THE IMPACT OF THE ECONOMIC CRISIS ON EDUCATION IN CENTRAL AND EASTERN EUROPE

From `emerging Europe` to `submerging Europe`?

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Hotel Novotel, Warsaw
2-4 September 2009

Structure of presentation

- The background of the crisis
- Basic facts and prognoses on the downturn in Europe
- Why Europe, why Central and Eastern Europe?
- Factors of vulnerability of emerging Europe
- Some Baltic states near to an economic and social abyss
- Why the public sector so much in focus in the Baltic states
- Where is Europe in this situation?
- Some employment policy tools
- Conclusions

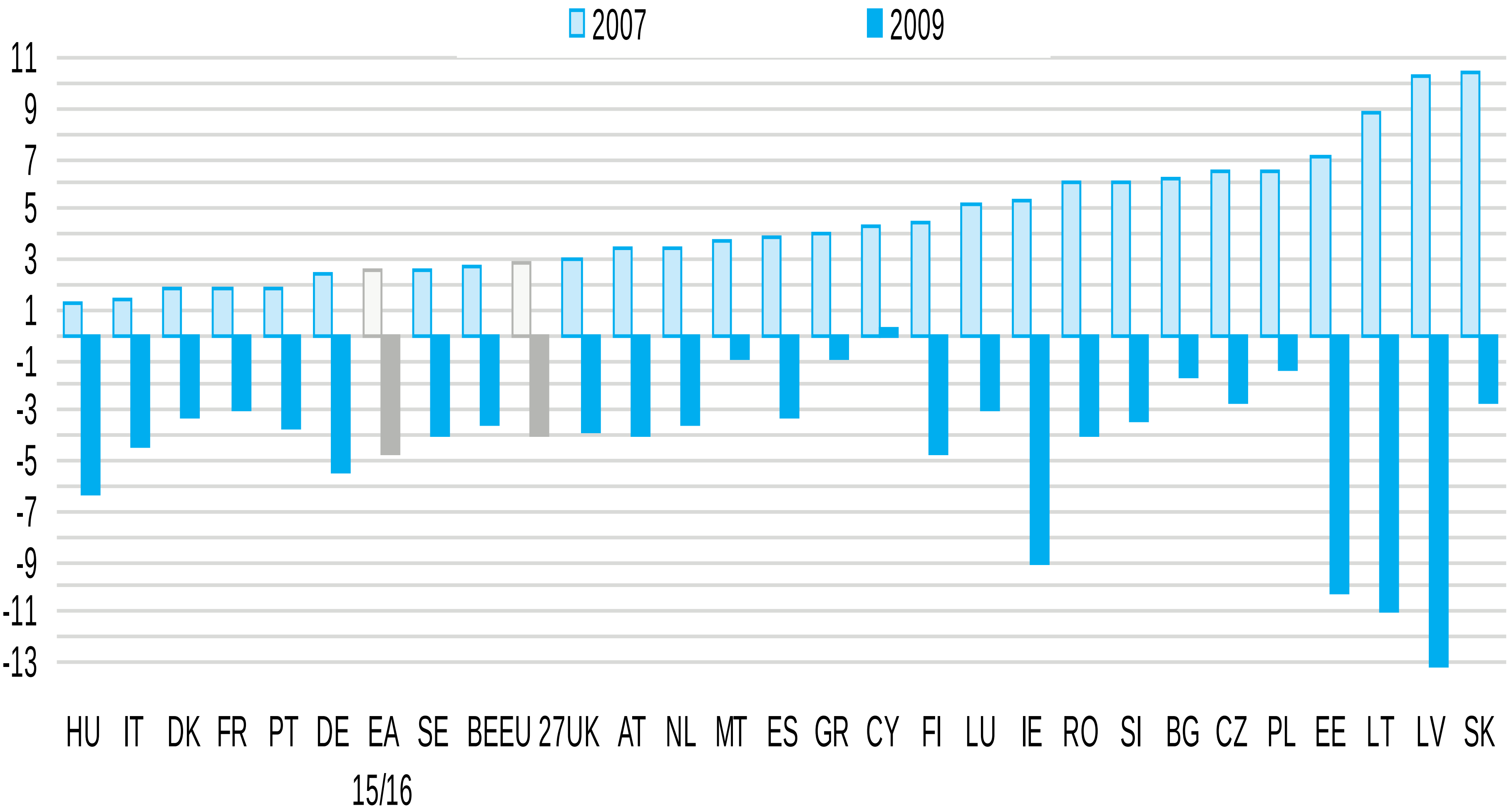
How the crisis spread to Europe

- The basic mechanism how the financial and banking crisis has hit the real economy in Europe is the failure of the banks – due to their financial losses and the evaporation of trust – to perform their basic function of financing the economy.
- Enterprises are unable to finance their daily operations, investments are blocked and consumption has collapsed in market segments in which credit financing had played an important role (construction in the US and in a number of European countries, automobiles and their suppliers generally in the US and Europe).
- All this led to a sudden demand-shock, affecting exports, investment goods and private consumption.

Europe in full grip of the economic crisis

- The ‘hard landing’ that is visible in the next graph refers mostly to those economies with unsustainable past growth strategies, characterised as ‘bubble growth’ in the previous section.
- The most dramatic downturn is to be seen in Latvia, where above 10% GDP growth in 2007 is likely to turn into a decrease of 13 % by 2009. Previous high-growth economies, such as Estonia, Lithuania and Ireland, are also expected to be hit hard, with a projected drop in GDP of 9-11 % in 2009. Ukraine (not indicated on the graph) faces a downturn over 10%.
- Other major economies are expected to experience a downturn of around 4-5%, with the Euro area GDP set to fall by 4% and the EU27 by 4 % in 2009 (European Commission 2009). The 5.4% likely downturn in Germany is a huge drag on whole Europe.

Gross domestic product in 2007 and prognosis for 2009 (annual growth)



Data Source: European Commission (2009).

Facts on the downturn in I.Q. 2009 – an even bleaker picture

- The downturn in the first quarter of 2009 was 18.6 % in Latvia, Estonia suffered a 16% drop and Lithuania 11%.
- Only Poland has managed limited growth in the I.Q – showing also that the region is not equally effected

- Lithuania already published its II.Q. GDP figure: with a 22.4% drop (year-on-year) this is the largest GDP fall ever measured in peacetime Europe
- In July 2009 the Latvian government and the IMF reached a financing agreement on basis of a forecasted 18% GDP decrease in 2009.
- Indeed a dramatic picture in the Baltic states

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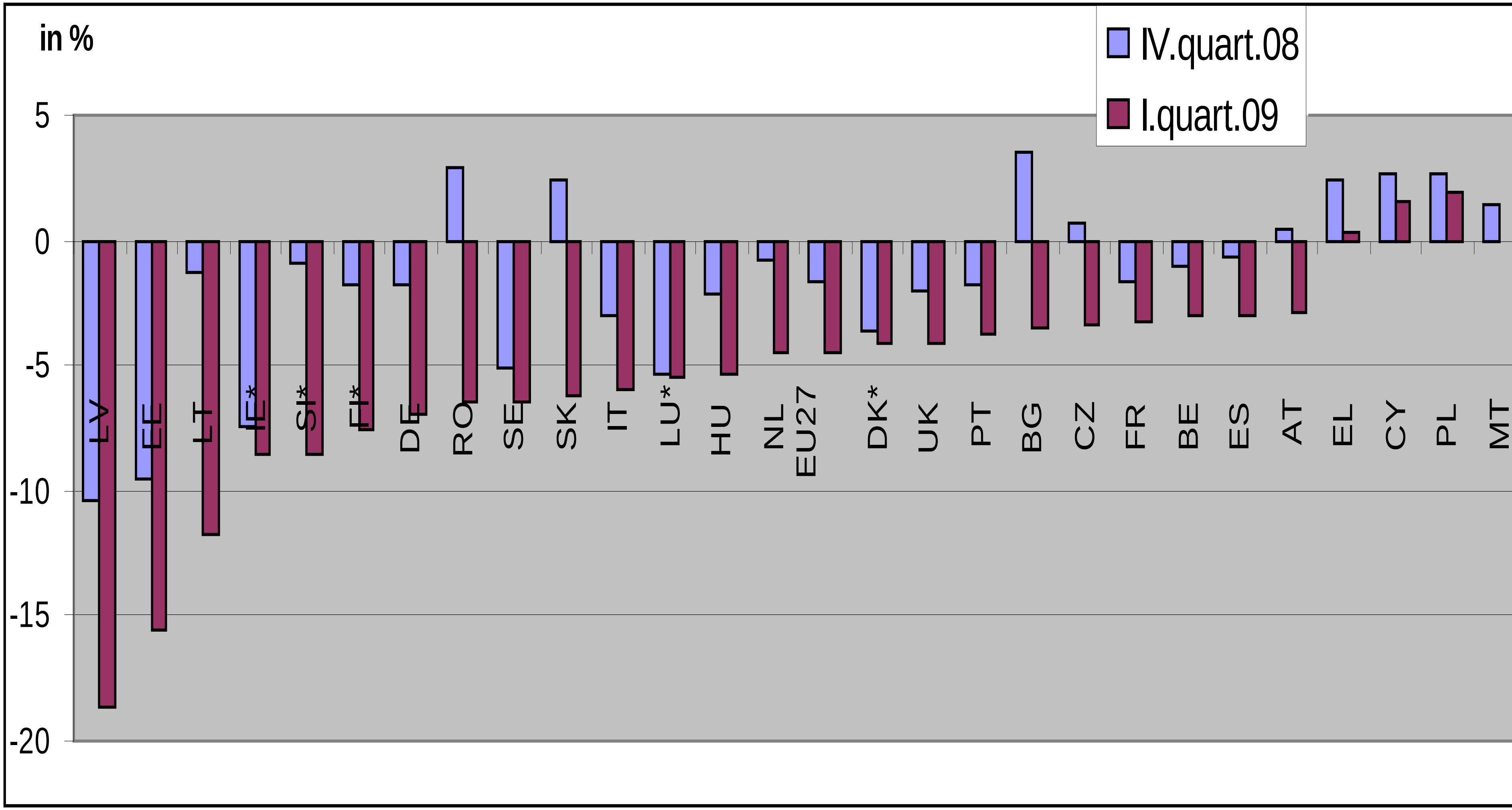
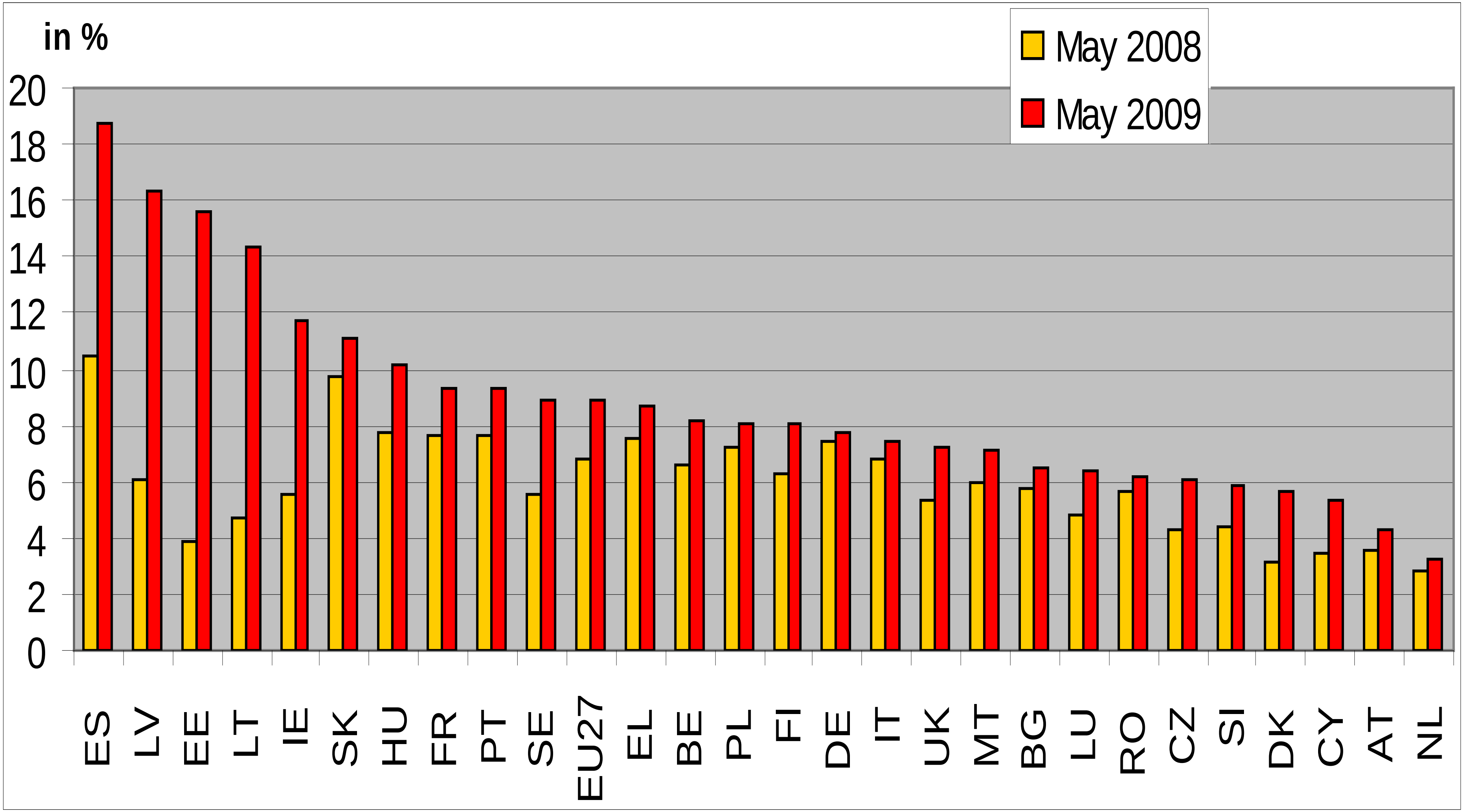
Gross domestic product in IV. Q 2008 and in I. Q. 2009 (year on year basis)



Data Source: European Commission (2009).

Unemployment rate



How the crisis could get Europe so much in grip?

- Opaque finances, toxic assets, paralysed banks were the origin of the crisis, but the vulnerability was there in Europe, as well..
- The fundamentals underlying the spread of the crisis, however, were chronic imbalances in the world economy, within the Euro area and within the national economies of many member states.
- Wage moderation led to unsustainable growth strategies in the past years, in ES, IE, the UK: instead of growth based real wage growth it was based on credit and asset bubbles, in the Baltic states both at the same time
- in Germany growth was based on the demand of OTHERS - through a high grade of export dependence

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The vulnerability of Eastern Europe

- Macroeconomic imbalances (deficits in current account, government debt, household debt and corporate debt)
- chronical dependence on external financing (in forms of FDI, credits (banks and IFI-s), financial investments (government and corporate bonds, other financial assets)
- and a high level of economic and trade integration with the EU15 (linked to the Western economic cycle)
- Effects of labour mobility (return migrants in crisis; shrinking remittances)

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The vulnerability of Eastern Europe

- Capital flows frozen, financial markets in eastern Europe dried up, capital retreats to home markets
- Devaluation of national currencies (for CEE NMS up to 20-25%),
- Tensions in countries with pegged exchange rate (Baltic states, Bulgaria)
- Daily debt financing paralysed, credit ratings of CEE countries downgraded, debt of Ukraine, Latvia, Romania rated as `junk-bonds`
- At the peak of the crisis (March 2009) Ukrainian state bankruptcy was priced to a probability of 40% shown by `credit default swap spreads` (CDS); in case of Latvia it was 10%

The vulnerability of Eastern Europe

- Households and enterprises often indebted in foreign currency – with debt burdens due to weaker national currencies and higher banks fees increasing
- Families in desperate financial situation – a burning social problem
- The banking sector in CEE is 80% in foreign hands and foreign banks were often reluctant to bail out their CEE affiliates
- The situation is alarming, mostly in the Baltic states

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The vulnerability of Eastern Europe

Financial indicators for selected CEE countries

Country	GDP/capita 2008, USD PPS	Financing need, % GDP[1]	Current account balance, % GDP[2] 2008	2009	Export share in GDP (2008)	5-year CDS[3]	S&P credit rating
Bulgaria	12,372	29.4	-24	-12.9	61.0	617	A
Czech Rep	25,757	9.4	-3.5	-2.8	80.1	309	AA
Estonia	20,754	20.0	-10	-6.3	72.0	700	AA
Hungary	19,830	29.9	-6.5	-3.9	80.2	574	A
Latvia	17,801	24.3	-14	-6.7	46.6	1,001	BBB
Lithuania	18,855	27.1	-12	-4.8	59.0	833	A+
Poland	17,560	13.2	-5	-4.9	42.3	387	A+
Romania	12,698	20.2	-12	-7.5	34.4	719	BBB+
Serbia	10,911	23.5		-12.9	22.2		BB-
Slovakia	22,242	12.5	-6		90.5	222	AAA
Slovenia	28,894	-	-6		70.5	206	AAA
Ukraine	7,634	16.1	-6.5	0.6	45.0	3,899	CCC+

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Economic and trade integration with the West as factor of dependence for CEE

- New member states from Central and Eastern Europe (CEE), in particular Visegrad Four (V4) countries – CZ, HU, PL, SK –particularly affected by the crisis due their high economic and trade integration with Western Europe, especially DE.
- Poland is less exposed due above all to its larger domestic market and less export dependence
- Particlularly effected is the large automobile sector with its suppliers, including chemical companies (SK especially).
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Baltic states in focus

- The Baltic states are hit hardest by the crisis
- A 20% GDP drop is dramatic and involves substantial sacrifice from the population (as a result of unsustainable growth strategies in past)
- Important is to have a future perspective and a socially just distribution of the burdens
- Non of this is happening with the crisis management now
- Maintaining the currency peg (or board) means adjustment costs will be more concentrated
- Why the public sector is so much under pressure?
- Within public sector, why education (that is key for future)?

Where is Europe in this situation? – no visible strategy

- Europe is paralysed in regard to CEE NMS and EU neighbourhood countries, as well
- Europe in lack of proper institutions and resources to cope with a crisis of this magnitude
- The leading role has been left to the IMF with adverse conditions
- Severe conditions for fiscal tightening – to cut public spending: Latvia 20% cut of public sector wages, 10% cut of pensions, social welfare schemes)
- Lithuania: 9.5% cut of public sector wages
- Hungary: scrapping 13th month wage in public services
- Refusal of a crisis intervention fund for CEE countries was a negative message from the EU to CEE NMS and to the whole Eastern Europe (beyond the EU)

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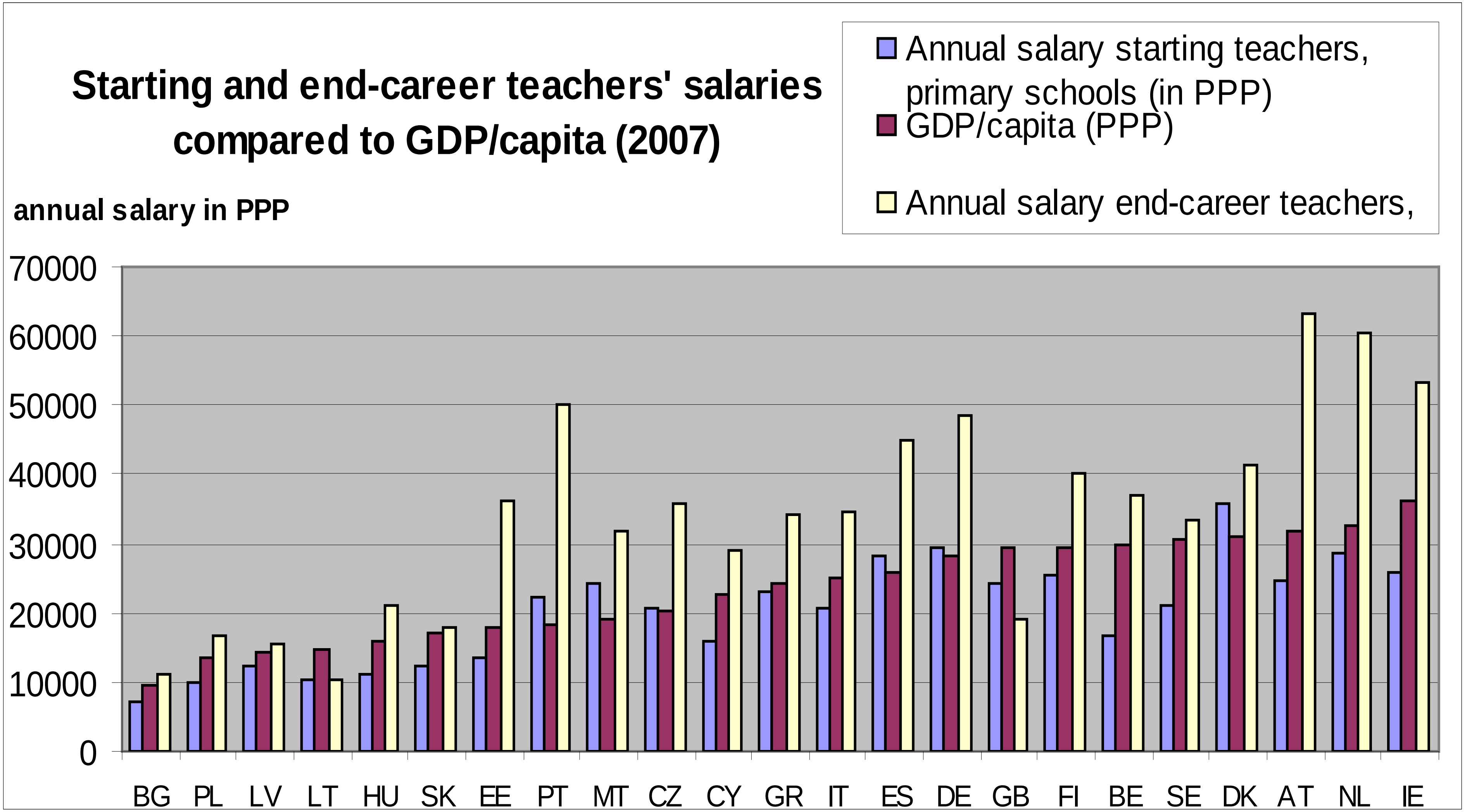
Teachers` pay has been low in the Baltic states even before the recent cuts

- The 2008 ETUI survey on teachers pay in Europe showed that especially in the Baltic states the pay level of teachers was very low in both absolute and relative terms in European comparison
- Lithuania was among the few countries where all teachers categories had lower yearly wages then the GDP/capita of the country (also one of the lowest in Europe)
- This was the pre-crisis situation, now these levels were cut by 20% (Latvia) and 9.5% (Lithuania).

Pre-crisis pay levels of teachers in Europe



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The role of the IFI-s in the region

EU – IMF

While Europe sets on a wide range of public resources to offset the effect of the crisis (stimulus packages, labour market schemes, more government deficit), countries in CEE in the deepest crisis need to apply brutal fiscal tightening

Europe and the world seem to abandon neo-liberal economic doctrine, but this is being applied in CEE as crisis management

receipee: cut spending at any price > this makes the downturn even more severe

Even so, it is true that the IMF showed certain flexibility

The role of the IFI-s in the region

With the consequtive daowgrading of the growth prospects the government deficit condition of the disposability of the credit line had been modified: from 5% of GDP to 7%, then to 10% - this is still a huge burden a a negativ spiral is threatening!

The IMF showed some flexibility and itself goes through a learning process as it now supports the abolition of the 23% flat tax (which was previously welcomed and copied as a competitiveness tool)

A sustainable development track with managable social sacrifices and without eating up future perspectives (education, health care) is needed

This is not viable without an active – and controlled – support of the EU

A concept is missing however – it is only fire-extinguishing that happens

Conclusions

- Sharp and deep drop in demand – paralysed financial institutions
- **European response**: not satisfactory and not properly co-ordinated
- **The leading role in the region left to the IMF**
- The current situation perfectly illustrates the adverse effects of an economic integration without social and political integration in the EU
- This is also a bad message to EU neighbourhood states
- Weak social welfare systems in the CEE region are being further dismantled. Perversely the failed neo-liberal economic doctrine seems to be further strengthened in the new member states, while developed Western economies seem to leave it behind.

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Conclusions

- The myth of the EU Eastern enlargement five years ago with the prospect of economic and social convergence toward the rich EU15 member state economies is seriously shaken.
- The lack of proper European responses to the crisis with its severe impact on the new member states might call the future of a united Europe into question, jeopardising the prospect of further enlargement rounds.