

Unmasking Austerity: The 'great recession' in the Baltic states, the myth of 'successful' austerity and its wider lessons



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(WISeR)**

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24 June 2014

The Baltic states

The Baltics: Between Russia and Nordics



The late 1980s: the end of (evil) empire

‘The singing revolution’



2 million people form a human chain of 'solidarity' spanning over 600 kilometres (370 miles) across the three Baltic states. 23 August 1989.



Unprecedented unity of Baltic nations

Small countries/ big myths

James K. Galbraith *Foreword to* ***The Contradictions of Austerity***

“It is the fate of small countries to serve as pilot projects, as battlegrounds, and as the point-of-origin for myths.

In the wake of the great financial crisis the three Baltic republics of Latvia, Lithuania and Estonia have played these roles.”

Their experience, which does include a return to economic growth and no public debt crisis, has become a world-model for global bankers, international financial bureaucrats and some economists.

The narrative of 'successful' Baltic model of austerity through 'internal devaluation'

- After a period of rapid economic growth in the mid-2000s (the highest in the European Union)
- Economic downturn followed (again the most severe) created mainly by a housing and consumption bubble
- Imposition of tough austerity (internal devaluation), including massive cuts to the public sector expenditures on social welfare, mass unemployment and wage cuts, raising taxes, and tight monetary policy has created a 'miraculous' economic recovery
- The Baltic model proves that radical austerity measures can be imposed in a socially 'costless' and economically 'successful' manner
- This model can be applied elsewhere



Doug Bandow
Contributor

OPINION

4/15/2013 @ 8:00AM | 9,748 views

The Triumph Of Good Economics: 'Austere' Baltic States Outgrow Their European Neighbors

In short, at a time when the question seems to be which European nation won't require a bail-out, the Baltic Three have demonstrated the art of economic reform. Fiscal prudence delivers economic growth. This experience offers a reform model for the rest of the continent and beyond.



**“IMF chief Lagarde
hails the recovery
of the Baltics”**

**“A triumph of austerity:
What Britain can learn
from the Baltic states”**



**Anders Aslund
Peterson Institute**

**“Crisis resolution in these countries
was decisive and successful.”**

**“Just how did the Baltics do it?
And what lessons should
policymakers elsewhere learn
from their experience?”**

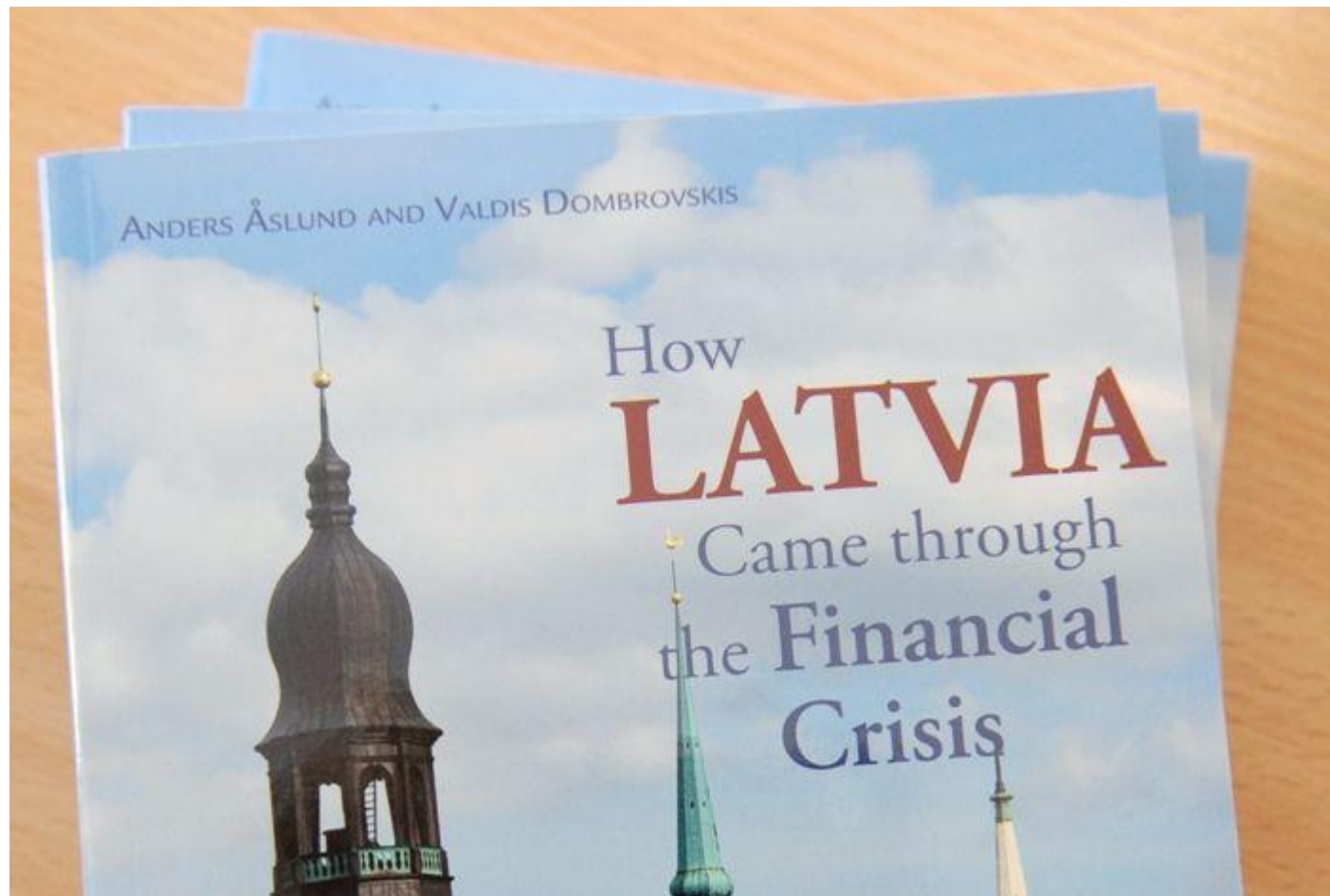
Anders Aslund *The Fiscal Lessons from the Baltic States Must Not Be Ignored*

- “When the global financial crisis hit in the fall of 2008, the three Baltic countries instantly put their house in order.
- They front-loaded fiscal tightening, carrying out a fiscal adjustment of about 9% of Gross Domestic Product (GDP) in 2009.
- Each of them cut public expenditures by about 6% and hiked tax revenues by about 3% of GDP.
- And most of the lessons they learned would be useful to other European countries as well.”

How Latvia Came through the Financial Crisis

Anders Aslund and Valdis Dombrovskis

Was **\$21.95**,
Now **\$17.56**



Peterson
Institute for
International
Economics

Riga: First austerity unrest in Eastern Europe

January 2009



Rioters in Riga clash with Latvian police outside the parliament building

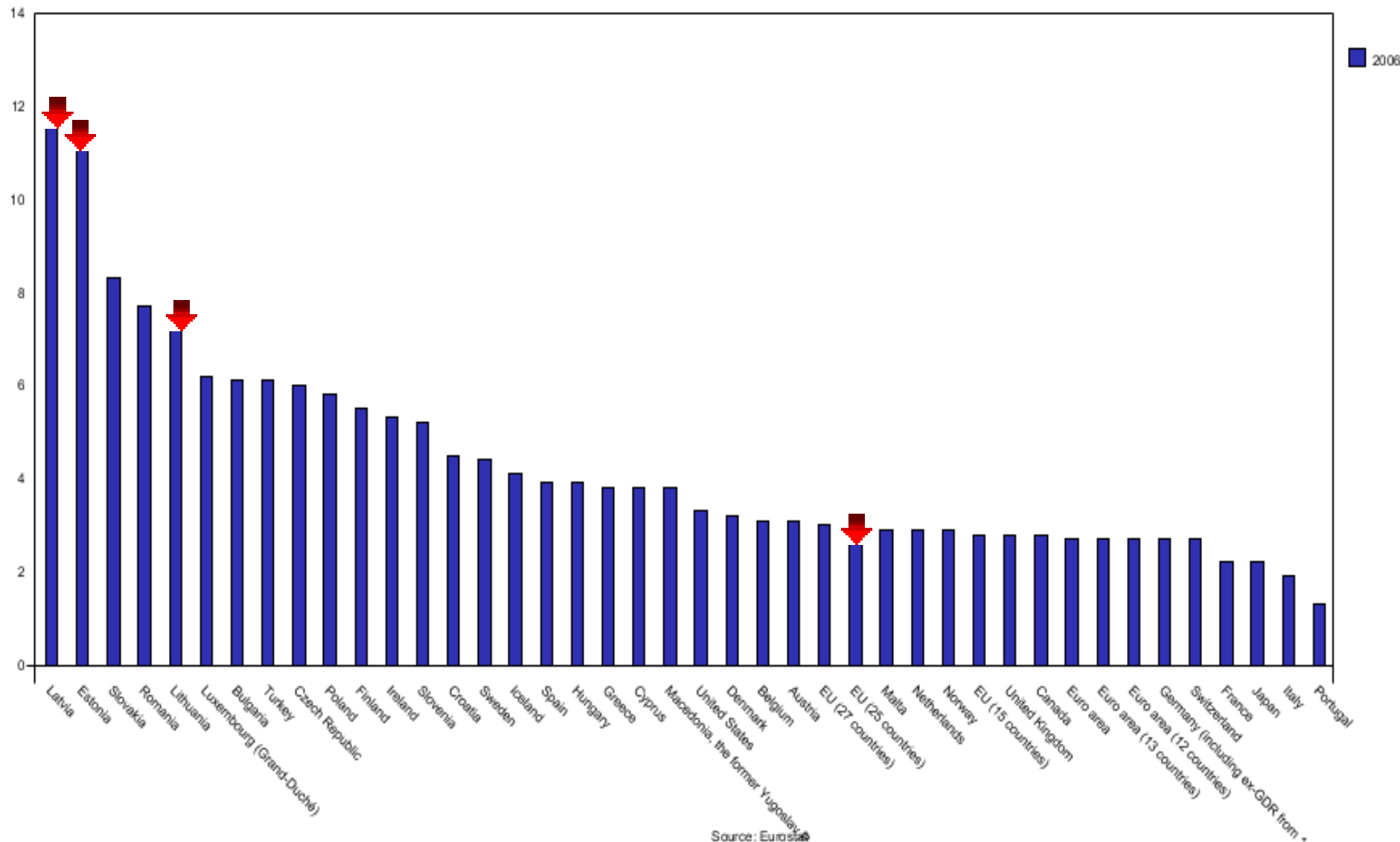
The Baltic “Tiger economies”: The way we were...

Baltic “champions of neoliberalism”

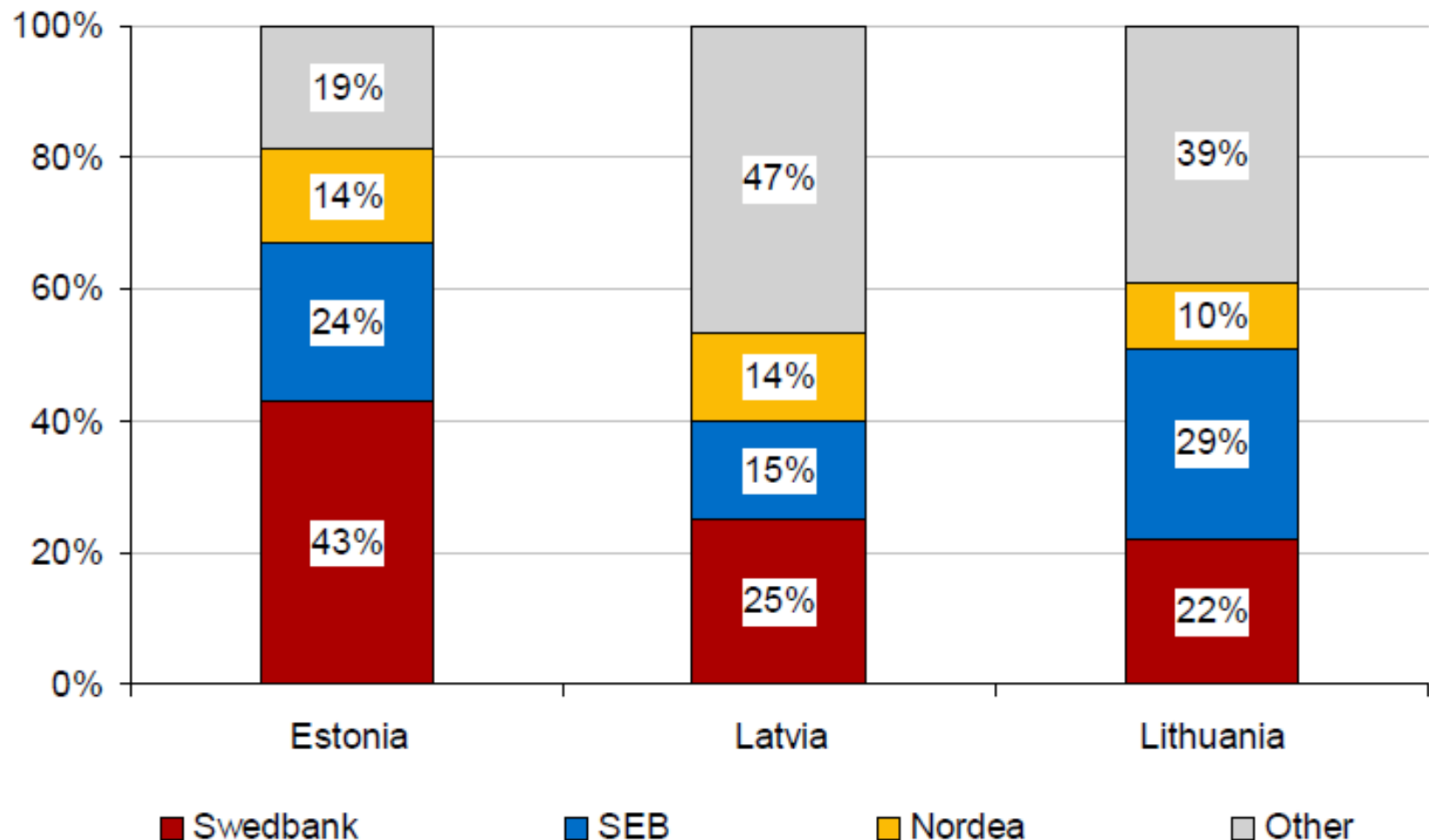
(Bohle and Greskovits 2013)

- Enthusiastic embrace of radical neoliberal macroeconomic, structural and social policies
- Rapid liberalization of trade and foreign investment, introduction of fixed exchange rates, tight monetary policy
- (‘Insider’) privatizations and little protection of inherited industries
- Most FDI in ‘new’ areas of finance, real estate, transport and communication services
- Nation-building project founded on (ethno)-nationalist rather than welfarist social contract
- Monetary stability pursued through currency pegs regardless of implied social costs

'Baltic Tigers' GDP 2006



Market shares of Swedish banks in Baltic states June 2009



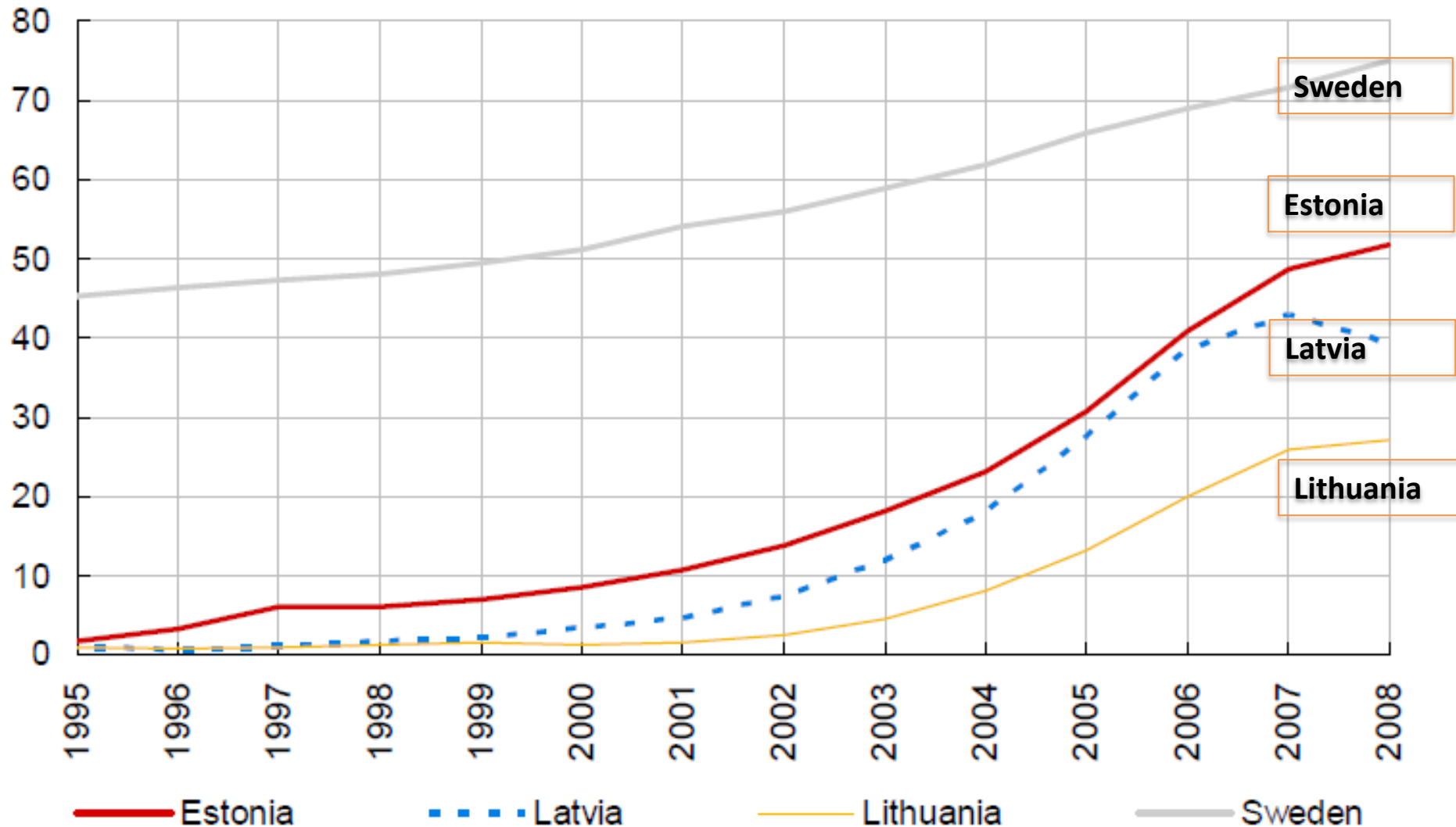
The Property Bubble

Global Property Guide, 2007

► House Prices in Northern Europe	Purchase price, € per sq. m.	Gross rental yield (%)
UK - London	€7,119	5.79%
Norway - Oslo	€5,117	4.22%
Ireland - Dublin	€5,000	4.00%
Lithuania - Vilnius	► €3,792	4.04%
Denmark - Copenhagen	€3,784	4.88%
Finland - Helsinki	€3,333	5.00%
Sweden - Stockholm	► €3,167	6.00%
Latvia - Riga	► €3,020	4.97%
Estonia - Tallinn	€2,383	6.13%


Source: Global Property Guide

Sweden and Baltic household indebtedness as % GDP




The 'Hard Landing' – a foreseeable disaster

FT.com
FINANCIAL TIMES



Video
Chris Giles on the Bank of England's decision to raise interest rates



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Sunday Jul 8 2007
All times are London time

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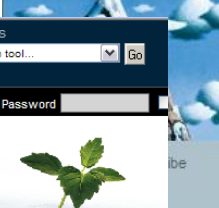
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Baltic boom states face hard landing
By Robert Anderson
Published: July 5 2007 03:00 | Last updated: July 5 2007 03:00
The Galerija Centrs shopping arcade in down Latvia's transformation from a former Soviet re state in the European Union.


Baltic Boom: The adjustment is likely to be painful and to start soon



Economist.com
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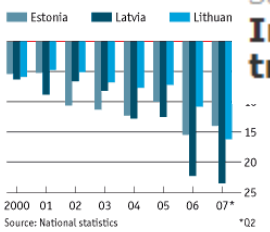
Eastern Europe's economies
Worrying about a crash
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From The Economist print edition
East European economies are still powering along—but the region is ill-prepared if the weather turns nasty



Peter Schrank

Finance & Economics Get article background

Eastern Europe
Baltic blues
Oct 18th 2007 | TALLINN
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Europe's fastest-growing economies hit choppy waters


Latvia dolorosa
Current-account deficit as % of GDP
■ Estonia ■ Latvia ■ Lithuania


Year	Estonia	Latvia	Lithuania
2000	-10	-10	-10
2001	-10	-10	-10
2002	-10	-10	-10
2003	-10	-10	-10
2004	-10	-10	-10
2005	-10	-10	-10
2006	-10	-15	-10
2007	-10	-20	-10

Source: National statistics

Saturday, October 13, 2007
Inflation soars in all three Baltic states, triggering renewed fears of contagion
overheating economies and fixed exchange rates: a risky mix. Some fear the region could be eastern Europe's Achilles heel.
Latvia is in the worst situation. Year-on-year inflation in September was a whopping 11.4%; the current-account deficit over a fifth of GDP. Bank lending, much of it in foreign currencies, has soared, creating a property bubble in the capital, Riga. Overheating has hurt competitiveness. To some the national currency, the lat, looks like the likeliest casualty.

IMAGINE some souped-up old bangers driven confidently but not expertly on a smooth road in fine weather. That is the economic picture of the ten east European countries that are now in the European Union. If the road gets wet or slippery, bad brakes and bald tyres make a crash, even a pile-up, horribly likely.



Europe prepares for a Baltic blast

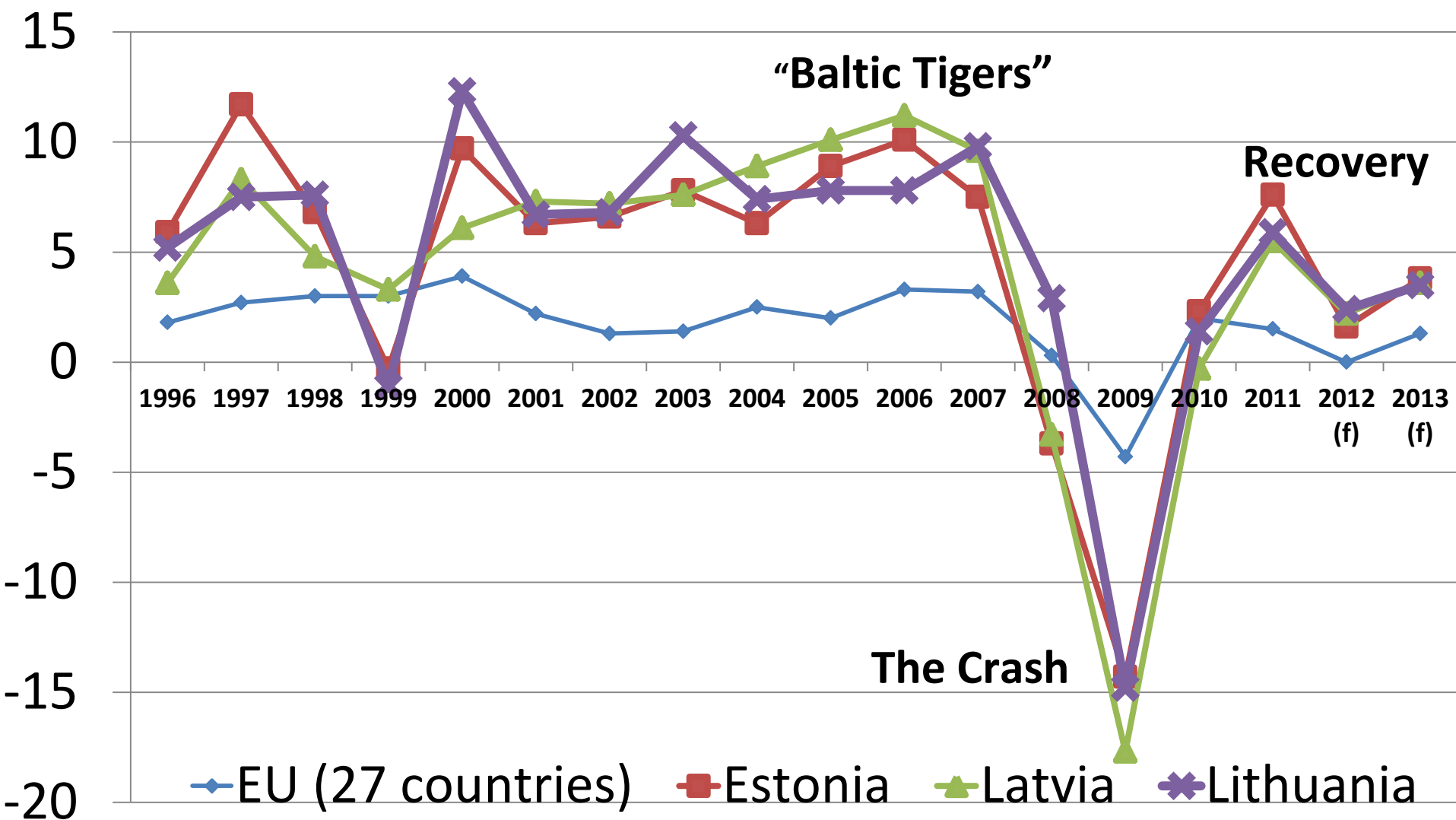
BY GIDEON RACHMAN FT 3 August 2009



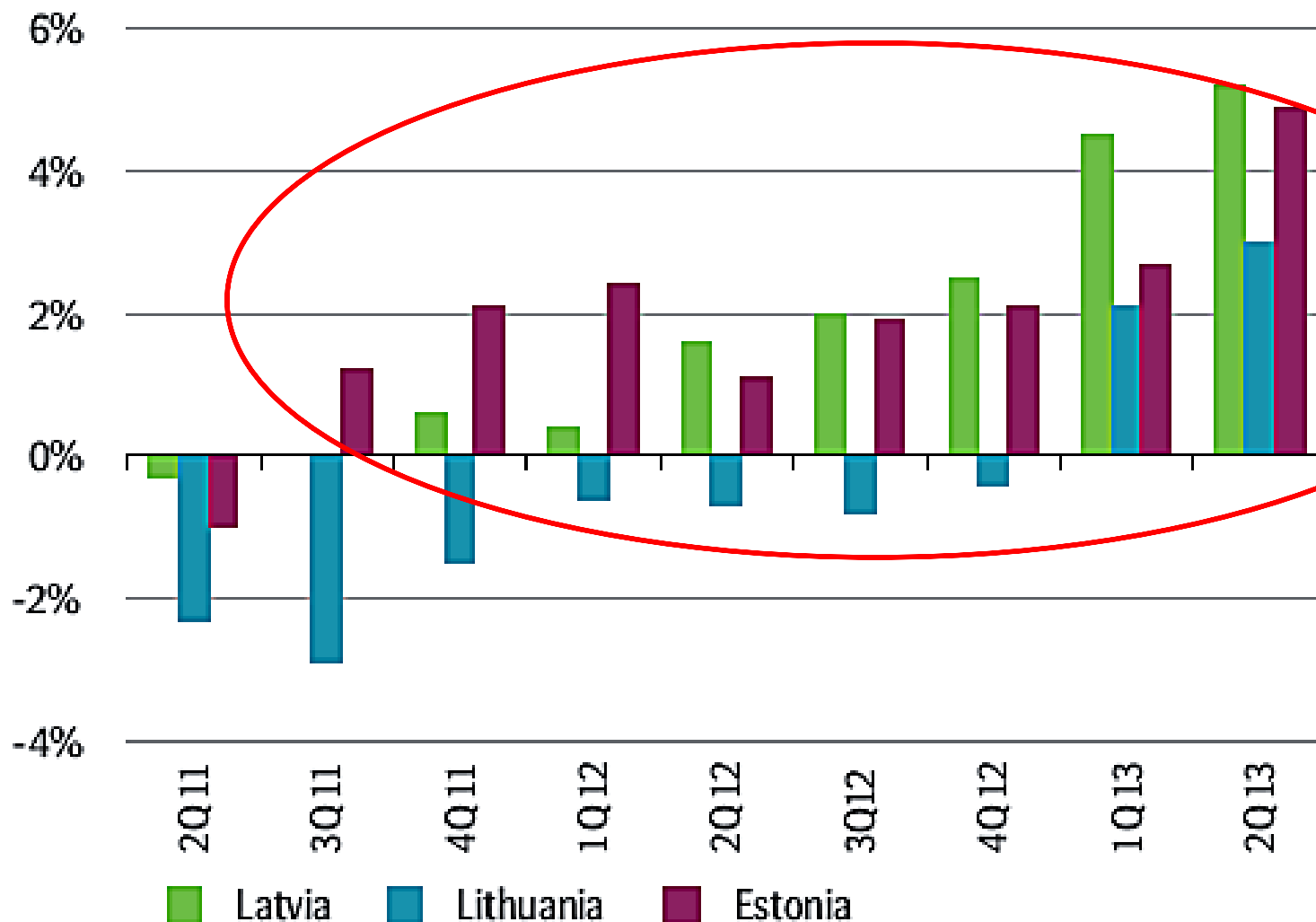
Jean-Claude Juncker Home page: “...instrumental in leading Europe safely out of the financial crisis” (<http://juncker.epp.eu/who-jean-claude-juncker>)

**Rapid 'recovery':
the way we are today**

Real GDP year-on-year 1996-2013 (Eurostat)

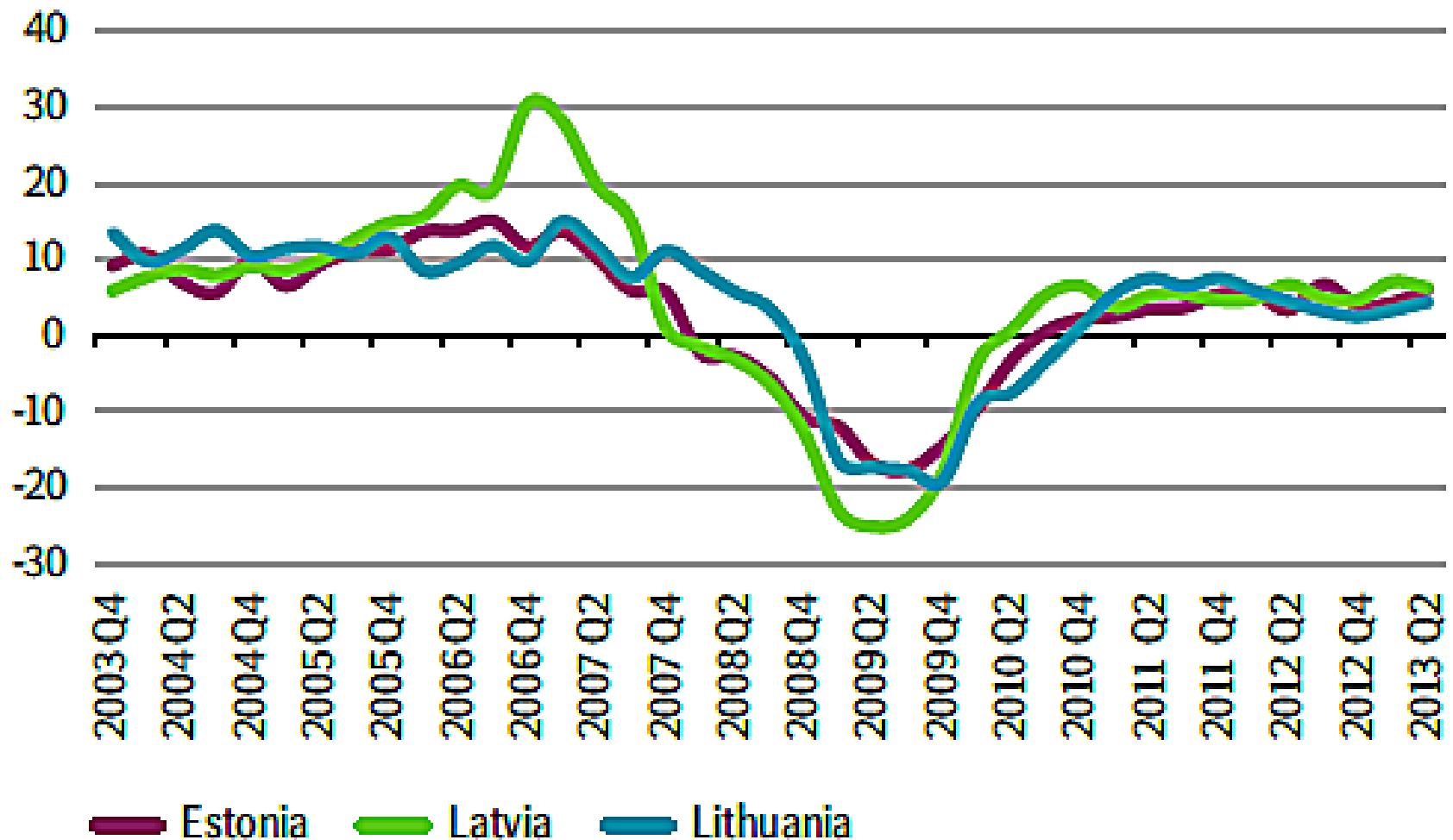


Real wages (% YoY) 2011-2013



Source: National Statistics

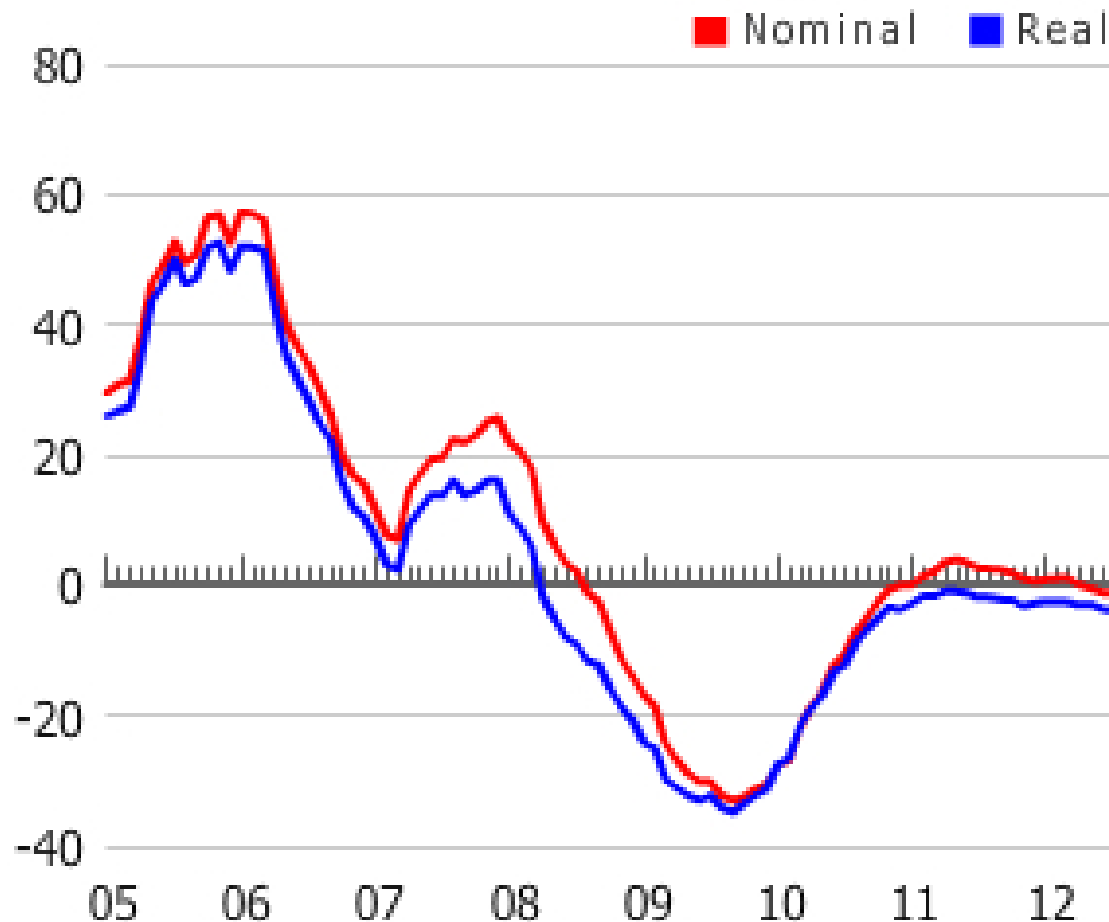
Consumption of household sector (y-o-y real change, %)



Source: Eurostat

House price change (5 Largest Cities) Lithuania

% change over a year earlier



**How we got to 'recovery':
austerity and 'internal devaluation'**

Austerity measures

- Imposition of flat (regressive) tax increases (VAT) hurting the more vulnerable sections of the population
- Extensive cuts in public sector, welfare, education, social benefits, pensions
- Mass unemployment and growing informality in private sector
- Reduction in wages, employment and redundancy rights
- Growth of long-term and youth unemployed

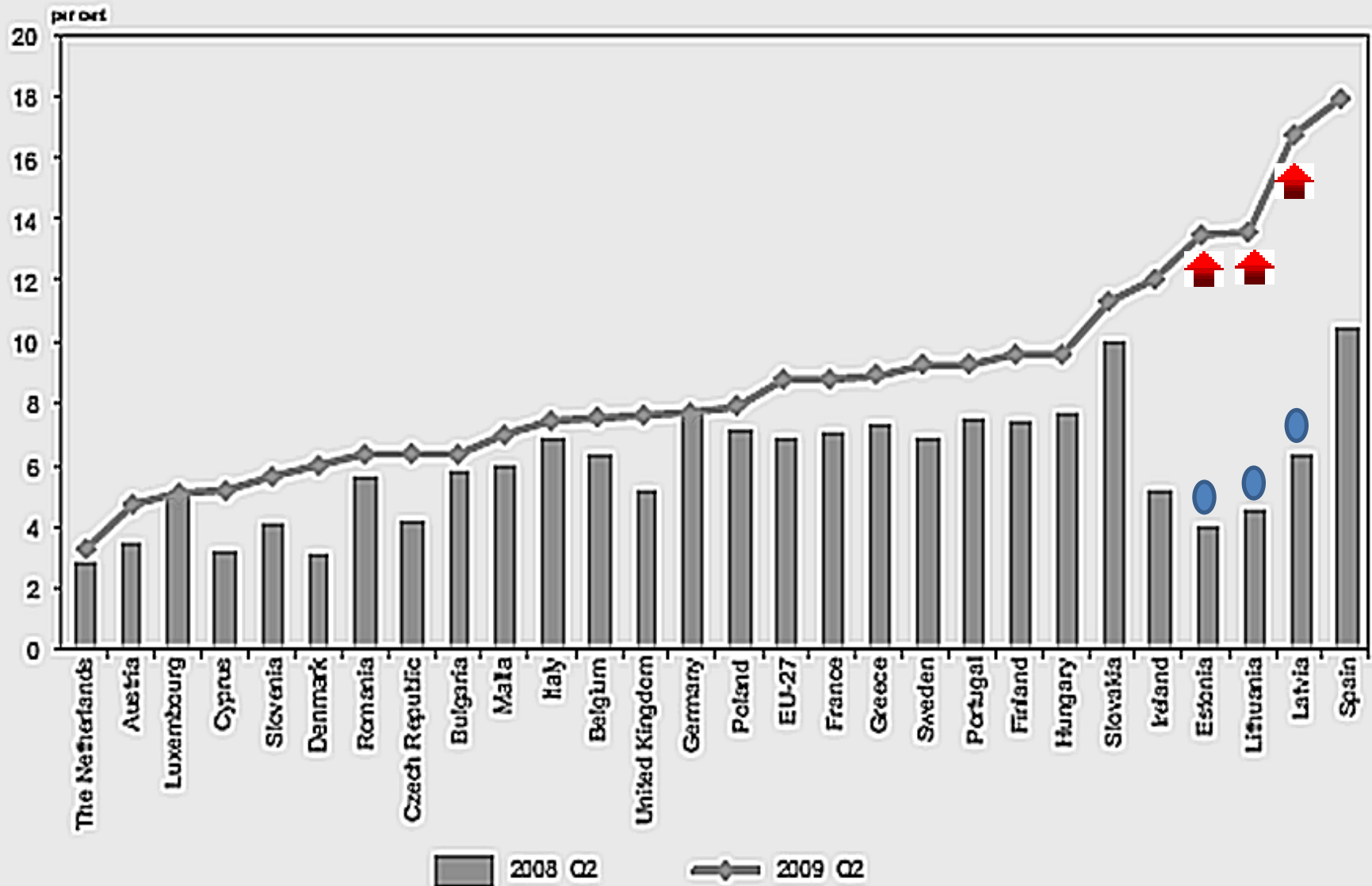
Baltic household consumption expenditure 2009 % change compared to same quarter of 2008

source: Eurostat PEEIs

	Q1	Q2	Q3	Q4
Estonia	-16.5	-19.4	-19.9	-18.2
Latvia	-18.3	-23.5	-25.6	-21.7
Lithuania	-14.5	-16.9	-17.7	-19.0

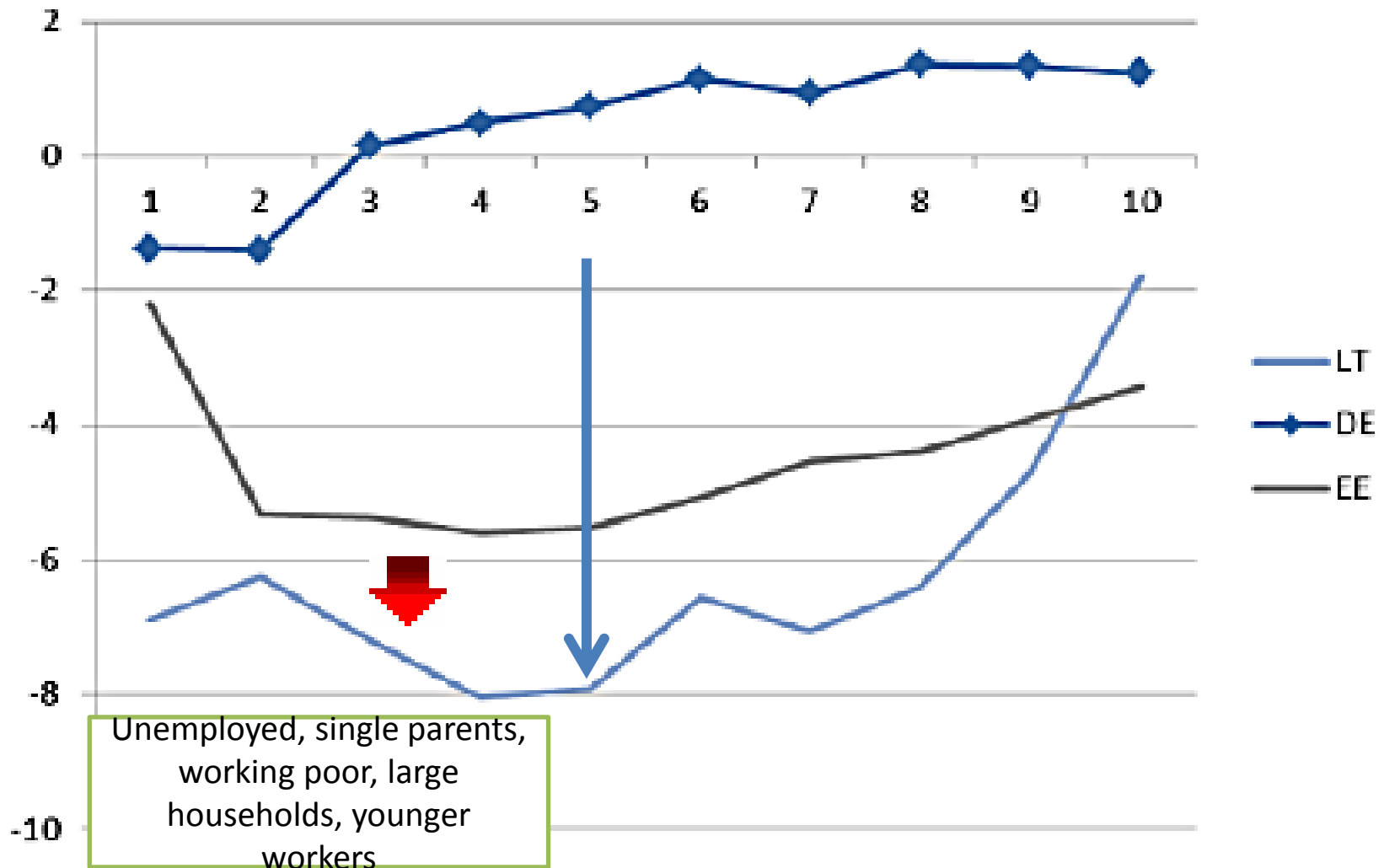
Unemployment rate in EU

Q2 2009 compared to Q2 2008



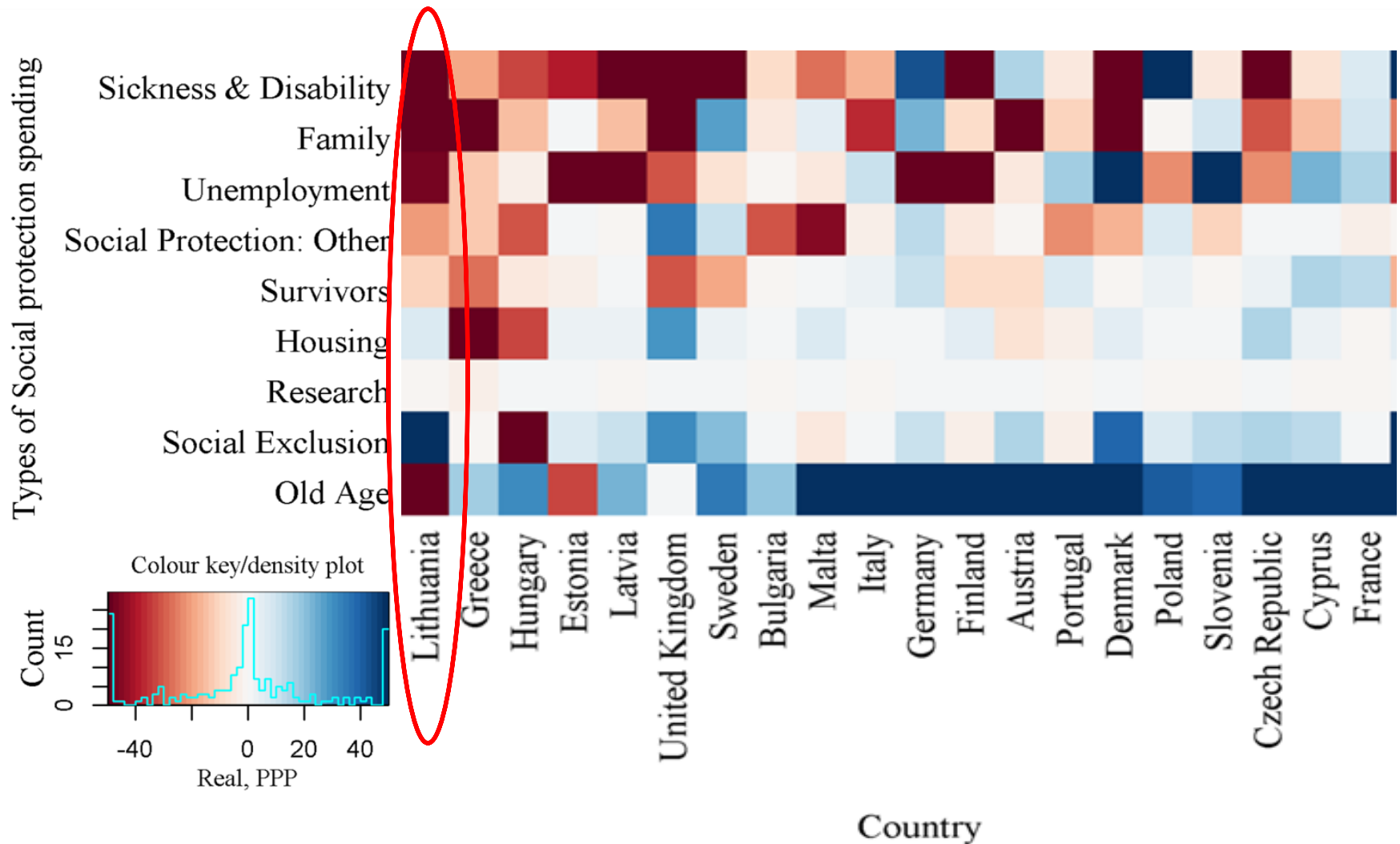
Percentage change in household disposable income due to policy changes 2008-2013 by household income decile group

source: EU Employment and Social Situation Quarterly Review March 2014



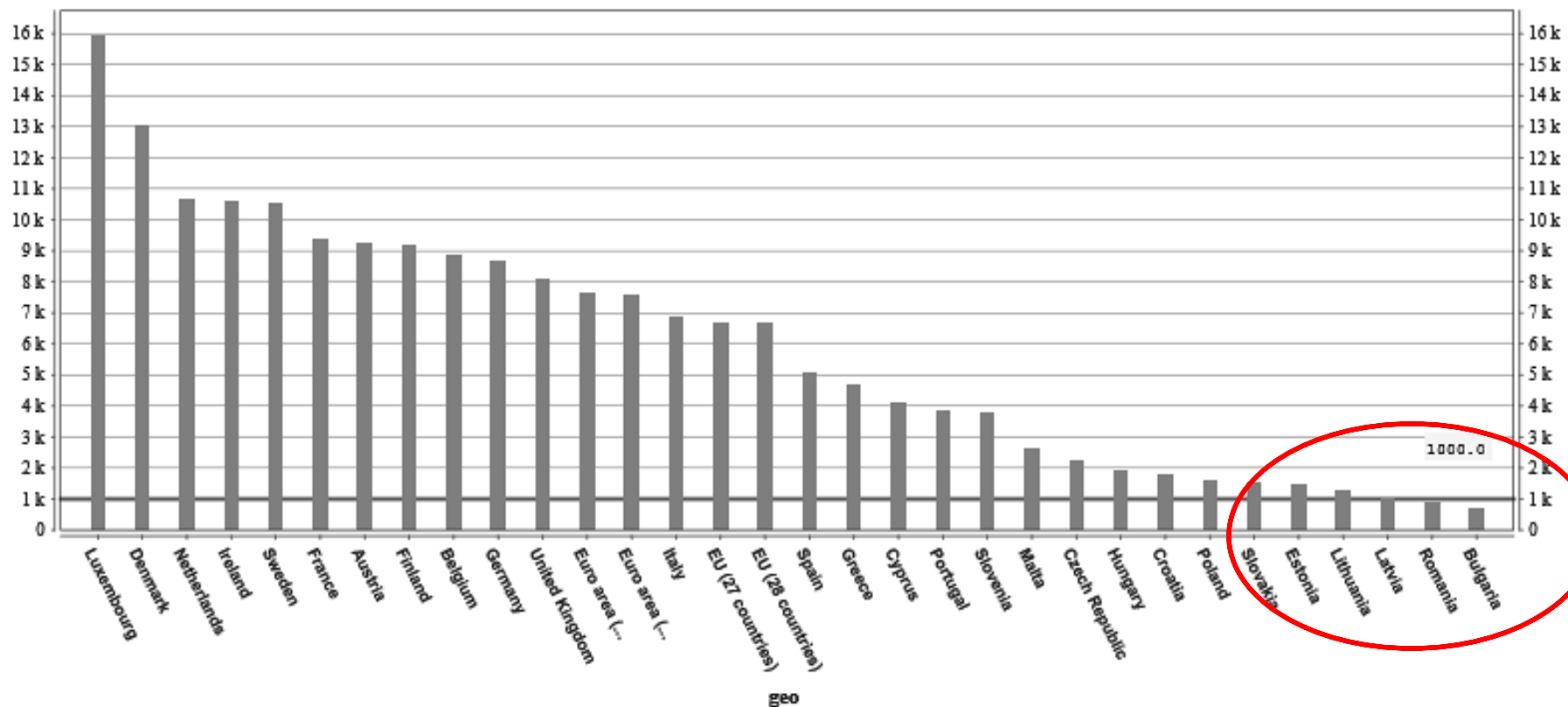
Social protection austerity: 2009-2011

(Brown= reduced per capita spending: Blue = increased)

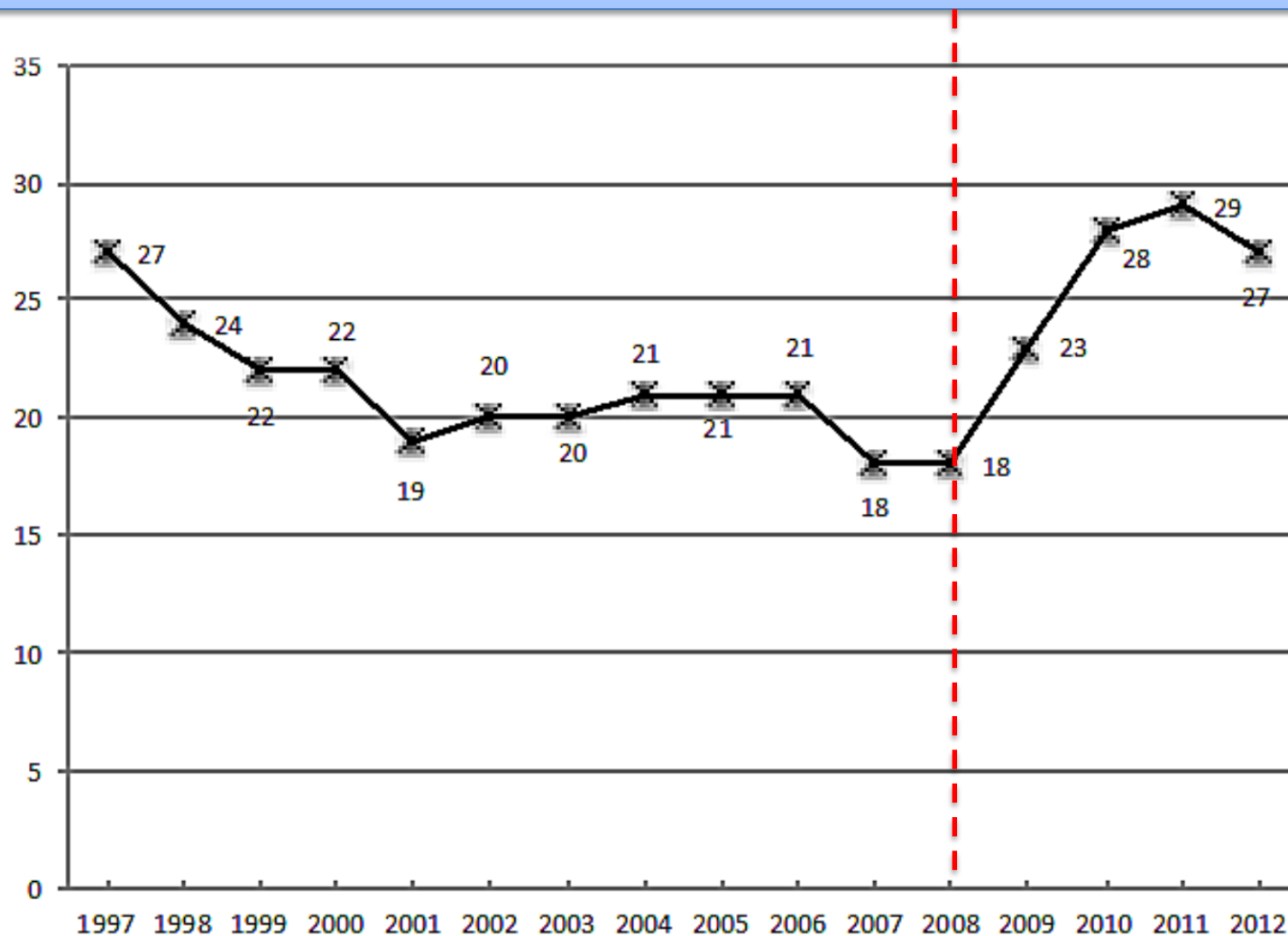


Total expenditure on social protection per head of population 2011

(source: Eurostat)

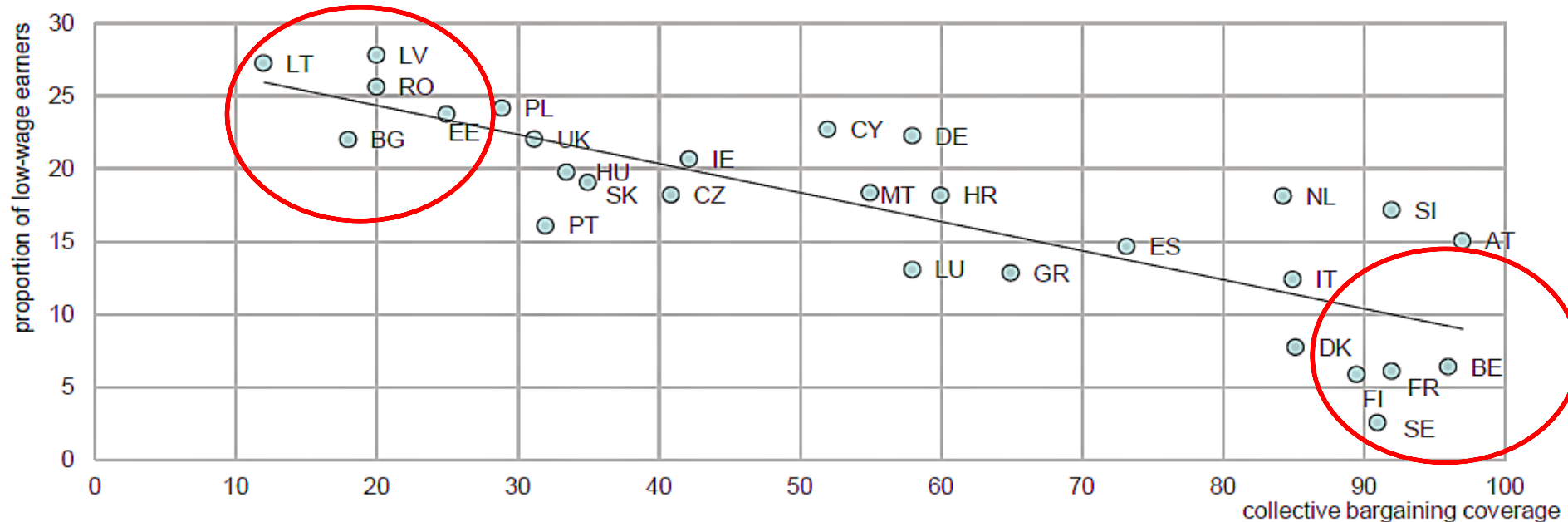


Size of Lithuania Informal Economy % of GDP 1997-2012



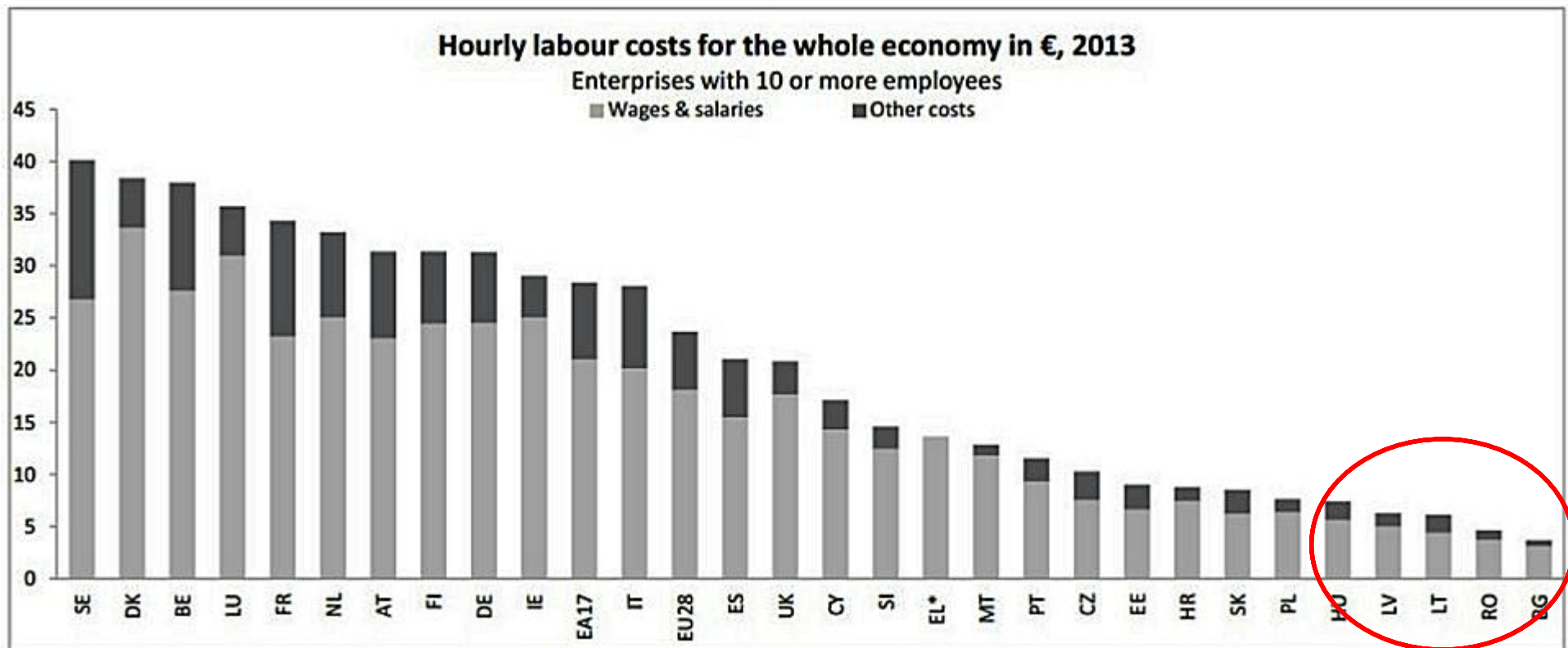
Source: LLRI 2012, p. 4

Collective bargaining coverage (%) and the proportion of low-wage earners (% of total employees in establishments with 10 employees or more), EU28



Source: ETUI (2014) Benchmarking the Crisis. P. 78 Eurostat 2010 data.

Wage suppression, low wage economy: the low road

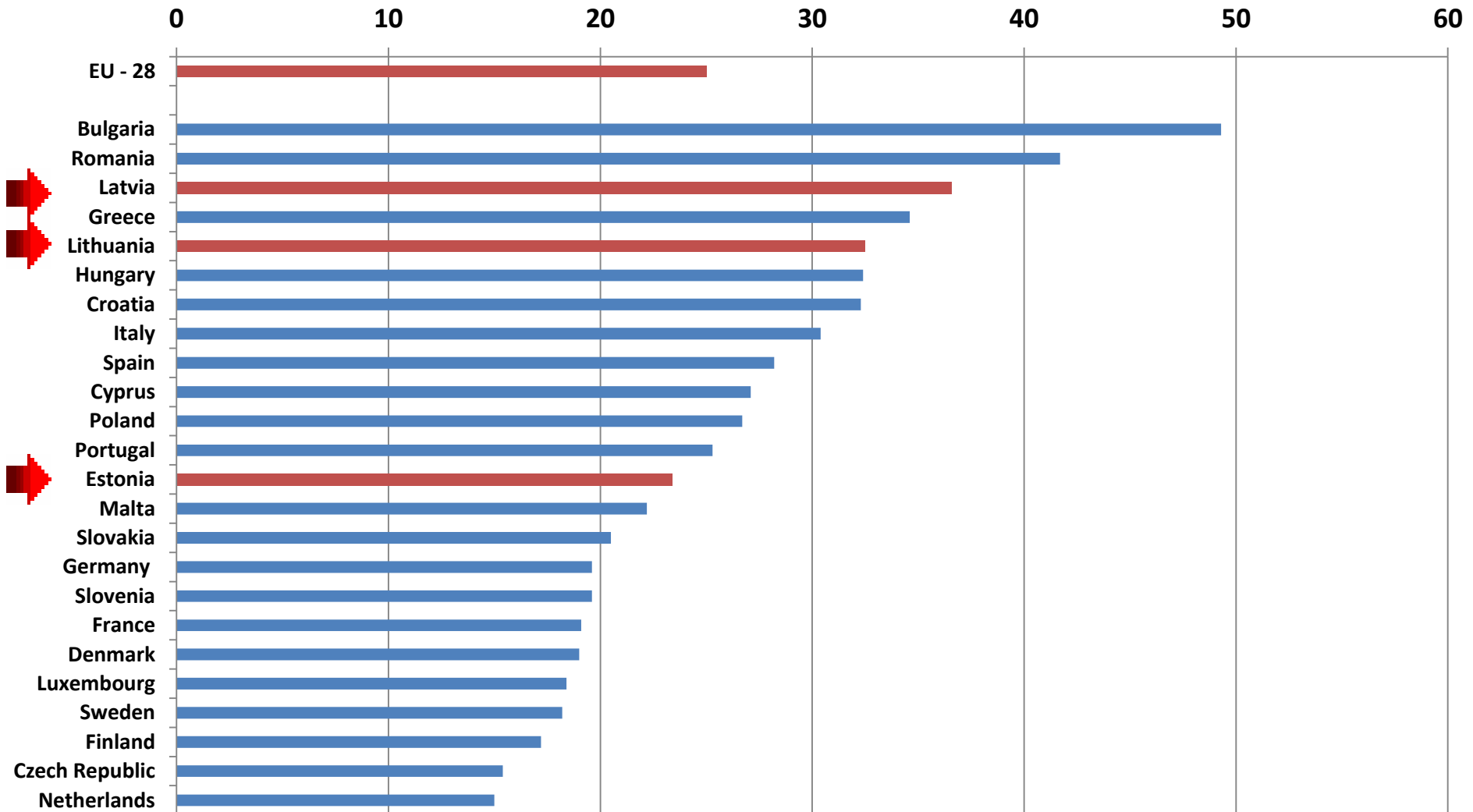


* Based on Eurostat's estimate for the 3rd and 4th quarter of 2013. Only the total level is estimated.

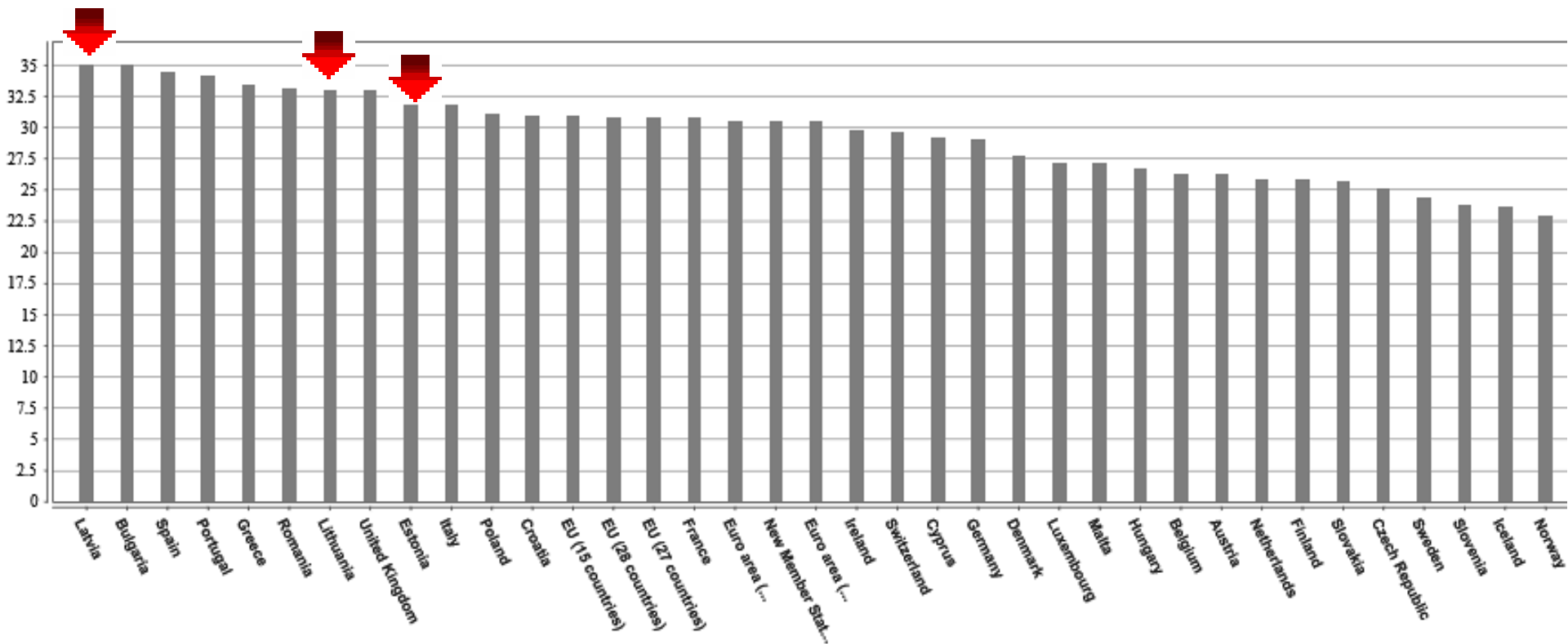
- Lithuania labour costs €6.2 per hour, Latvia €6.3; EU average €23.7 per hour;
Lower labour costs only in Romania €4.6 per hour; Bulgaria €3.7 per hour.
Sweden labour costs more than €40 per hour or 6.5 times more than in LT;
in Norway €48.5 per hour.

Proportion of population at risk of poverty or social exclusion (%) 2013

Source: Eurostat

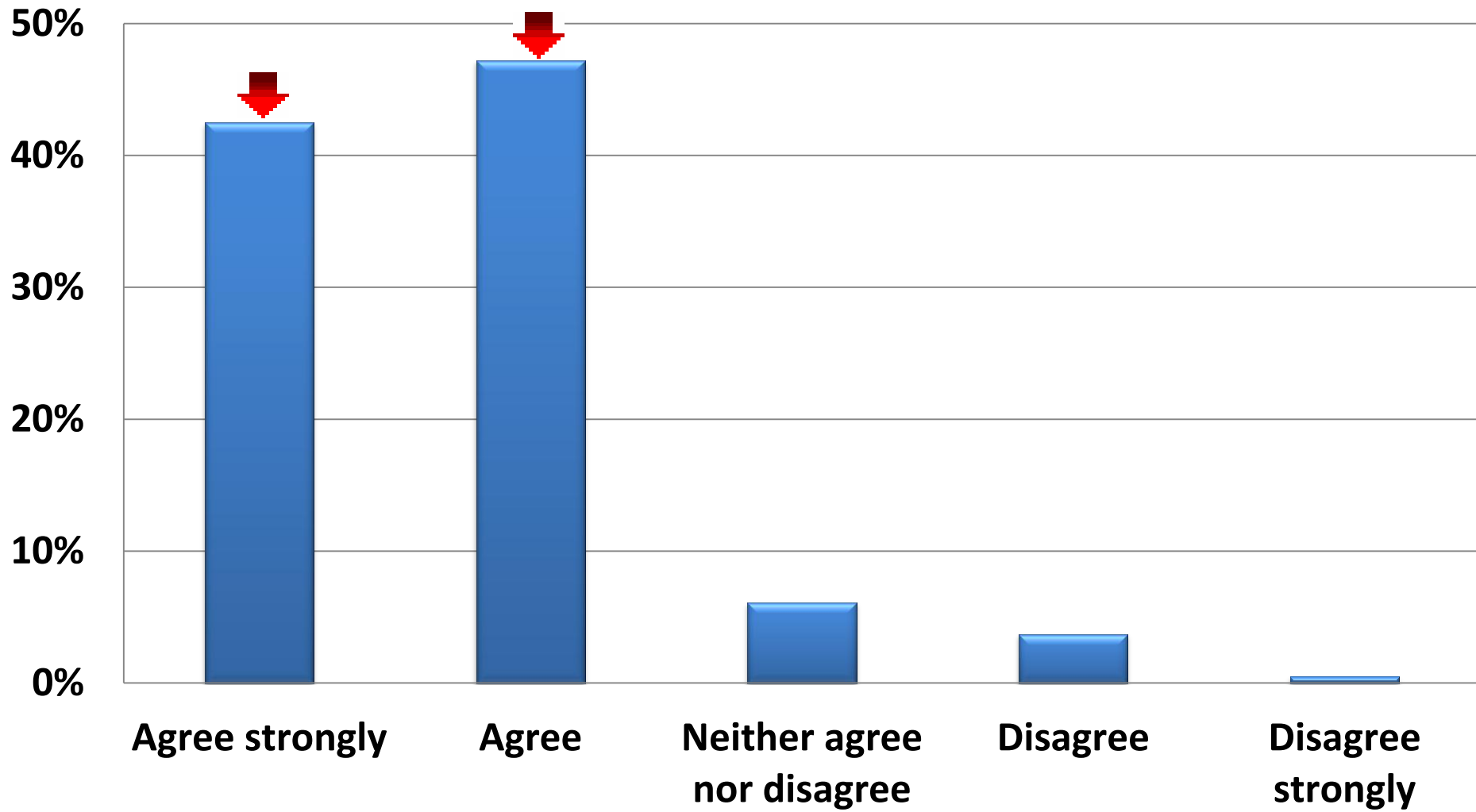


Gini coefficient of equivalised disposable income 2011 (source: SILC)



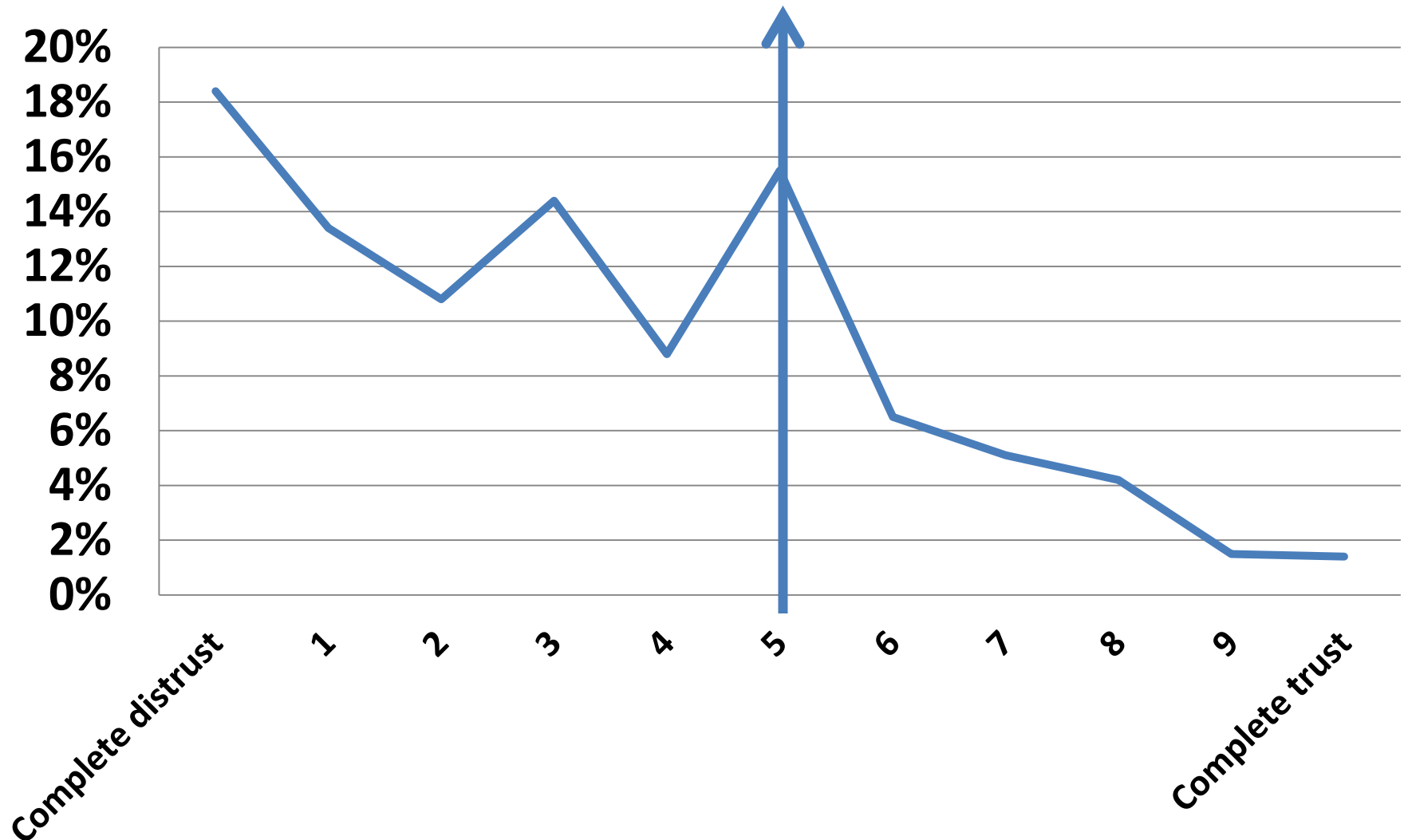
Government should reduce differences in income levels (Lithuania sample)

European Social Survey 5th Round 2010



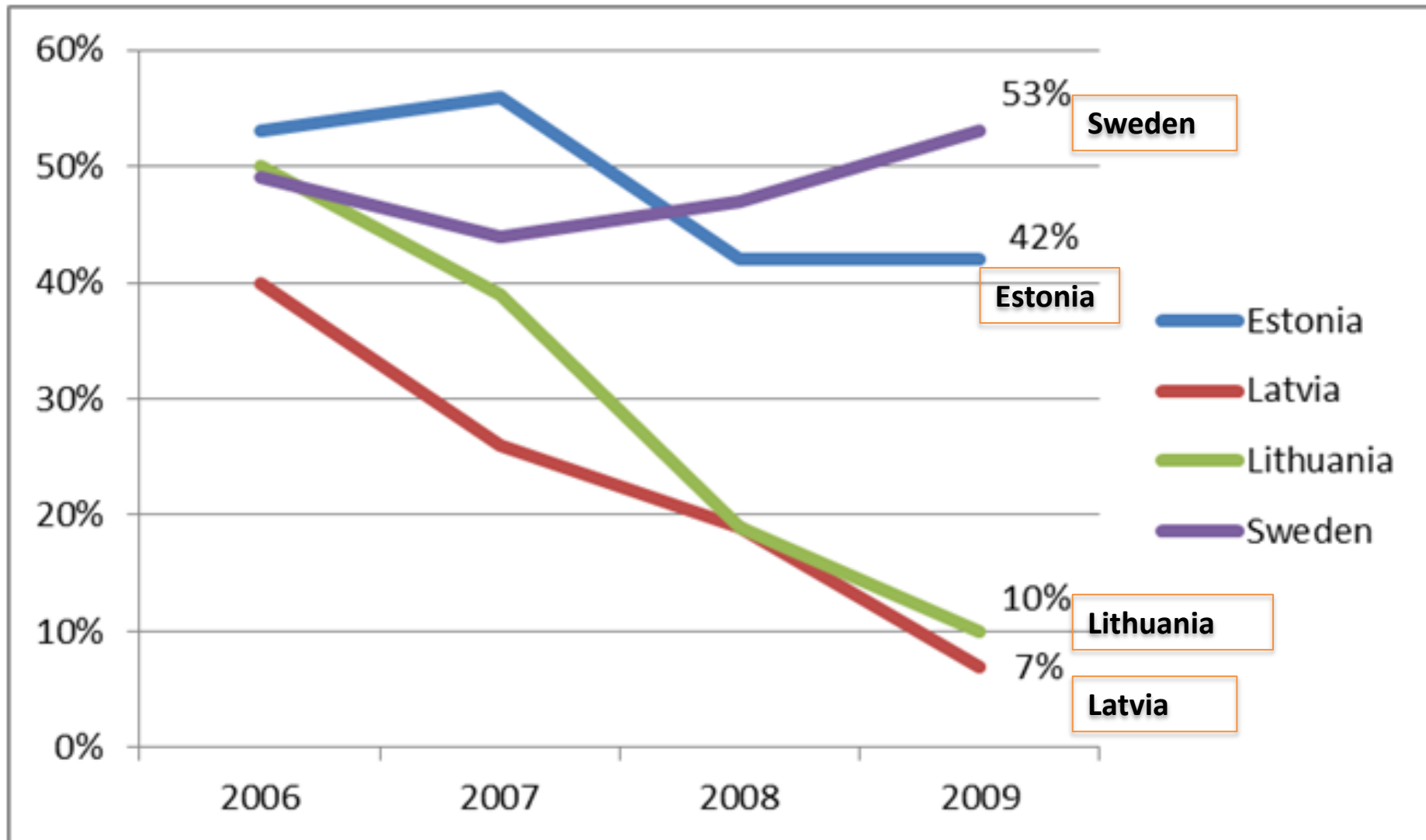
Trust in Lithuanian State Institutions

European Social Survey 5th Round 2010

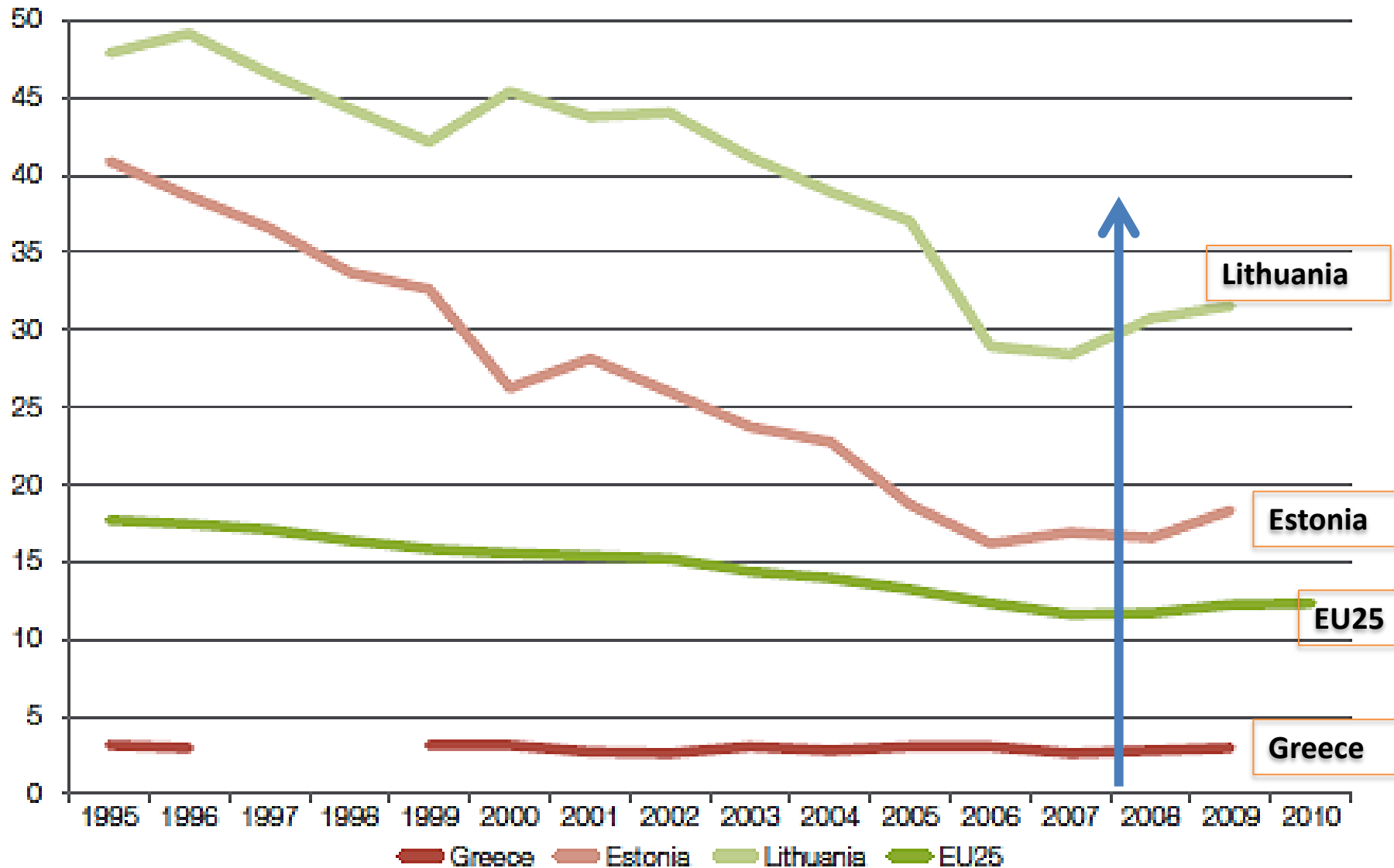


Things are going in the right direction or in the wrong direction in your country? (% positive)

Source: Estonia HDR 2011



Trends in suicide rates in selected European countries, 1995–2010

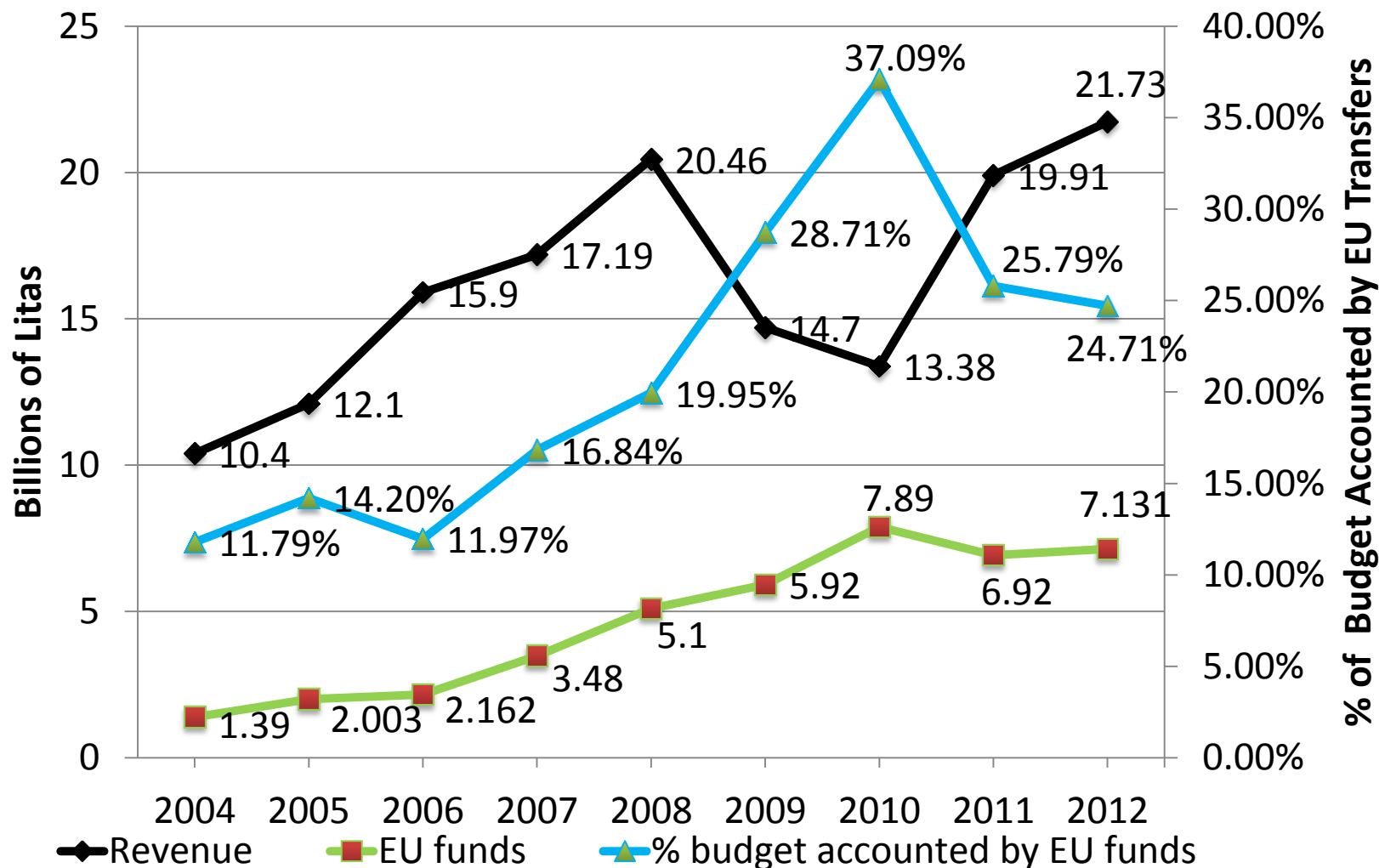


**New “winners” and “losers”:
dualisation of the labour market**

The State sector and the new “nomenklatura”

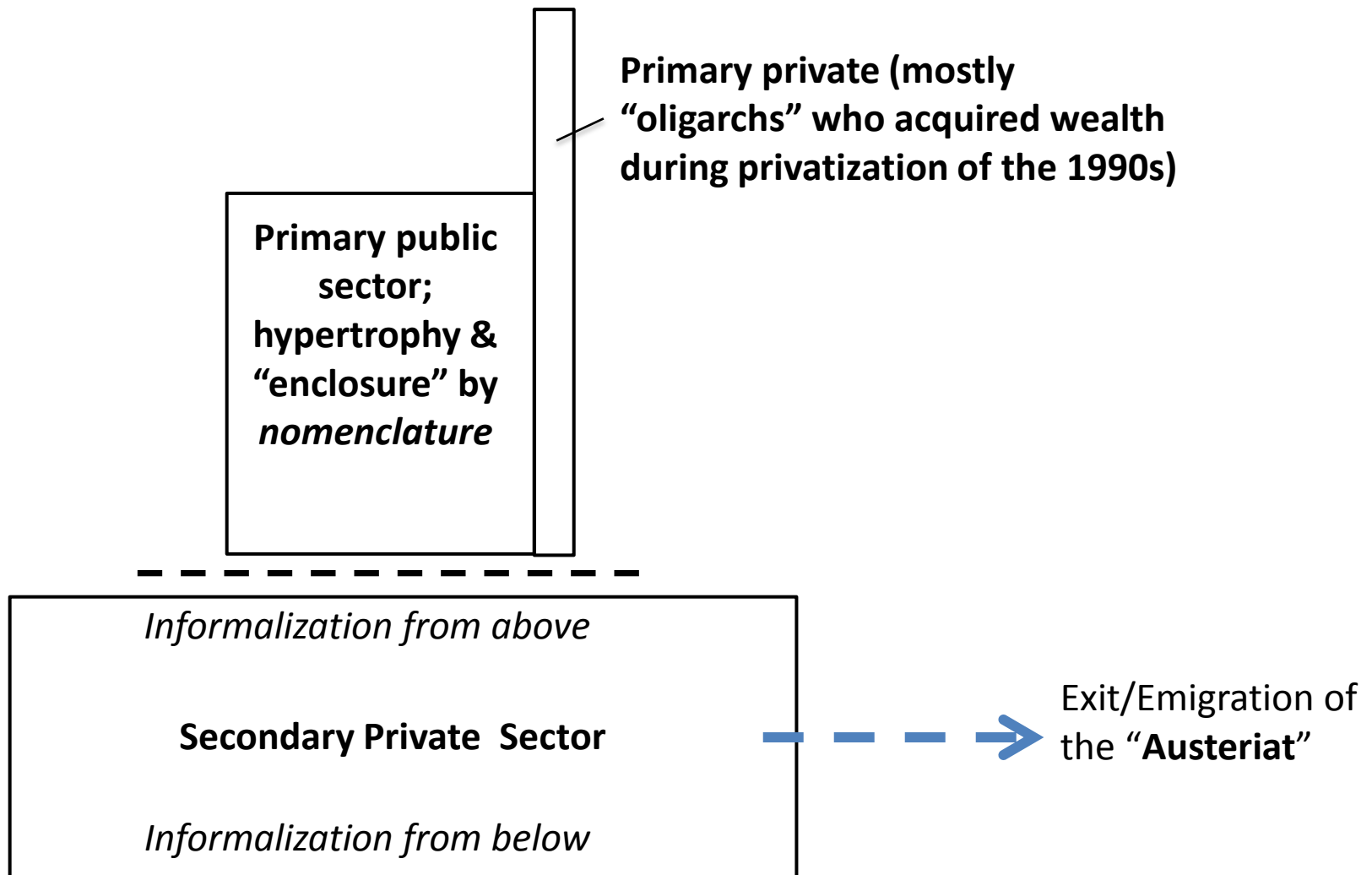
- **EU Structural funds:** 25% of the state budget; €6.8 billion in 2007-13; 10% increase in 2013-20
- Highly coveted and prestigious public sector jobs—‘**permissioning**’ power:
- 11,318 applications 2007-13 distributing €9.2 bn
- **Networks of patronage** and “bureaucratic enclosure”—the country of “brothers in law”
- “*Valdininkai*” – a cast of bureaucrats who are the object of populist anger and demonization

Growing dependency on EU funds



Primary and secondary labour markets during the crisis

- Those in the (large) **primary state sector** experienced some **wage reductions** but generally **stable employment**
- Those in the **secondary sector** business and manufacturing experience **larger wage reductions** and **mass unemployment**
- A new generation of '**winners**' and '**losers**' in a dual labour market



“Lithuanian Exports and Imports”

Lithuanian
Exports
to the EU



EU money
imports

4 PIEŠINYS: Lietuvos eksportas ir importas

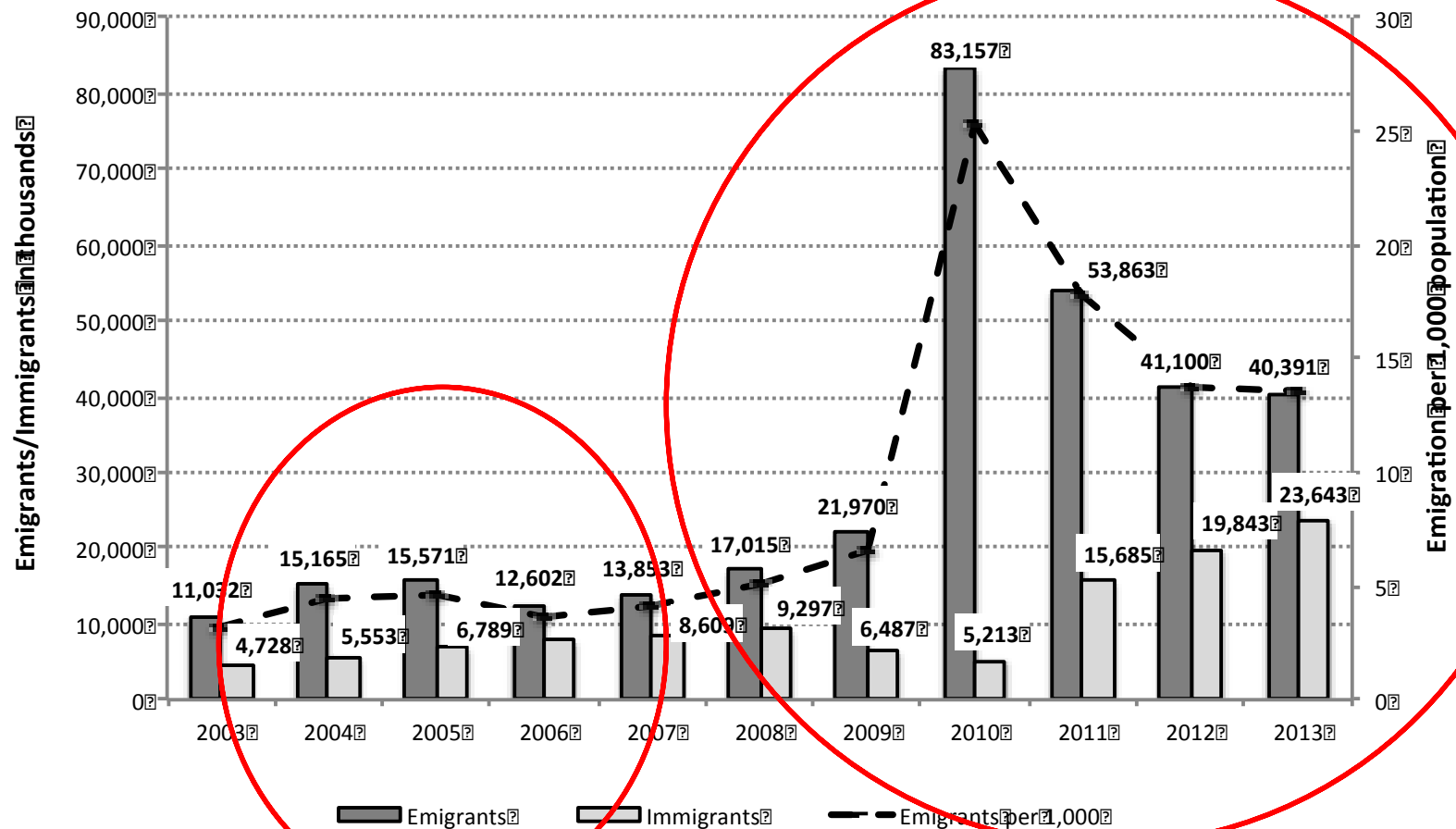
The export of the 'austeriat'

The 'austeriat'

From '*precariat*' to '*austeriat*'

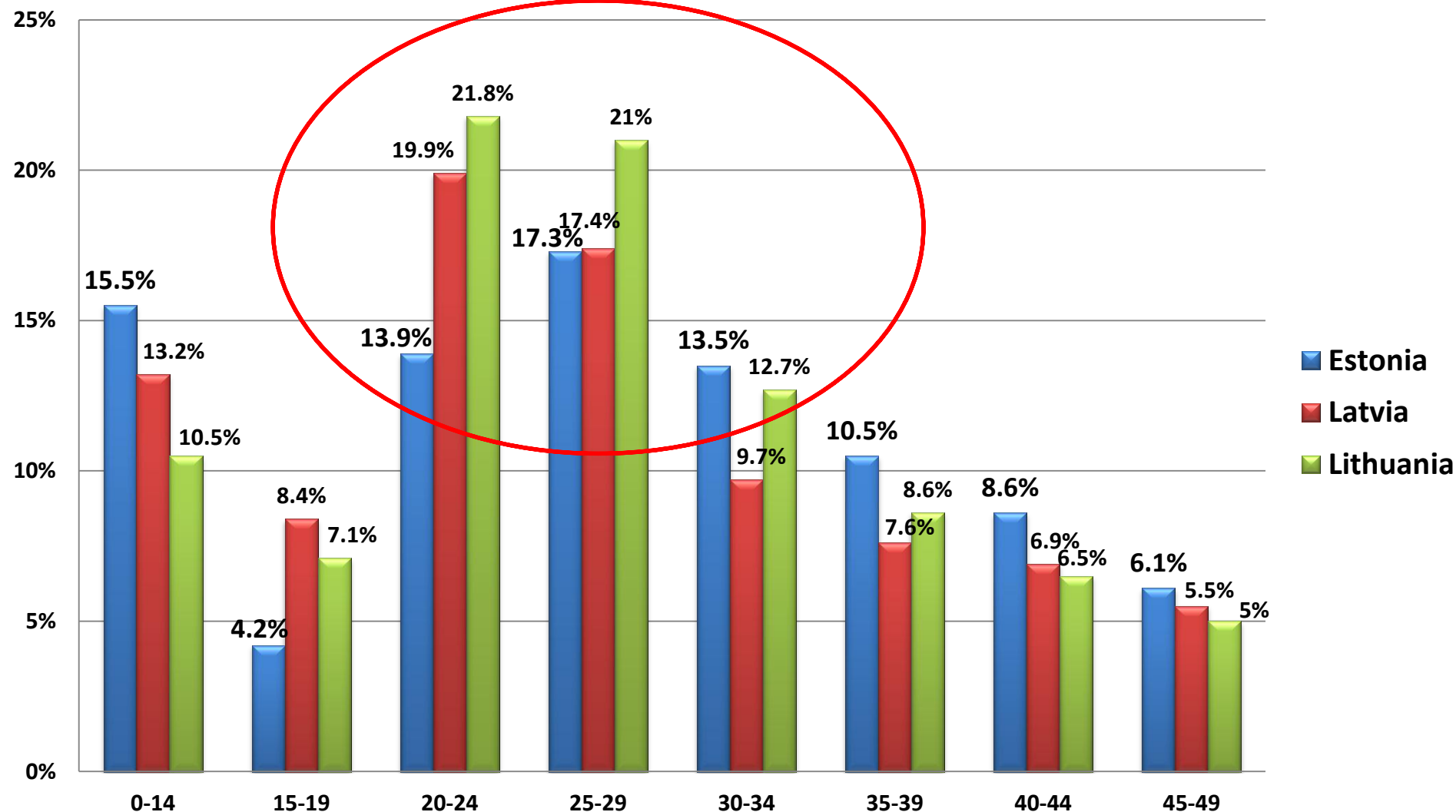
- mainly young, unemployed, but increasingly family groups with young children
- using mobility or “free movement” - as a ‘survival strategy’ under conditions of ongoing austerity
- Vulnerable to exploitation and ‘brain waste’
- Increasingly less likely to embark on ‘circular’ or return migration

Emigration from Lithuania 2003-2013

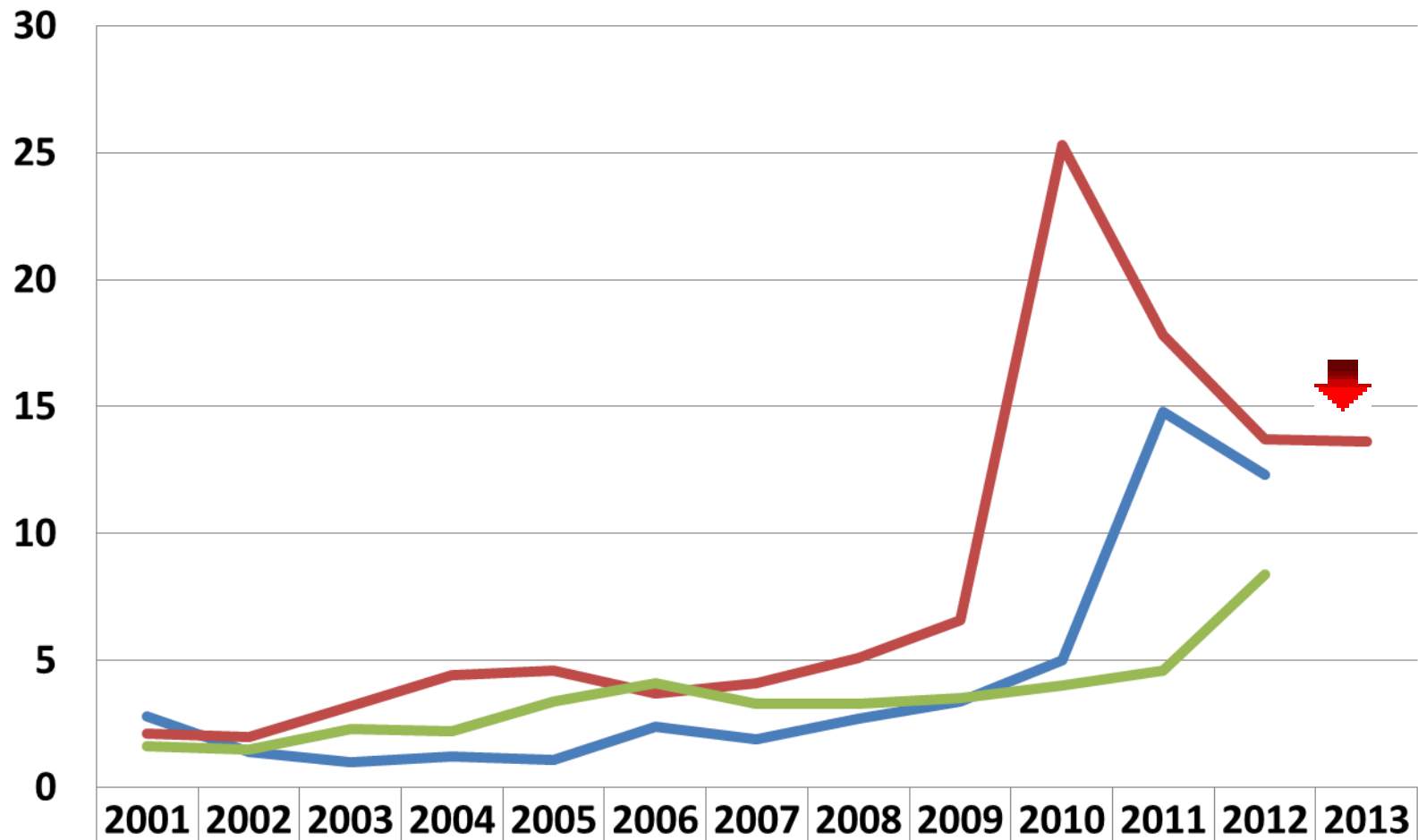


Baltic emigrants by age group 2011 (% of all who emigrated that year)

Source: National statistic offices, 2012



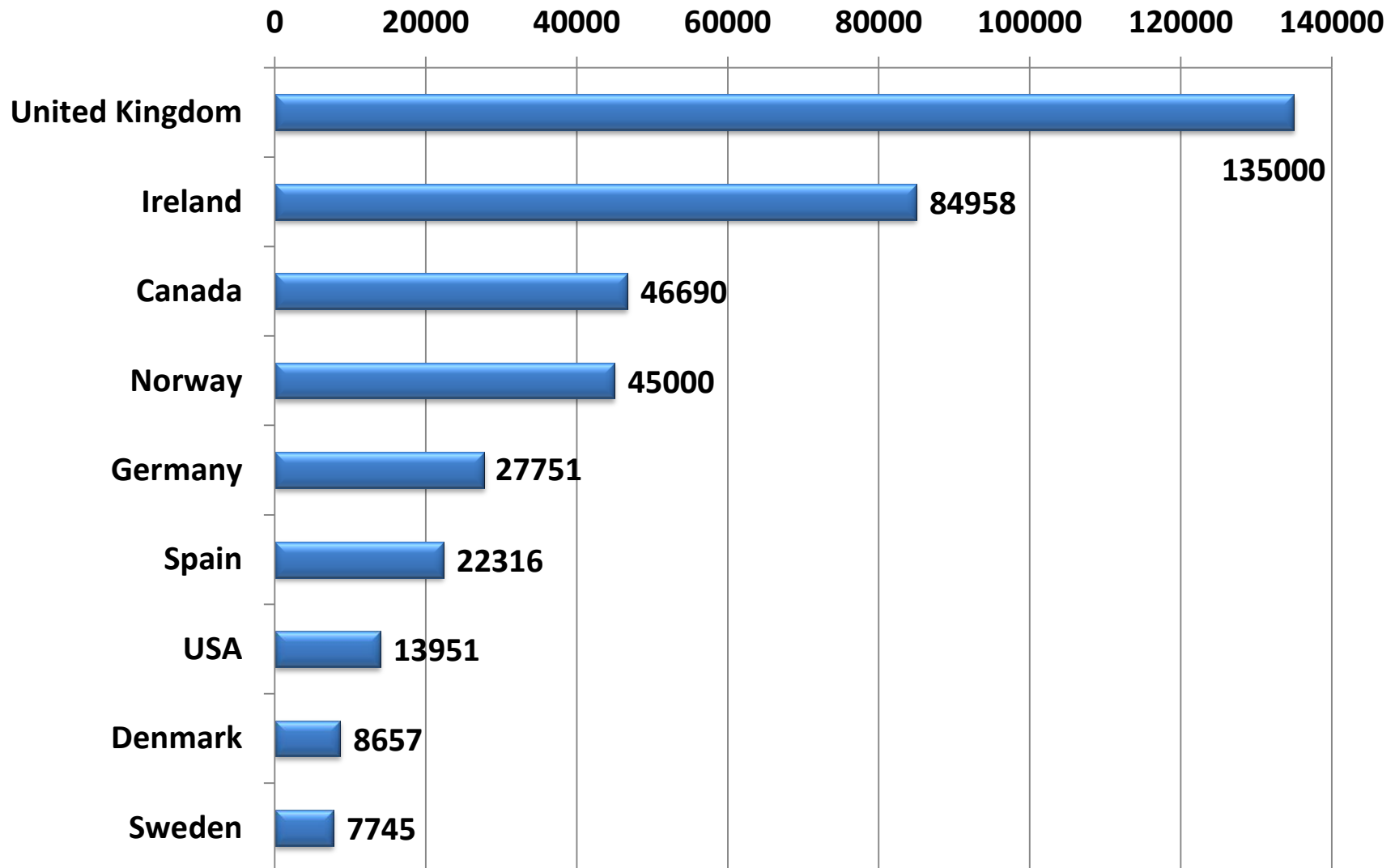
Emigration rates (per 1000 inhabitants) from Estonia, Latvia and Lithuania (2001-2013)



Latvia	2.8	1.4	1	1.2	1.1	2.4	1.9	2.7	3.4	5	14.8	12.3	
Lithuania	2.1	2	3.2	4.4	4.6	3.7	4.1	5.1	6.6	25.3	17.8	13.7	13.6
Estonia	1.6	1.5	2.3	2.2	3.4	4.1	3.3	3.3	3.5	4	4.6	8.4	

Number of Lithuanians living abroad in 2013 (thousands)

Source: Statistics Lithuania



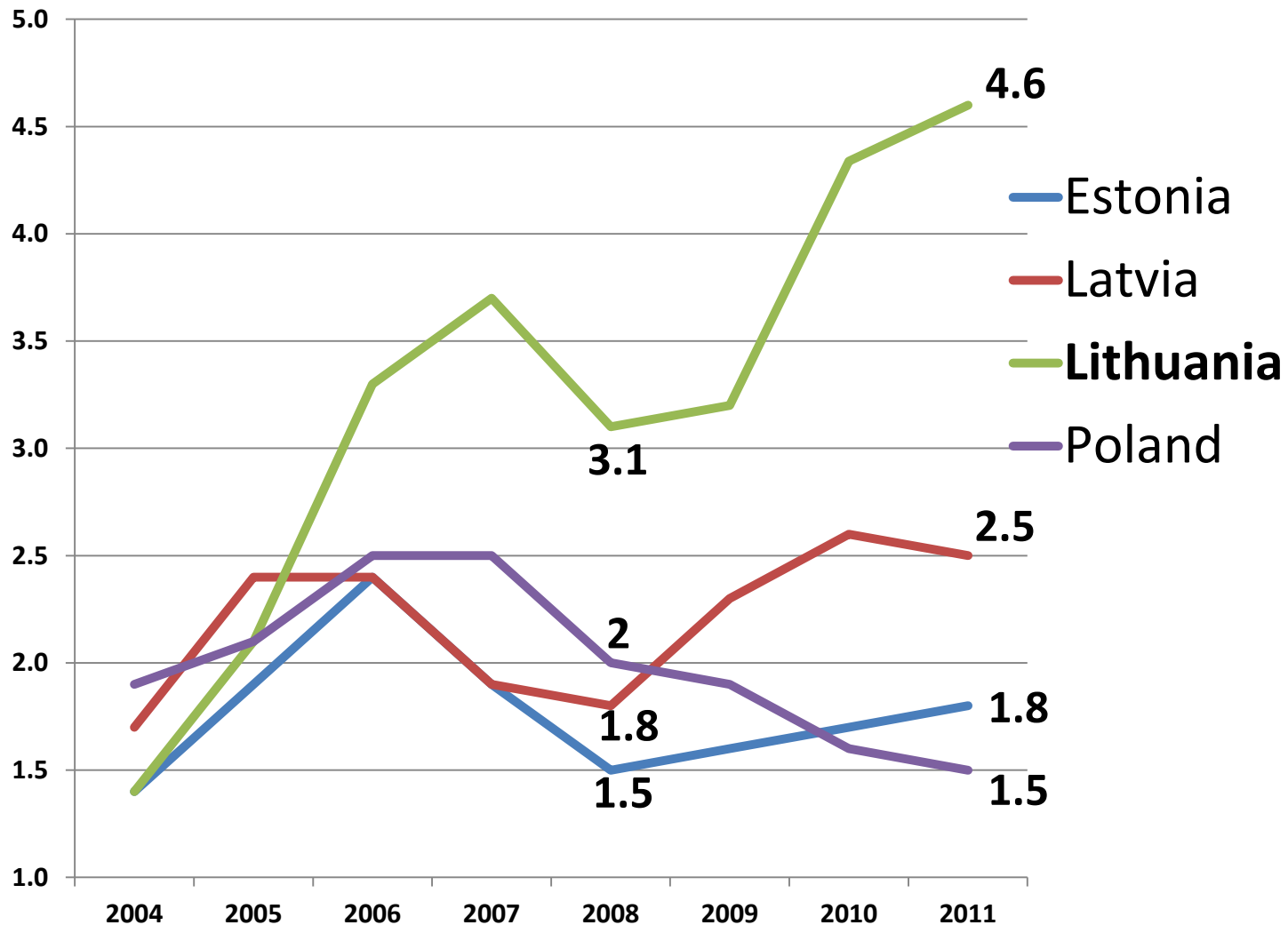
Lithuania emigration intentions increasing

(Sipavičienė and Stankūnienė, OECD 2013).

- Surveys indicate that **nearly half of the Lithuanian adult population** is considering emigration and would like to move abroad for employment (**48.4% in 2012**, compared with 37% in 2011, 29% in 2010, 23% in 2008)
- Migration intentions among young adults have taken on '**unprecedented dimensions**'.
- These tendencies have been accelerating since the onset of the crisis and '**represent a real threat to Lithuania's future**'

Remittances to Baltics and Poland % of GDP (2004-2011)

Source: World Bank and Eurostat



President Dalia Grybauskaite

'State of the Nation' address 2010

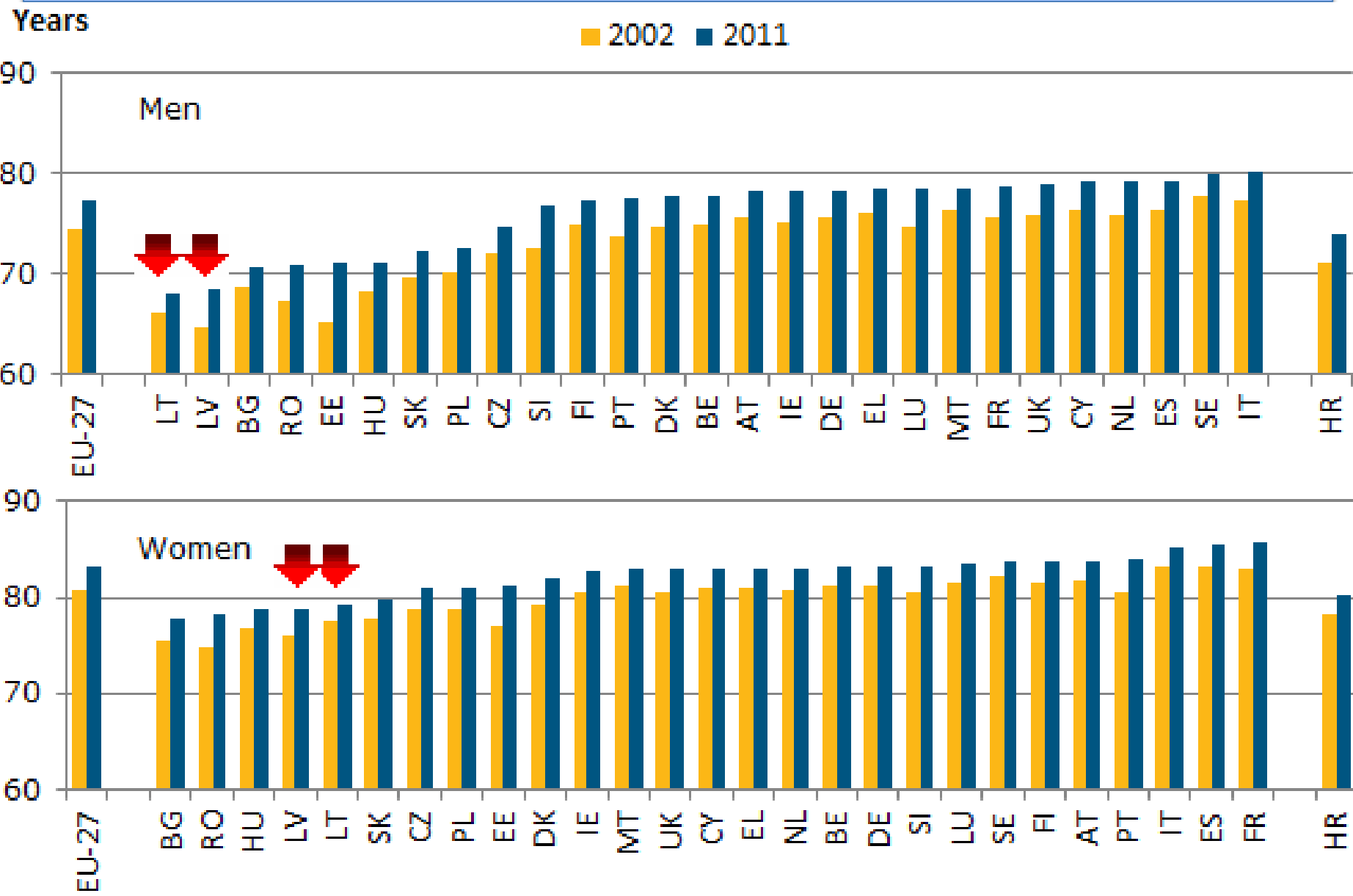
I do not think about (emigration) as **merely an economic phenomenon**. It is rather ***a reflection of the relationship between an individual and the state.***

The decision to leave the homeland is a difficult one. We console ourselves by saying that it is a ***natural consequence of the downturn***. However, the countries where our fellow citizens emigrate are ***also challenged by the crisis...***

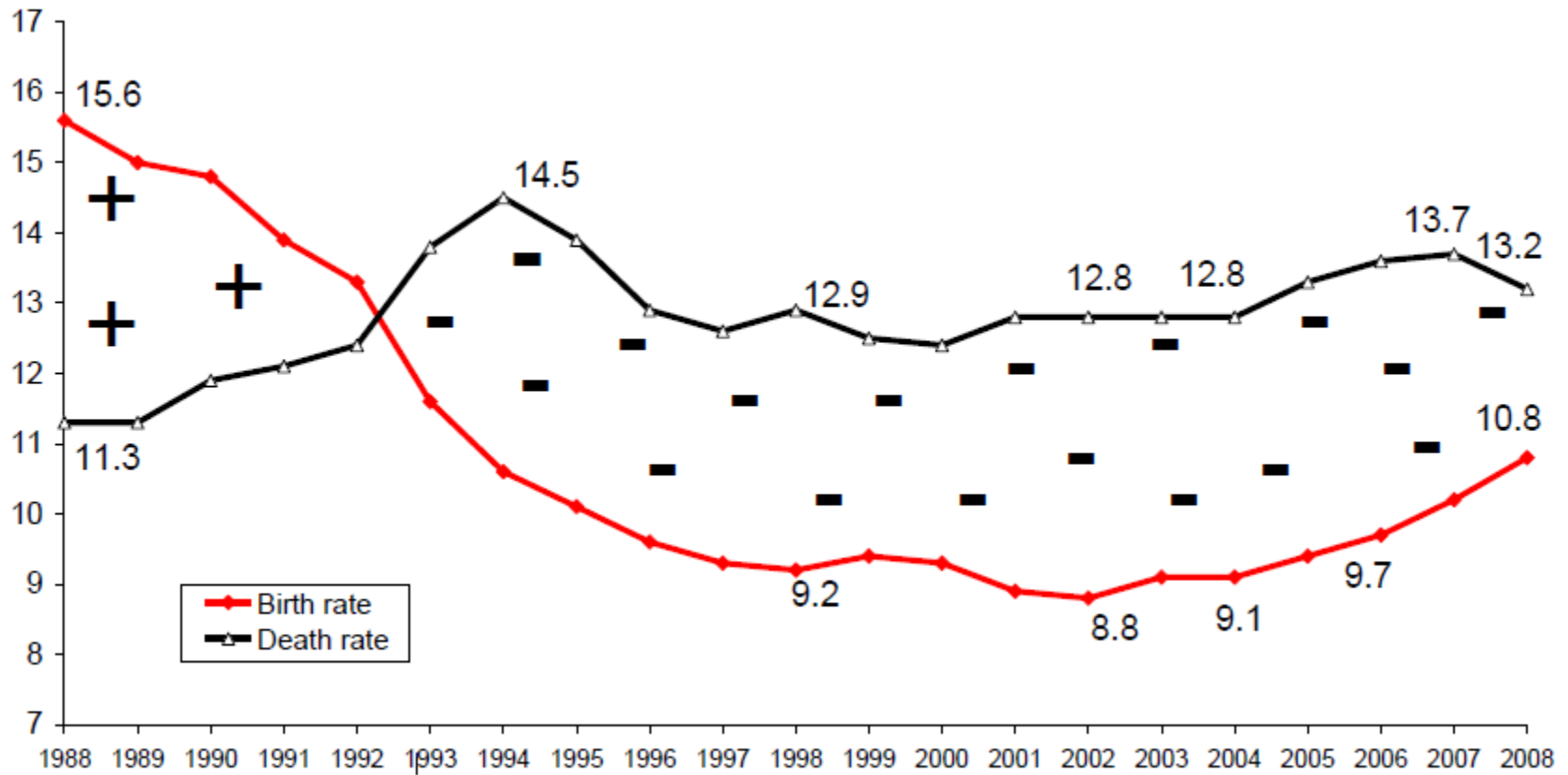
So, let us look the reality in the face and admit that **people are emigrating not only for economic reasons**. They are ***moving abroad because they feel alien at home.***

The demographic crisis

Life expectancy at birth, men and women 2002 and 2011 compared

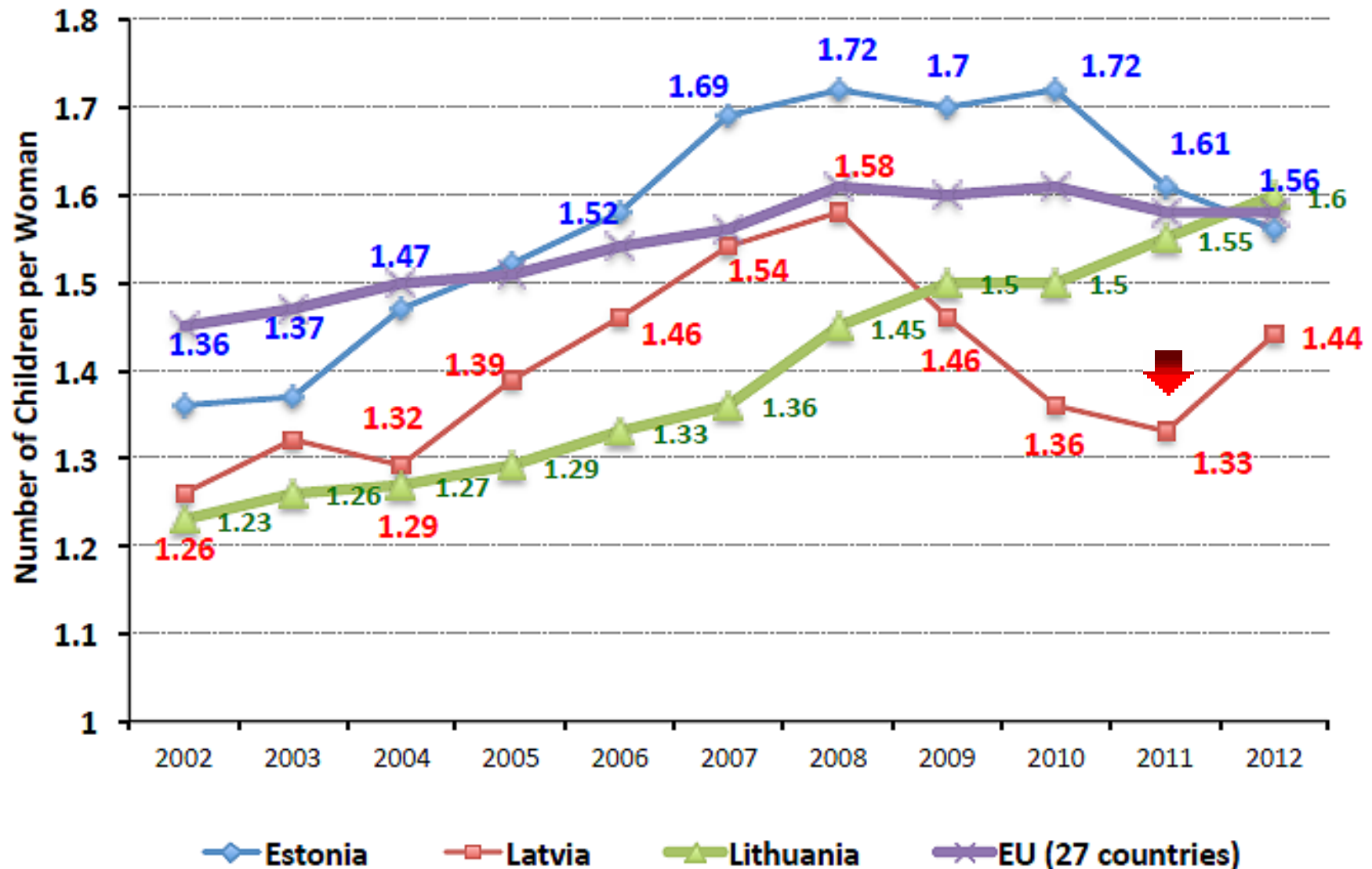


Natural increase/decrease in the Baltic States per 1,000 population



Source: Peteris Zvidrins Centre of Demography, University of Latvia

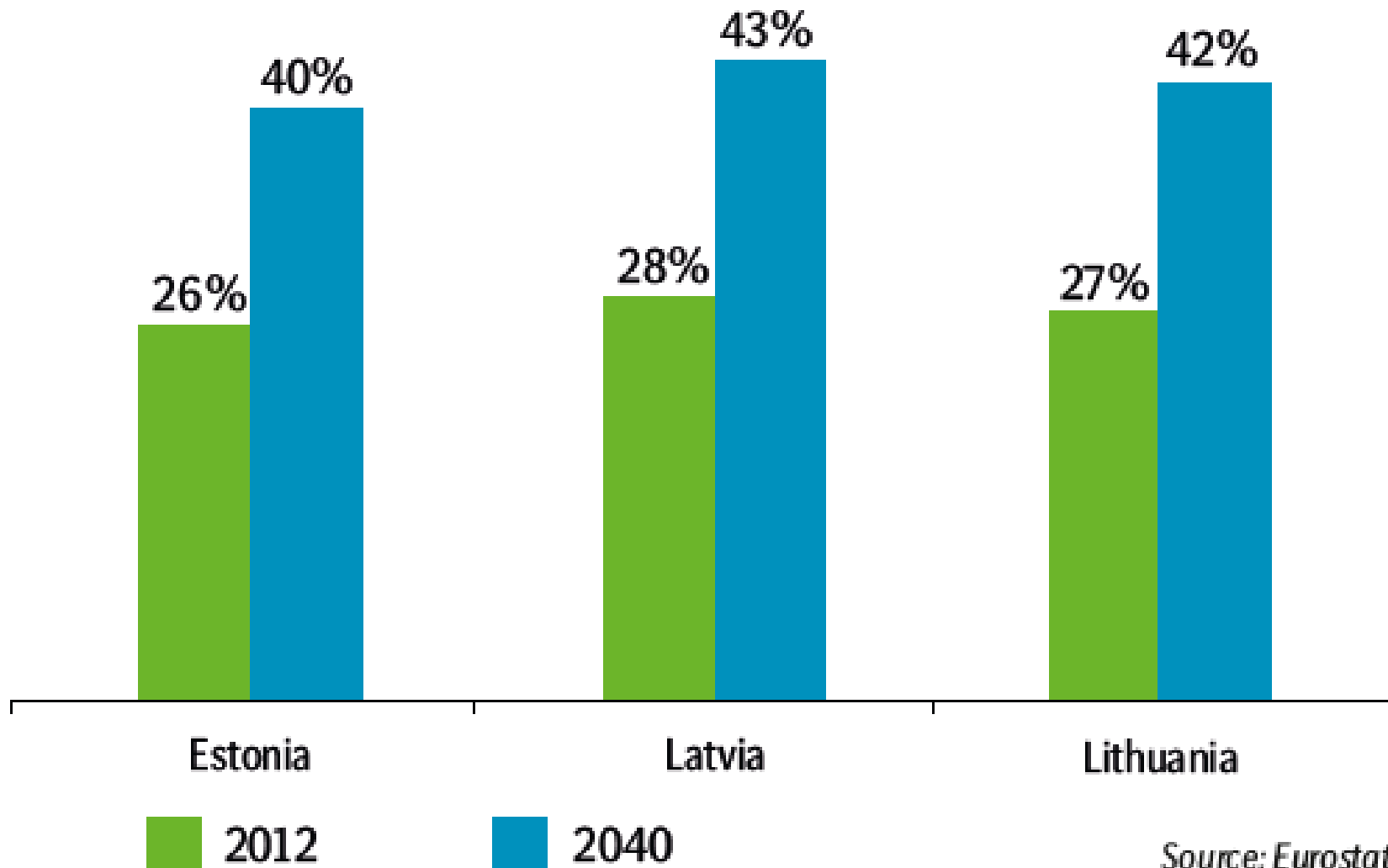
Total fertility rate in the Baltic states, 2002-2012



Old age dependency ratio 2012/2040

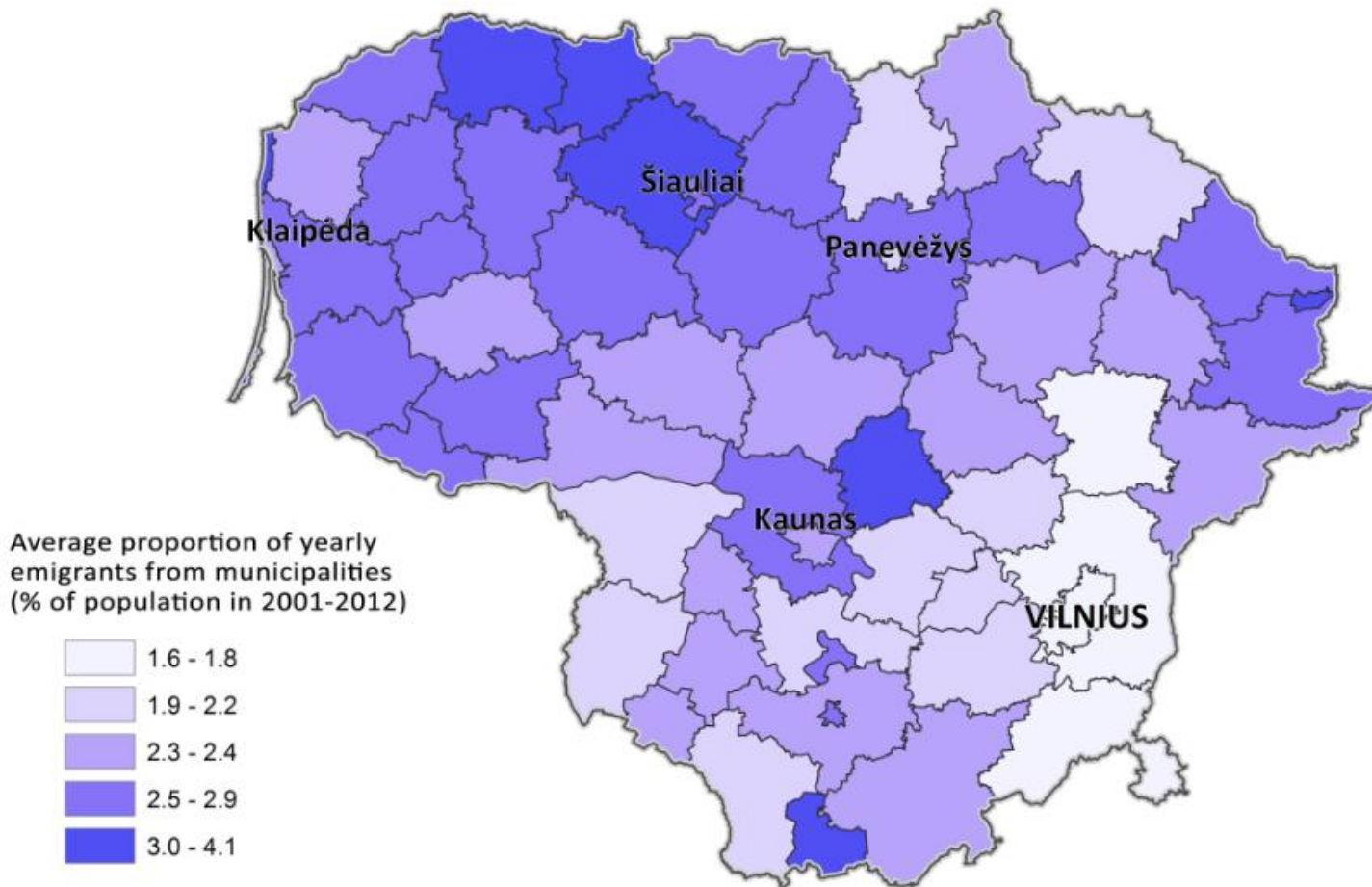
number of elderly people as a share of those of working age

Source: SEB Baltic Household Outlook April 2013



Source: Eurostat

The 'geo-demographic wastelands'



Burneika, D. and Ubarevičienė, R. (2013). *Expert Seminar - Labour migration in the Baltic Sea countries: Trends and prospects*, April 25, 2013, Vilnius

Fastest population decline in EU in 2011 reported for Šiaulių apskritis (-22.7 per thousand)

“We are creating the future together”



‘The Wilding’ of Lithuania

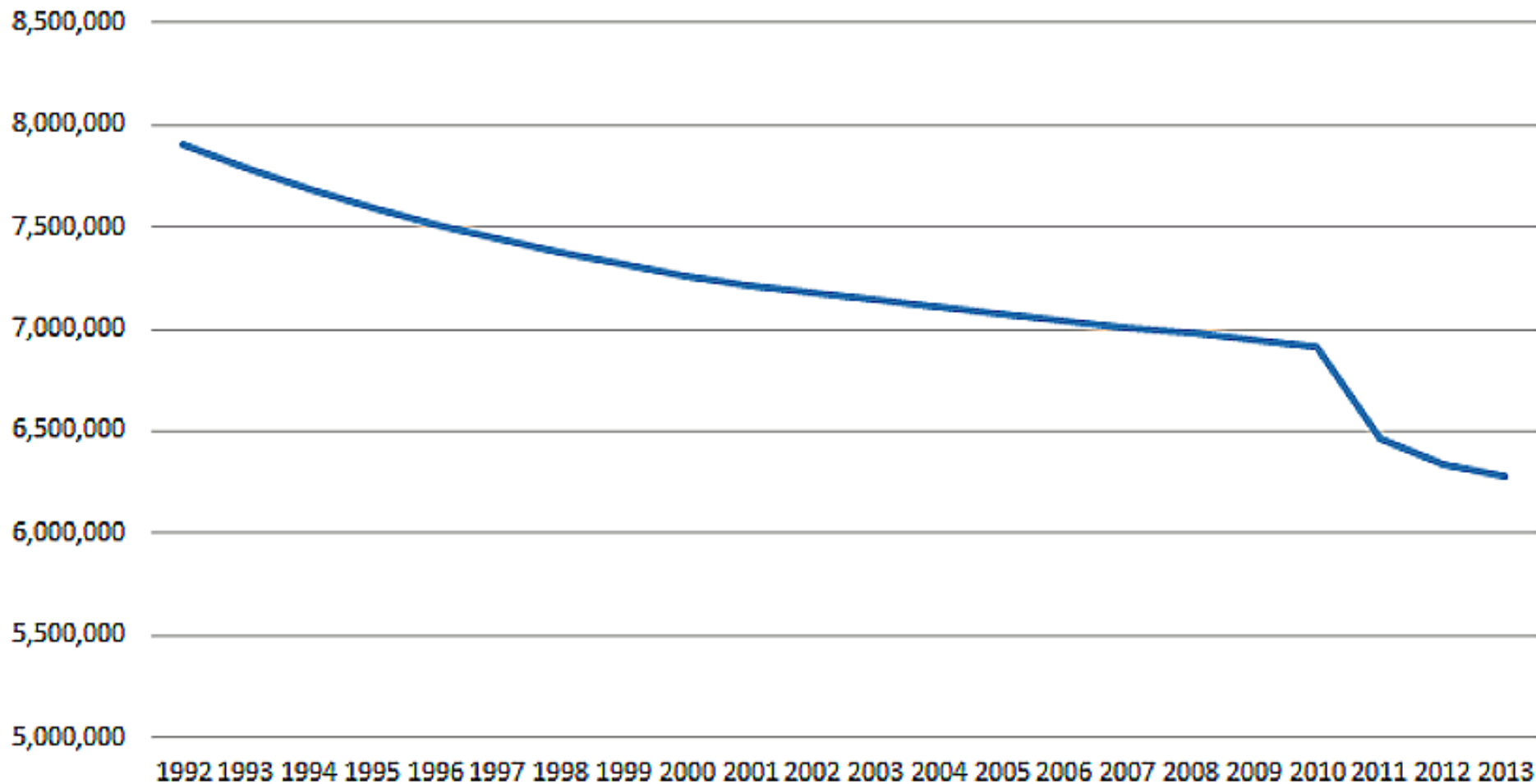
An elk roams in Klaipeda City Centre

(1 May 2014)

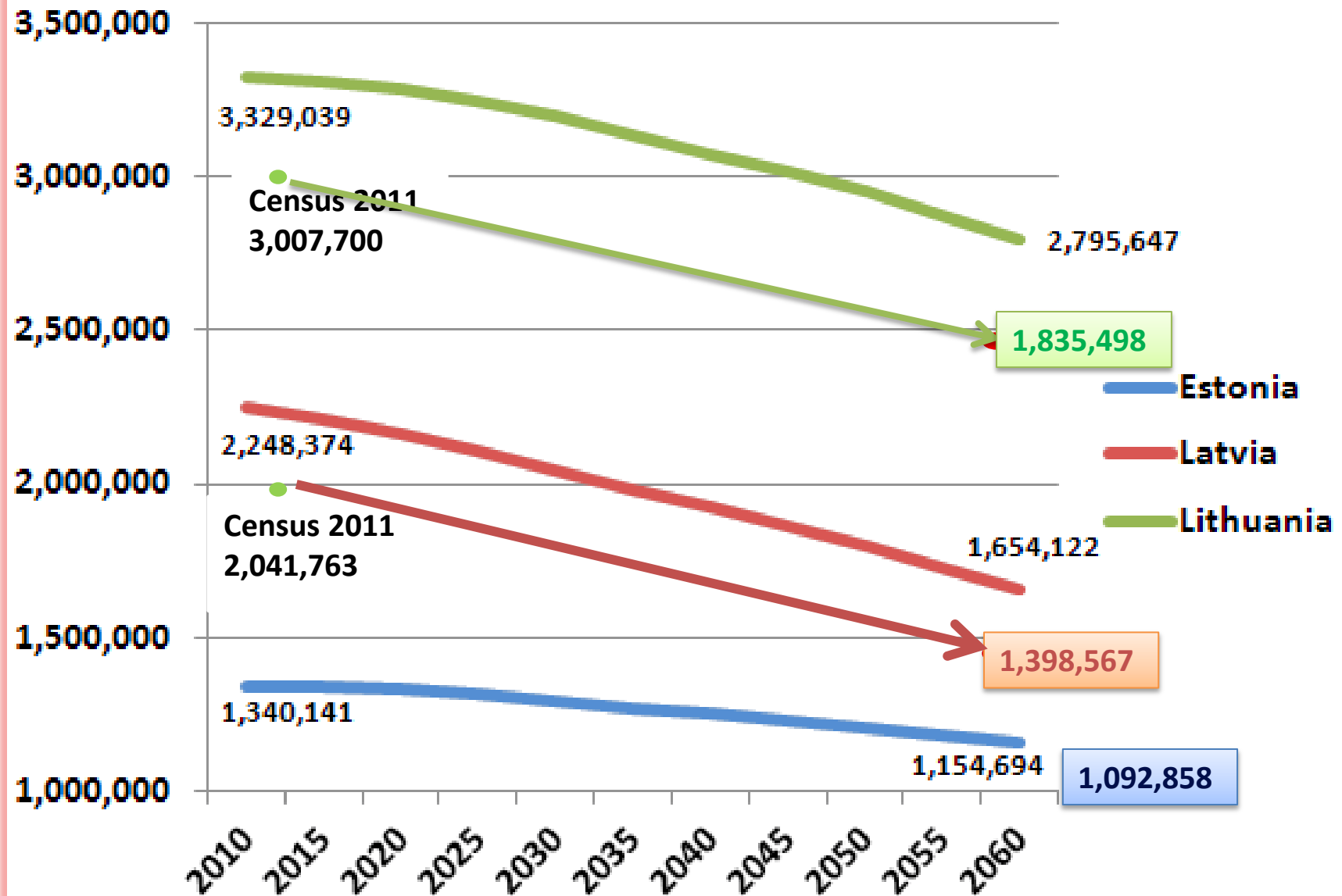


<http://grynas.delfi.lt/gamta/klaipedoje-nufilmuotas-mieste-klaidziojantis-briedis.d?id=64677647>

Baltic states total population loss (20%) 1992-2013



Demographic projections for Baltic states 2010-2060 (Eurostat)



**The wider lessons of the Baltic model
for preserving a 'Social Europe'?**

Costs of Austerity

- Suppression of mass living standards, growing social inequalities and poverty
- Mass emigration and demographic decline
- Loss of democracy and 'voice'
- Uncertain longer-term economic recovery and social sustainability
- Social pessimism, loss of solidarity and breakdown of trust between citizen and state

Communication from European Commission on ‘Social Europe’ 2 October 2013

- *EC Communication on ‘Social Europe’...at last!*
- “Scoreboard” to highlight employment and social problems in EU countries to include:
- unemployment levels
- rate of youth unemployment
- gross disposable income of households
- poverty rates
- László Andor “a further step towards consolidating the social dimension of economic and monetary union”, allowing the Commission to "detect major employment and social problems to prevent serious crises developing in the future".

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2 October 2013 Last updated at 17:36 GMT



EU promises to cut back on red tape

The European Commission has published proposals to simplify EU rules and "make them less burdensome".

It says it wants, for instance, to replace 37 acts of animal health regulation with a single law, and standardise VAT (sales tax) forms.

The idea is to ease the burden on businesses, and respond to public concerns about excessive red tape, says the BBC's Chris Morris in Brussels.

The Commission president said the EU should "not meddle on small matters".

"Not everything that is good is good at European level," said Jose Manuel Barroso in a statement.



Barroso: "We need this change...Europe should not meddle on all matters"

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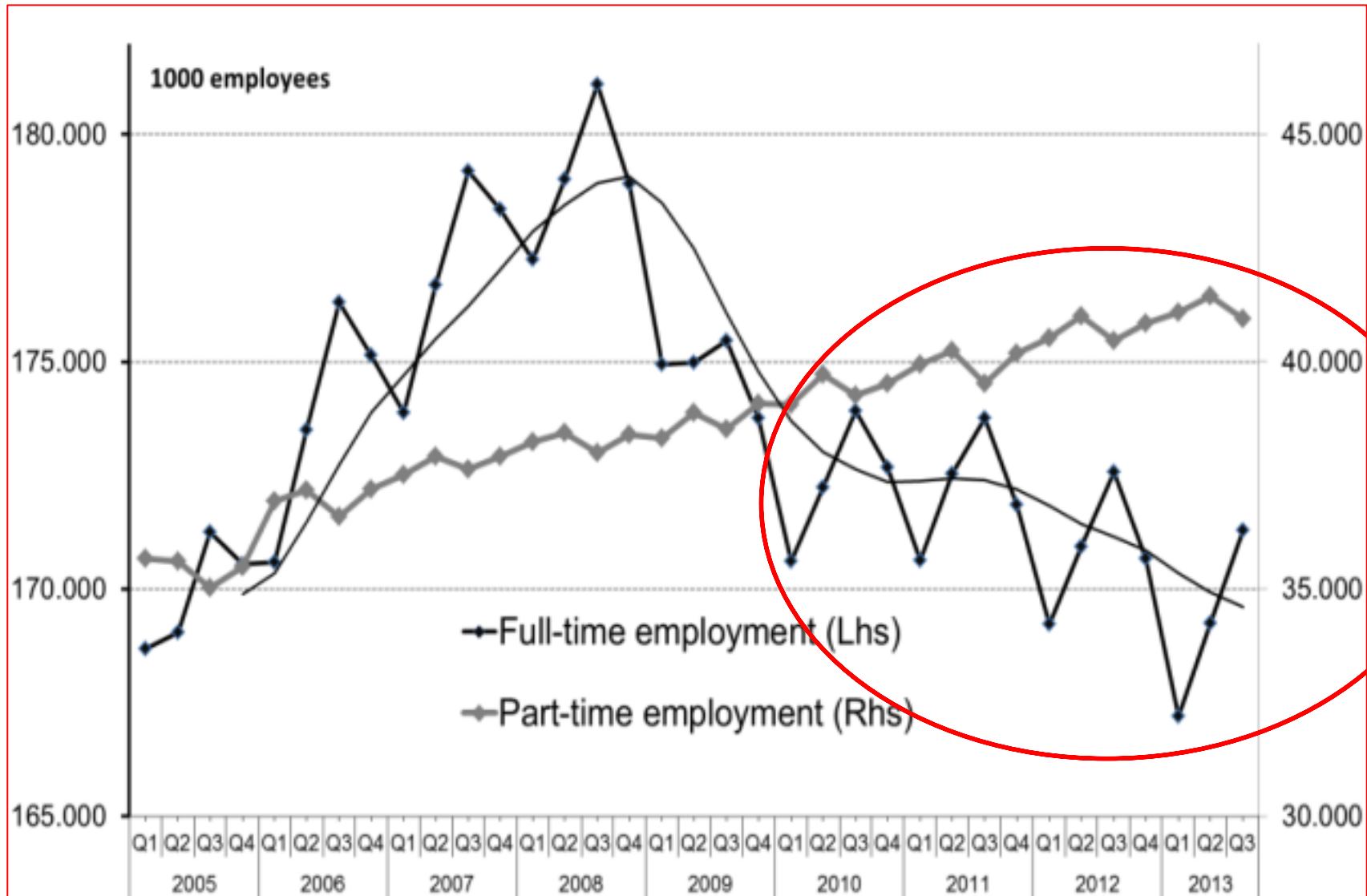
Barroso: EU must not delay reforms

European “recovery” *pace* Juncker?

EU Employment and Social Situation March 2014

- **EU economy ‘maintaining growth’** (+0.4% Q4 2013)
- **Young people ‘continue to be the hardest hit by the job crisis’** 23.4 % in January 2014 for the EU as a whole.
- **In 2013, the ‘gross disposable income of households continued to decline’** in the Euro area in real terms, **‘but at a slower pace and nearly stabilised in Q3 2013’**
- **Poverty and social exclusion has deteriorated during the crisis – ‘little signs of improvement’**
- **Improvements in employment in Europe** (+0.1% Q4 2013) but **‘unemployment still at record high’** – 26m (10.8 % of the economically active population).
- However **‘long-term unemployment increased’** and an **‘increasing share of jobs do not ensure a living wage’** (e.g. involuntary part-time).

Part-time and full-time employees in the EU-28 (1 000 employees), 2005-13



The politics of austerity:

EU parliamentary elections May 2014

“Monstrosity Created by Austerity”



Golden Dawn 10% vote



Danish People's party 27% vote

Front National 26% vote



UKIP 27% vote



Syriza
26.6%
vote



Final words

Austerity - a worthwhile sacrifice? Estonia (2011), Latvia (2014) and Lithuania (2015) join the Eurozone



The Faustian bargain

Suppose Mephistopheles had appeared before the Baltic independence leaders in 1991 and had offered this bargain:

Independence. Capitalism. Freedom. Democracy. The dissolution of the USSR. NATO. Europe.

And eventually the euro.....

And the price?

Only that within a half century the Latvians, Lithuanians, and Estonians would be an elderly remnant in their own countries, their society in tatters, their children in economic exile, their homes abandoned or in hock, and eventually their economies and governments permanently subordinated to new elites—local and foreign....

Would they have taken the deal?

James K. Galbraith

The booka health warning....



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Foreword by **James Galbraith**

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