Table 1 : OECD Economic Outlook, June 2009, projections

In the Western European countries, other than Spain and Ireland, OECD claims that there will be a recovery earlier than expected, â€œbut the pace of the recovery is likely to be modest for some time to come.â€ (OECD, September 2009). Clearly the forecasts of OECD must be perceived as an upper limit of recovery.

Real wages are expected to decline in both the UK and Germany in 2009 (by 1.3% and 1.2% according to our own calculations based on the forecasts about nominal wages and CPI inflation,) as well as 2010, and this is already following a decline of 1.6% and 0.9% in 2008. Belgium and Ireland are the two other countries, where real wages are expected to decline in 2009, and in Ireland this trend continues also in 2010. This is all the more striking given the optimism of OECD, particularly for 2010 in pointing at a low but positive growth. It has to be also mentioned that in 2008 in France, Italy, Austria, Belgium, Luxemburg, and Sweden, there had already been some real wage losses. Sharp and long lasting increases in unemployment are likely to make the wage losses much stronger in 2010. If the political and organizational conditions remain like this, there will be dramatic effects in the bargaining power of labor. The case of Japan shows that during the initial phase of a deflationary crisis (or a long lasting recession), labor share stagnates or in some years even slightly increases, but as the recession and deflation persists, even nominal wage declines take place; eventually in Japan wage share has declined by 8.9% in 2007 compared to 1992 (Onaran, 2009a). The decline in the wages in Eastern Europe, which will suffer from the global crisis, will also add further international competitive pressures on wages in Western Europe. Differences with respect to skill levels and further dispersion of within labor distribution are also to be expected. It is already the case that the temporary workers are losing their jobs first, and the more qualified workers are being hoarded. However some skilled workers in the automotive or metal industry or finance have already been the first to be affected. Furthermore the future cuts in governmentsâ€™ social expenditures will also asymmetrically affect labor.

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Unemployment is expected to increase by 2.5% in the UK as well as the old Euro area and further worsening is expected in 2010. Particularly high increases are expected in Ireland and Spain (6.2%-points and 6.8%-points of increase respectively).

Overall the fiscal capacity of many Western European countries helped them to better weather the shock through policies that were denied to the developing countries of the periphery during the crises of the 1990s and 2000s. Therefore the shock seems to be less severe at the beginning given the actual dimension of the problem. However a persistent L-type crisis with a long recession seems very likely. The economies might have arrived the bottom of the valley, but might not be able to get out of there for a long time, and further deteriorations cannot be excluded. Despite the moderating effects of the policy reaction, the depth of the crisis can be much stronger than the long Japanese recession of the 1990s, given the global dimension of the crisis.

3.2. Eastern European Member States

During the global crisis, the emerging markets of Eastern Europe are being severely affected by the credit crash and capital outflows, and possible currency crisis accompanying the banking crisis. 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 soft lending have also been replaced by fears of hard lending since Fall 2008; 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 episode 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 were not due to the global crisis, this could have been triggered through traditional channels of expectations regarding the sustainability of the overvalued exchange rate and high current account deficits. Simply ignoring the possibility of a massive capital outflow was always gambling in policy making. This behavior is like ignoring a gas leakage in your house, and choosing a "wait and see" strategy, rather than trying to fix the leakage. 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-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 will be heavier. The credit crunch has also a global dimension, which makes the usual capital inflows after the bust phase and the depreciation of the currency 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, will now only have the negative balance sheet effects, and no positive demand effect. The extent of debt-led consumption growth and household debt, most of all in foreign currency, is also increasing the risks more than the former crises with wider social implications of a further depreciation.

The slowdown in global demand, the decline in FDI inflows, portfolio investment outflows, the contraction in remittances, and credit crash are effecting all the developing countries, but the degree of accumulated imbalances including current account deficits, exchange rate appreciation, housing market boom, and foreign-currency denominated private debt will determine the differences in the depth of the effects among these countries. Baltic Countries, Hungary, Romania, Bulgaria, are more exposed than Poland, Czech Republic, Slovenia, and Slovakia. But even the latter group is suffering from the contagion effects, the slowdown in global demand, and the decline in FDI inflows. The contraction in remittances can also become an issue in the future. Excessive dependence on export

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markets and a dangerous specialization in the automobile industry as in the case of Slovakia in particular, but also in the Czech Republic and Slovenia turns out to be major risks. It is no surprise that Poland is projected to have the lowest rate of contraction thanks to its more diversified market and large domestic economy with a lower trade volume as a ratio to GDP. It is also important to note that the growth rates in Poland only accelerated in 2006, thus the boom had not created all the fragilities yet (Gligorov et al., 2009). Both Slovakia and Slovenia have escaped turbulences in the currency markets by adopting the Euro; however their problem will be a permanent loss of international competitiveness relative to their competitors, who are devaluing.

The myth that these countries would not experience bottlenecks regarding the current account deficits thanks to FDI 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 in the first quarter of 2009, FDI inflows have fallen by 20-80%, reaching the level of 2001-2002 (Hunya, 2009). Although the current account deficits are also falling because of lower imports due to the slow down, FDI is now financing a declining part of the deficits. Furthermore FDI not only finances but also creates current account deficits; average repatriation rate of profits have been 70% 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).

What has been different in this crisis in the CEECs 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 10-30% in Hungary, Poland, and Romania, and the fixed pegs are still holding in the Baltic States and Bulgaria. The major difference compared to East Asia and Latin America was reliance on parent banks in the mature markets with a longer term strategy in the region rather than market finance for foreign capital flows. 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 will suffer from a deeper recession than in the West in the absence of former capital inflows. The expansionary fiscal policies of the Western countries are also creating rival investment opportunities for the limited global financial funds. The currency depreciation as well as the recession will lead to increases in non-performing loans and further affect the parent banks' approach to the Eastern affiliates. A currency crisis in the form of an abandoning of the pegs in the Baltic States and Bulgaria due to further capital outflows and a new wave of depreciation in the floating exchange rate countries cannot be completely ruled out. Any devaluation can trigger further contagion effects in the region. The maintenance of the problematic pegs require rather large international rescue packages in comparison to the size of the economy, which might not be possible if the EU funds contract due to the existing funding problems in the core countries themselves, and it is debatable whether the available IMF funds would suffice. The Western European banks operating in the region, like the Swedish in the Baltic States and the Austrian in Bulgaria and their home country governments are pressurizing to avoid devaluation in 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 will come at the cost of a very deep recession and deflation to create a real devaluation, and the mechanism for that seems to be 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 might lead to also 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, 2009b). So far during the recent global crisis, not only the depreciation rate has been moderate, but also the pass through effect to inflation has been restrained by the global deflationary environment and the falling commodity prices. However, both can become severer in the future.

It is hard to make forecasts at this stage, but based on the forecasts of European Commission (Annual Macroeconomic Indicators (AMECO), April 2009 round) all ten NMS will have a recession in 2009 (Table 2).

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Employment will decline and unemployment will increase significantly in all countries, with the sharpest increases taking place in the Baltic Countries. Evidence in the former developing country crises shows that the unemployment rates do not go back to pre-recession rates long after the recession (Onaran, 2009a). The real wages are estimated to fall in Hungary, Lithuania, and Latvia, and they are estimated to be stagnant in Estonia and Poland. The austerity programs in Hungary, Romania, and Latvia will further reinforce the pressures of the crisis. The wage share is often observed to be increasing during a crisis in advanced countries, but in developing country cases, dramatic inflation shocks due to the currency crises had made the decline in real wages much stronger than that in productivity, and thereby the wage shares fell strongly (Onaran, 2009a). It is yet to be seen how the wage share will evolve in 2009 in the CEECs; it is already expected to fall in Latvia, Lithuania, and Slovenia; however further developments will be critically determined by the extent of the depreciation. Moreover the case of a long lasting recession cannot be ruled out, which would certainly have eventually negative effects on the real wage and labor share.

[https://association-radar.org/IMG/jpg/Onaran_Table2.jpg]
Table 2: Average annual growth in GDP, employment, productivity, and real wage, 1989-2009 and sub-periods
Notes: *The starting date differs with respect to data availability. GDP data is only starting in Estonia in 1993, the employment data starts in Slovakia in 1994, in Hungary in 1992, and in Estonia in 1990, the employee data starts in 1995 in Czech Republic, in 1992 in Hungary and Latvia, in 1993 in Slovakia, Estonia, and Lithuania, in 1990 in Romania and the wage data starts in Latvia in 1993 and in Estonia in 1990.
GDP is in 2000 prices in national currencies. Employment is total industry. Productivity is Real GDP/Employee. Real wage is labor compensation deflated by private consumption deflator, index 2000=100.
Period averages are geometric averages. The data for 2009 is AMECO forecast from April 2009 round.
Source: Own calculation based on AMECO (Economic and Financial affairs, Annual Macroeconomic Indicators online database); in 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.

If we take the current forecasts of the European Commission as given, which seem to be rather optimistic as of now, and calculate the long term average annual growth in GDP, employment, and real wages in the last 20 years of transition to a market economy in the 10 CEECs, the record is shocking (Table 2). Having started the period with a transition recession, and ended it with a global crisis, the gains in terms of growth and wages are far from spectacular. Employment has at best stagnated, and even decreased in Romania, Estonia, Lithuania, and Hungary. Real wages have stagnated in Hungary and Slovenia, and even fallen in Lithuania and Bulgaria (Table 2). Real wage growth has overall lagged behind productivity growth. The only relevant real wage growth has taken place in Romania, but then again this is exactly comparable to improvements in productivity. This does not look like a politically and socially viable balance sheet of the painful transition recipes of the last 20 years (See Onaran, 2009c for more details).

4. Policy reaction in Europe

4.1 Western Europe

All advanced countries reacted to the crisis with unprecedented rescue efforts to weather the global economic slowdown (ILO, 2009): monetary policy tools were mobilized through unforeseen reductions in policy rates as well as quantitative and qualitative easing in the Central Banks' lending to the banks, albeit ECB reacted slower than Bank of England and FED. Further financial rescue packages for the financial system were created in the form of guarantees of private deposits, state participation via capital injections into banks, and even nationalization and forms of buying of "toxic assets". Fiscal rescue packages were started, although with a delay, in the form of new spending on public goods and services, stimulus aimed at consumers like tax cuts and transfers, and stimulus aimed at firms like corporate tax cuts and sectoral subsidies. The biggest fiscal stimulus package among the advanced capitalist countries was announced by the US, and European packages were much smaller in size (as a % of GDP). A recent

report prepared at ILO by Khatiwada (2009) argues that fiscal measures have been relatively inadequate: 32 countries (including the G20), the stimulus spending in 2009 accounts for 1.7% of GDP, which is less than the 2% recommended by the IMF. Rescue packages were announced based on relatively optimistic forecasts. Furthermore financial measures have outweighed fiscal measures by a factor of on average 10 (Khatiwada 2009). Although a comparison is imperfect, because guarantees in the financial packages might never be used, the relations are still absurd. The ratio of the financial rescue package in 2008 reaches 28.6% of GDP in the UK and to an absurd level of 235.7% in Ireland (OECD, Economic Outlook, June 2009). Ireland additionally has a contractionary fiscal policy. Although continental European Banks claim to have a more conservative banking and credit policy at home, they also proved to be prone to significant risks via purchasing of CDOs of US banks as in the case of Germany, or via excessive credit expansion in Eastern Europe without calculating the risk of a bust of the boom-phase as in the case of Austria, Sweden, and partly Greece. In this latter group due to high exposure to the risk of credit default in Eastern Europe, Austria has a financial rescue package of 36.9% of its GDP and Sweden 50.5%. Moreover the lack of government conditions for support to banks have so far been weak, which does not punish the liquidity hoarding behavior of banks, and therefore bank lending continues to decline.

Composition of the fiscal package is also inadequate: in advanced economies only 3% of total spending is on employment, 10.8% on social transfers to low-income households, and only 15% in infrastructure (Khatiwada 2009). OECD (Economic Outlook June 2009) usually emphasizes that the automatic stabilizers like unemployment insurance benefits in the EU, particularly in the northern EU, are almost 3 times the fiscal stimulus plans, and thereby the total size of the fiscal stimuli are adequate. However the numbers in the same report shows that the US total fiscal stimulus including automatic and discretionary measures are still above 10% of GDP as opposed to a mere 6% in Germany. The size of the total fiscal stimulus exceeds that in the US in only 4 EU countries (Sweden, Luxemburg, Spain, Denmark).

Apart from the size of the package, one major problem in the EU is the absence of a coordinated policy reaction, other than the European Commission's decision to ask that the countries achieve a stimulus plan of 2% of GDP. The divergences within the EU, even within the Western EU are not sufficiently addressed by the policy. There has been only vague and random declarations in the press, e.g. by the German finance minister, that the EU will not let any member state having trouble with its sovereign debt, in case the financial investors increase the pressure over the government bond interest rates of the deficit countries to levels, which would push countries to default.

It is also unclear, when the neoliberal economists will start cheering for fiscal discipline and fear of inflationary pressures. As of now the OECD (Interim Economic Assessment September 2009) emphasizes the need of fiscal stimulus but already starts warning: there is â€žneed to prepare for the removal of the exceptional degree of support afforded by current monetary and fiscal policy stances, credible exit strategies and fiscal consolidation plans now." Despite the size of the rescue packages, the existing policies are missing the reasons. As the source of the crisis there is an overemphasis on low interest rates in the US, and very little debate about the liberalization of the financial markets. The new EU regulation that the Banks have to hold 5% of their credits in their balance sheets now sounds more like a joke after the crisis of the â€žoriginate and distribute" model of banking. Also in the G-20 meeting just a regulation of the â€žsystemic important financial institutes" is foreseen, and the hedge funds are only required to register and be transparent instead of achieving certain capital ratios (Stockhammer, 2009). Although the costs of the rescue packages are clear, no policy design is being made to make the responsible and the wealthy pay the costs through a tax reform. Further policies to address the real root of the crisis, which is the dramatic pro-capital shift in income distribution, is any way not expected to be addressed by the ruling elite given the current balance of power relations; however minor tax reforms are also not debated. With regards to the global imbalances, much of the emphasis is on the over-consumption of the US or too low wages and undervalued currency of China, rather than the wage dumping and stagnant domestic consumption in Germany.

It is also hard to label these policies as a return to Keynesian policy. Although Keynes was also dedicated to saving capitalism from itself, Keynesian policies would be to foster a wide program to stimulate investments through public

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initiatives as well as incentives to the private sector, a re-regulation of the financial system, and at the international level capital controls and fixed exchange rates. Under the current balance of power relations, the ruling elite will not voluntarily accept to implement a Keynesian policy framework. Thus going back to the golden age of managed capitalism requires already major organizational effort of the working people and a radical shift in the power relations.

4.2 Eastern Europe

The current global crisis has created no change in the policy stance so far regarding European enlargement and social cohesion. The concerns of the EU for the CEECs 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 CEECs including the NMS to the IMF, albeit with some financial support to prevent a big melt down 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, 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 former crises in the developing countries in the 1990s and 2000s, the IMF policies are again much more restrictive than what IMF finds appropriate for the Western European countries, e.g. Germany. The credit line to Poland without conditionality is the only new tool the IMF has used. Otherwise Hungary, Romania, and Latvia are having strongly pro-cyclical fiscal policy; fiscal discipline is still the norm, and cuts in public sector wages and pensions are part of the recipes. In Latvia public wage bills have been cut by 35%, pensions by 10%. Together with increases in the VAT rate from 18% to 21%, these were the conditions, which the government in Latvia had to agree to get the second tranche of the IMF package (Gligorov et al., 2009). In Estonia and Lithuania also at least 20% cut in public wages and a reduction in social benefits was decided (Gligorov et al., 2009). One difference is that the IMF is now trying to bail in the banks to maintain the level of credits in the countries that have an IMF financial program, but it is yet to be seen whether the huge international rescue package will remain in the country, or whether it will in the future help to bail out the international investors as it has happened in East Asia and Latin America. Capital controls to avoid speculative outflows or a managed devaluation are not even mentioned in the IMF or EU debates.

5. There is an alternative!

There is a great public discontent regarding how the ruling governments, in particular the social democrats, reacted to the crisis by socializing the costs of the crisis. This is ironically also decreasing the legitimacy of any policy alternative that includes "collective" mechanisms in governance or nationalization. There is, however, a window of opportunity for the first time after the fall of the Berlin Wall, to argue that capitalism is economically, ecologically, and politically unstable and unsustainable. The road to bridging the popular discontent to an alternative sustainable, egalitarian, democratic, participatory and planned socialist economic model is rocky due to the ideological barriers of the last decades. But we have also advantages: now it is clear that higher profits do not lead to investments or more jobs; growth does not mean a decrease in inequality, and capitalist market economies are prone to systemic crisis. In order to formulate the policy alternatives to the crisis, it is important to emphasize the big picture behind the crisis: This is not just a crisis of improperly regulated markets, but also a crisis of unequal distribution, and it should be asked why labor should go on paying the costs of this crisis further. Any economic recovery plan must not imply a return to business as usual in economic as well as ecological terms. The major crisis calls for a major policy restructuring, and in building the way to this major alternative, our starting point is the urgent problems of employment, distribution, and ecological sustainability. Many of the solutions already point at the need for changes that are not consistent with a capitalist economy and the private profit motive:

a) First fiscal policy has to be centered around a public employment program, and a distributional policy to reverse the negative effects of the crisis. Public expenditures in labor intensive services like education, child care, nursing homes, health, community and social services, as well as in public infrastructure and green investments should be the target. These are also areas to redirect the economy towards a sustainable as well as solidarity-oriented development. The need for social services is not met under the present circumstances, where such services are provided either at very low wages (to ensure an adequate market rate of return) or as luxury service for the upper classes or via invisible unpaid female labor within the gendered division of labor in the private sphere. To avoid this deficit they can be provided by the state or by non-profit organizations. Gender aspect of the public employment programs should also be carefully designed in order to not only avoid disadvantages for women but also increase the female employment share.

For the purpose of ecological sustainability, there is need for a shift in the composition of demand towards long term green investments; this cannot be achieved without the new strategic tasks for active public investments.
Regarding employment in the private sector, it is important to avoid the "socialization of the costs", i.e. to prevent that the working people and the unemployed pay the costs of the irresponsible behavior of the global capital. Particularly some firms might be making use of the crisis to implement their long-term downsizing strategies. "Short work" regulations are being used in many European countries to tame unemployment, however this is simply to solve the issue by workers' solidarity via government transfers to offset part of the income losses of the workers sent to shorter work hours. An alternative would be to make the employers pay the costs via legal measures to freeze firings and implement wage floors: in firms that are in a position to distribute dividends and pay high managerial wages, the logical thing would be to ban lay-offs. If the firing freeze leads to bankruptcy in certain firms, these firms can be re-appropriated and revitalized under workers' control, supported by public credits. Widespread examples of that were seen in Argentina after the crisis as a de facto survival strategy of the workers in shut-down companies, often without paying past wages, let alone severance pay. As of 2007 still 10,000 people were employed in self-managed businesses in Argentina. In cases of sectors that are under the threat of mass layoffs, like the auto industry, socialization of the firms and restructuring of these public firms as part of a medium-term plan should be considered, e.g. in the auto industry a shift of focus towards the production of public transport vehicles, and a gradual transfer of labor towards new innovative sectors.

The stimulus and employment packages and a green recovery plan should be financed from highly progressive income and wealth taxes, higher corporate tax rates, inheritance tax, and tax on financial transactions, which are the only way to make the responsible pay for the costs of crisis. This is also the only way to avoid future budget cuts in social expenditures, education, health, child and elderly care.

The tax rebates/subsidies on low income groups or extension of unemployment benefits to those workers who are unable to access unemployment benefits are the usual short-run solutions. However this is not a substitute for the requirement to correct the overall deterioration in the labor share. This is not only an egalitarian but also macroeconomic concern. The usual wage moderation of the European macroeconomic policy mix can indeed only worsen the demand deficiency problem now. The risk is the persistence in the low wages in some countries like Germany. In order to solve the problems of this crisis fundamentally, economic policy must first solve the distributional crisis. This requires also a substantial shortening of work-time (i.e. in parallel with the historical rate of growth of labor productivity) with upward wage correction. The high profits of the past are responsible for the crisis, so now they have to pay the costs. This is not only a crucial answer to the problem of unemployment after the crisis, but also an answer to the ecological crisis: sustainable development requires zero or low economic growth in the developed countries; i.e. full employment can only be achieved through shorter working times and not unsustainable growth. The income losses for the working masses can be prevented through substantial redistribution. Furthermore if we want to achieve democracy in decision making, this requires time for participation, i.e. shorter working hours.

b) The redesign of the financial sector is urgent, on which most of the alternative debate is also focusing. However regulation is important but not enough; the financial institutions have an amazing capacity to avoid regulations

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through new innovations. Thus finance is a crucial sector which cannot be left to the short-termism of the private profit motive. This sector has already been de facto nationalized, but absurdly without any voice for the public, and as soon as possible the public shares will be privatized again. 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. Instead what needs to be done is to build a public finance sector, which however does not merely mean state ownership, but rather collective ownership with the participation of the workers and other stakeholders to decision making. This publicly owned finance sector also has to ensure the transparence of the accounts. Only based on this structure, the following financial regulations can be pursued further to deliver socially desirable outcomes: full regulatory over-sight for all financial institutions, full accountability of the decision makers, counter-cyclical capital requirements, and the elimination of off-balance sheet instruments, as e.g. ATTAC (2008) suggests.

c) The need for public ownership in the finance sector opens up new questions about critical sectors for the society, in which the ownership rights cannot be left to the private sector and private profit motive. The crisis has indicated that the finance and the housing sectors are clear candidates for public ownership. The energy crisis is indicating that the energy sector and alternative energy investments also require public ownership. The problems with the private pension funds as well as private supplies of education, health, and infrastructure are showing that social services are also too critical to be ruled by private profit motives. A creative and participatory public discussion should question, in which other sectors public ownership would produce more egalitarian as well as more socially efficient outcomes. This does not mean to praise the public sector as such, but calls for the participation and control of the stakeholders (the workers, consumers, regional representatives etc.) in the decision making mechanisms within a public and transparent economic model. Such a shift in decision making also facilitates economy wide coordination of important decisions for a sustainable and planned development based on solidarity. A major transition requires also a change in the present institutional setting of lightly regulated profit-maximizing economies with weak voice for labor and communities.

d) Regarding the international level within the EU, how or whether the West supports the East in weathering the current global crisis will be critical in creating positive signals for cooperation as well as the political credibility of the EU. A genuine support needs to go beyond financial support to maintain the exchange rate, but rather involve public investment programs with a focus on regional development. EU-level public investments financed by EU level progressive taxes should carry an active role. Another important fact that became clearer after the global crisis is that capital account openness creates turbulences and structural problems particularly in emerging economies. The devastating risk of depreciation/devaluation can only be overcome with capital controls and a managed devaluation of the currencies with price controls.

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