Department of Economics and Statistics

Middlesex University Business School

Discussion Paper
No 135
March 2010

From transition crisis to the global crisis: Labor in the Central and Eastern EU New Member States[1]

Özlem Onaran

Contact address:
Middlesex University, W213
The Burroughs,
London NW4 4BT,
London, UK
Email**:** o.onaran@mdx.ac.uk
Tel: +44 (0)20 8411 5956

[1] The author is grateful to Jane Hardy and the participants of the Workshop on "The Transformation of Post-Soviet Economies Twenty Years on" on October 9-10, 2009 in Hertfordshire organized by the European Association of Evolutionary Economics for comments and suggestions. The usual disclaimer applies.

From transition crisis to the global crisis: Labor in the Central and Eastern EU New Member States

Abstract

This paper analyzes the developments in wages, employment, and income distribution in the Central and Eastern European New Member States twenty years after transition to market economies in three episodes: i. the transition crisis, ii. the post-transition growth, iii. the crisis episode of 2008-09. The balance sheet of the 20 years of transition in terms of employment and wages is marked by the negative effects of the transition crisis at the beginning and the global crisis in the last two years. Total employment has at best stagnated or slightly decreased along with significant job losses in industry. Modest wage increases have fallen way behind phenomenal 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.

Key words: Central and Eastern Europe, wage, employment, wage share, crisis

JEL code: P300, J300, J210

1. Introduction

It has been now 20 years since the transformation of the Central and Eastern European Countries (CEECs) from planned to market economies. 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 performance in terms of GDP growth vs. labor market outcomes. This paper analyzes the consequences of this policy framework on wages, employment, unemployment, and income distribution in the CEECs twenty years after transition to market economies in three episodes: i. the transition crisis, ii. the post-transition growth, iii. 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 optimism turned itself soon to an unquestionable dogma, particularly since any critique of the process was also perceived wrongly as a praise of 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 the extension of markets and creation of new secure and profitable areas for capital mobility with little concern for social cohesion. The official policy line of the EU was legitimized 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, EU budget and the amount of structural funds have been very limited, and consistent with the neoliberal policy framework, 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 (CEE NMS) find themselves obliged to get involved in wage as well as tax competition to attract capital.

The global crisis of 2009 and its consequences for the region have now laid bare the major short comings 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 NMS are now facing the costs of integration to unregulated capital markets, despite differences in their development trajectory.

The rest of the paper is organized as follows: section two analyzes the trends in labor market outcomes and institutions in the CEE NMS since the transition era. Section three discusses the expected consequences of the crisis both at a macro level and for labor. Section four derives the conclusions and policy implications.

2. Labor from transition to European enlargement

2.1 Labor Market outcomes

The 1990s started by a severe transition crisis in the CEECs with the cumulative loss in GDP ranging between 13.2% in the Czech Republic to 22.1% in Slovakia, and reaching up to 45% in Latvia and Lithuania. Figure 1 shows the growth rates in GDP and 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 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 labor market, and only moderate job creation. In particular industrial employment has decreased in all countries not only in the first period of transition recession, but also in the post-recession period at least until 2004-06 (Figure 2). 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 off-set the negative effects of the major downsizing in the industry, but even during the uninterrupted growth years of 2000s new service jobs have just sufficed to generate stagnation in total employment (Hungary, Czech Republic, Romania), or modest increases in employment in late 2000s (See Figure 3 and Table 1). As a result of the disappointing employment performance, the employment rates remained quite low, between 63.2% in Estonia, 62.6% in Latvia, and around 50.0% in Hungary, Poland and Bulgaria as of 2008 (see Figure 4). The fall in unemployment rates in Poland, Slovakia, Baltic Countries, Bulgaria, and Romania in the 2000s seem to be much less spectacular when the low employment rates are considered (see Figure 5).

Table 1

Figure 1-5

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 stagnation in the other countries of the EU (Boeri and Garibaldi, 2006). Izyumov and Vahaly (2002) find a lower Okun's coefficient of -0.526 (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 about the quality of the jobs created in the service sector. One major problem of the neoliberal pattern of European integration continues to be jobless growth and deindustrialization going 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 deindustrialization in the CEECs is qualitatively very different from the slow 'de-industrialization' 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.

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 (see Table 2). As of 2008, the difference is particularly high in Slovakia (2.5%), the Czech Republic (2.1%), and Poland (1.6%). The female unemployment rates are higher despite the lower female labor force participation rates, which range between 42.7% in Hungary to 55.5% in Latvia as of 2008 for the total working age female population (see Table 2). The massive withdrawal from the labor market at the early stage of transition was stronger among the women. The participation rates for prime age population (age group 25-54) are higher for both men and women, and the difference between women and men is lower. The lowest female labor force participation rates for prime age population are in Romania (70.7) and Hungary (73.4), which are still quite high; and the highest rates are in the Baltic Countries (84-86%) and Slovenia (88.5%). This is an improvement that indicates that once the wave of withdrawal from the labor markets after the transition crisis is over, the gender gaps in participation has also narrowed down for the new prime age cohort.

The youth unemployment rate (covering persons aged 15-24) is also strikingly higher than total unemployment rate (see Table 2), reaching up to 19.9% in Hungary, 19.0% in Slovakia, and 18.6% in Romania. The ratio of youth unemployment rate to adult unemployment rate is particularly high in Romania (4.2 as of 2008), followed by a ratio of 2.9 in Hungary, Poland, and Slovenia.

An indicator about the quality of employment is the share of the 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%), 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% share of vulnerable employment. In the Czech Republic, Slovenia, and Slovakia the share is slightly higher than 10%; however in Slovakia further data about informal employment reveals a very high and increasing share of informal employment in total employment in non-agricultural economy (23% as of 2008; ILO, 2009).

This disappointing employment performance took place despite massive wage cuts at the early stage of transition, which then was followed by moderate wage growth compared to productivity. The transition shock came with a sharp real wage cut in the first 2-3 years: 39% in Slovenia, 30% in Czech Republic and Slovakia, 15% in Hungary during 1989-1991/92, above 60% in the Baltic countries during 1990-1992/93, and a prolonged decline of 70% during 1990-97 in Bulgaria. Table 1 shows the period average for annual growth in real wage and productivity (GDP/employee) and Figure 6 shows the index of real wages (2000=100). Although wages started to recover in the second half of the 1990s, real wages significantly lag behind productivity in seven out of ten countries during 1994-2000, despite strong growth in GDP and opening up to Western Europe through trade and FDI. Slovakia, Latvia, and Romania are the exceptions in this period. During 2000-07 wage growth is still lower than productivity growth in Poland, Slovakia, and Slovenia. In manufacturing this gap is more pronounced (Onaran, 2008). Indeed with the onset of the global crisis, the real wage growth already slowed down 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 (0.6% and 0.4% annual average rate of increase, respectively). The forecasts for 2009 point at already declining real wages in the Baltic States, Hungary, and Romania as will be discussed in more detail below.

Figure 6

As a consequence of this moderate wage growth, which lags behind productivity, and low employment, the labor share has been declining in Slovenia, Poland, Bulgaria, and Romania and stagnant in Hungary and Slovakia (Figure 7). The only exception to that are the last years in the Baltic countries and Czech Republic, when the labor share is back to the

former peaks at the starting 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 it will be discussed in more detail below.

Figure 7

In the meantime the GINI coefficients have increased in all 10 CEECs (See Table 3). The low GINI coefficients of the early 1990s ranging between 19.4 in the Czech Republic to 25.2 in Poland increased to a range of 25.4 in the Czech Republic to 34.9 in Poland. The Baltic countries have the highest GINI coefficients of the region reaching to 36. In Poland, Slovenia, Slovakia, and Romania the increase in inequality was continuous; in Hungary and Lithuania the improvement in equality in the late 1990s was reversed again later.

Table 3

A further controversial fact is that rapid improvements in exports and foreign direct investment have not generated a stronger boost to employment. Hunya and Geishecker (2005) provide evidence that the nature of FDI flows can account for this development to some extent. About half of the FDI in the New Member States between 1990 and 1998 was in the form of privatization-related acquisitions, and the restructuring of the former state-owned enterprises led to massive labor shedding. 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 destructed through negative spillovers as foreign investors replaced traditional domestic suppliers by imports or domestic firms disappeared or downsized due to intensified competition of larger and technologically more advanced subsidiaries of multi-national enterprises.

Onaran (2008) estimates the effect of exports (to EU15), imports (from EU15), and FDI of the sector on employment in the sub-sectors of manufacturing for the period of 1999-2004. Among eight CEECs, only in Romania and Lithuania and only in the high-skill sectors exports have the expected positive effect on employment. In Slovakia the effect of exports on employment in the high-skill sectors has been negative. The insignificant effects in the

medium and low skilled sectors are particularly inconsistent with the optimistic expectations regarding increased labor demand in sectors where these countries are supposed to have their comparative advantage. Regarding imports, in the high-skill sectors a negative effect on employment is found in Slovenia and in Lithuania. Finally, FDI has a significantly positive effect on employment only in the medium and low-skill sectors in Slovakia, but a negative effect on employment in the high-skill sectors in Slovakia and Slovenia. Regarding the domestic factors, an interesting finding is that employment does not respond to wages in more than half of the cases, thus jobless growth in manufacturing is taking place irrespective of the wage developments in the majority of the cases. The response of employment to output is mostly positive; however the output elasticity of labor demand is rather low. Further downsizing almost a decade after transition indicates the relevance of international competitive pressures in determining the continuation of downsizing and productivity enhancing job destruction in the 2000s.

Onaran and Stockhammer (2008) estimate the effects of FDI and trade on wages in the manufacturing industries during 2000-2004 in five CEE countries, and find that only in the capital intensive and skilled sectors FDI has a positive effect on wages, and international trade has no significant effect. Interestingly, in the long run the effect of FDI turns 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. Egger and Stehrer (2001) find that the wage bill of both skilled and unskilled workers significantly lose from an increase in the share of Multinational Enterprises (MNEs), since the labor productivity increase induced by MNEs is larger than their positive impact on output and wage rates. MNEs also do not necessarily transfer their "high-road" employment practices and industrial relations to the CEECs. Stehrer and Woerz (2005) report evidence of a downward pressure of FDI on wage growth for a cross-country analysis for OECD and non-OECD Eastern European and Asian countries. Although MNCs 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 unionize or raise their wages (Burke and Epstein, 2001).

2.2 Labor 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 organized in associations. Privatization, foreign direct investment, and EU accession have shaped the transition of

industrial relations (Aquilera and Dabu, 2005). EU accession process affected in particular the states' role in establishing industrial relations through the adoption of modern labor 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% compared to a ratio of 50% on average in EU15. Schroeder (2002) reports that the minimum wage to average income ratio as of 2001 is ranging between 33% in the Czech Republic to 42% in Lithuania; Slovenia is an exception with a ratio of 52%. 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 characterized by large "union-free" spheres; 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 threatening of the trade union president 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). Table 4 below reports the union density, collective bargaining, and dominant level of bargaining based on the data by Viser (2009). With the exception of Slovenia, only a minority of the workers are covered by collective bargaining. The adjusted rate of collective bargaining coverage is 44% in the Czech Republic, and 35% in Hungary, Slovakia, and Poland. Bulgaria, Latvia, and Estonia have even lower rates around 20-25%, and Lithuania has the lowest collective bargaining coverage at 12 percent. Union density varies substantially, being highest in Slovenia (at 41.3%) and Romania (33.7%), followed by Slovakia (23.6%), with the other countries ranging between 16-21%. 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, reported in Table 4, most countries have firm-level wage negotiations; only in Slovenia and Slovakia there are 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 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 labor 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 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.

3. Crisis and the possible consequences for labor

During the global crisis, the CEE NMS are being severely affected by the credit crash and capital outflows, albeit significant differences regarding their dependence on export market markets, capital inflows, and fragilities in the banking sector. 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 seem 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 asking the old Minsky question "can it happen again?", particularly in the case of countries with high current account deficits like Hungary, the Baltic Countries, Bulgaria, and Romania, and it did "happen again" (Onaran, 2007; Becker, 2007; Goldstein, 2005). Even without the global crisis, this crisis in the CEE NMS 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 some countries in the periphery of Europe will be heavier. The credit crunch has a global dimension now, which makes it unlikely that the bust phase and the initial depreciation of the currency will be followed by capital inflows, as it was the case after former emerging market crises. 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. The effects of further depreciation can have wider social implications in this case.

The slowdown in global demand, the decline in FDI inflows, portfolio investment outflows, the contraction in remittances, credit crash are the various channels of the effects of the crisis on the CEE NMS. However, the degree of accumulated imbalances including current account deficits, exchange rate appreciation, housing 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 (see Table 1 for the forecasts of European Commission, Economic and Financial Affairs, Annual Macroeconomic Indicators (AMECO), October 2009 round). But even the latter group is suffering from the contagion effects, the slowdown in global demand, and the decline in FDI inflows. Excessive dependence on export 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. Poland

is the only country, which is experiencing only a slow-down, and not a recession. This is no surprise thanks to its more diversified market and large domestic economy with a lower trade ratio; thus lower export dependency. 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 FDI inflows have already fallen down to the levels 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).

Faced with the pressure of capital outflows, Hungary, Latvia, and Romania have resorted to the IMF and have received credit. The EU connection, thanks to the interests of the MNEs, in particular Western European banks in the region, has determined the size of the packages, but not the direction of policy. 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. 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 the government agreed to cut public wage bills 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 turn into bailing out the international investors as it has happened in East Asia and Latin America. Capital controls to avoid speculative outflows are not even mentioned in the IMF or EU debates.

What has been different in this crisis in the CEE NMS compared to the former crises in the developing countries was the moderate scale and pace of depreciation. In the countries with the floating regime, there has been some contagion even in the more stable 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 the 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. Again Poland is the exception. 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 a new wave of depreciation in the floating exchange rate countries, and an abandoning of the pegs in the Baltic States and Bulgaria due to further capital outflows 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. The Western European banks operating in the region, like Swedish Banks in the Baltic States and Austrian Banks in Bulgaria are pressurizing to avoid devaluation in fear of high non-performing loan rates, which would erode their profitability. 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 is operated through the IMF program in Latvia. Moreover, despite the decrease in current account deficits, the size of the debt service in the Baltic Countries, and in Bulgaria in the absence of future capital flows, puts a dramatic pressure on fiscal policy and wages.

However devaluation alone is also not the solution. A devaluation without price controls and a medium run industrial policy of restructuring, 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. 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, the depreciation wave and thereby the inflationary effects can become an issue once again in the future.

Next we look at the effects of the crisis on employment and wages based on the forecasts of European Commission (AMECO, October 2009 round), which are reported in Table 1. Employment is decreasing and unemployment is increasing significantly in all countries, with the sharpest increases taking place in the Baltic Countries (Figures 3 and 5, the last observation). The crisis scenarios of ILO (2009) indicate persistence in the unemployment rates even after the recovery. Evidence in the former developing country crises also show that the unemployment rates do not go back to pre-recession rates long after the recession (Onaran, 2009). According to the European Commission forecasts, the real wages are estimated to fall in Hungary, the Baltic Countries, and Romania, and to stagnate in the Czech Republic and Poland. The austerity programs in Hungary, Romania, and Latvia will further reinforce the pressures of the crisis. It is yet to be seen how the wage share will evolve in 2009 in the CEECs; it is already expected to fall in Hungary, Poland, and Latvia; however further developments will be critically determined by the extent of the depreciation in addition to the relative movements of wages and productivity. It is often observed that the wage share increases during a crisis in advanced countries due to strong declines in productivity along with stable wages, but in developing country cases, dramatic inflation shocks following the currency crises have led to much higher rates of decrease in real wages compared to those in productivity, and thereby the wage shares have fallen strongly in a variety of countries like Korea, Mexico, and Turkey (Onaran, 2009). Moreover even if the immediate real wage effects are not as high as during the former developing country crises, the case of a long lasting recession cannot be ruled out, which would have negative effects on the real wage and labor share eventually. The case of Japan shows that during the initial phase of a crisis, 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, 2009).

Finally, we calculate the long term average annual growth in GDP, employment, and real wages in the last 20 years of transition to a market economy (Table 1, 2009 values are based on the forecasts of the European Commission). The record is shocking: 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.[2] Even the highest average annual growth rates in GDP in the 20 years are 3% in Poland, 2.7% in Slovakia, and 2% in Slovenia. The average growth rates in Romania and Bulgaria are merely 0.8% and 0.4% respectively. Latvia and Lithuania have had almost no growth on average (0.1% per year). The GDP per capita trends are similar, although due to the population decline in Hungary, Bulgaria, Romania, and the Baltic Countries, the increases are slightly higher. 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. The growth rate in productivity is not exactly comparable to the wage data, since the productivity data only dates back to 1995 for Czech Republic, 1992 for Hungary and Latvia, and 1990 for Romania due to lack of data on the number of employees. Nevertheless, it can be said that real wage growth has overall lagged behind productivity growth. The only relevant real wage growth has taken place in Romania[3], but then again it is in line with the productivity growth. This does not look like a politically and socially viable balance sheet of the painful transition recipes of the last 20 years.

4. Conclusions

FDI inflows to the CEECs have been the channel, 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 or trade has not necessarily brought positive aspects for labor 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. Simply reliance on private capital flows

[2] In Estonia GDP data is only starting in 1993, therefore the higher positive growth rate is not comparable to the other countries, where the transition recession is involved. Similarly, the employment data start 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.

[3] The growth in real wages in Latvia refers to the period of 1993-2009 and excludes the initial transition years.

seems 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 labor 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, and Romania.

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 CEE NMS lag behind productivity, the convergence of wages to Western levels proceeds at a rather slow pace. The depth of the crisis in some CEE NMS will not only slow down convergence but also create a further divergence in wages.

However, negative effects of regional integration are not an unavoidable destiny, rather an outcome of the current domestic and international policies. In the European context, labor in the old and new member states have more common ground than they currently exploit. There is scope for international cooperation, in case the coordination failure can be overcome. This common ground must combine the ruling out of destructive wage (and tax) competition with a coherent and coordinated EU-wide policy for social and economic convergence. The coordination of collective bargaining activities is vital in order to avoid the beggar-thy–neighbor policies, the relocation threats of the employers to suppress union demands, and the drifting apart of wage and productivity trends within Europe. Redefining the rules of the game, coordinating the institutional setting of wage bargaining, incorporating productivity-led wage increases, and designing a European framework for minimum wages, shorter working hours, higher corporate tax rates, more progressive income and wealth tax is the only alternative to readjust the playground back to conditions that are fairer to labor. Nevertheless the issue of wage coordination and imposition of such minimum conditions is a process of adjustment that requires also the consensus of the labor in the lower wage areas of Eastern Europe. And understandably labor 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, which requires an economically relevant EU budget. Industrial and technology policy should set investment priorities and recognize the significance of public investment to achieve these ends. The regional and cross-country distribution of these investment programs should be based on dynamic long term targets instead of static comparative advantages. The flow of goods, services and capital should be subject to the social and economic convergence priorities. To

achieve stability, particularly international coordination for the regulation of financial markets needs to be achieved.

The current global crisis has created no change in the policy stance so far in Europe. 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 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 involves public investment programs with a change in the regional development paradigm within the EU. Another important fact that became clearer after the global crisis is that capital account openness creates turbulences and structural imbalances. The fragility generated by financial capital flows and the contagion effects points out once again the relevance of capital controls. The devastating risk of depreciation/devaluation can only be overcome with capital controls and a managed devaluation of the currencies with price controls and EU wide public investments to overcome the bottlenecks regarding growth.

20 years after the transformation of the Eastern European countries and amidst the global crisis of the neoliberal model, it is time to discuss about 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 plan as well as unstable market mechanisms. Bringing democracy, participation, and plan together to avoid short-termism, instability and inequality requires mobilizing our collective creativity, intelligence, and technological capability.

References

Aguilera, R and Dabu, A. (2005) 'Transformation Employment Relations Systems in Central and Eastern Europe', Journal of Industrial Relations 47(1): 16-42.

Becker, J (2007). Dollarisation in Latin America and Euroisation in Eastern Europe: Parallels and Differences, in Dollarization, Euroization and Financial Instability, Ed.. Becker, J. and Weissenbacher, R., Metropolis-Verlag, Marburg.

Boeri, T., Garibaldi, P. (2006), Are Labour Markets in the New Member States Sufficiently Flexible for EMU?, Journal of Banking and Finance 30 (5), 1393-1407.

Boeri, Tito, Terrell, Katherine (2002), Institutional Determinants of Labor Reallocation in Transition, Journal of Economic Perspectives 16 (1), 51-76.

Burke J. and Epstein G. (2001) Threat effects and the internationalization of production, Political Economy Research Institute Working Papers; 15

Egger P, Stehrer R. International outsourcing and the skill-specific wage bill in eastern europe. The Vienna Institute for International Economic Studies Working Papers 2001; 17

Galgoczi B. The impact of multinational enterprises on the corporate culture and on industrial relations in Hungary. South-East Europe Review 2003; 1/2; 27-44

Gligorov V., Pöschl, J., Richter, S. et al. (2009). Where have all the shooting stars gone?, The Vienna Institute for International Economic Studies, Current Analyses and Forecasts 4.

Goldstein, M. (2005): What might the next emerging-market financial crisis look like?, Institute for International Economics, Working Paper Series, No. 0 5-7

Havlik, Peter, Landesmann, Michael (2005), Structural change, productivity and employment in the new EU member states, in: Economic restructuring and labour markets in the accession countries, The Vienna Institute for International Economic Studies Research Project commissioned by EU DG Employment, Social Affairs and Equal Opportunities.

Hunya, G., Geishecker, I. (2005), Employment effects of foreign direct investment in Central and Eastern Europe, The Vienna Institute for International Economic Studies Research Reports, no. 321.

Hunya, G. (2009) FDI in the CEECs under the Impact of the Global Crisis: Sharp Declines, The Vienna Institute for International Economic Studies Database on Foreign Direct Investment in Central, East and Southeast Europe, 2009.

Kohl, H. and Platzer, H. (2007) 'The role of the state in Central and Eastern European industrial relations: the case of minimum wages', Industrial Relations Journal 38 (6): 614-635

ILO (2009) Key Indicators of the Labor Market, 6th ed., http://www.ilo.org/empelm/what/lang--en/WCMS_114240

Izyumov, Alexei, Vahaly, John (2002), The Unemployment-Output Tradeoff in Transition Economies: Does Okun's Law Apply? Economics of Planning 35 (4), 317-31.

Mencinger, Joze (2003), Does foreign direct investment always enhance economic growth?, Kyklos 56 (4), 491-508.

OECD (2004), Employment Outlook, Paris.

Onaran, Ö. (2007) "International financial markets and fragility in the Eastern Europe: "can it happen" here?", in Dollarization, Euroization and Financial Instability, Ed.. Becker, J. and Weissenbacher, R., Metropolis-Verlag, Marburg, pp. 129-148

Onaran, Ö. (2008) "Jobless growth in the Central and Eastern European Countries: A country specific panel data analysis for the manufacturing industry", Eastern European Economics, 46(4): 97-122.

Onaran, Ö. (2009) "From the crisis of distribution to the distribution of the costs of the crisis: What can we learn from the previous crises about the effects of the financial crisis on labor?" Political Economy Research Institute, University of Massachusetts Working Paper 195, 2009

Onaran, Ö., Stockhammer, E. (2008) "The effect of FDI and foreign trade on wage bargaining in the Central and Eastern European Countries in the post-transition era: A sectoral analysis" Structural Change and Economic Dynamics, 19, 66-80

Reinert, Erik S., Kattel, Rainer, (2004), The Qualitative Shift in European Integration: Towards Permanent Wage Pressures and a 'Latin-Americanization' of Europe?, PRAXIS Center for Policy Studies Working Paper no. 17.

Schroeder, W. (2004) ‚Arbeitsbeziehungen in Mittel- und Osteuropa: Weder wilder Osten noch europäisches Sozialmodel', Politikinformation Osteuropa 119

Stehrer R, Woerz J. (2006) Attract FDI! A universal golden rule? Empirical evidence for Europe and Asia. presented at the the Joint Vienna Institute, February 15, Vienna

Stasek, F. (2005) 'Employee relations in the Czech Republic – past, present and future', Employee Relations 27 (6): 581-91

Visser, J. (2009) ICTWSS: Database on Institutional Characteristics of Trade Unions, Wage Setting, State Intervention and Social Pacts in 34 countries between 1960 and 2007. http://www.uva-aias.net/208

World Bank (2006), Doing Business Report, Washinton D.C.

Table 1: Average annual growth in GDP, employment, productivity, and real wage, 1989-2009 and sub-periods

	1989*-1994				1994-2000				2000-2007			
	GDP	Employment	Productivity	Real wage	GDP	Employment	Productivity	Real wage	GDP	Employment	Productivity	Real wage
Czech Repub	-2.3	-2.0	-	-3.0	2.2	-0.8	3.2	3.2	4.5	0.8	3.9	4.8
Hungary	-3.2	-4.2	3.7	-1.9	3.3	0.5	2.1	-1.9	3.7	0.3	3.0	4.6
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	0.0	12.6	-5.6	3.8	-0.6	4.8	5.3	6.2	1.0	5.9	3.4
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	5.8	10.0
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	5.7	2.0	3.3	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	10.1
	2008				2009				1989*-2009			
	GDP	Employment	Productivity	Real wage	GDP	Employment	Productivity	Real wage	GDP	Employment	Productivity	Real wage
Czech Repub	2.5	1.5	1.3	1.0	-4.8	-2.0	-2.6	0.1	1.5	0.0	3.0	2.2
Hungary	0.6	-1.2	1.7	0.9	-6.5	-3.0	-3.7	-5.4	1.2	-0.5	2.3	0.3
Poland	5.0	3.8	0.6	3.8	1.2	-0.7	3.9	0.7	3.0	0.3	3.1	1.1
Slovenia	3.5	2.9	0.2	1.2	-7.4	-2.6	-3.1	2.3	2.0	0.2	3.4	0.5
Slovakia	6.4	2.9	4.1	4.2	-5.8	-2.0	-5.1	2.0	2.7	0.3	5.1	1.6
Estonia	-3.6	0.2	-5.1	0.8	-13.7	-9.0	-7.2	-4.7	4.4	-0.4	5.4	1.3
Latvia	-4.6	0.7	-5.8	1.0	-18.0	-11.9	-9.9	-14.6	0.1	0.1	4.4	5.1
Lithuania	2.8	-0.5	0.7	2.9	-18.1	-8.3	-11.6	-9.9	0.1	-0.3	4.8	-1.0
Bulgaria	6.0	3.3	2.3	7.4	-5.9	-2.0	-2.9	6.3	0.4	0.7	3.2	-2.9
Romania	6.2	0.3	4.6	11.7	-8.0	-3.3	-4.9	-0.9	0.8	-0.9	3.9	4.1

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 as of October 2009.
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.

Table 2: Male, female, and youth unemployment, and the share of vulnerable employment, 2008

			Labor force participation rate*, age group 15+		Labor force participation rate*, age group 25-54			
	Female unemployment rate (%)	Male unemployment rate (%)	Male	Female	Male	Female	Youth unemployment rate (aged 15-24) (%)	Share of vulnerable employment in total employment** (%)
Bulgaria	5.8	5.5	62.3	49.4	88.7	81.3	12.7	8.7
Czech Republic	5.6	3.5	68.3	49.4	94.8	79.7	9.9	12.5
Estonia	5.2	5.8	69.1	55.2	93.0	83.6	12.0	5.8
Hungary	8.1	7.6	58.4	42.7	87.2	73.4	19.9	7.1
Latvia	6.9	8	70.3	55.5	92.2	85.7	13.1	6.8
Lithuania	5.6	6.1	63.0	51.3	87.3	83.8	13.4	9.4
Poland	8	6.4	63.1	46.8	88.8	76.2	17.3	18.9
Romania	4.7	6.7	62.8	46.9	85.9	70.7	18.6	31.2
Slovakia	10.9	8.4	68.4	51.0	93.4	82.1	10.4	11.0
Slovenia	4.9	4	65.6	53.5	91.5	88.5	19.0	10.6

Source: ILO (2009), Key Indicators of the Labor Market

*ILO estimates

**The vulnerable employment rate is calculated as the sum of contributing family workers and own-account workers as a percentage of total employment.

Table 3: GINI coefficient, 1985-2005

	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Bulgaria					23.43			30.8		24.32	31.13	35.04	26.38				34.34		29.21		
Czech Republic				19.4					26.55			25.4									
Estonia				22.97					39.5		30.06			37.64		37	36.9	36.81	35.78	36.029	
Hungary			20.96		25.05				27.94					24.93	27.78	27.32	26.92	26.82		30.06	
Latvia				22.49					26.99		30.99	31.6	31.69	33.62				35.91	37.66	35.75	
Lithuania				22.48					33.56	37.33		32.36		30.21		31.85	32.4	32.33	36.01	35.83	
Poland	25.16		25.53		26.89			26.7	32.39			32.66		32.85	33.08	32.93	32.84	34.05			34.91
Romania					23.31			25.46		28.2				29.44		30.25	30.57	31.46	31.06		31.537
Slovak Republic				19.54				19.49				25.81									
Slovenia			23.6						29.18					28.41						30.94	

Source: AMECO (Economic and Financial affairs, Annual Macroeconomic Indicators online database)

Table 4: Industrial relations and the institutional structure of wage bargaining

		Union density (%)	Adjusted collective bargaining coverage (%)*	Coordination of wage bargaining**
Bulgaria	2007	21.3	25	2
Czech Republic	2007	21.0	44	2
Estonia	2007	13.2	22	1
Hungary	2005	17.8	35	2
Latvia	2006	16.1	20	1
Lithuania	2006	14.4	12	1
Poland	2006	14.4	35	1
Romania	2006	33.7	-	3
Slovakia	2006	23.6	35	4
Slovenia	2003	41.3	100	4

Source: Visser (2009)

*Employees covered by wage bargaining agreements as a proportion of all wage and salary earners in employment with the right to bargaining, expressed as percentage, adjusted for the possibility that some sectors or occupations are excluded from the right to bargain

**The data for the dominant level of bargaining is for 2007 for all countries. The ranking of the index is as follows:

5 = economy-wide bargaining, based on a) enforceable agreements between the central organizations of unions and employers affecting the entire economy or entire private sector, or on b) government imposition of a wage schedule, freeze, or ceiling.

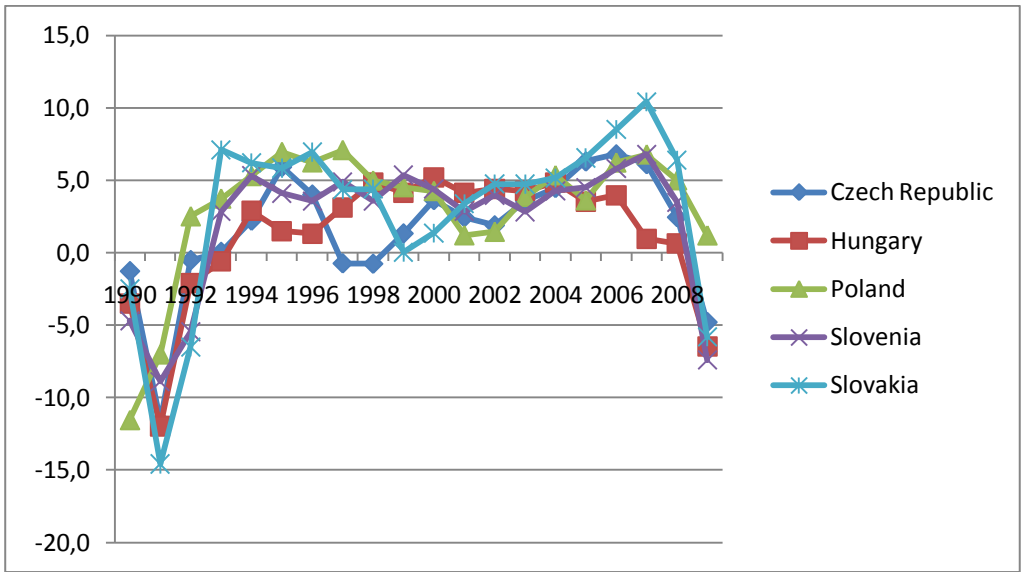
4 = mixed industry and economy-wide bargaining: a) central organizations negotiate non-enforceable central agreements (guidelines) and/or b) key unions and employers associations set pattern for the entire economy.

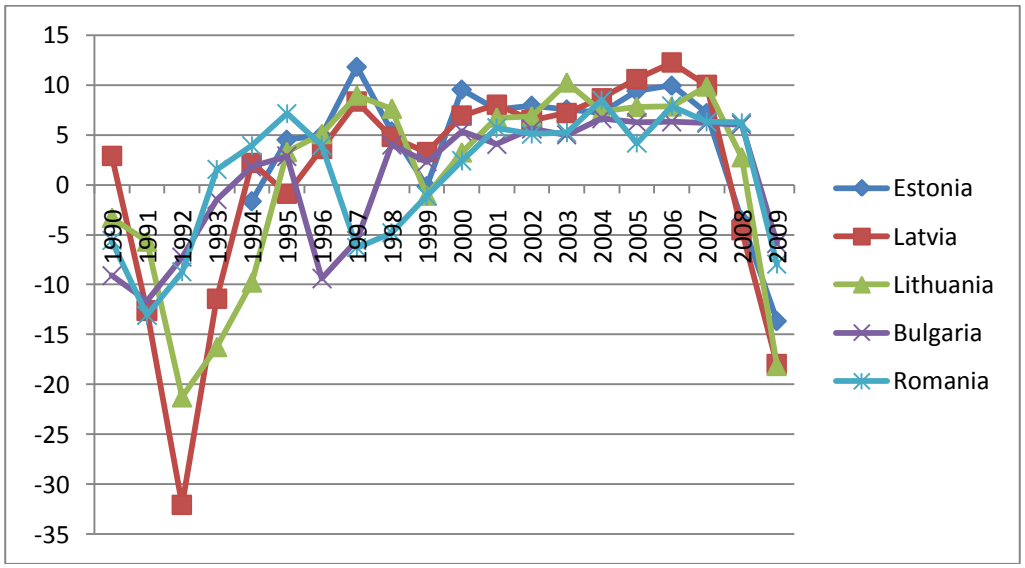
3 = industry bargaining with no or irregular pattern setting, limited involvement of central organizations and limited freedoms for company bargaining.

2 = mixed industry- and firm level bargaining, with weak enforceability of industry agreements

1 = none of the above, fragmented bargaining, mostly at company level

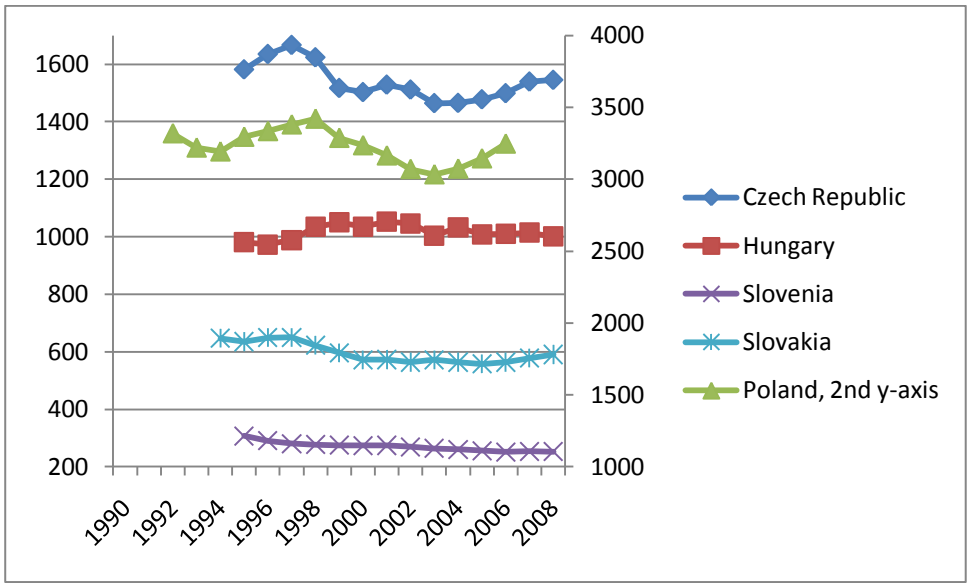
Figure 1a and b: Growth in GDP, (in 2000 prices)

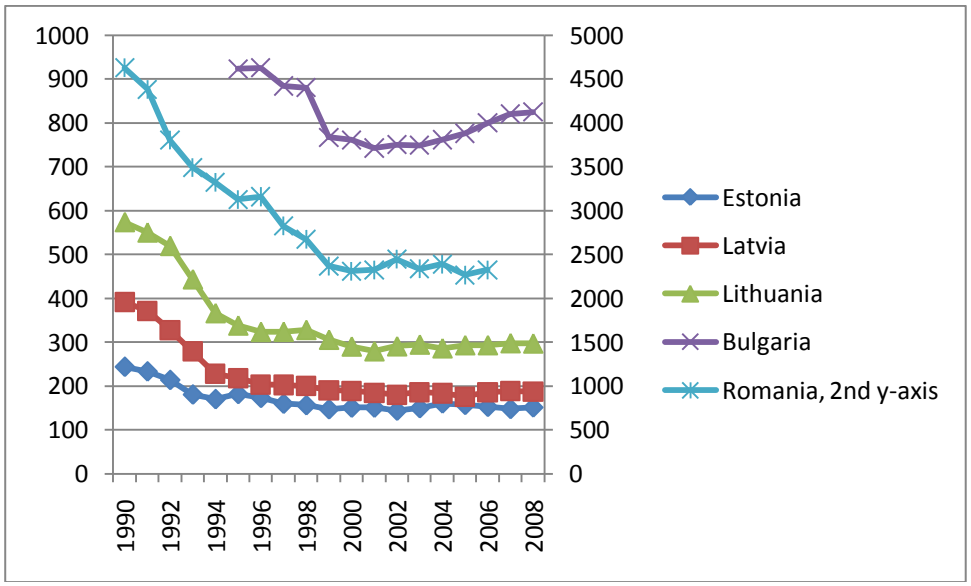




Source: See Table 1

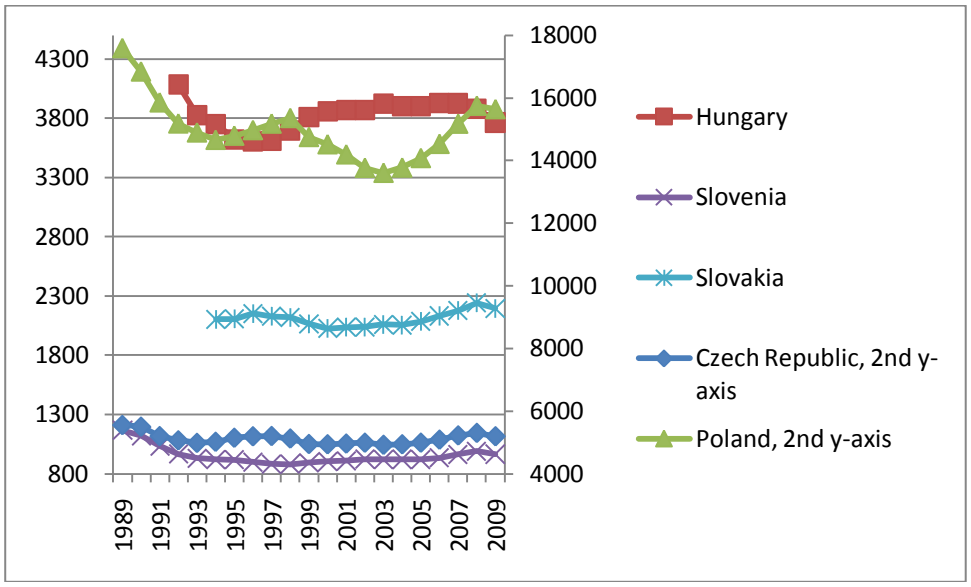
Figure 2: Employment in industry (1000 persons, excluding building and construction)

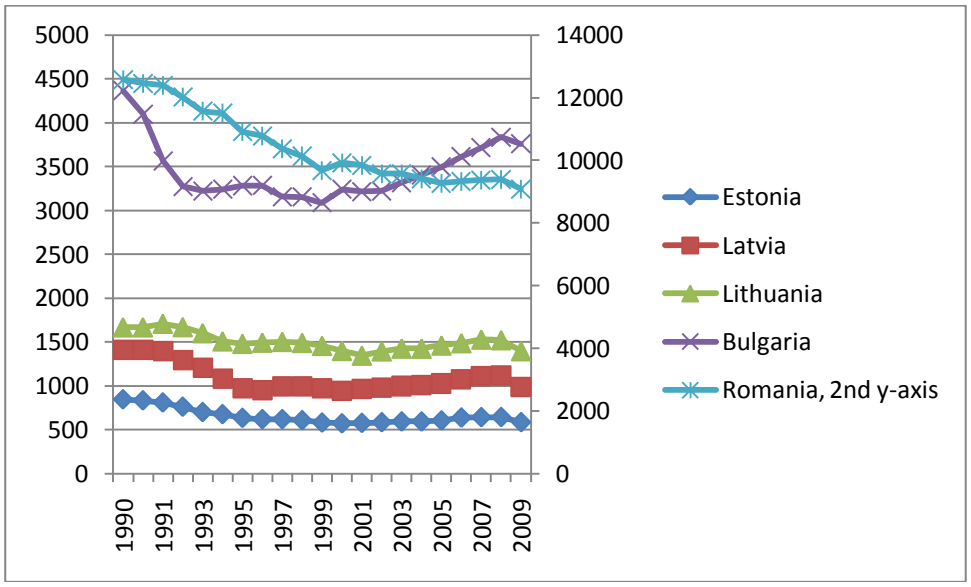




Source: See Table 1

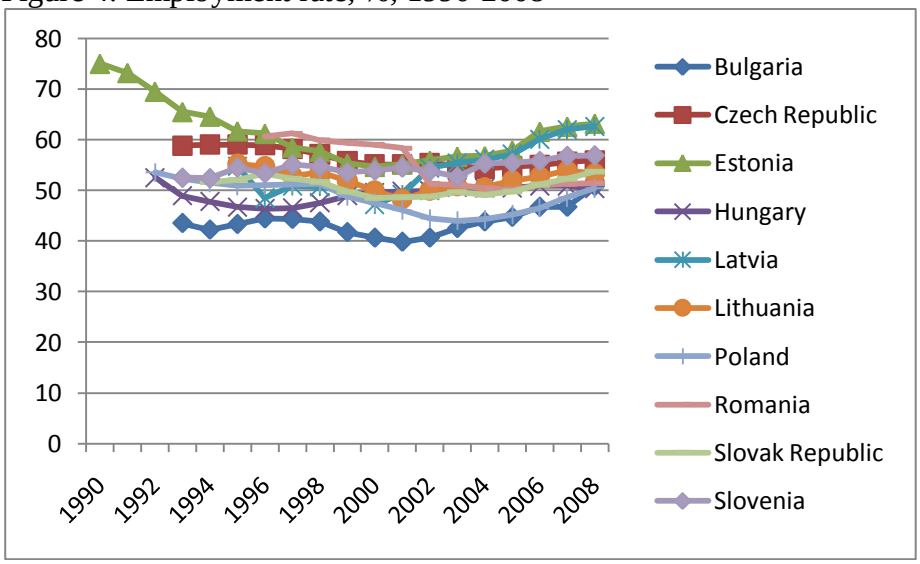
Figure 3: Total Employment (1000 persons, all domestic industries)





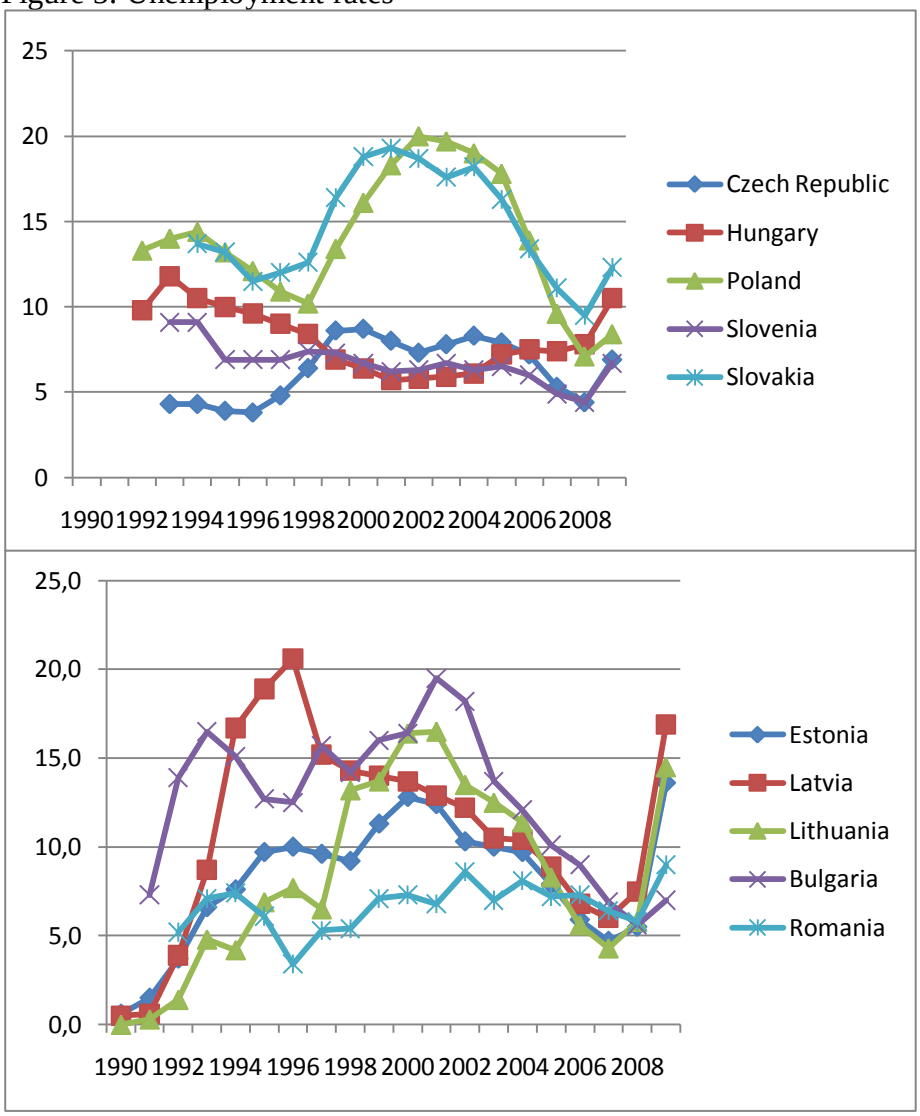
Source: See Table 1

Figure 4: Employment rate, %, 1990-2008



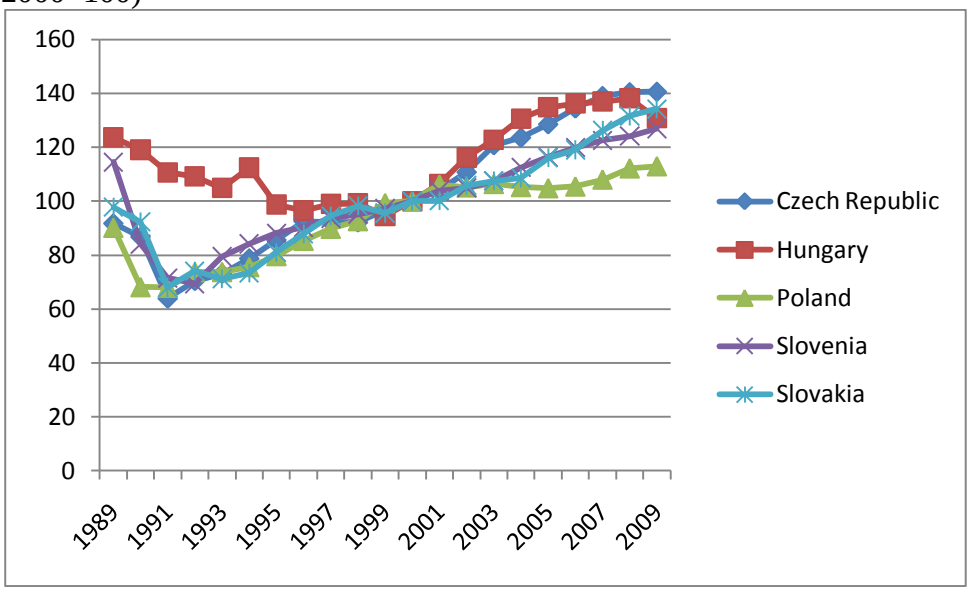
Source: WIIW (The Vienna Institute for International Economic Studies), Handbook of Statistics, online database

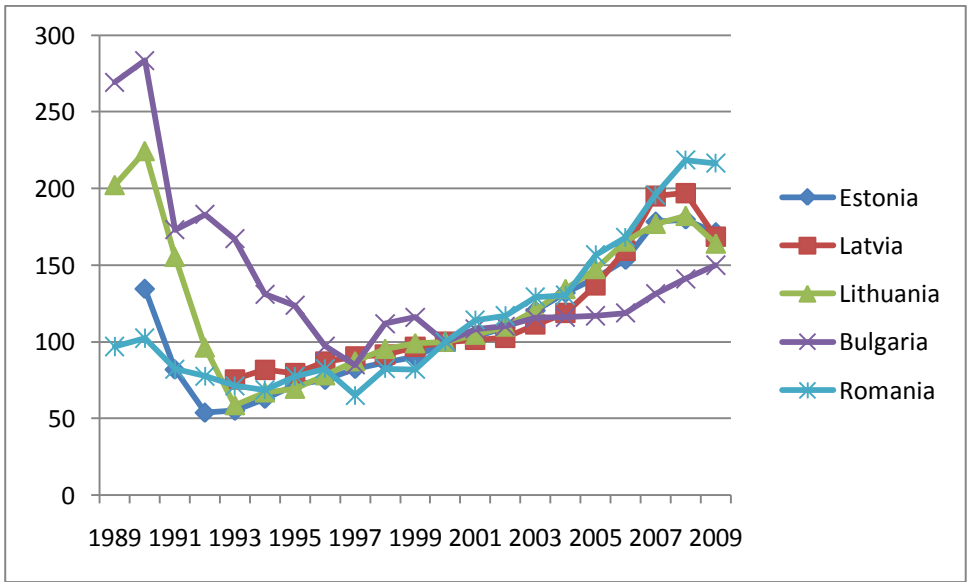
Figure 5: Unemployment rates



Source: See Table 1

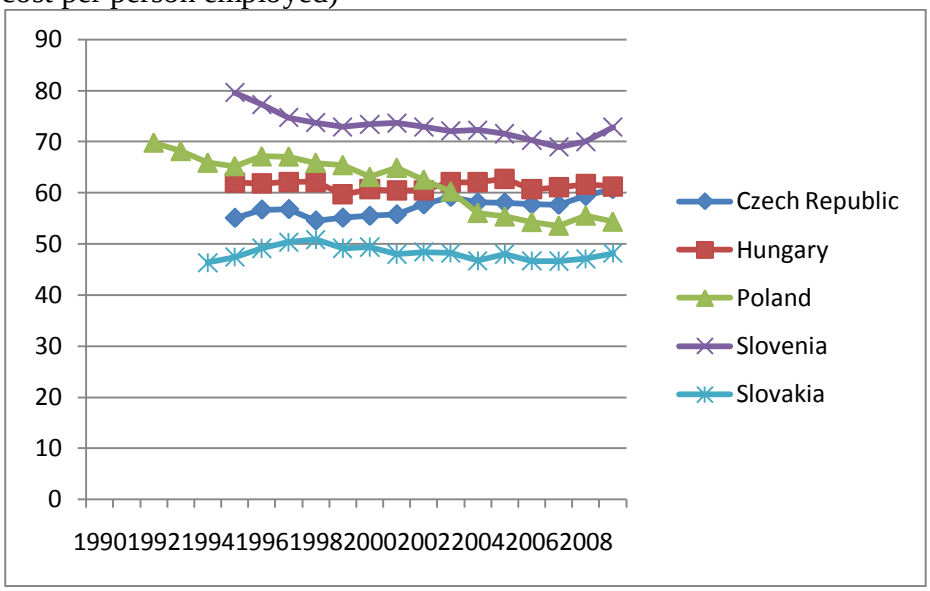
Figure 6: Real wage (compensation per employee, deflator private consumption, index 2000=100)

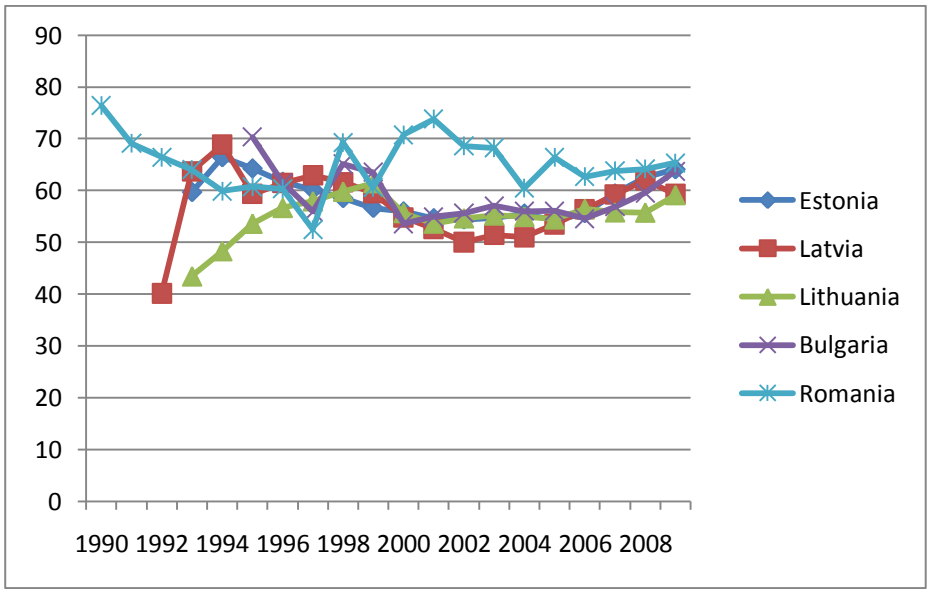




Source: See Table 1

Figure 7: Adjusted wage share (Compensation per employee as percentage of GDP at factor cost per person employed)





Source: AMECO (Economic and Financial affairs, Annual Macroeconomic Indicators online database)