

Seminarreihe

Aktuelle volkswirtschaftliche Fragen im Rahmen von internationaler Wirtschaft und Europäischer Integration

Seminar 1:	„Neue Erkenntnisse der Außenwirtschaftstheorie – von Ricardo bis Melitz“ mit Ingrid KUBIN (WU)		27.3.2015
Seminar 2:	„Europäische Integration“ mit Michael LANDESMANN (FIW/wiiw)	Teil 2	26.6.2015
Seminar 3:	„Freihandelsabkommen“ mit Fritz BREUSS (FIW/WIFO) und Julia GRÜBLER (wiiw)		9.10.2015
Seminar 4:	„Open Markets Matter“ mit Manfred SCHEKULIN (BMWFW)		1.12.2015

FIW Seminar – Europäische Integration – BKA Juni 2015

1. Teil: Ökonomische Analyse der

- Marktintegration
- Währungsunion
- EU-Erweiterung
- Aktuelle(n) Wirtschaftskrise

2. Teil: Convergence, divergence and the problem of external imbalances in the European economy

FIW Seminar – Europäische Integration – BKA Juni 2015

1. Teil (siehe Handout):

Ökonomische Analyse der

- Marktintegration (Produkt-, Kapital-, Arbeitsmärkte)
- Währungsunion (EWU, EMU)
- EU-Erweiterung (NMS, Kandidaten, Nachbarschaft)
- Aktuellen Wirtschaftskrise

FIW Seminar – Europäische Integration – BKA Juni 2015

2. Teil

Convergence, divergence and the problem of external imbalances in the European economy

Convergence, divergence and external imbalances in the European economy – motivation

- In the decades prior to the crisis there was a perception of the **EU as a ‘convergence model’**; including sustainability of convergence processes
- This perception has been severely challenged through the crisis
- Non-sustainability of development patterns and lack of (pervasive) convergence **puts European integration at risk**
- Are **evolving policy frameworks** (at national and EU levels) able to deal with this challenge?

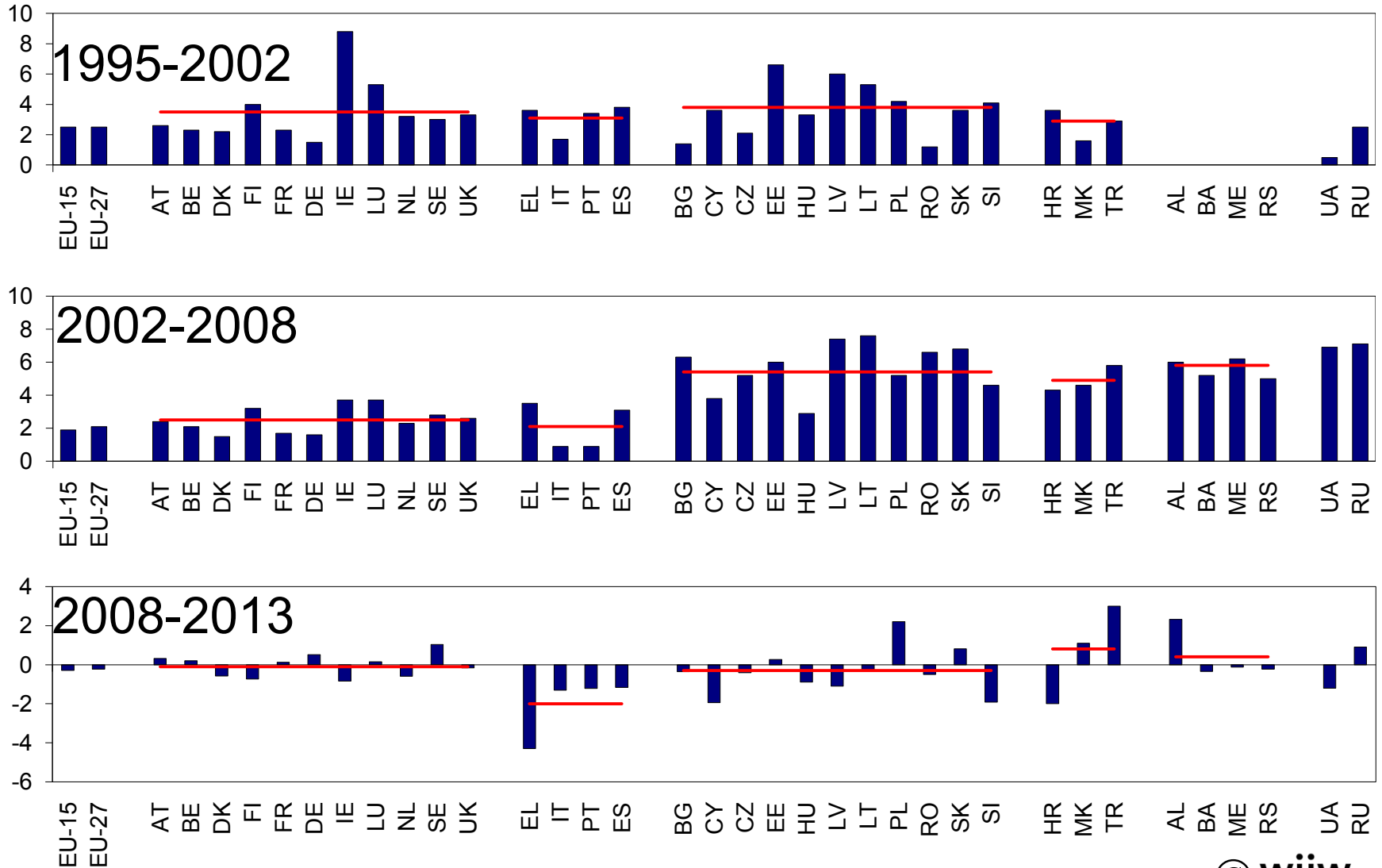
Convergence, divergence and external imbalances in the European economy – overview of the talk

- Discussion of convergence/divergence tendencies: Europe's '**North-South**' problem
- Is there a '**structural**' external imbalances problem in Europe? What are its **causes**?
- **Differentiation of 'Europe's South'**, i.e. Europe's medium- and low-income economies
- **Policy remedies** within Europe's incomplete integration scenario

Convergence, divergence – various dimensions

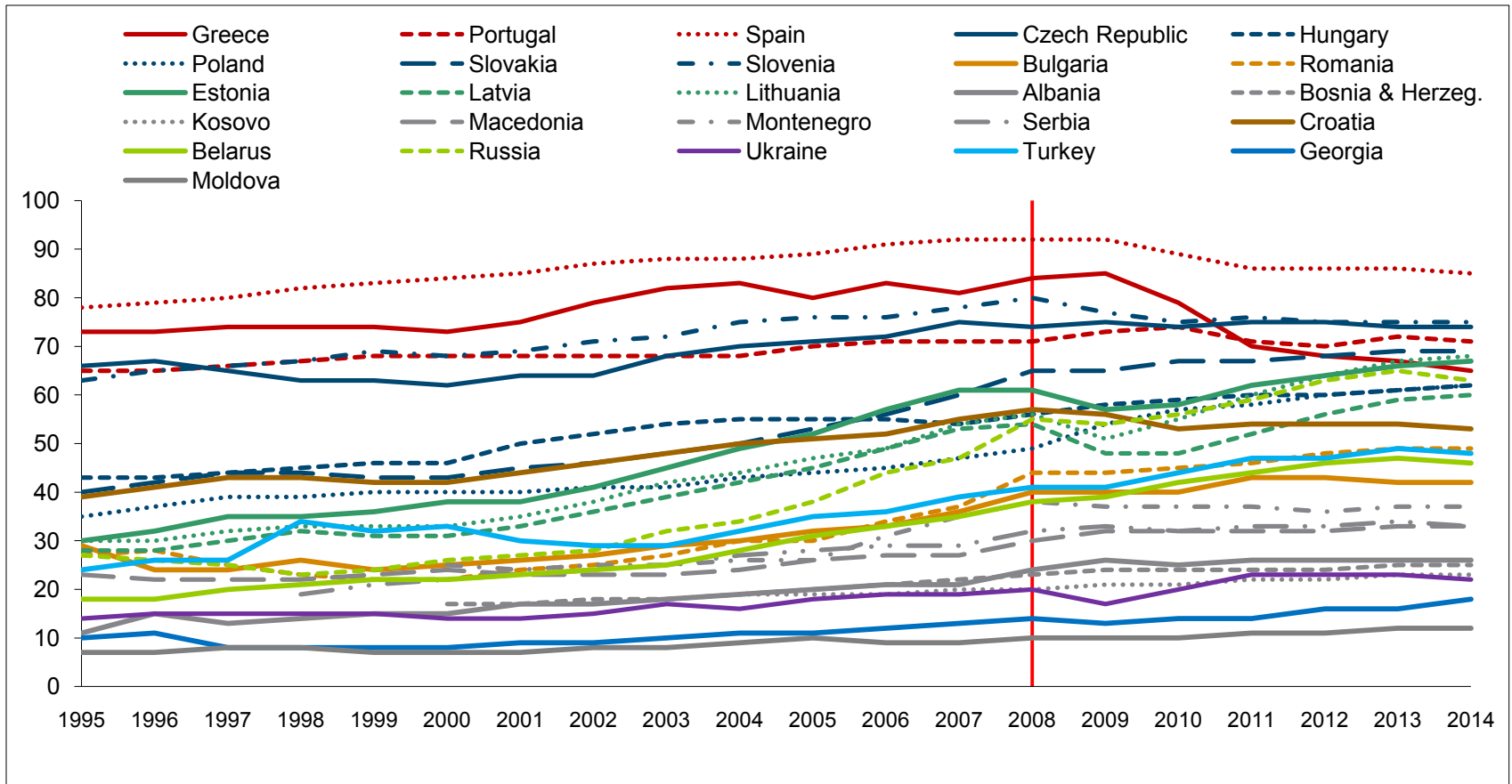
- **Cross-country convergence/divergence**
- **Intra-country regional convergence/divergence**
- **Sustainability** of catching-up: **Achilles heel – external imbalances**
- **Special contexts**: integrated financial markets, Euro membership/exchange rate regimes
- **Europe's 'South'**: CEECs/NMS, Southern Europe, Balkans, Turkey, neighbourhood (Ukraine, Russia, etc.)

Convergence record: Growth of GDP, av. annual growth rates, in %

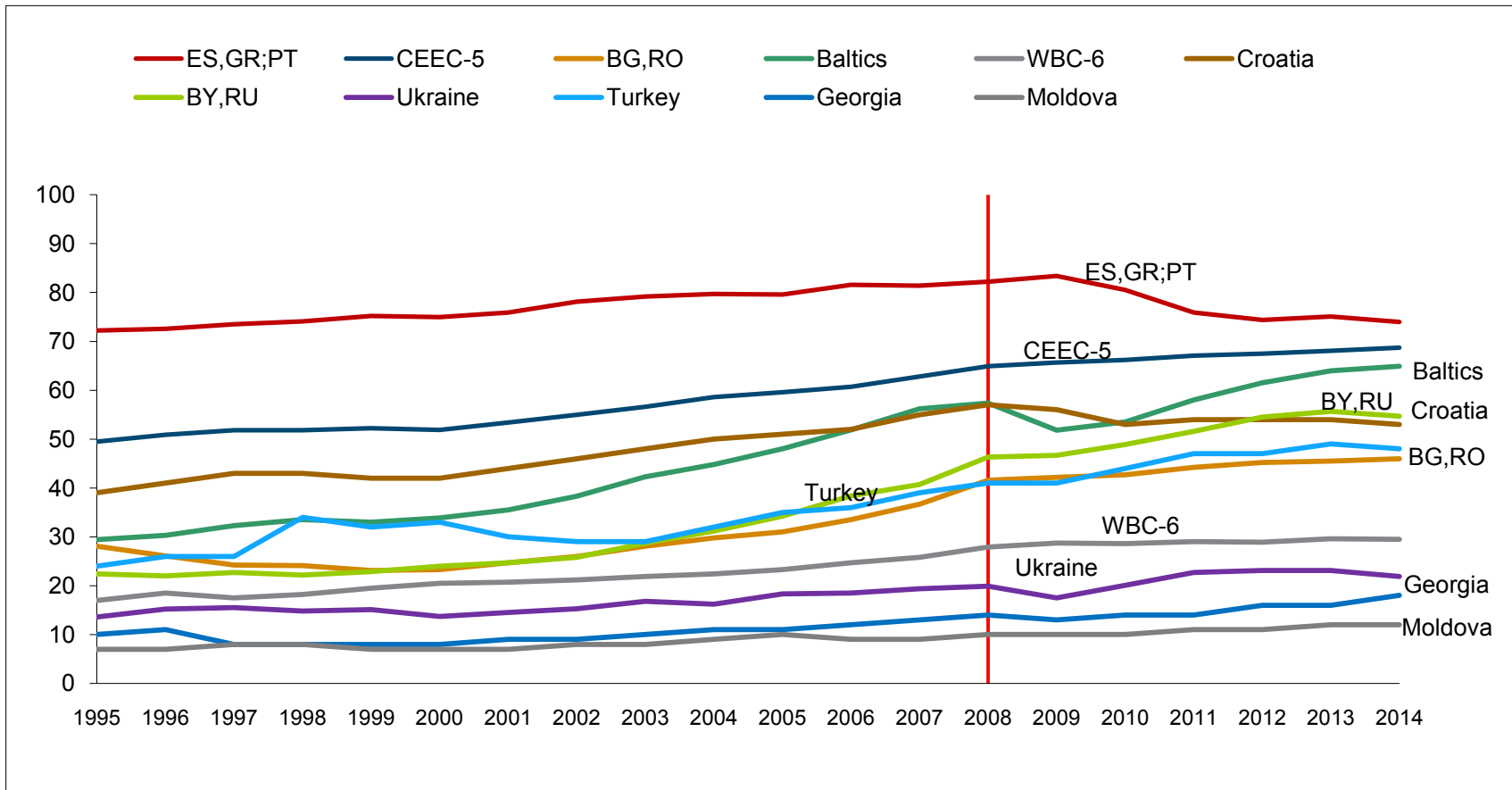


Source: wiiw Annual Database incorporating national statistics, Eurostat.

GDP per capita at current PPPs (EUR), 1995-2014



Convergence in GDP per capita at current PPPs (EUR), 1995-2014; EU-15=100



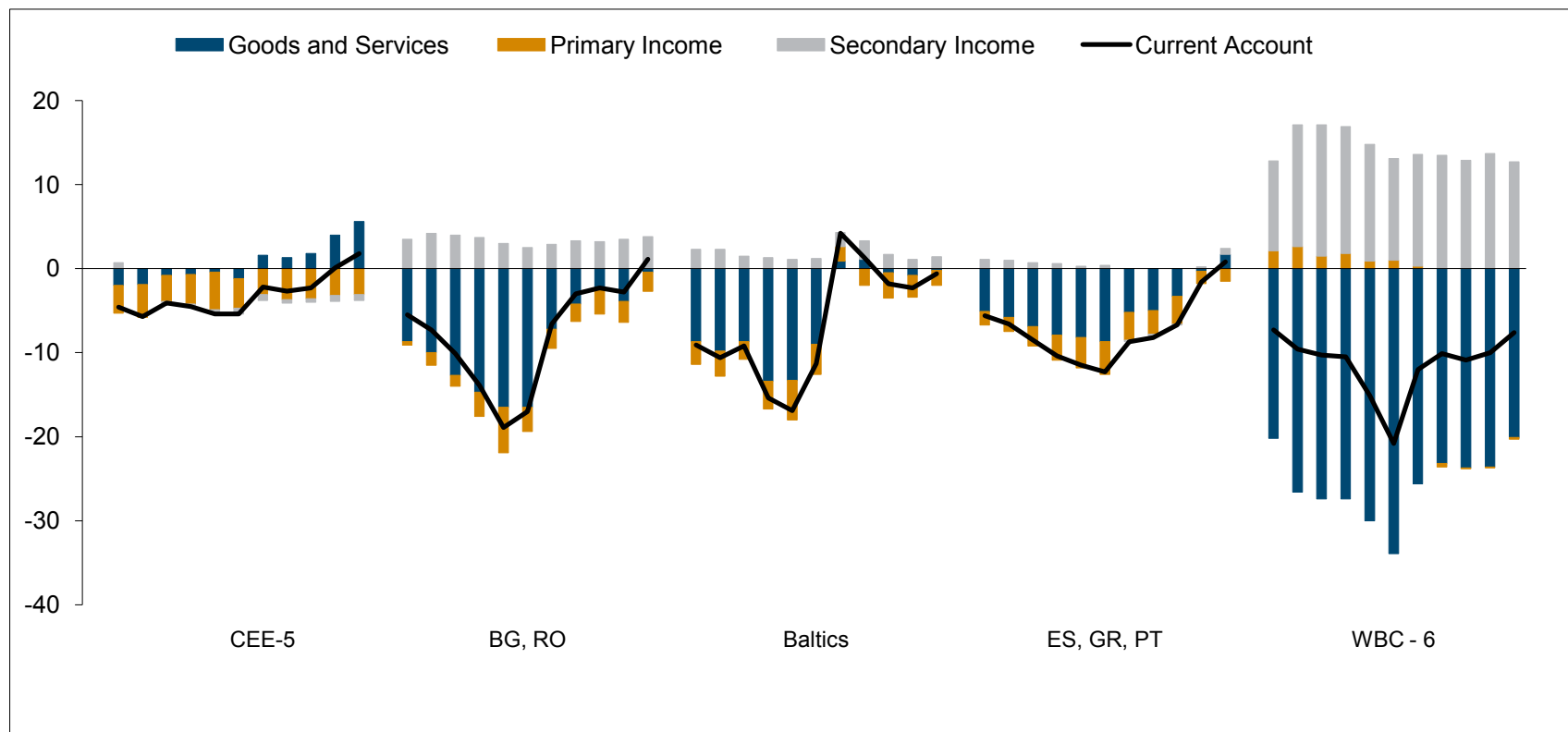
Convergence, divergence – research results

- **Evidence for inter-country convergence in Europe prior to crisis;** slowdown resp. divergence post-crisis
- **No evidence of intra-country regional convergence:** special issue of **capital cities** in CESEE economies; **de/re-industrialisation** and **agglomeration** of industrial activity and of market services
- Relative uniformity of inter-country convergence pre-crisis hid **underlying diversity in external imbalances**

External imbalances in the European economy – focus on lower-/medium-income economies

- Specific issues for **catching-up economies** in an **unstable external environment**
- We focus on **differentiation between**:
 - **EU-South** (ES, GR, PT)
 - **CEE-5** (CZ, HU, PL, SK, SL)
 - **Baltics** (EE, LT, LV)
 - **BG, RO** (at times HR)
 - **Western Balkans** (WBC-6; AL, BA, MK, ME, RS, XK)

Composition of the current account of the balance of payments, 2003-2013, in % of GDP - pre-crisis: run-away deficits in some countries (trade balances, capital flows); post-crisis (income effects; capital flows)



Remark: Components refer to BOP 6th edition as far as available, BOP 5th edition before. Primary income refers to Income Accounts, secondary income to current transfers.

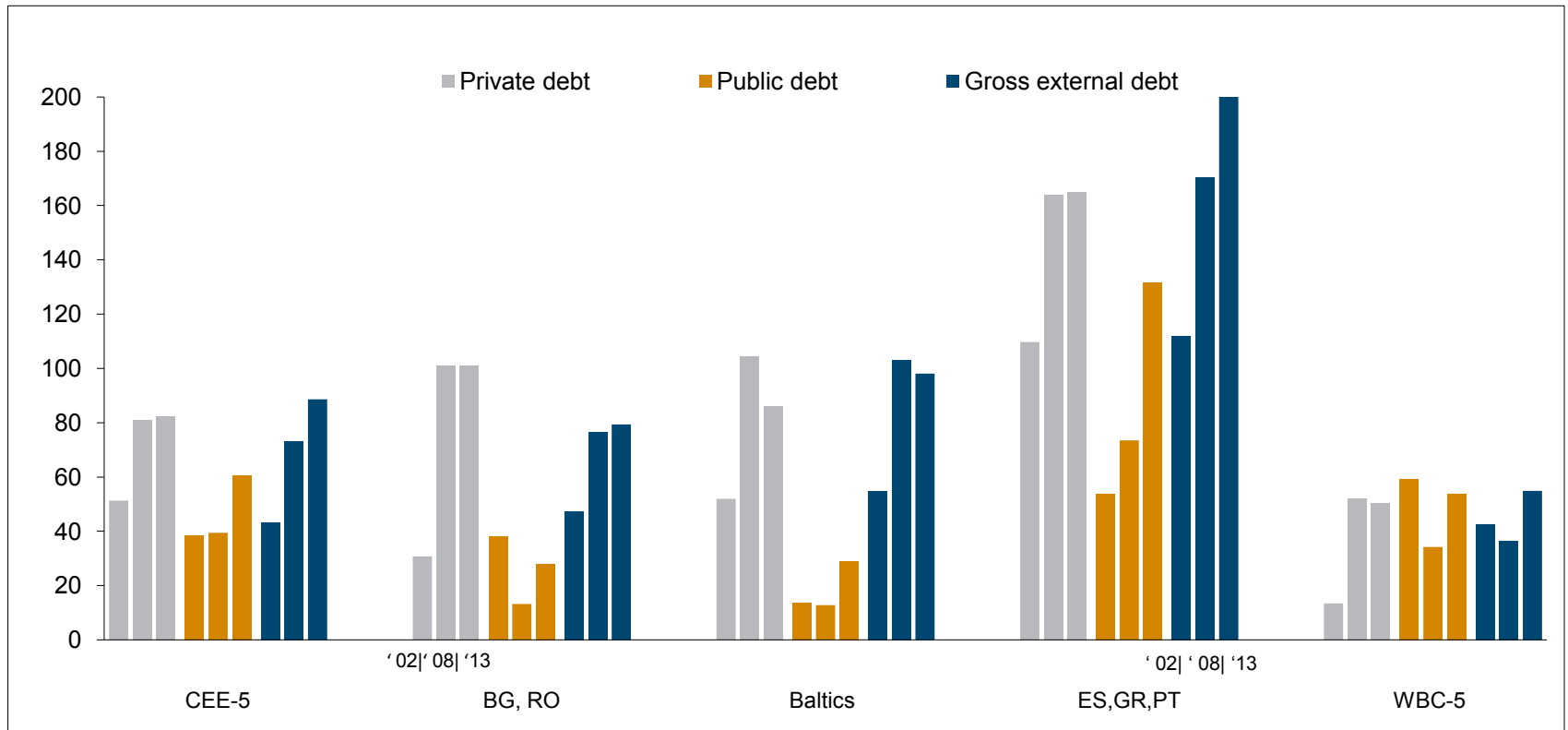
Source: wiiw Annual Database incorporating national and Eurostat statistics.

External imbalances in the European economy – **why is it a problem?**

- Pre-crisis we did not think it was a problem in the EMU
- Now (after the onset of the crisis) we think it is a **central problem of European integration**
- Sustainability problem i.e. stock not flow problem; inside and outside the EMU
- **Resulting debt problem** acts as a **long-run constraint on growth** plus **vulnerability to shocks**
- Focus on strength of tradable sector

Debt in % of GDP, 2002, 2008, 2013 – private, public, external

Sequencing in private, public, external debt evolution

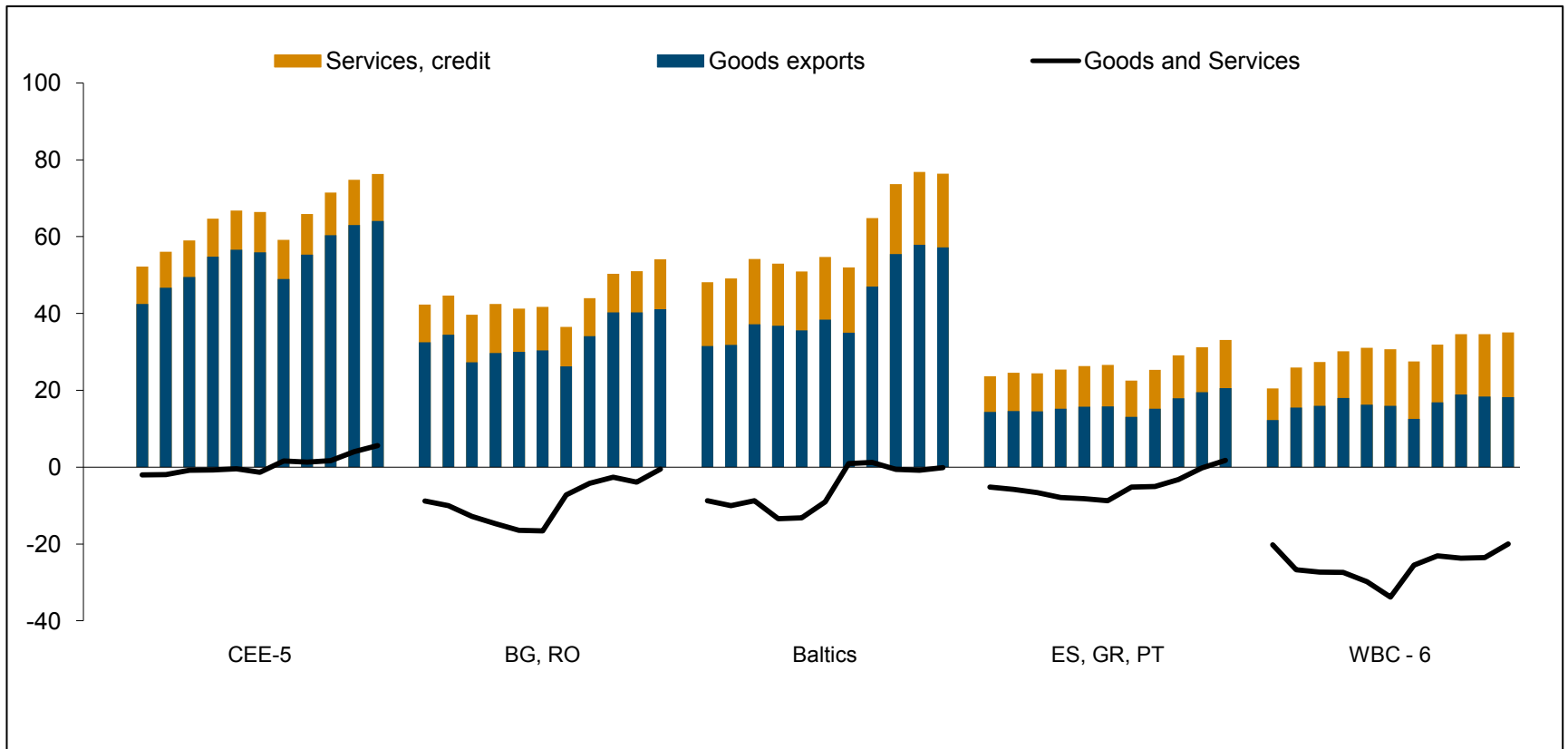


Remark: Data 2002: Public debt for ES, GR, PT refers to ES, PT only and to 2003. Gross external debt for ES, GR, PT refers to 2003, BA and ME gross external public debt.

Private debt for Baltics refers to 2004 (without EE), for WBC-5 to 2003 (without BA).

Source: wiiw Annual Database incorporating national and Eurostat statistics.

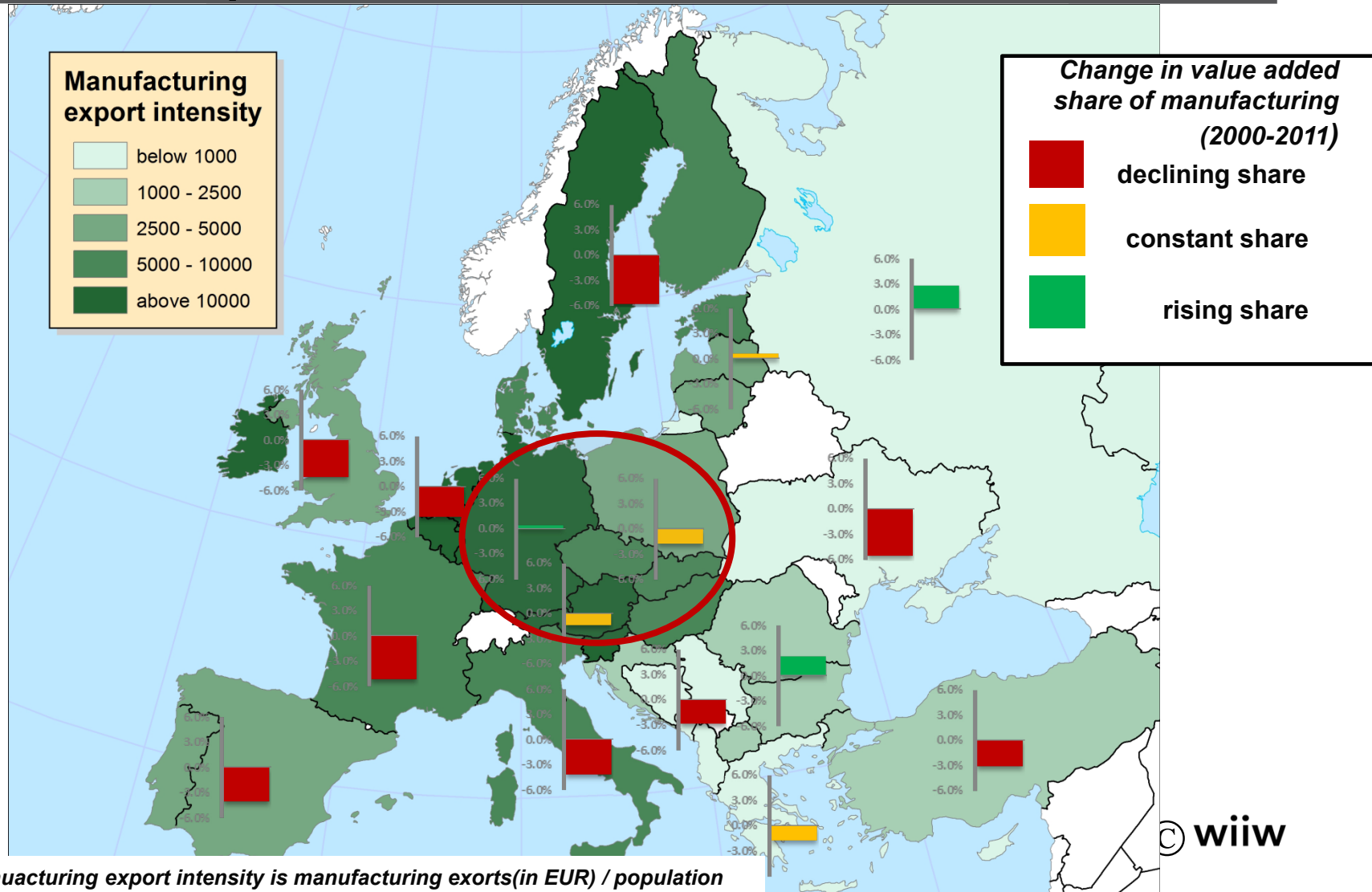
External trade, 2003-2013, in % of GDP - **Persistent low export capacity in some groups of countries**



External imbalances in the European economy – what stands in the way to resolve the problem?

- **Reversing past patterns of de-industrialisation** in ‘Europe’s Periphery’ (at country and regional levels)
- **Agglomeration tendencies** of Europe’s manufacturing industry
- **Insufficient focus of policy instruments** on the issue and conflicts of policy instruments (e.g. competition and industrial policy; level-playing field)

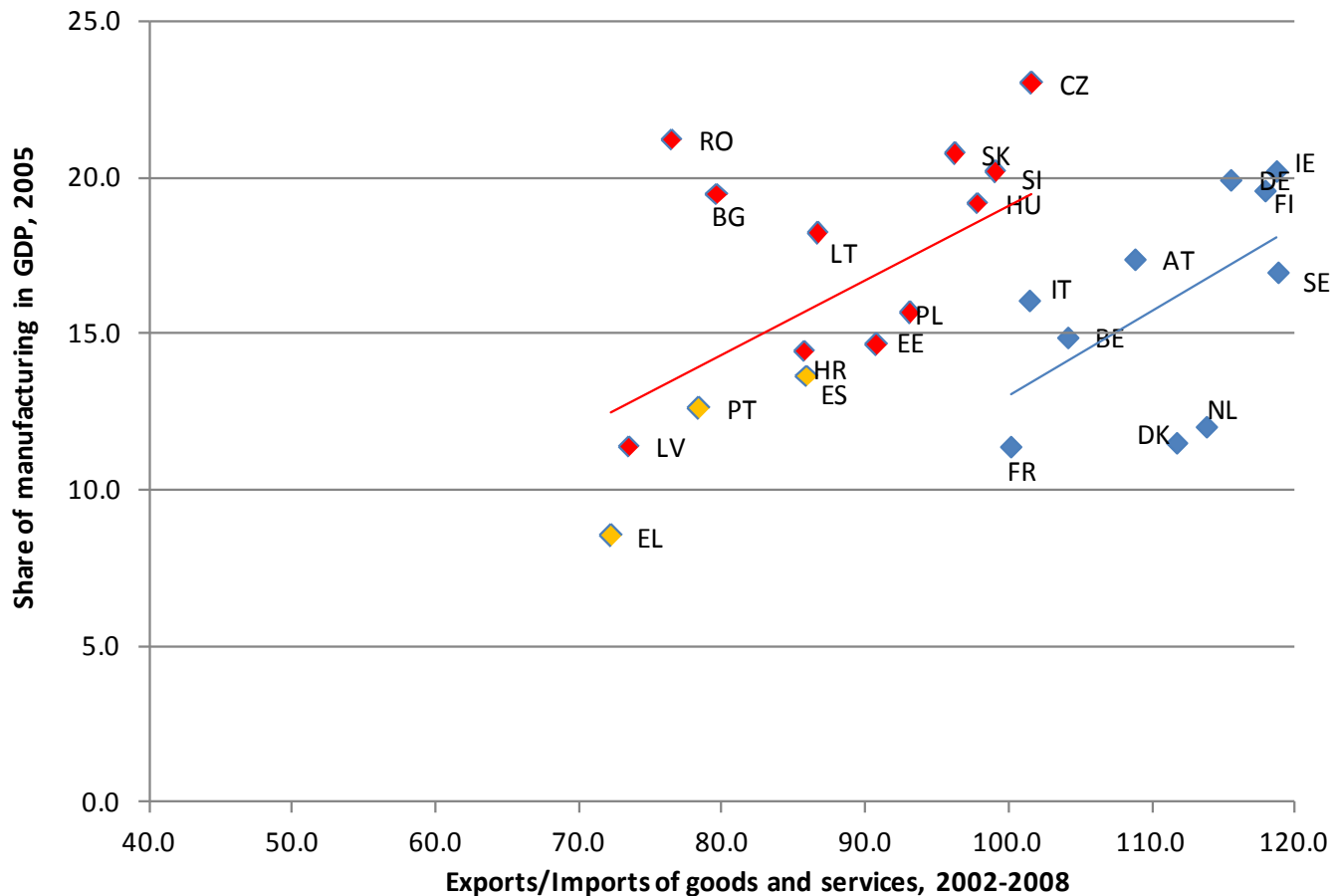
Manufacturing activity is increasingly concentrated in a Central European Core



Position of manufacturing and longer-term trade balances

Share of manufacturing in GDP in 2005 and exports/imports of goods and services, average 2002-2008 –

Manufacturing particularly important for medium-income countries!



Source: Eurostat and wiiw own calculations.

Trade Account and Manufacturing

Relationship between the trade account and the manufacturing base, 1995-2011

Dependent variable: Trade account balance (goods and services balance) in % of GDP

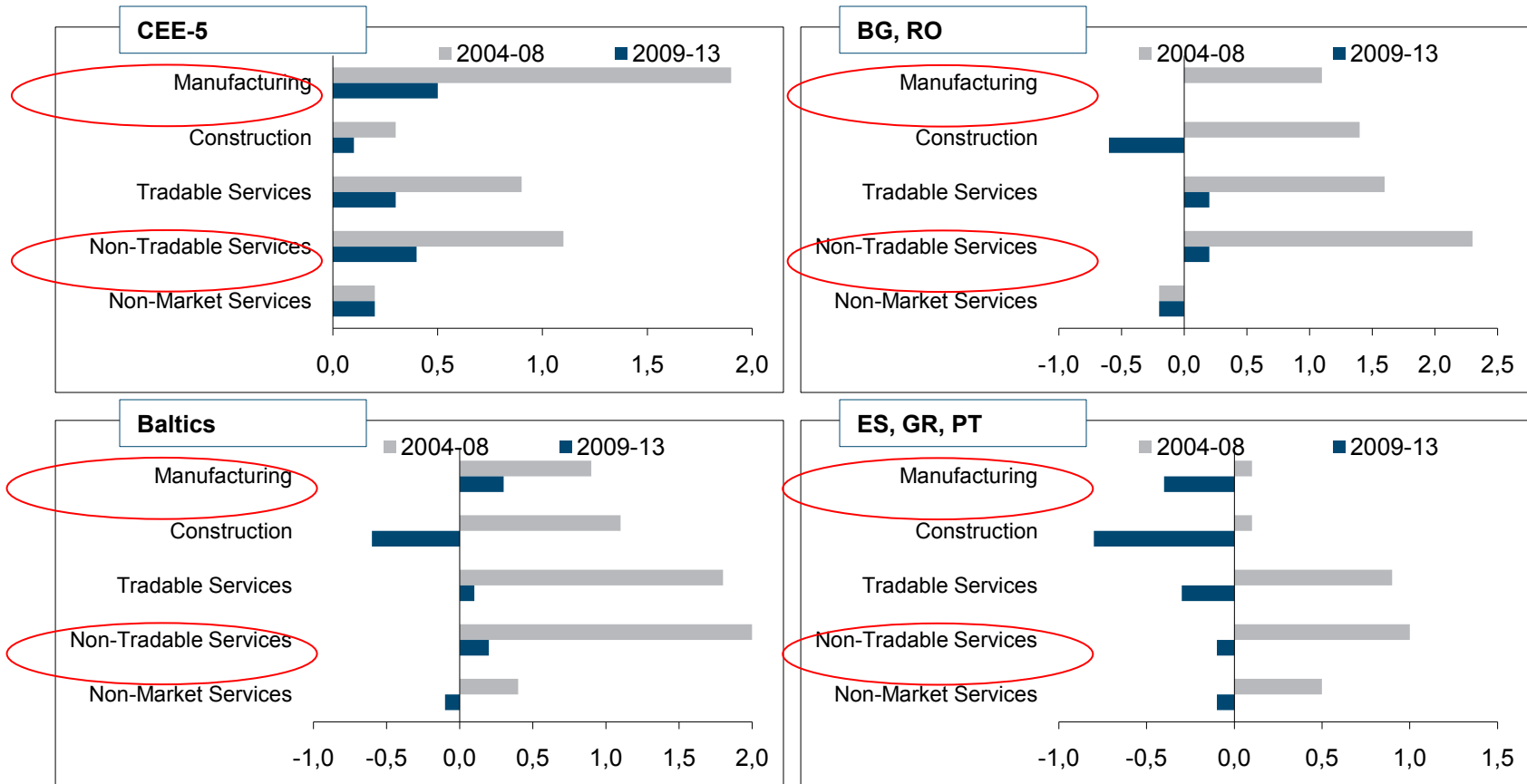
Variable	EU27 (4)	EU27 (5)	EU27 (7)	EU27 (8)	EU27 (10)	EU27 (11)
Manufacturing base	0.5224 *** (0.131)	0.5911 *** (0.134)	0.5138 *** (0.139)	0.8013 *** (0.135)	0.7811 *** (0.133)	0.7002 *** (0.139)
Manufacturing base x GDPcap					0.6757 *** 0.148	0.7361 *** 0.157
GDPcap		-0.0420 (0.030)	-0.0430 (0.032)	-1.0840 *** (0.208)	-1.5750 *** (0.235)	-1.6966 *** (0.248)
GDPcap ²				0.0659 *** (0.012)	0.0931 *** (0.014)	0.1004 *** (0.015)
ΔReal effektive FX			-0.001 ** (0.001)			-0.001 *** (0.000)
F	4.220	4.577	4.630	6.114	6.735	7.399
R ²	0.888	0.886	0.893	0.900	0.908	0.917
R ² -adj.	0.876	0.874	0.881	0.889	0.897	0.907
Obs.	459	454	427	454	454	427

Source: WIOD, Eurostat, World Development Indicators, wiiw-estimations.

Notes: All estimates include a constant, time and country fixed effects. standard errors in parenthesis. *, **, *** indicate statistical significance at the 1,5 and 10 level respectively. Specifications with interaction terms use mean-centered values of regressors.

Contributions to GDP growth by sectors, percentage points 2004-2008 and 2009-2013 (from constant prices)

– **Look at manufacturing and NTS!**



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations.

External imbalances in the European economy – what have we learnt?

- **‘Structural’ external imbalances** refer to persistent weaknesses of the tradable sector; danger particularly for catching-up economies
- Lead to **build-up of external debt and vulnerability to external shocks** (e.g. ‘sudden stops’); thus act as long-term constraint on growth
- **Two distinct patterns of capital inflows:**
 - capital inflows can generate overvaluation and longer-term distortions of sectoral structures (tradables/non-tradables);
 - equally, FDI can cause positive cumulative causation – up-grading of export structures, quality improvements, real appreciation
- **Agglomeration tendencies get entrenched in European economy**

External imbalances in the European economy –

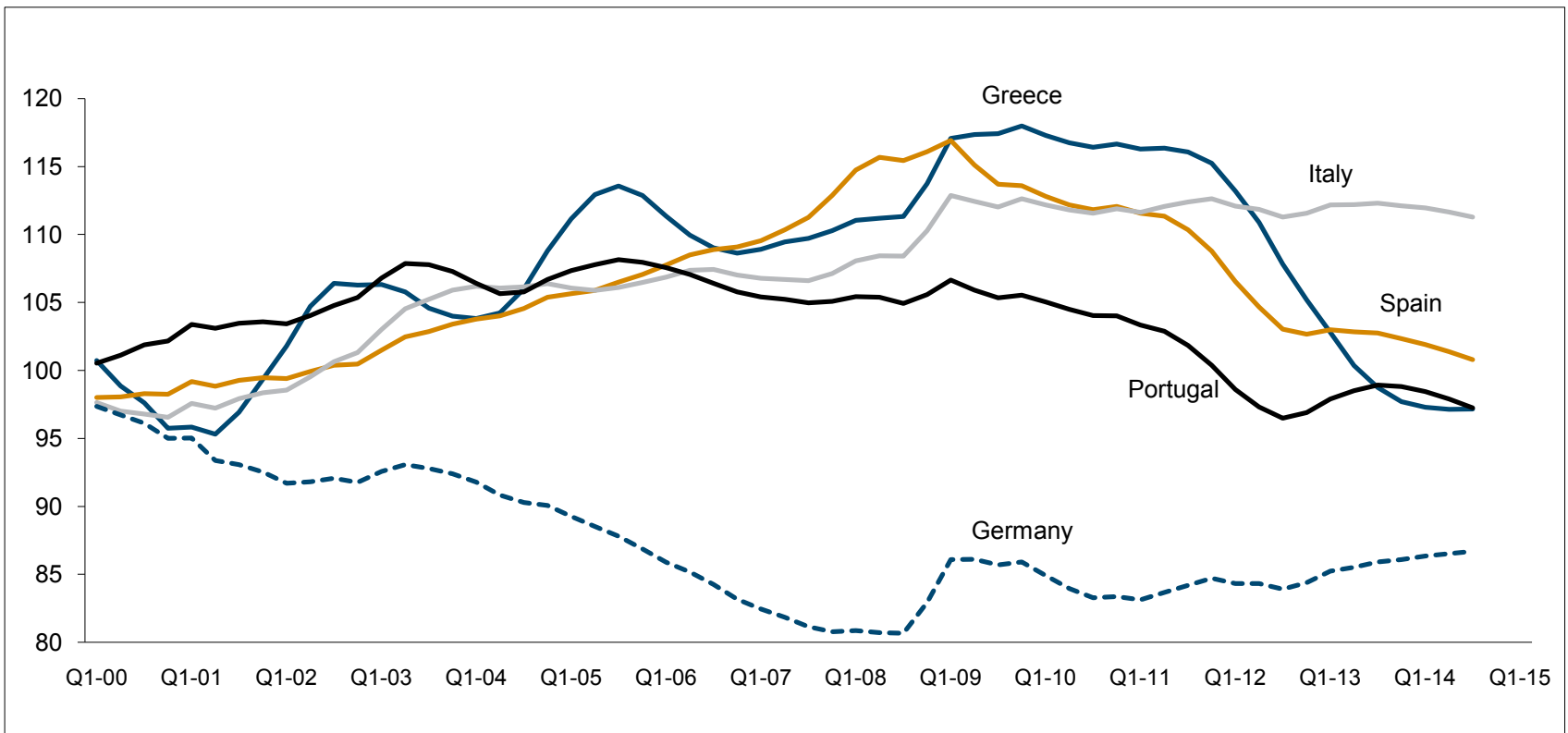
How to rectify the problem?

- **CEE-5**: paragon path of ‘convergence story’ prior to the crisis; so far an **exception amongst Europe’s EMEs**
- **Difficult adjustment processes in many countries** following the crisis – correction of external imbalances; debt legacy problem; adjustment processes do not necessarily address longer-term structural imbalances
- **Main question**: what is needed to deal with external imbalances problem in the longer-run?
- Economists point to the **role of real exchange rate adjustments**

Real Effective Exchange Rates vs (rest of) EU28

(average 1994-2004= 100), based on nominal unit labour costs, total economy

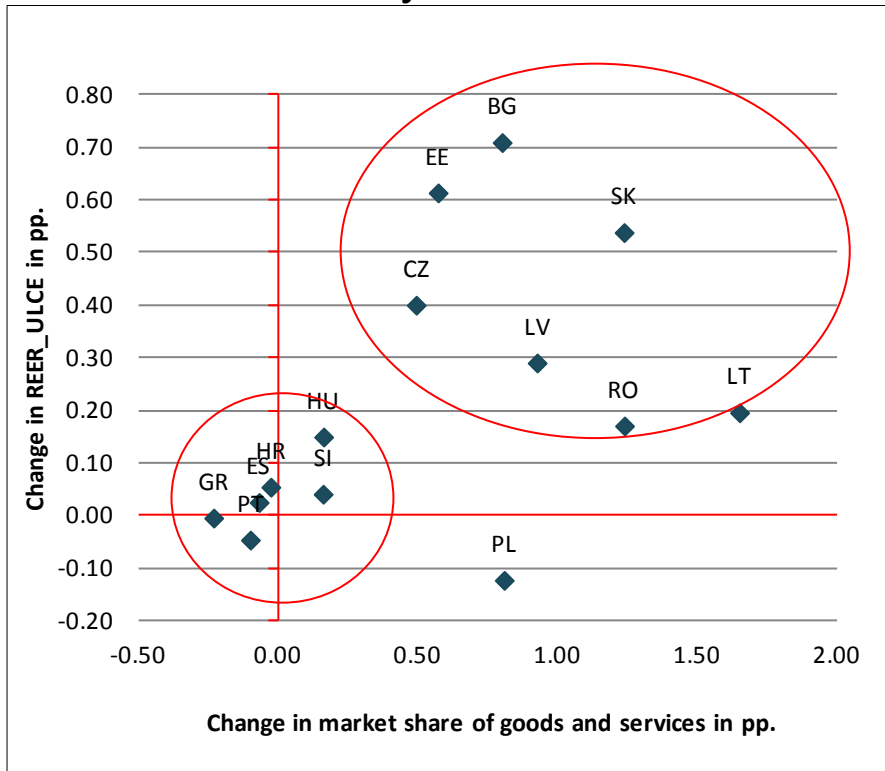
The focus of the media:



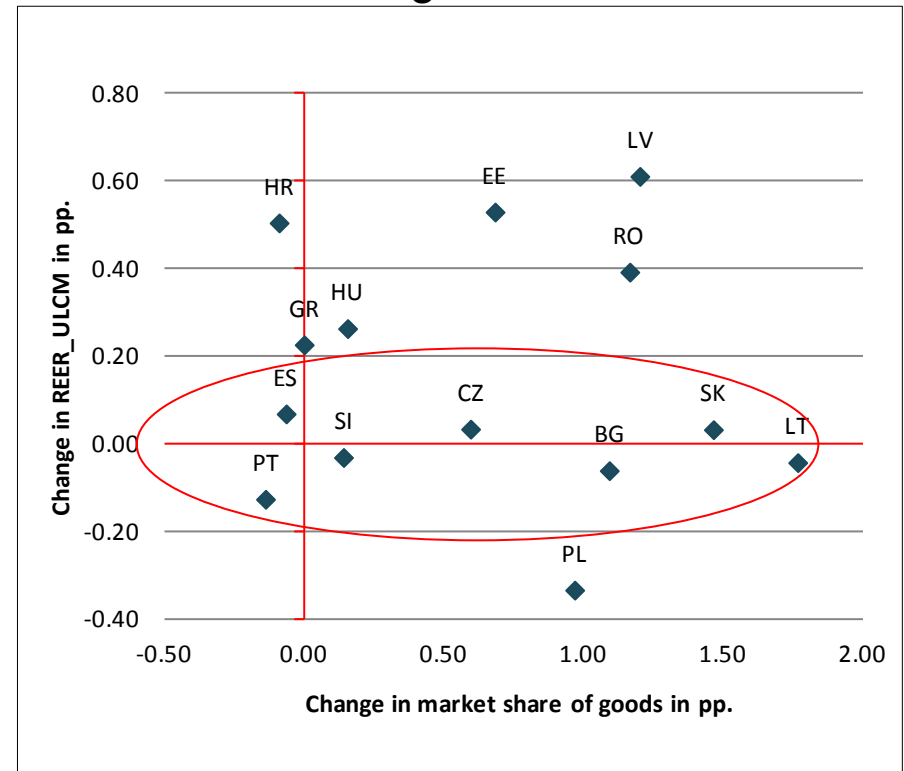
Source: AMECO, own calculations.

Change in global export market shares and change in REER - Goods and services pp changes – 2000 to 2014 (2000=0.0) – Any relationship?

Total economy



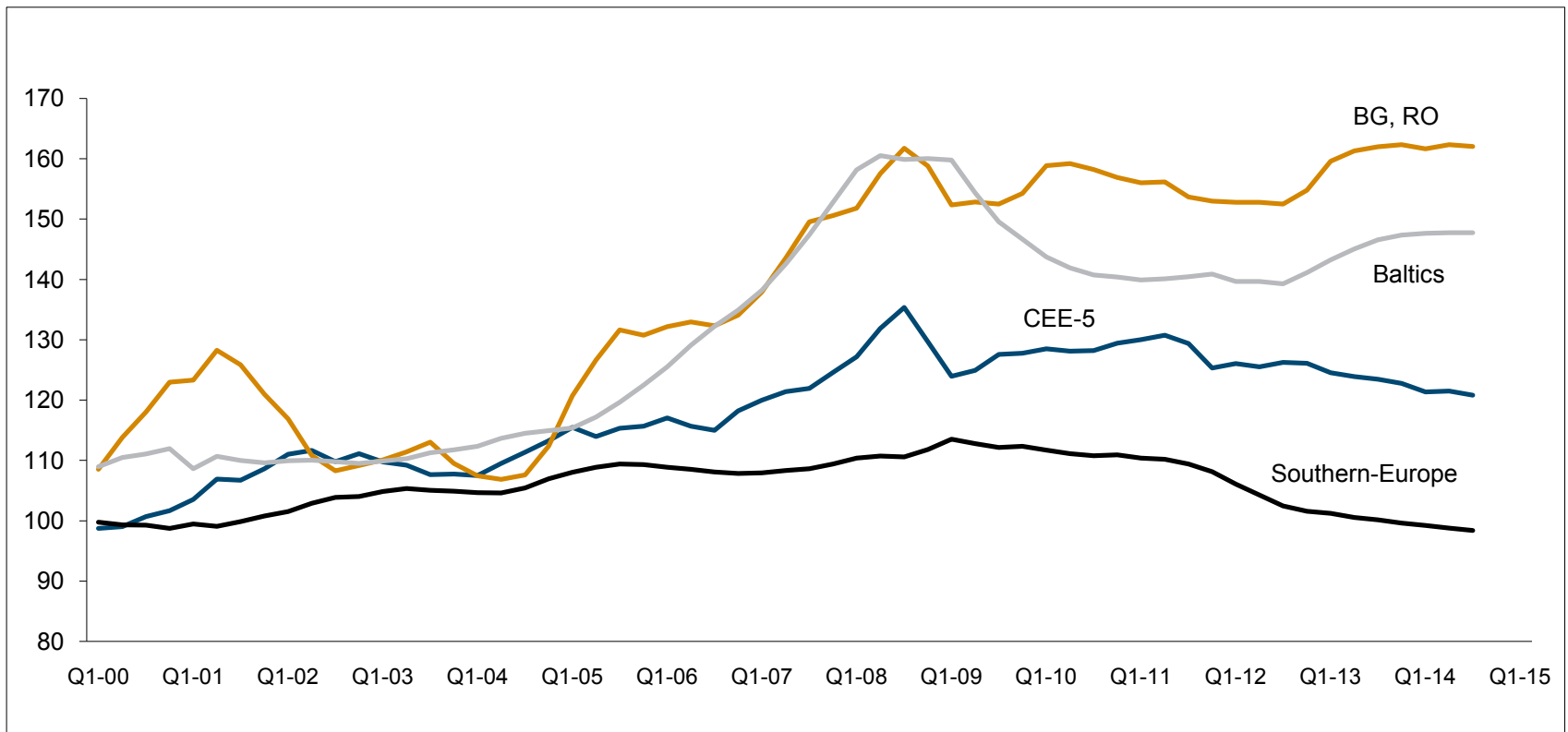
Manufacturing



Real Effective Exchange Rates vs (rest of) EU-28

(average 1994-2004 = 100) – 2000Q1 – 2015Q1

based on nominal unit labour costs, total economy; **CEEs and Southern Europe**



External imbalances in the European economy – focus on real exchange rates too simplistic?

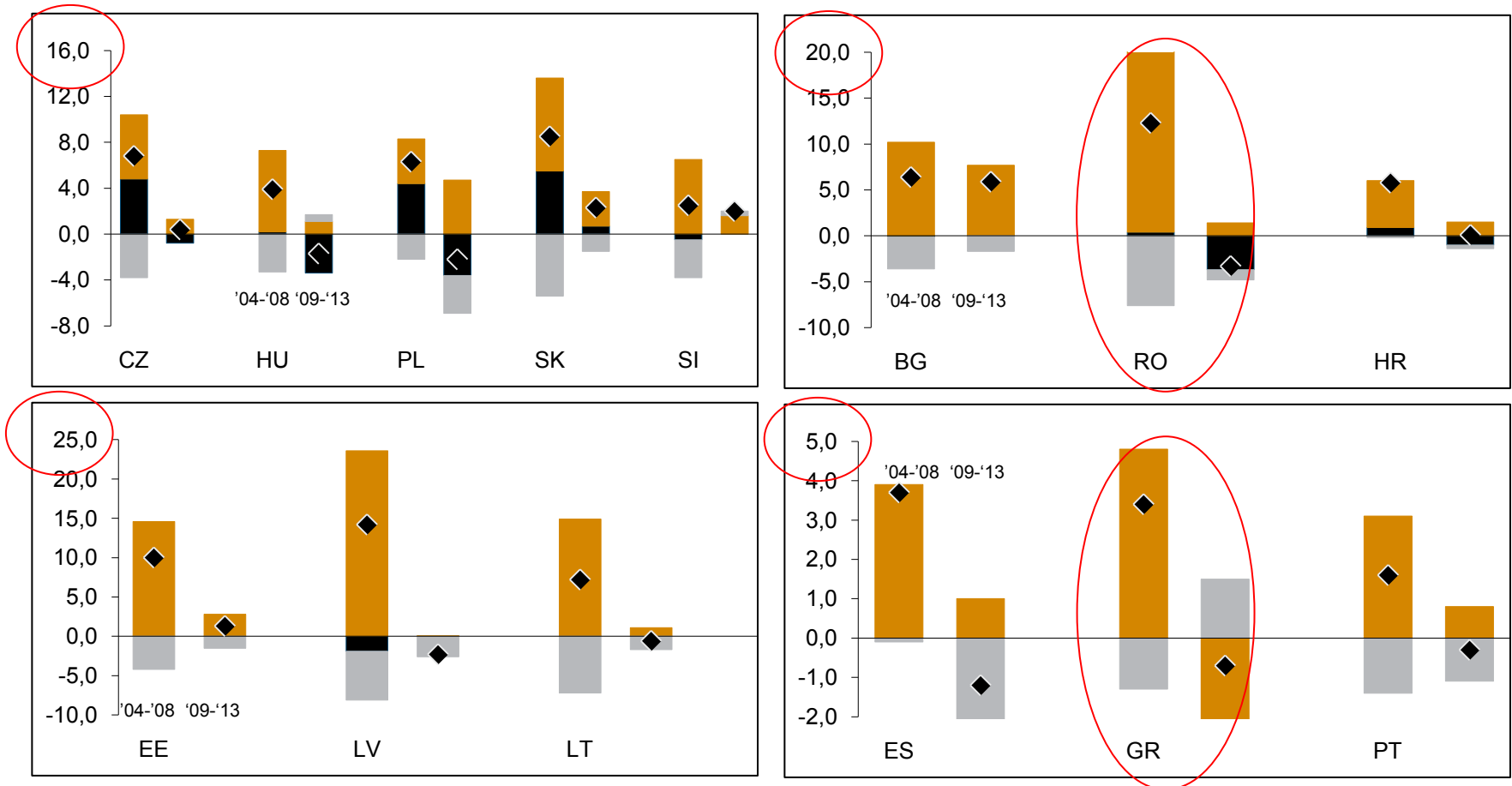
- Relationship between real exchange rates and external imbalances is not a trivial one
 - (i) Measurement issue: no quality adjustment of REER measures
 - (ii) Inverse causality? Improved trade performance causes REER to appreciate rather than the other way round
 - (iii) Levels of economic activity important determinants of external imbalances

- Let us move to the determinants of REER

Components of ULCs – Changes: 2004-2008, 2009-2013

Total economy – **What drives the development of ULCs?**

■ Exchange rate ■ Compensation per employee ■ Labour productivity ◆ ULC

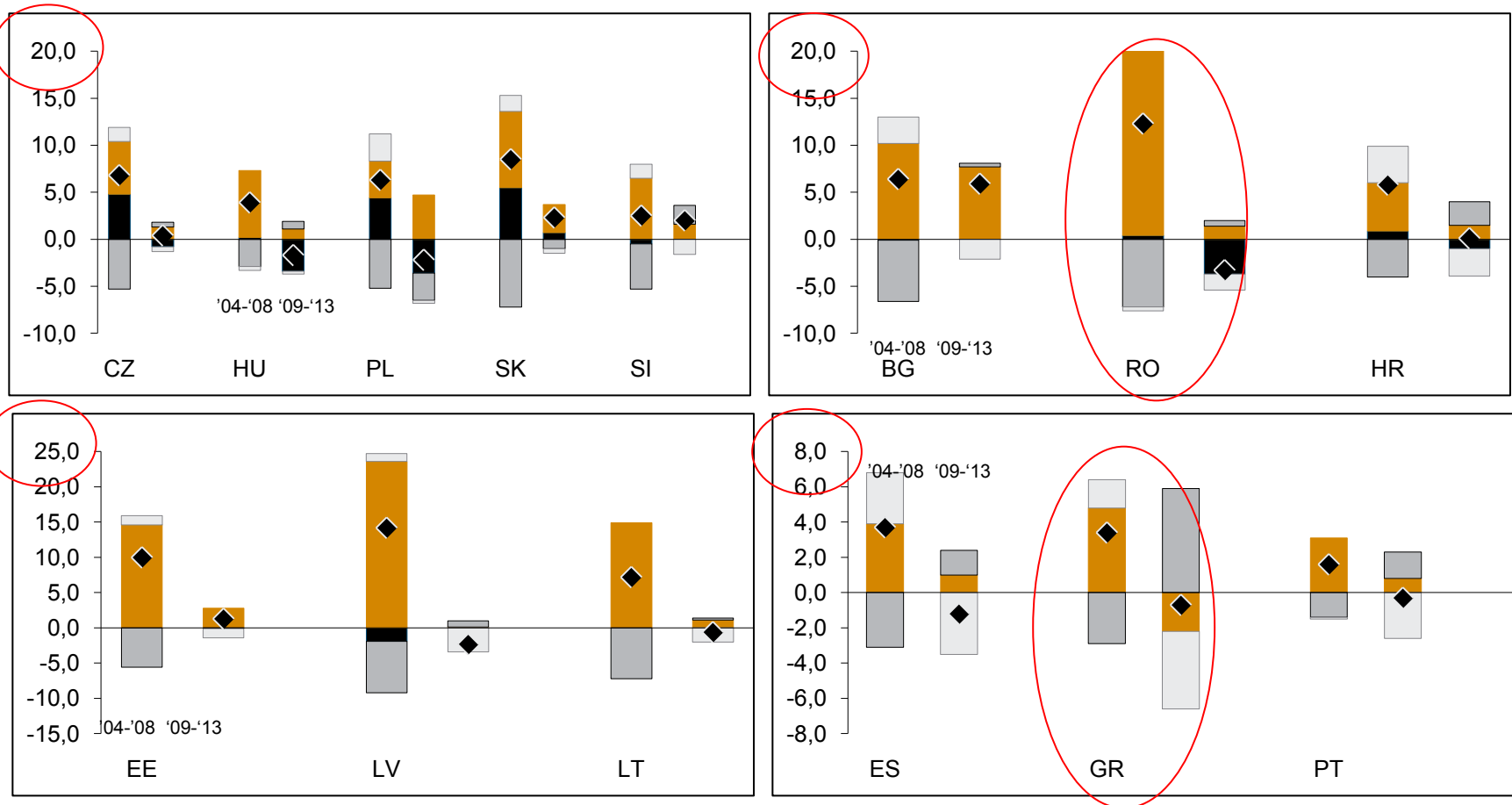


Source: wiiw Annual Database incorporating national and Eurostat statistics.

Components of ULCs – Changes: 2004-2008, 2009-2013

Total economy – **What about output and employment?**

■ Exchange rate ■ Compensation per employee ■ Output ■ Employment ◆ ULC



Source: wiiw Annual Database incorporating national and Eurostat statistics.

External imbalances in the European economy – Which are the fundamental forces at work?

- Determinants of longer-term trade/competitive performance:
 - (i) Move towards higher income elastic products
 - (ii) Sufficient export capacity
 - (iii) Diversified export structure to be less vulnerable to shocks

External imbalances in the European economy – **Policy issues**

- Simple **adjustment of real exchange rates is weak mechanism**; economic contraction during crisis might have counter-productive short-term and longer-term hysteretic impact
- In economies with ‘structural’ current account problems, **wider range of instruments needed**:
 - incentive structures to **attract FDI to tradable sector**;
 - **industrial policy instruments** to steer export activities towards dynamic comparative advantages and sufficient degree of diversification;
 - REER determined by **wage-productivity-skill dynamics**; incomes policy, as well as human capital and productivity-enhancing policies are integral part of real exchange rate policy
- **‘Structural’ current account problem is a long-run policy issue inside and outside of EMU**

Thanks for your attention !!!