

Euro area periphery lessons for central and eastern European countries: Is there a role for EU economic governance?

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Session IV. EU Structural Policies

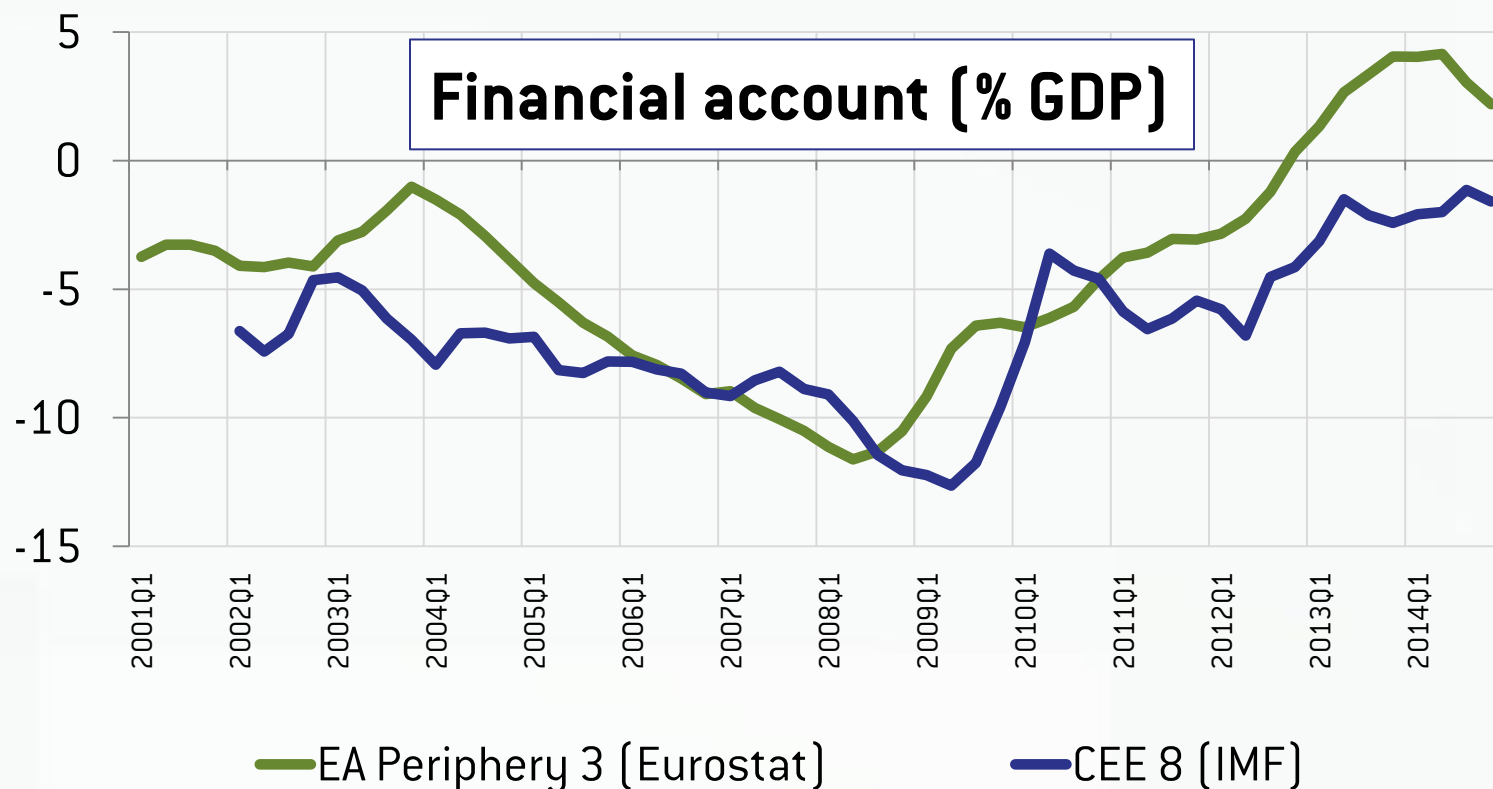
Conference on "Boosting EU Competitiveness – The Role of the CEE Countries"

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Euro-area periphery vs CEE

- **Pre-crisis – both regions:** rapid growth (*except Portugal*), capital inflows, imbalances (*except Czech Rep, Slovakia, lesser extent in Poland*)
- **Crisis and its aftermath:** capital outflows & foreign bank deleveraging



Euro-area periphery vs CEE

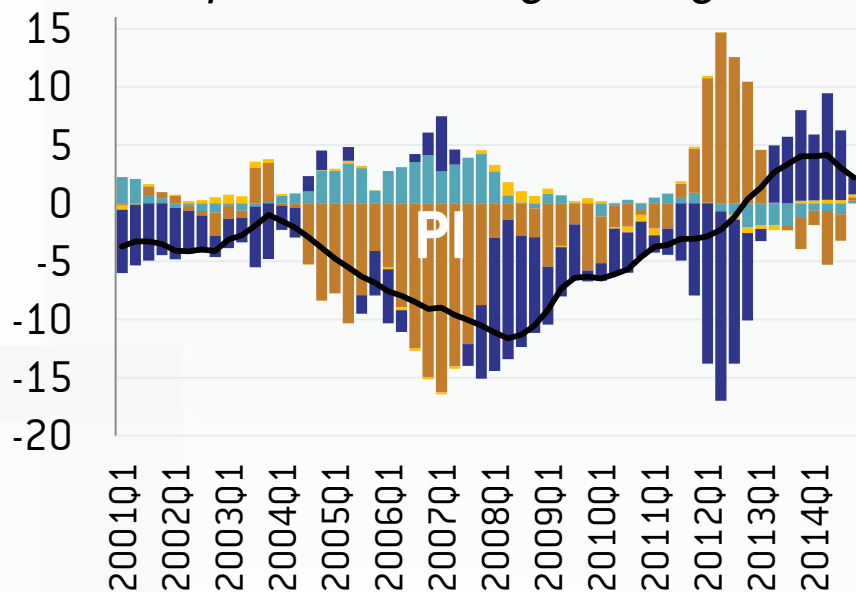
- **Composition of capital flows differ:**

- CEE: predominant FDI plus loans in 2005-2008 in CEE
- EA periphery: predominantly portfolio investments (PI) and loans; crisis lending since 2010

Components of the Financial account (% GDP)

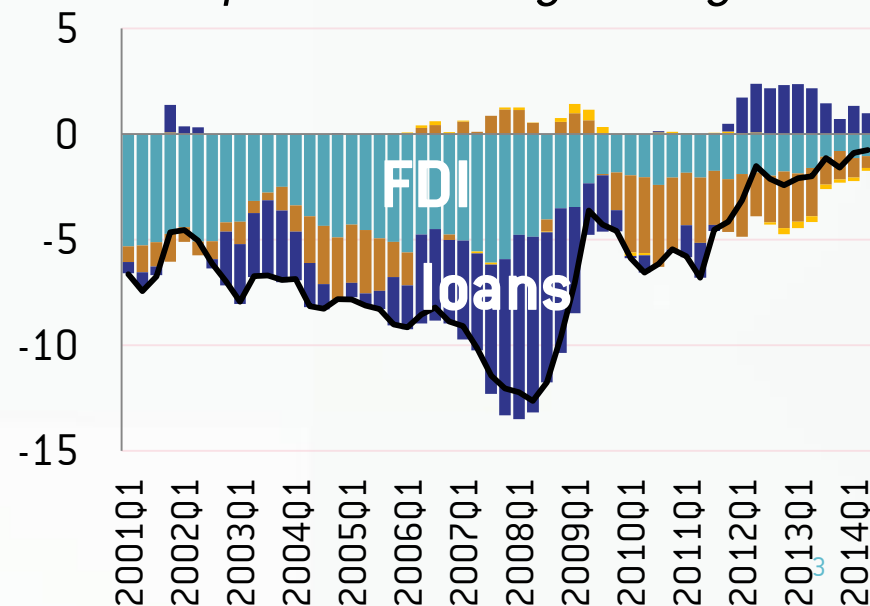
Euro area periphery

4-quarter moving average



CEE

4-quarter moving average



Euro-area periphery has a problem, CEE less so

- **Euro area periphery:**
 - Misalignment of wages and productivity
 - Accumulation of large foreign debt
 - Low foreign bank ownership, while foreign bank lending withdrawn
 - Large public debts
 - Little integration into global value chains
 - Large share of SMEs
 - Weak institutional quality
- **What to do?**
 - Internal devaluation
 - Fiscal adjustment
 - Structural reforms (institutions, public sector, insolvency frameworks, red tape, product & labour markets, education, social redistribution)

EU governance frameworks for structural reforms

- **Pre-crisis:**
 - **Belief:** fiscal discipline and price stability are sufficient for smart, sustainable and inclusive growth; capital flows reflect integration
 - **Instruments:** Broad economic policy guidelines; "long" Commission reports
- **Reforms recent years:**
 - European Semester, including:
 - Macroeconomic Imbalance Procedure (MIP)
→ Track record is very weak
- **5 Presidents' report – "Economic Union" pillar:**
 - Euro-area system of competitiveness authorities
 - Coordination within a revamped European Semester
 - Formalisation and making binding the convergence process

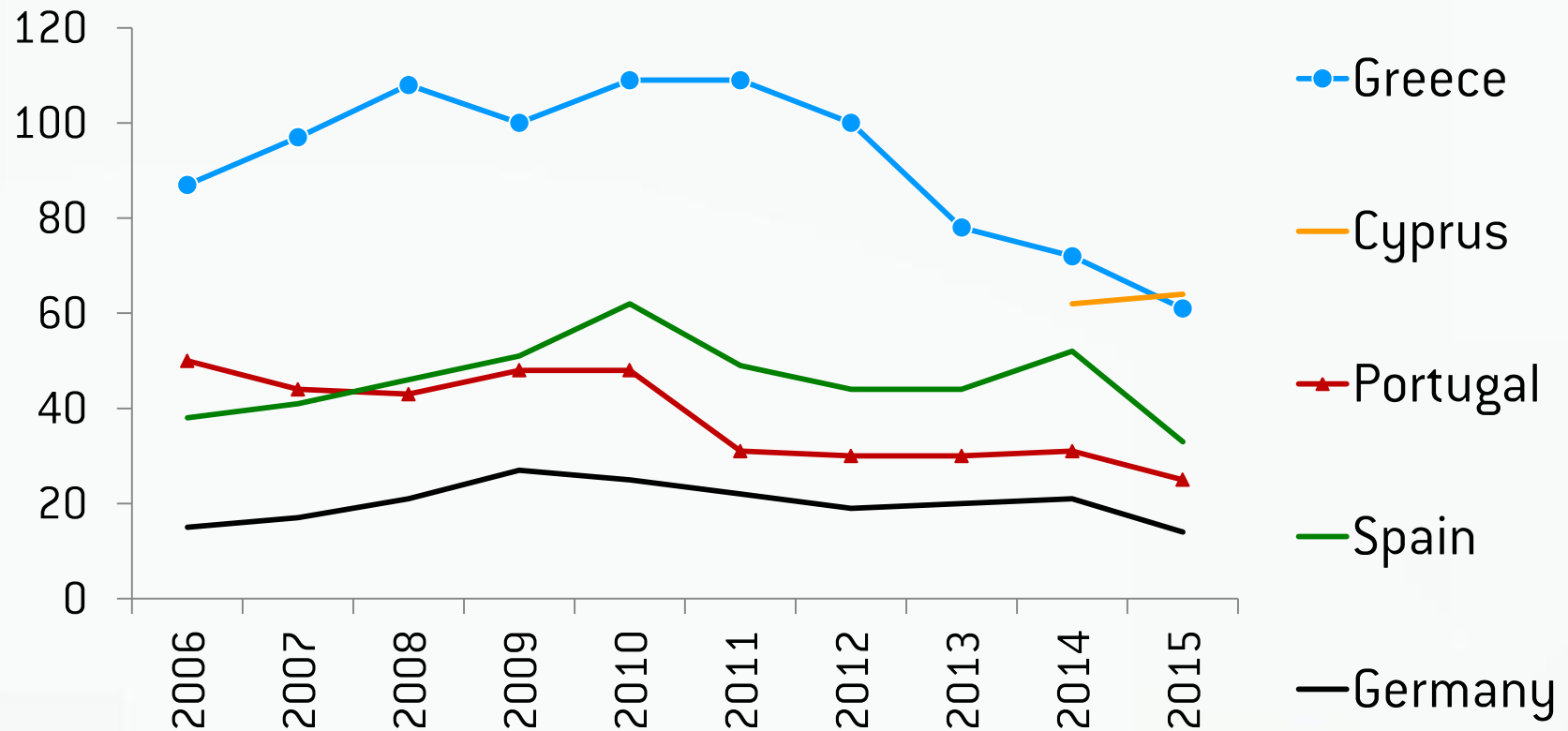
Which countries reform?

- **Our assessment of the European Semester recommendations:**
 - Good on structural reforms
 - Weak on macro adjustment (symmetric adjustment within the euro area, aggregate position of the euro area)
- **European Commission's assessment on compliance:**
 - Weak compliance with European Semester recommendations
- **Bruegel research – those countries reform that:**
 - Face market pressure
 - Face high unemployment
 - Are under financial assistance programme

Ease of doing business (World Bank)

Improvements in euro-periphery, though there is still a long way to go

Ranking among approx. 180 countries

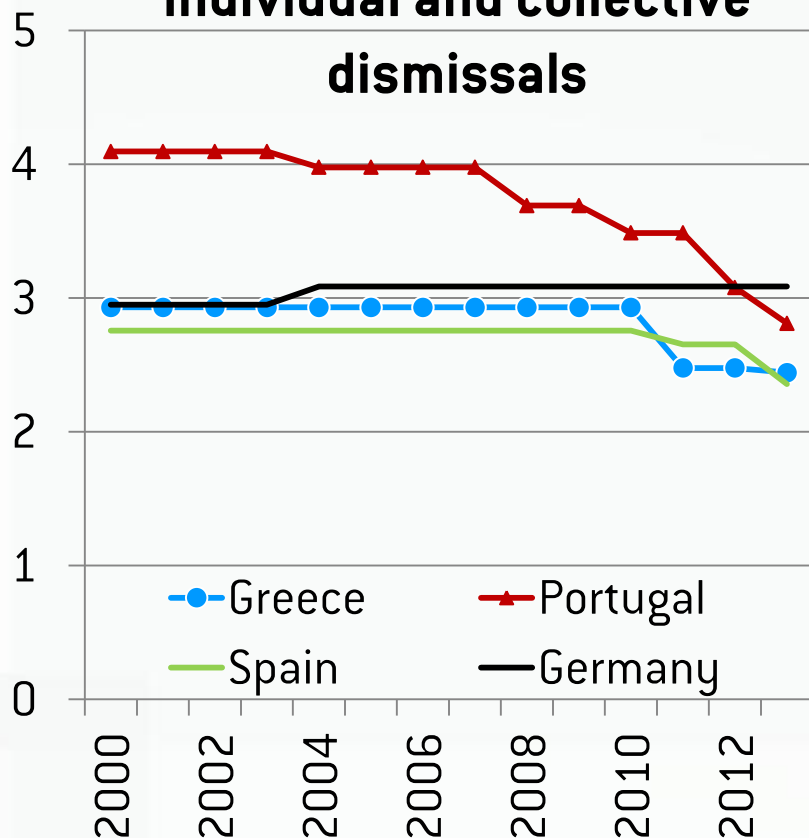


Source: World Bank. Note: 1=most business-friendly regulations. Among 153 countries in 2006, while among 189 countries in 2015. Cypriot data was reclassified in 2014.

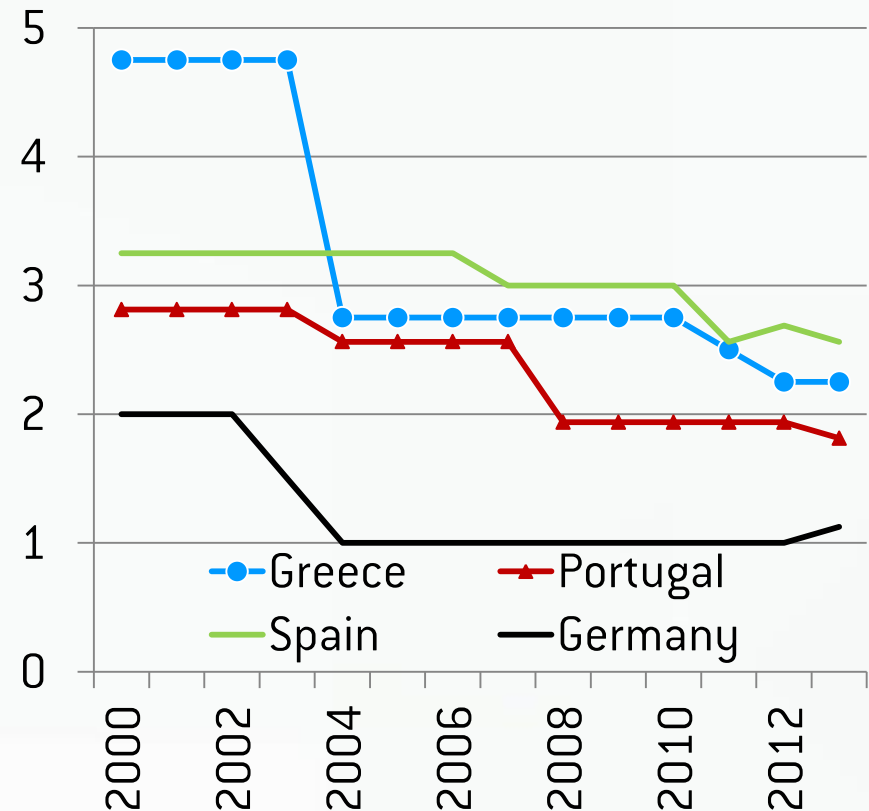
Labour market flexibility (OECD)

Regular contracts: periphery more flexible than Germany

Regular contracts: Strictness of employment protection – individual and collective dismissals



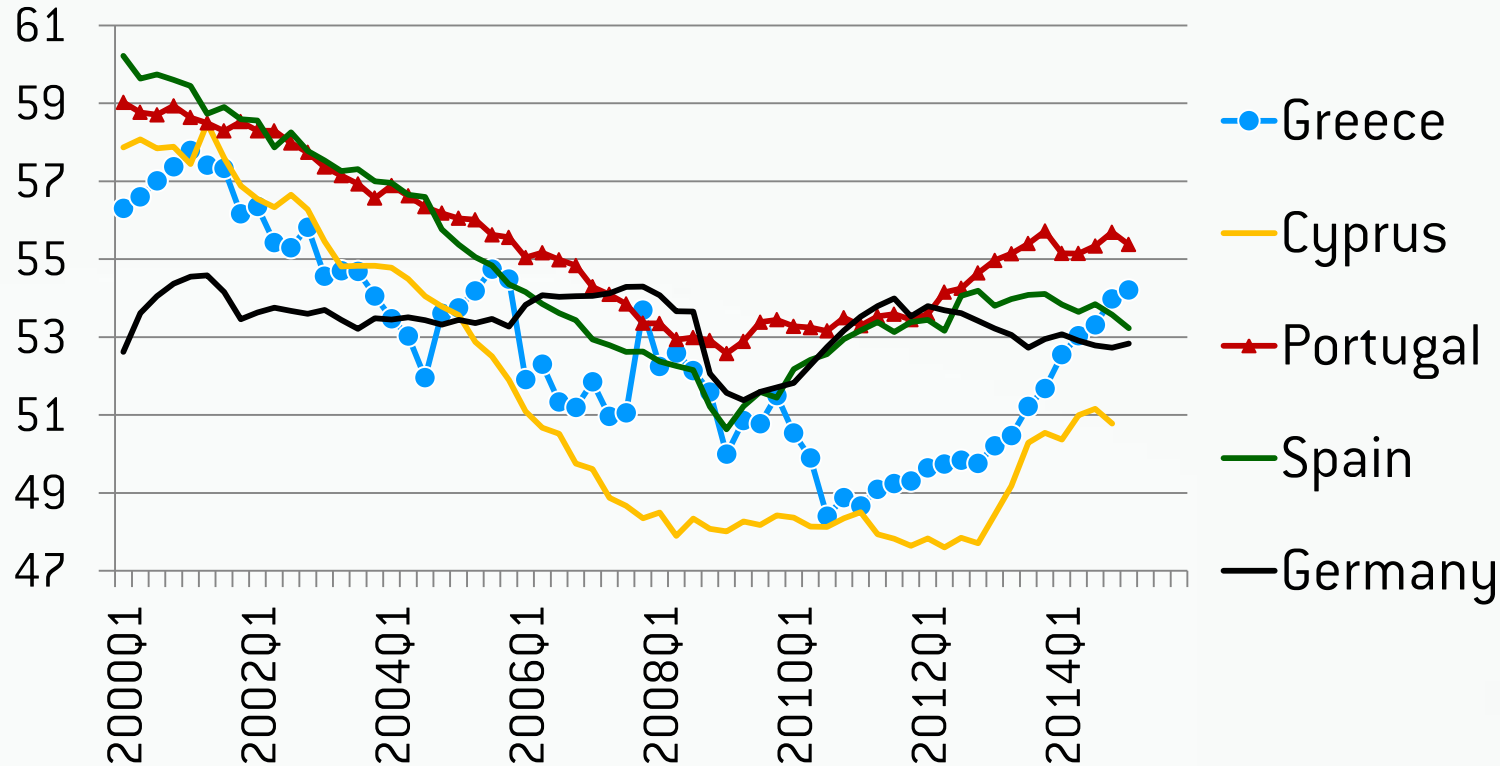
Temporary contracts: Strictness of employment protection



Source: OECD. Note: for regular contracts, version 2 of the indicator is used, while for temporary contracts version 1 (in the absence of version 2). Version 3 is available for both indicators, but only for 2008-2013.

Share of tradable sector in private sector (%)

Tradable sector decline reversed in 2010, now higher than in Germany



Source: calculation using Eurostat data

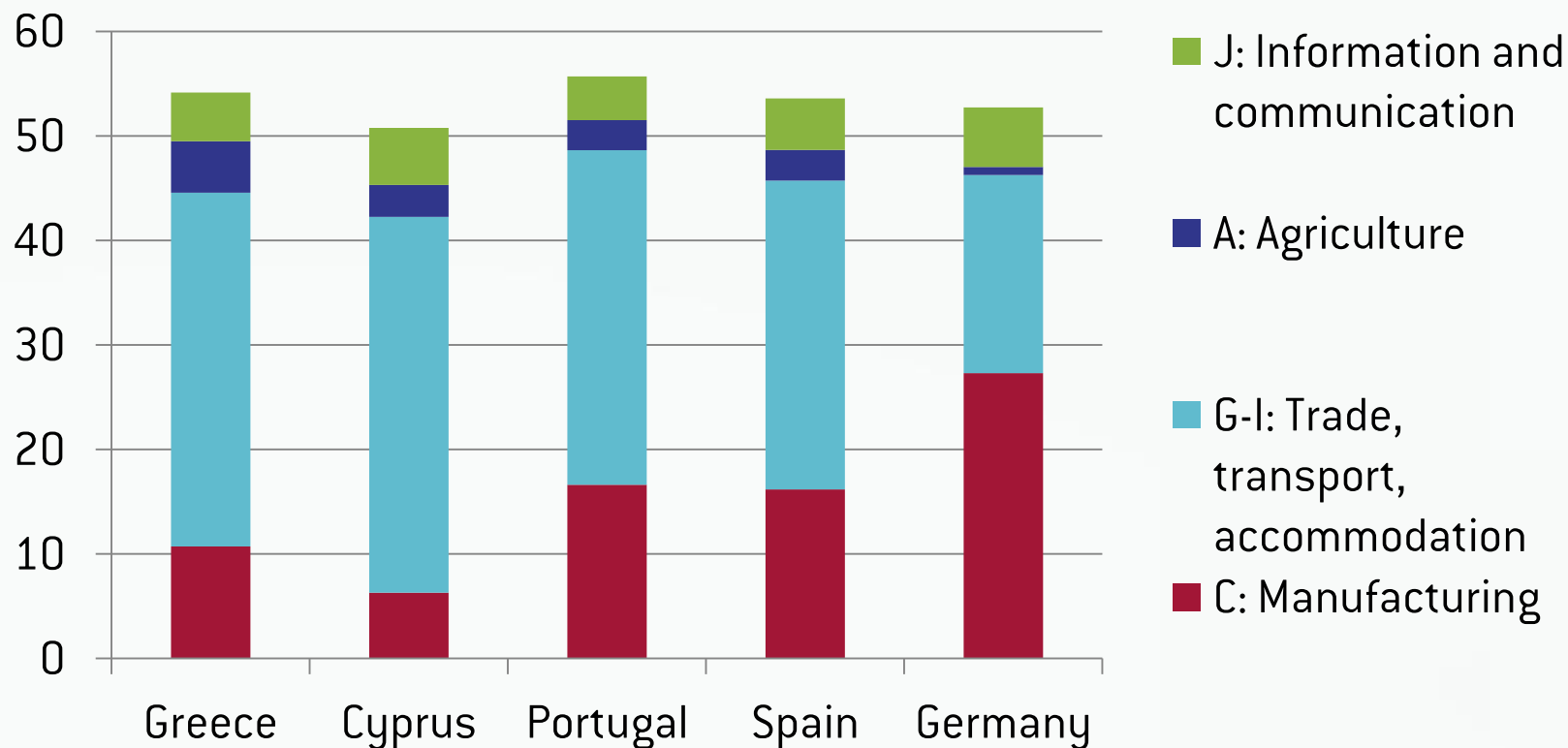
Tradables: A: agriculture, forestry and fishing, C: Manufacturing, G-I: Wholesale and retail trade, transport, accommodation and food service activities, J: Information and communication.

Non-tradables: B, D, E: non-manufacturing industry, F: Construction, K: Financial and insurance activities, L: Real estate activities, M-N: Professional, scientific and technical activities; administrative and support activities, R-U: Arts, entertainment and recreation; other service activities; activities of household and extra-territorial organizations and bodies.

Not considered: O-Q: Public administration, defence, education, human health and social work activities.

Share of tradable sector in private sector in 2014Q4 (%)

Services dominate in the south



Source: calculation using Eurostat data

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Conclusions

- **Pre-crisis euro-periphery problems are well understood now:** CEE has a chance to avoid after joining the euro
- **Slovakia**, a euro member, is thriving
- **Euro area governance in fostering structural reforms:**
 - Failed before the crisis
 - Macroeconomic Imbalance Procedure: useful addition, yet limited effectiveness so far
 - Network of national competitiveness authorities: can help to foster both domestic and cross-country discussions and ownership
 - Overall, enforcing structural reforms from a centralised process is hard
- So far **those countries reformed that were under pressure**; some encouraging results in euro-periphery
- **CEE:** discuss and coordinate, yet responsibility remains national

Thank you for your attention

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