Capitalist crisis: Towards a Western/Eastern Europe Banking and Social Tsunami

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From the end of the 1990s and up until 2008, the dominant perceptions and the majority of the analyses relating to Eastern Europe were praising a "success story". This view was both illustrated and reinforced by the admission of ten countries of this region into the European Union (EU) in 2004 and 2007. The upsurge of growth rates (measured by Gross Domestic Product, GDP) was in sharp contrast to the weak averages recorded in Western Europe, which was described as a "catching-up" (supposedly concerning the standard of living). To believe that was to be unaware that GDP is not an indicator of wellbeing, and that the "great capitalist transformation" of Eastern Europe [1] has been expressed over the last decade by a high level of debt and financial dependence on Western European banks, which is without precedent since decolonization…

On November 15, 2006, Erik Berglof, chief economist of the EBRD (European Bank for Reconstruction and Development, aimed at Eastern Europe and based in London), commented as follows on the transformations that had been carried out in Eastern Europe: "Eight years after the rouble crisis (in1998) sent its shock wave through the whole of Eastern Europe, the region's banks are bigger, stronger, better regulated, more profitable and more competitive than ever".

He added: "This indicates, more than any other development in the economic sphere, that market forces have firmly established their ascendancy over the former command economies. The majority of these countries 'in transition' are flourishing, and the support of the banks greatly contributes to the current growth rates…" [2]. And it is true that, in particular following entry into the EU, growth rates took off, averaging between 5 and 8 per cent for the countries of Central Europe, more than that for the Baltic States, Latvia reaching more than 12 per cent in 2007…

Less than two years later, the International Monetary Fund (IMF)was called to the rescue by Hungary, Latvia, Poland, Romania, Serbia and Ukraine… which are confronted with a fall in growth and in foreign exchange rates, with capital flight and a banking crisis. The policies of budgetary austerity, under the pressure of the IMF and of the European Union, are producing governmental crises. The governor of the central bank of Latvia declared that its economy "had clinically died" after a drop of 10.5 per cent of GDP in the fourth quarter of 2008 and a similar drop for the month of January 2009 alone. The population laid the blame at the door of the Parliament and the Treasury and a demonstration of more than 10,000 people in February turned into a riot, causing the fall of the government. Hungary, whose GDP is expected to fall by 6 per cent in 2009, has, along with Austria, asked the EU for an emergency plan for Eastern Europe - in vain.

Admittedly, the world recession, affecting in particular the European Union (within which the new members conduct the main part of their commercial exchanges) is reducing exports and employment for those who had emigrated. The situation in Germany will weigh heavily in the balance, because it is by far the dominant force in Eastern Europe [3], which it uses in particular as "workshops" to reduce its costs of production of spare parts for cars (which are designed, assembled in these countries and then exported with the label “made in Germany”).

And for the countries, like Hungary, who accumulated a high level of public debt (to try and alleviate popular discontent, before the crisis…), the financial crisis produced (psychologically) a movement of “flight to quality”, towards financial products in euros and dollars, therefore a flight of capital and a fall in foreign exchange rates. These financial markets which are collapsing are often (still) quite small. They make their influence felt especially when the financing of the national debt depends on them (what is the case in Hungary). But it is the nature of the previous period of growth and the banking system itself which are at the heart of the problem…

As a journalist of *Business Week* on March 3 2009 [4] put it, the question is: why “all the countries of Central and Eastern Europe [PECO] are waking up today with a painful hangover, after years of debt-fuelled growth, largely financed by Western banks”? The chief economist of the EBRD, Erik Berglof, to whom the question was put, “confessed”: “they adopted a model of growth which we usually thought correct… ”. But, he adds: “The mistake was not in the model.

The mistake was in the lack of an architecture to support the model” evoking the absence of regulation of credit flows. But why regulate what was supposed to bring efficiency and growth? The truth is that an Eastern European variant of the credit crisis that occurred in the United States is taking place, against the background of the particular conditions of capitalist restoration in the East in the framework of l’ integration into the EU [5].

What income to consume and what capital for privatizations? Capitalist restoration is confronted with the absence of national capital capable of buying the means of production which “had to be” privatized: in the former system money did not function as capital capable of making a profit (the means of production; were not, in their great majority, commodities and there was no capital market). This is what capitalist restoration has radically transformed. The generalized commoditisation of the economy affected first of all the enterprises (via privatizations) and, in so doing, removed all the former protections of the labour force – including the very important part that consisted of “social wages” in kind (social benefits generally associated with employment in large companies). But how to privatise such companies – which was the condition for access to the credits and institutions of globalization - without “endogenous” capital?

There were two types of answers to these questions in the 1990s. Hungary (in order to refund its debt) and Estonia (to detach itself from the USSR more quickly) were the only ones to choose to sell their best companies to foreign capital. In the vast majority of the other countries there was the invention of “mass privatizations”, without the contribution of capital. They consisted in juridically transforming the companies into public limited companies divided into shares. These shares could then be massively distributed by various procedures, more or less free to the workers (with often a bonus for the “top executives” and a rapid concentrations of shares in their hands), or sold at auction (in the opacity of various financial operations), the remainder being taken by the state.

The state could thus become a real owner capable of selling its shares later on, of re-launching these large enterprises (as in Slovenia) or dismantling them (after having suffocated them). For a time, the maintenance (deteriorated) of wages “in kind” (housing, services), as well as the existence of smallholdings, attenuated the social explosions. But the whole process resulted in a considerable rise in unemployment (of the order of 20 per cent in Poland at the time of its accession to the EU…), in poverty and inequalities - on a scale which the World Bank regarded as without equivalent in the world, taking into account the weakness of income differentials in the former system.

The “big bang” of EU enlargement and of the privatization of the banks The choice of a real enlargement of the EU towards the East was basically made in 1999 to face up to increasing popular disillusionment, to which were added the effects of NATO's war in the Balkans [6].

The promise of admission to the EU was to be used to pacify and to get the unpopular policies of dismantling of the social state accepted. But there was no question of financing this "reunification of the continent" by an increase in the European budget, contrary to the efforts that had been made towards the countries of Southern Europe… and the East German Länder [7]. Freedom of movement of capital in a vast free exchange zone was to provide the financing…

Also, within the framework of the liberalization represented by the General Agreement on Trade in Services (GATS), the majority of the governments of Eastern Europe who were candidates for integration into the EU – with the exception of Slovenia - perceived as a windfall the privatization of their banking systems (previously completely nationalized) by their sale to the banks of Western Europe. And these banks saw accession to the EU as a guarantee of juicy business. Control of the banking system of the future members (encouraged by the European Commission and the institutions of globalization) was acieved, at a level of more than 50 per cent, by2001, except in Slovenia.

Share of foreign banks in the bank shares of some new members of the EU

Estonia 98%

Bulgaria 90%

Czech Republic 90%

Lithuania 90%

Hungaria 61%

Romania 55%

Latvia 53%

Poland 51%

Slovenia 35%

Source: Die Bank, 2006 [8].

Flows of foreign direct foreign investments (FDI), in particular in the financial sector, increased with entry into the European Union. The banks of Latvia, as in the other Baltic States, but also in Bulgaria and the Czech Republic, are now more than 90 per cent controlled by Western banks. The only country which always escaped this scenario (in spite of the pressures of the European Commission) remains Slovenia [9]. Resistance to cut-price selling-off of the assets of self-management (which were real in Slovenia), the transformation of the old trade unions into a powerful support for general strikes at the beginning of the 1990s and over the last several years, played an important role both in the forms of privatization and in opposition to the introduction of the single-rate tax (or "flat tax", implemented in Slovakia and in other Eastern European countries at levels much lower than the EU average in order to attract capital).

On the whole, in Slovenia, the state maintained its control over the financing of the economy.

Foreign or not, private banking remained a source of profitable placements and took immediate advantage of the free circulation of capital. The banks concentrated on placements on the national debt and consumer credit,facilitating the access of the multinationals to the large-scale retail trade and to investments in real estate [10]. Such were the bases of a profoundly unbalanced take-off of growth. The multinational firms are at the same time the principal exporters, but also (in retail distribution, cars, telephones...) channels for increasing imports and for repatriation of their profits to their countries of origin. The result has been growth marked by an upsurge in credit and current account imbalances.

2006

GROWTH OF GDP

Lithuania 7.8% Estonia 10.4% Latvia12.1%

GROWTH OF CREDIT

Lithuania 35% Estonia 53% Latvia 52%

CURRENT ACCOUNT BALANCE (as % of GDP) Lithuania - 9.5% Estonia -14.6% Latvia -21.3%

The explosive character of this “growth” is reinforced by the rise in inequalities (in particular, the place of Latvia in the Human Development Index - HDI - has deteriorated), with, as in the United States a madness for consumption by the nouveaux riches, in particular in real estate, but also by the population as a whole, encouraged by the offers of credit financing. However, an Eastern European “subprime” mechanism encouraged indebtedness: the utilisation by the banks of the Swiss franc as a currency to finance their loans (in particular, but not only, the Austrian banks) was initially justified by very low interest rates and by the general tendency of the Swiss currency to fall against the euro…

Nearly 90 per cent of Hungarian mortgages have been made out in Swiss franc since 2006 and it is estimated that 45 per cent of the entire real estate credit market and 40 per cent of all consumer credits in Hungary are expressed in Swiss francs rather than in forints (the national currency)! And Hungary is not - by far - the only Central and Eastern European country to have exploited what was a gold mine and has become a trap: the interest rates on the Swiss franc have risen by more than 3 per cent in less than five years, thus contributing to make heavier the repayments by the debtors of Central Europe. The fall of the Hungarian forint by almost 10 per cent compared to the Swiss franc in the space of a few weeks further increased the debt of Hungarians whose incomes are obviously always made out in forints…

The amount of the loans granted is everywhere considerable, on the scale of the countries concerned: thus, the Austrian and Swedish banking networks cover with their loans the equivalent of 20 per cent of the GDP of the Czech Republic, Hungary and Slovakia and of 90 per cent in the Baltic States.

And the countries which are in a delicate situation – like Hungary - are those in which the total of the everywhere loans granted far exceeds that of local bank deposits. These loans originate from borrowings contracted by the head offices on the international markets. We can also understand why the Austrian Minister of Finance, Josef Pröll, made frantic efforts at the beginning of February to set up a rescue plan of 150 billion Euros for the countries of the ex-Soviet bloc: Austrian banks make 35 per cent of their profits thanks to the Central European and Balkan countries; they have lent 230 billion Euros in the region (70 per cent of the GDP of Austria)…

The global total of loans authorized in Swiss francs outside of Switzerland is estimated at 500 billion euros. And practically all of the 1700 billion dollars of Eastern European loans are held by Western European banks (Austria, Italy, France, Belgium, Germany and Sweden alone account for some 84 per cent of these debts). And short-term repayments on the debt are considerable: these countries will have to reimburse or refinance the equivalent of 400 billion dollars in 2009 - the equivalent of one third of the GDP of the region (and of the increase in the resources of the IMF which the countries of the G20 have just decided…).

Epilogue or prologue?

One week after his nomination (on April 14), the new Hungarian Prime Minister revealed the principal measures of a plan of Draconian purging of public finances, whose state had delayed by several years the entry of Hungary into the euro zone. It involves, subject to approval by Parliament, making 400 billion forints (1.4 billion euros) of savings in 2009, then 900 billion (3.7 billion euros) in 2010. VAT would increase from 20 to 25 per cent, but would be reduced for essential items, including bread, milk and central heating… to 18 per cent (by way of comparison, in France VAT is 5.5 per cent for the majority of these items). These “strong austerity measures” would affect mainly public services, retirement pensions and social subsidies. Civil servants will see their thirteenth month removed, their wages frozen for two years and the level of social security benefits slightly reduced. As soon as the new government was nominated, on April 14, 50,000 people demonstrated in the streets of Budapest. With the announcement of the austerity measures more demonstrations have been announced, in particular by civil servants, and all the signs are that that they will be at least as big…

The countries of Central and Eastern Europe which have been admitted to the EU are at the same time in a dependent (peripheral) situation and at the heart of neoliberal European construction. Confronted with the crisis, they expected from the EU various forms of protection and solidarity. But the European Union has just directed them to the IMF, like the other peripheral countries. It is likely to receive as a boomerang a new banking tsunami, whose epicentre will this time be within the Union, with as a premium increasingly explosive social discontent.

P.S.

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Footnotes

[1] For an analysis of the various phases which led to this historical turning point, and of what were the scenarios and effects of privatizations, see “Les enjeux sociaux de la grande transformation capitaliste à l’Est”: www.france.attac.org/spip.php?article872. Disponible sur

ESSF: Les enjeux sociaux de la Grande Transformation capitaliste à l'Est européen…

[2] Cf. *BusinessWeek*, reproduced in Spiegelonline.

[3] In the hinterland close to Germany, more than 50 per cent of secondary school pupils learn German (compared with 24 per cent in the 27 EU countries), including 64 per cent in Poland and 72 per cent in Slovakia: this makes relocation of industry easier. The stock of German capital invested in Eastern Europe in 2003 amounted to 29 billion euros (compared with 18 billion for France and Great Britain and approximately 8 billion for the United States). At the end of 2007, the figure reached 50 billion euros, according to H. Brodersen, "Le modèle allemande à l'exportation", November 2008: www.ifri.org/files/Cerfa/Note_57.pdf

[4] Cf. Jason Bush, "Latvia's Crisis Mirrors Eastern Europe' s Woes", 3/03/200,9 reproduced by Spiegelonline.

[5] On the conditions for being admitted to the European Union, see « Des privatisations forcées à la démocratie imposée... », http://www.france.attac.org/spip.php?article1773. See also the site of Le Monde Diplomatique on this subject.

[6] It was at the end of NATO 's war over Kosovo in June 1999 that the "Stability Pact" was proposed in the Balkans, as an "ante-chamber" to the EU (in order to isolate Milosevic's Serbia). The Council of Salonika in 2003 confirmed the choice of regarding the Balkan countries as possible candidates for the Union.

[7] The draft European Constitutional Treaty mentions explicitly: German federal subsidies to the new Länder (some 100 billion DM per annum over more than ten years) were to be the exception.

[8] Cf. Olena Etokova, "Case study: Foreign capital entry to Banking Systems of Economies in Transitions: prospects for Ukraine" www.eurojournals.com/finance.htm. This study stresses that the law in Ukraine prevents the takeover of banks by foreign capital.

[9] Cf. "Overview of banking sector in Slovenia", Oct 27, 2008, www.qualobster.eu/doc

[10] See the study cited in note 7.