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Is there an education bubble in the Western Balkans?

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Abstract

Bubbles arise in cases where price exceeds the asset's intrinsic value, yet they are notoriously hard to detect. In order for them to develop, a displacement in expectations must occur which will impact the rational perception of the asset's value. Human capital, although not as tangible as other forms of wealth, represents a distinct asset class which increases one's earning potential through education. As the price of an asset is justified by the expectations of future cash flows, the current value of education can be calculated via discounting the value of the future, education-enhanced, earning potential. The aim of this paper is to analyze the newly emerging patterns in the changing educational landscape of the region known as the Western Balkans and identify the possible formation, if not existence, of a bubble. The authors propose an alternative methodology of detecting these market anomalies and utilize empirical evidence to corroborate the finding that the market price of the investment in human capital in Western Balkan countries has started diverging from its fundamental value. Although the focus of this paper is on uncovering a tendency in a highly specific asset class within a narrow geographical area, the preliminary conclusions and related discussions can be extended to detecting such bubbles in other countries and regions that could possibly warn against the eruption of the next big financial crisis.

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1. Introduction

Financial bubbles are exceptionally difficult phenomena to diagnose and study given that the only true affirmation of their existence in the market can be manifested ex post, either through a full-fledged collapse or a rather subdued deflation, both visible in downward price pressures. Most hypotheses about the existence of a bubble in one market or another therefore remain in the realm of speculation as bubbles can subsist during prolonged periods without being detected, pending they sustain a relatively minor discrepancy between the market and the fundamental value of the asset.

Bubbles have been detected – and in some cases have spectacularly burst – in various sectors in the global economy. Long associated solely with finance, bubbles have drifted into technology, real estate, health care and most recently, education, becoming the resident culprit any time a new social contagion emerges. While in reality no major economic recession can be attributed to just one cause, a number of studies have found a link between the eruption of the two most recent crises of the 21st century and the Dot-com bubble of 2001, as well as the Real Estate bubble of 2007, respectively (Basco, 2014).

Taking into account the fact that over the past few decades the education sector has experienced a global surge in expenditures estimated to be US\$4.5 trillion worldwide for 2012 and second only to healthcare (GSV Advisors, 2012), legitimate concerns have abounded concerning the formation of a bubble in the highest value-added segment of this sector, that of higher education (Vedder, 2007). Nowhere has this been as evident as in the Western Balkan region where tertiary education – after a wave of regulatory liberalization in the educational sector – experienced skyrocketing growth rates during the past decades. The purpose of this paper is to demonstrate the developments leading to mass education and identify some of the factors that could potentially expose a bubble in the making, mostly visible through the proliferation and devaluation of a higher education degree. Even more relevant to this anomaly in the Balkan region is the asymmetric information present in the educational market where the benefits of higher education as being the key to economic opportunity are overestimated relative to the costs incurred while attaining the degree. The main contribution of this paper is to provide a framework for analyzing the earnings vis-à-vis the costs of investing in human capital in the Balkan countries which may signal a divergence of the value that the market places on the university degree from its intrinsic value.

The remainder of the paper is organized as follows. Section 2 discusses the methodology used to detect the existence of a bubble. Next, Section 3 surveys the available literature on bubble formation and the rising costs of education. Section 4 provides the overview of the current state of the national education systems and the trends that may signal the formation of a bubble. Section 5 discusses the results and provides a number of concluding remarks.

2. Methodology

The bubble hypothesis starts with the assumption that an undergraduate degree is an investment in human capital and as such will be subject to various valuation methods determining its intrinsic value. Even though education is not a commodity in a traditional sense as it cannot be traded in the market, owning it significantly increases one's earning potential.

The analysis presented in this paper includes the following countries under the umbrella term *Western Balkans*: Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Montenegro and Serbia, but excluding Kosovo mainly because little, if any, reliable statistical data is available for the period in question. Moreover, the analysis relies heavily on the results obtained from secondary data collection of statistical bureaus and higher education institutions of all observed counties. The time series of the number of students under examination cover a period from 2005 when the Lisbon declaration, i.e. the Bologna process entered in force until 2012 as the most relevant benchmarks for this study. Other data that is collected and analyzed covers period between 2010 and 2013. The authors used a cross section analysis for improved depiction of the evaluated data for all observed countries. A cost-benefit investigation along with a partial analysis on investment returns is included in the body of the paper providing potentially relevant metrics that could evaluate the fundamental value of investment in higher education. In addition, univariate analysis has been performed through individual research.

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