



CROATIAN NATIONAL BANK

**Boosting EU competitiveness
Contribution to Growth - The Role of the
CESEE Countries**

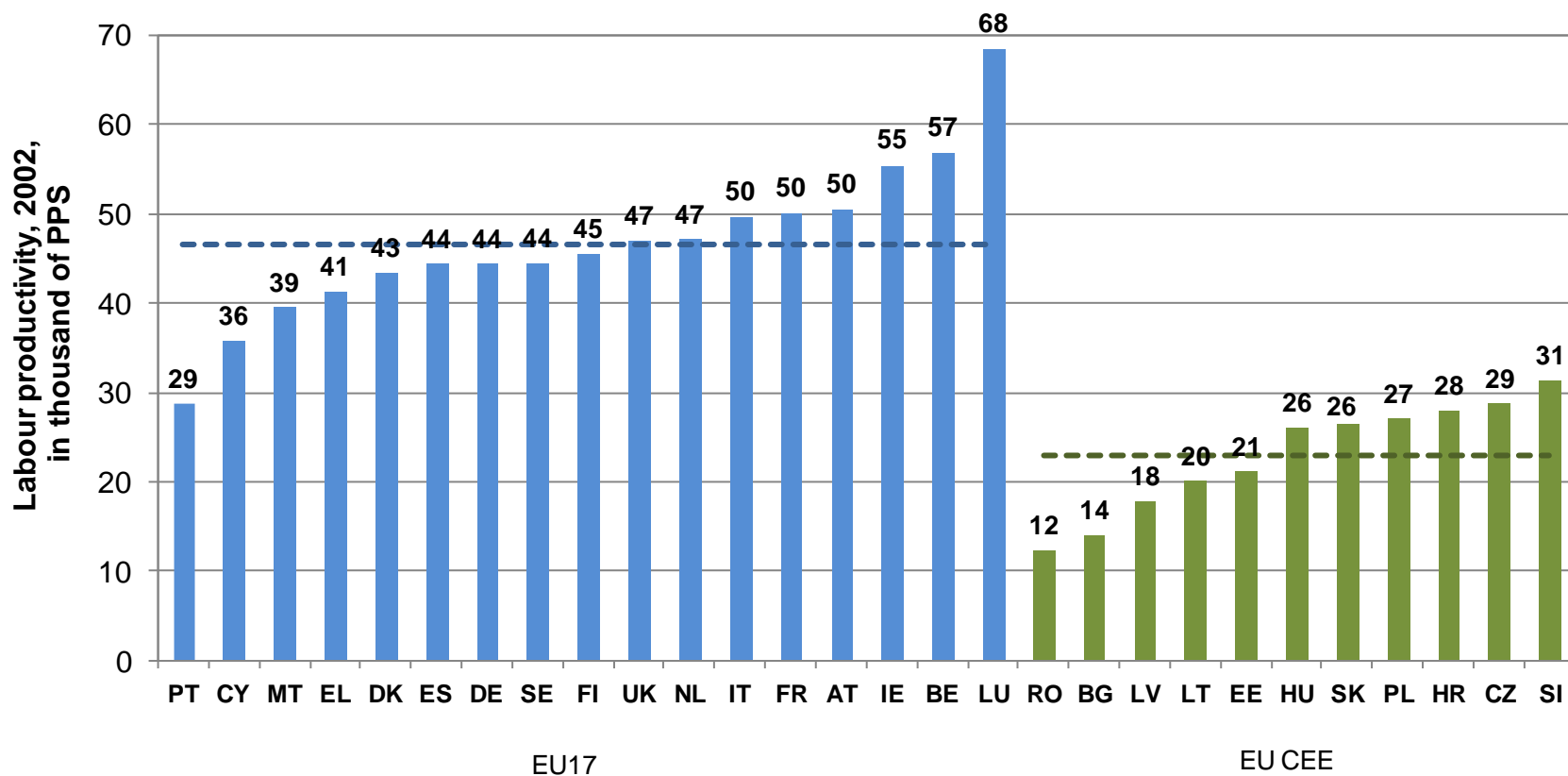
Joint NBP and OeNB Conference, 15-16 October 2015

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**Through the rapid catch-up, CEE has been
the key driver of growth in Europe**

Initial productivity levels in CEE were low

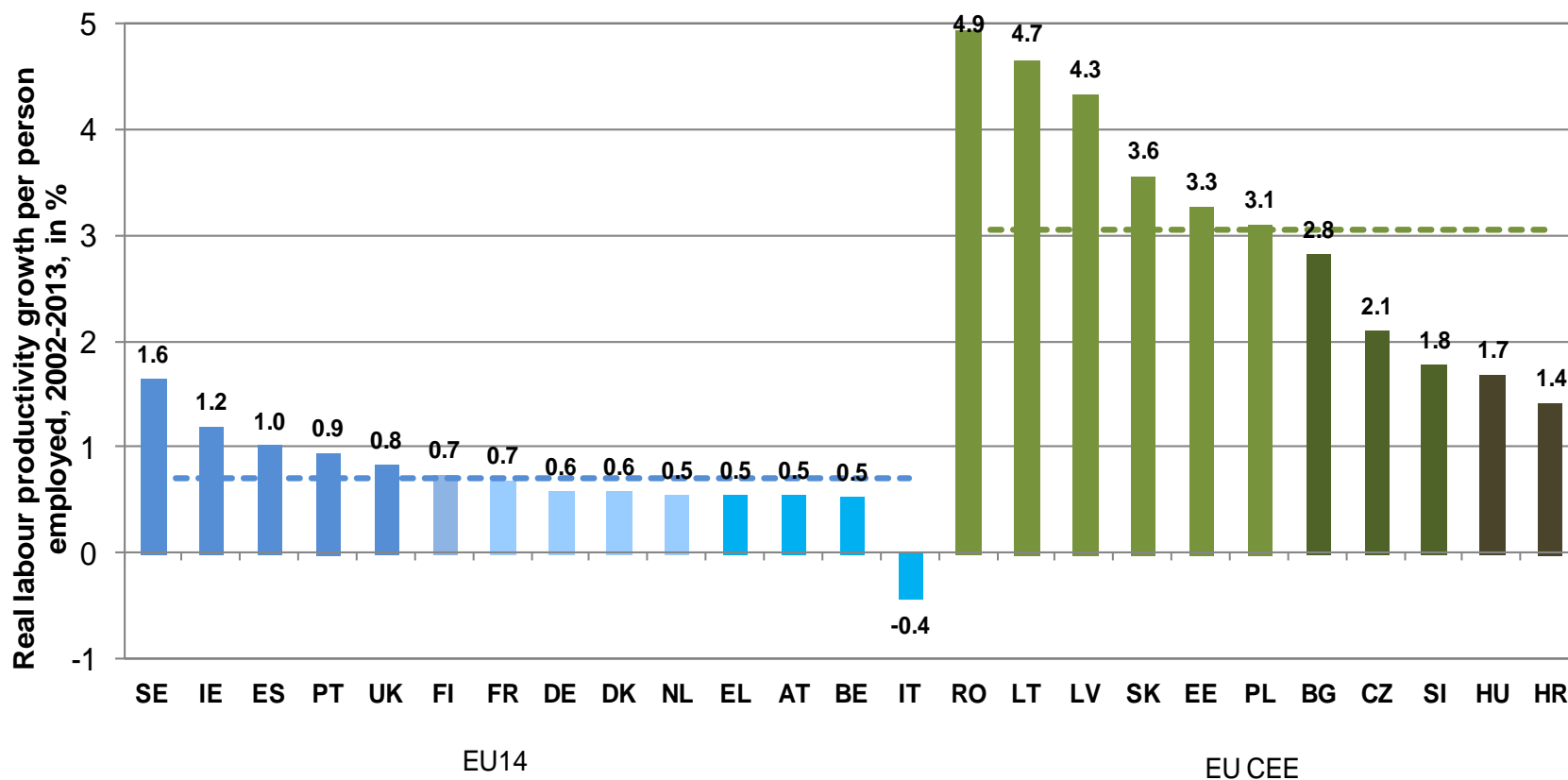
Labour productivity levels, 2002, in thousands of PPS



Source: Eurostat

...but catching up quick

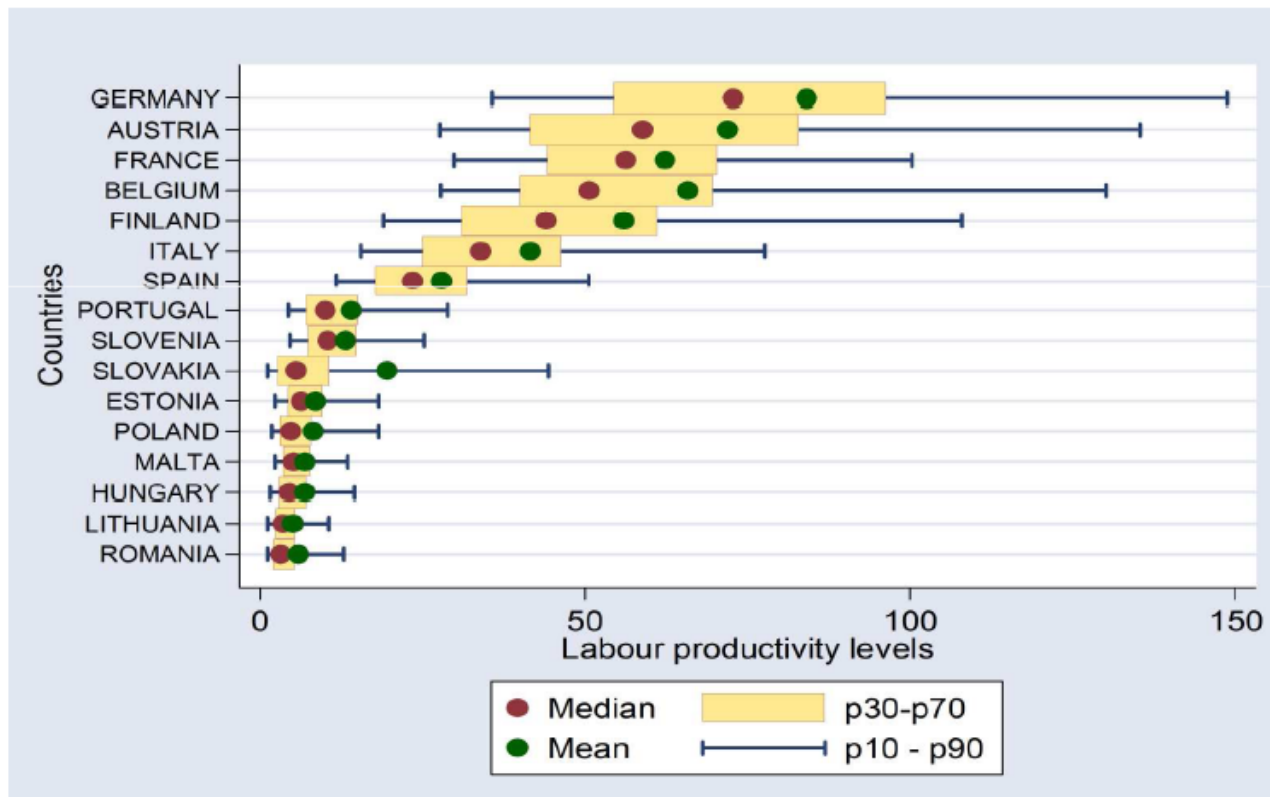
Labour productivity growth, 2002–13, average annual percentage change



Source: Eurostat

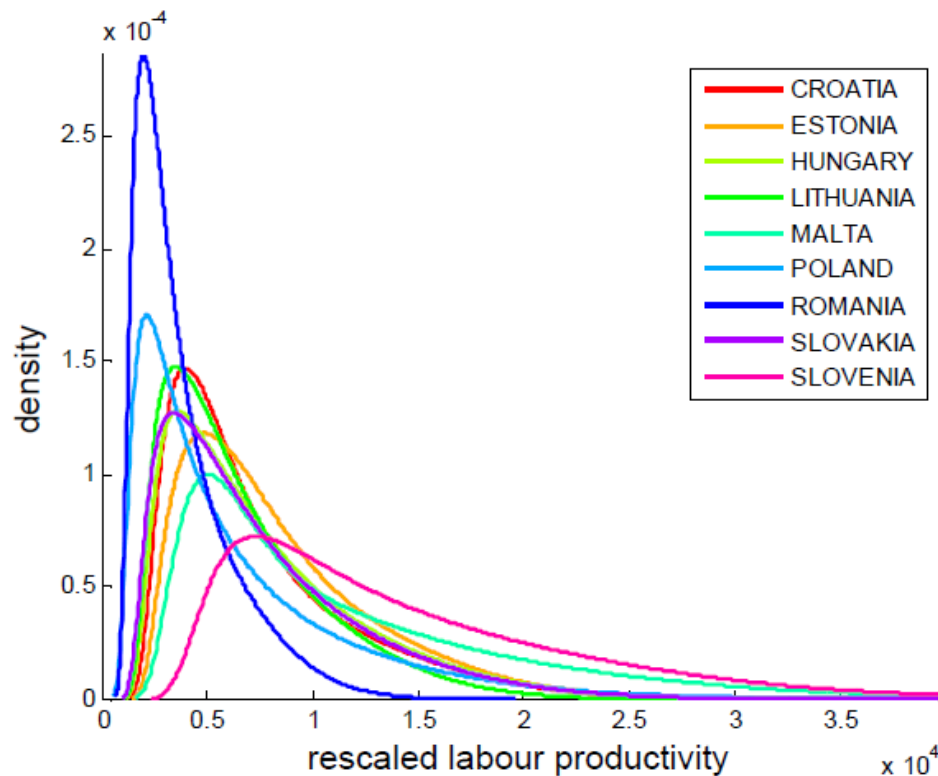
Missallocation of resources remains a potential issue in EU countries

Within-sector reallocation toward more productive firms can generate substantial aggregate productivity gains



Source: CompNet Task Force(2014), Micro-based evidence of EU competitiveness: the CompNet database, ECB WP N.1634

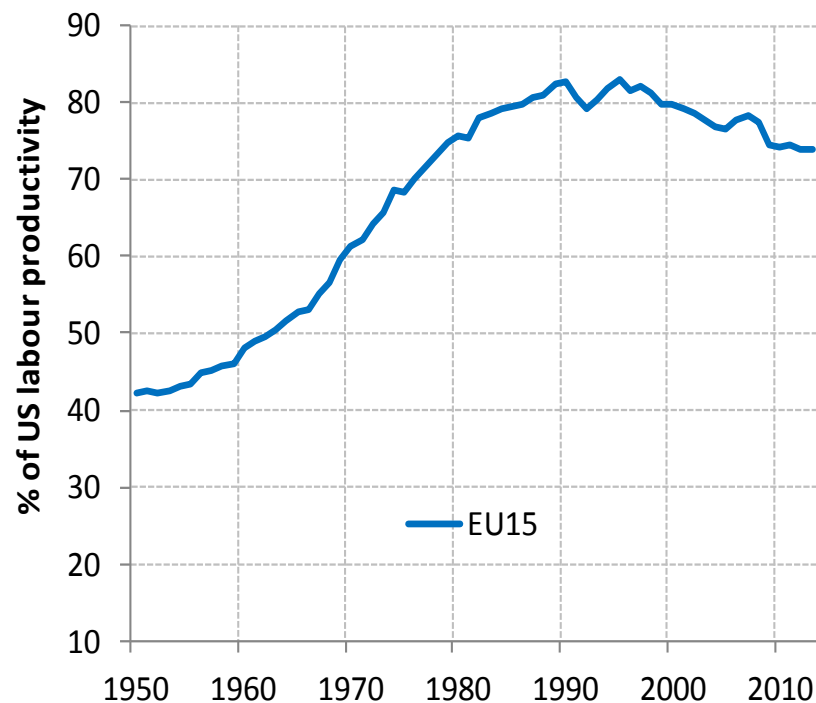
Furthermore, in CEE countries there is a large number of low productive firms and very few high productive firms



Source: Lopez-Garcia et al. (2015), Assessing European competitiveness: the new CompNet micro-based database, ECB WP N.1764

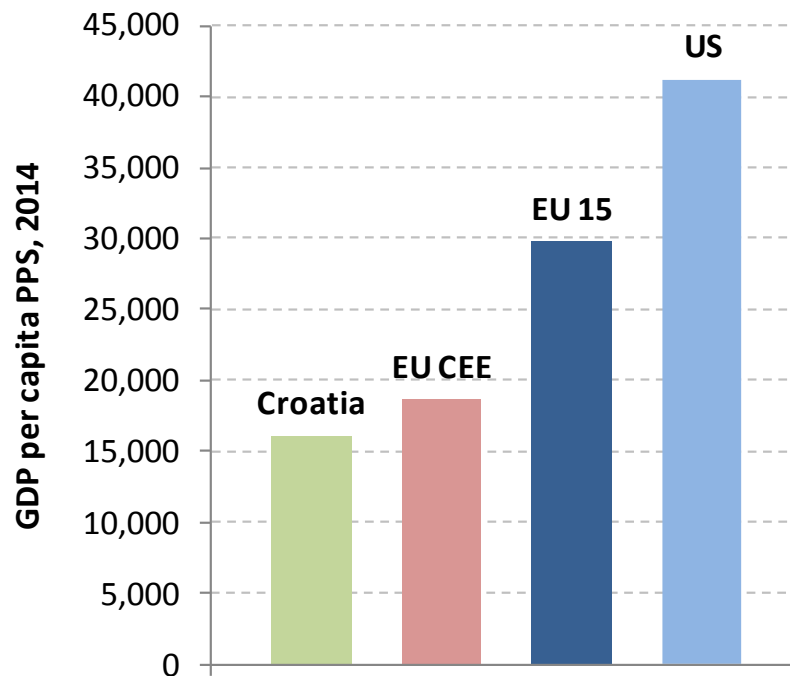
Where does EU stand compared to the US: Europe lagging behind

Europe's convergence to the US stopped in the 1990s



Note: GDP per hours worked in Geary/Khamis \$, U.S. = 100
Source: Total Economy Database, Conference Board (2014)

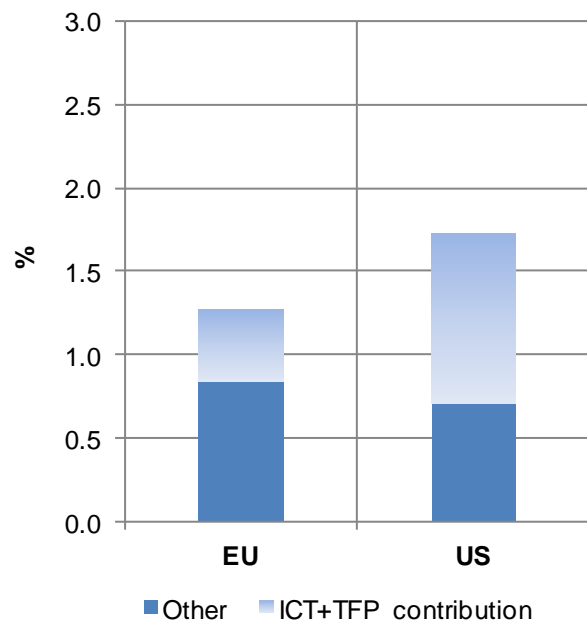
EU 15 GDP per capita standing at 2/3 of the US level



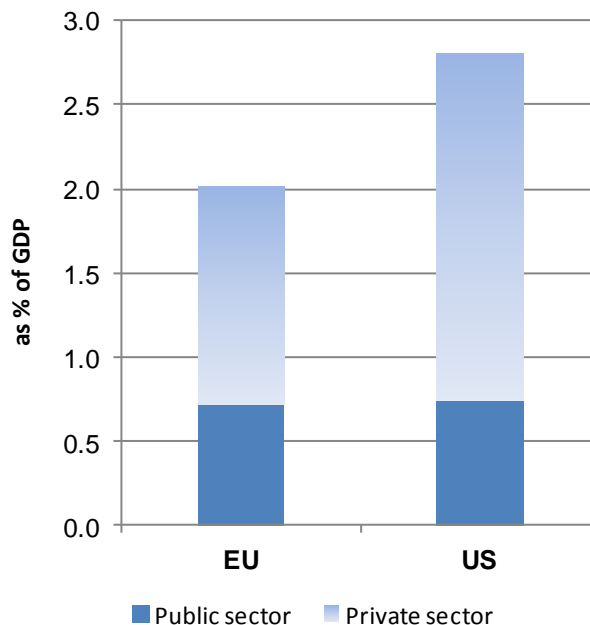
Source: Eurostat

ICT revolution explains some of the difference

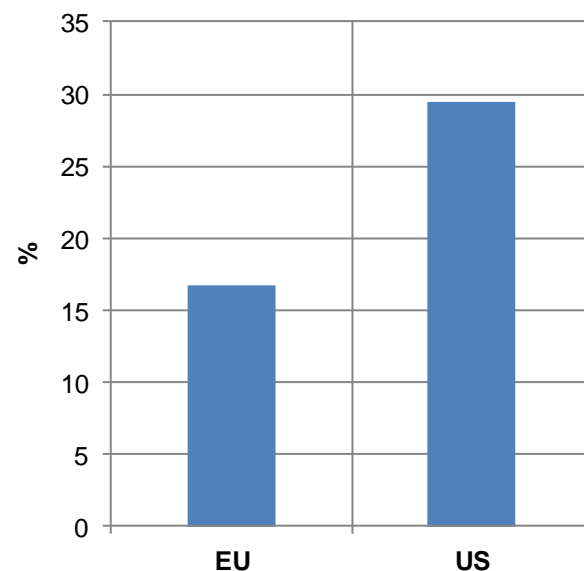
ICT and productivity growth, 2000-2013



Expenditure on R&D, 2011



Investment in ICT, % of total investment, average 2000-2010

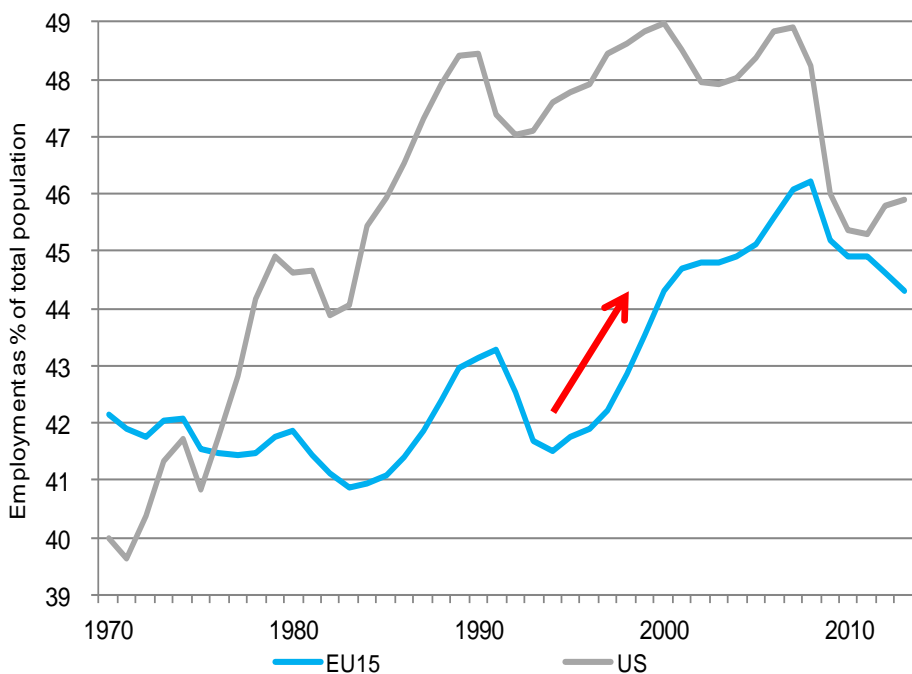


Note: ICT investment EU aggregate is an average of Austria, Denmark, Finland, France, Germany, Ireland, Italy, Netherlands, Spain, Sweden and United Kingdom

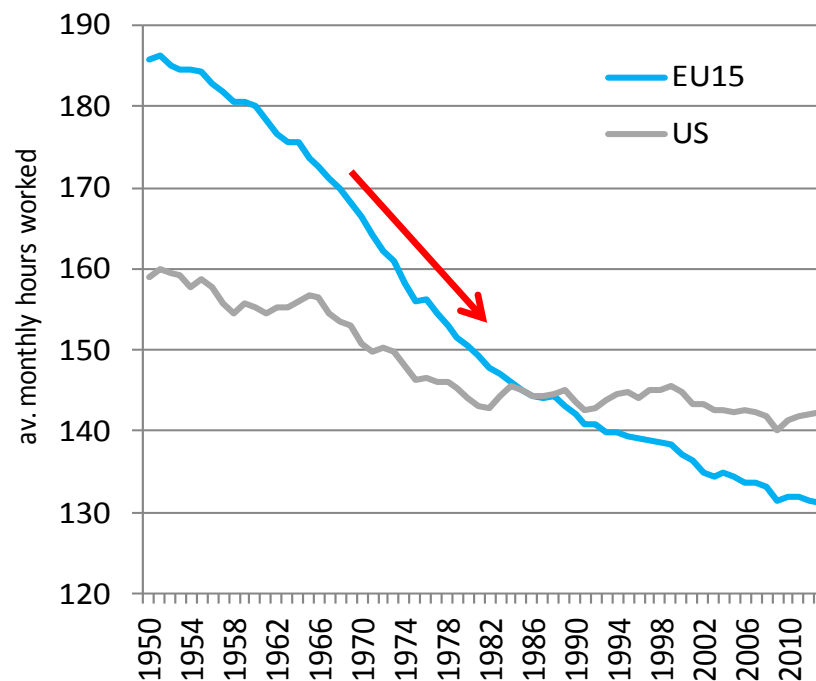
Sources: European Commission, OECD, van Ark

Other - labour market trends ...

Since mid-90s, increasing EU employment ...



... and shorter working hours in the EU



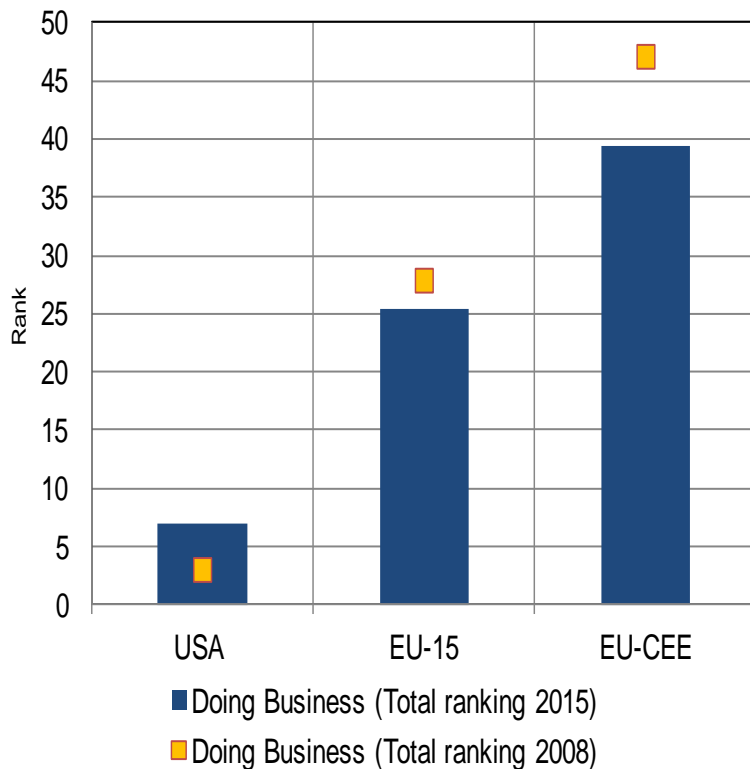
Source: Total Economy Database, Conference Board (2014), OECD

Note: Average monthly hours worked for EU 15 are weighted by GDP in Geary/Khamis \$, United States = 100

Source: Total Economy Database, Conference Board (2014).

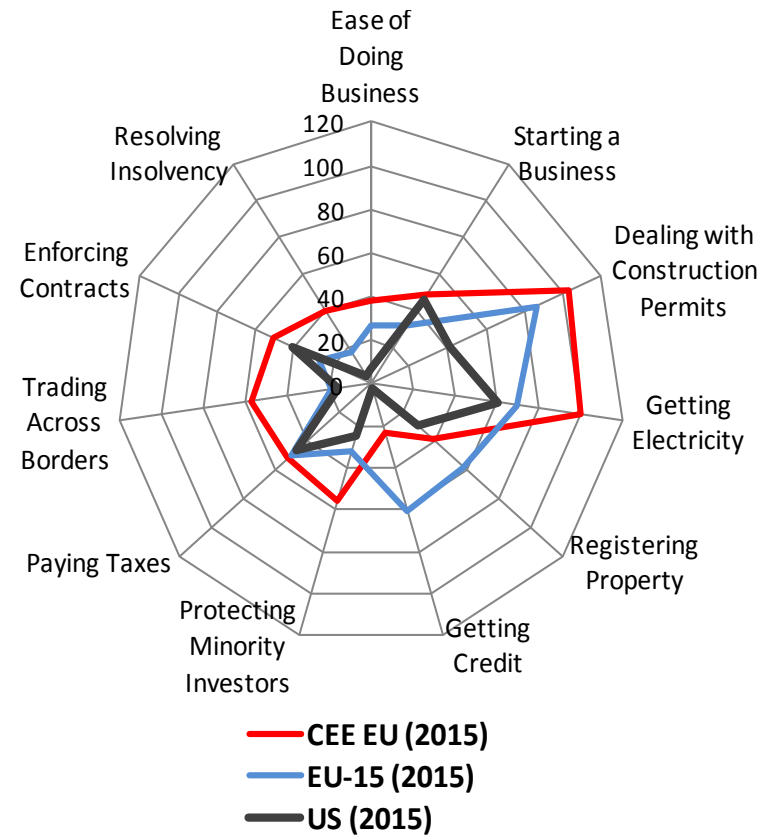
... and other institutional differences..still a significant catch up potential for the CEE

Doing Business



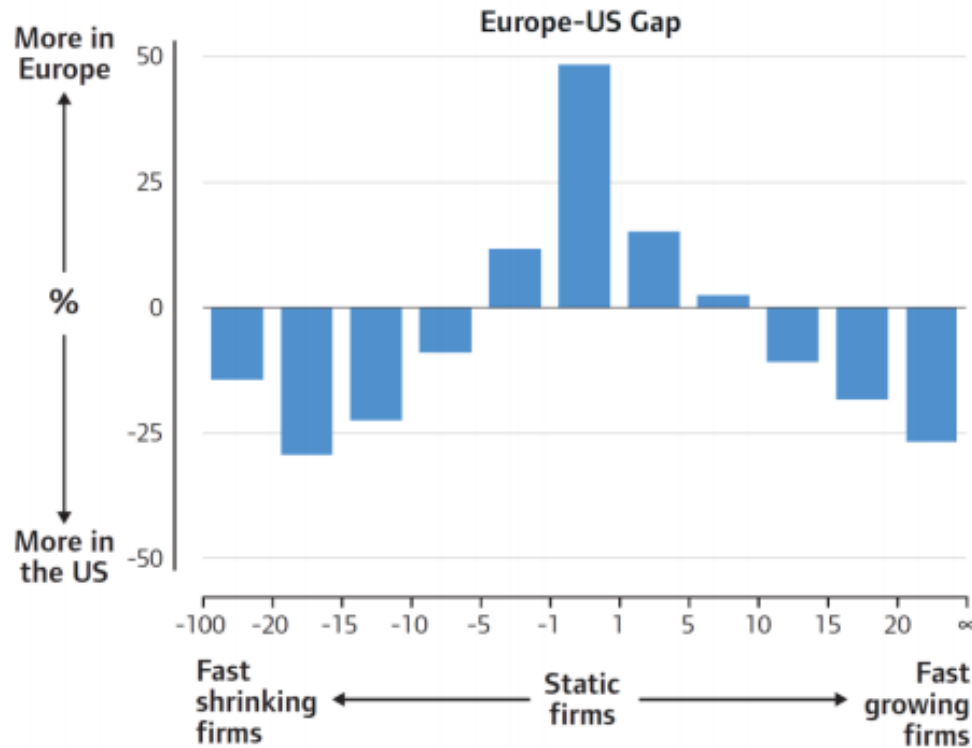
Note: EU-15 stands for average of "old" EU member countries.
Source: World Bank, Doing Business 2015 and 2008.

Doing Business - Components



Note: EU-15 stands for average of "old" EU member countries.
Source: World Bank, Doing Business 2015.

Europe is lagging in business dynamism ...

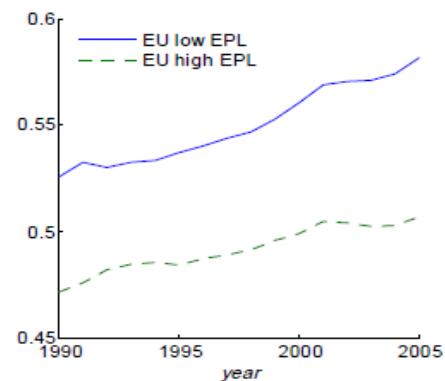
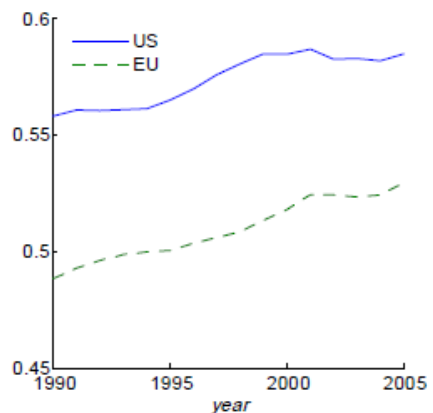


Source: Biosca, A. B., A look at business growth and contraction in Europe, 2011, 3rd European Conference on Corporate R&D and Innovation

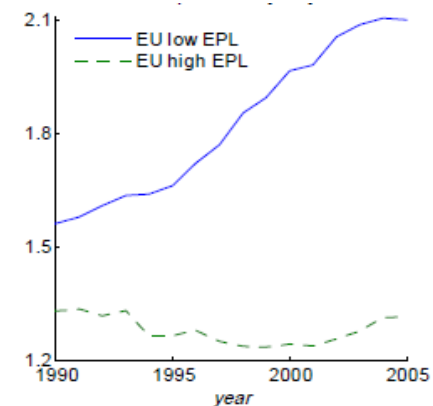
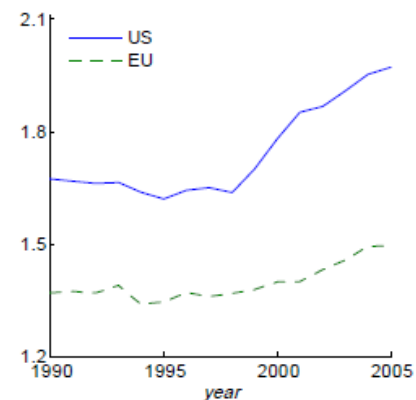
Why were firms like Facebook, Google and E-bay created in the US and not in EU?

Labour market institutions not conducive to adopt risky ICT investment decisions ...

Employment share in ICT intensive sectors



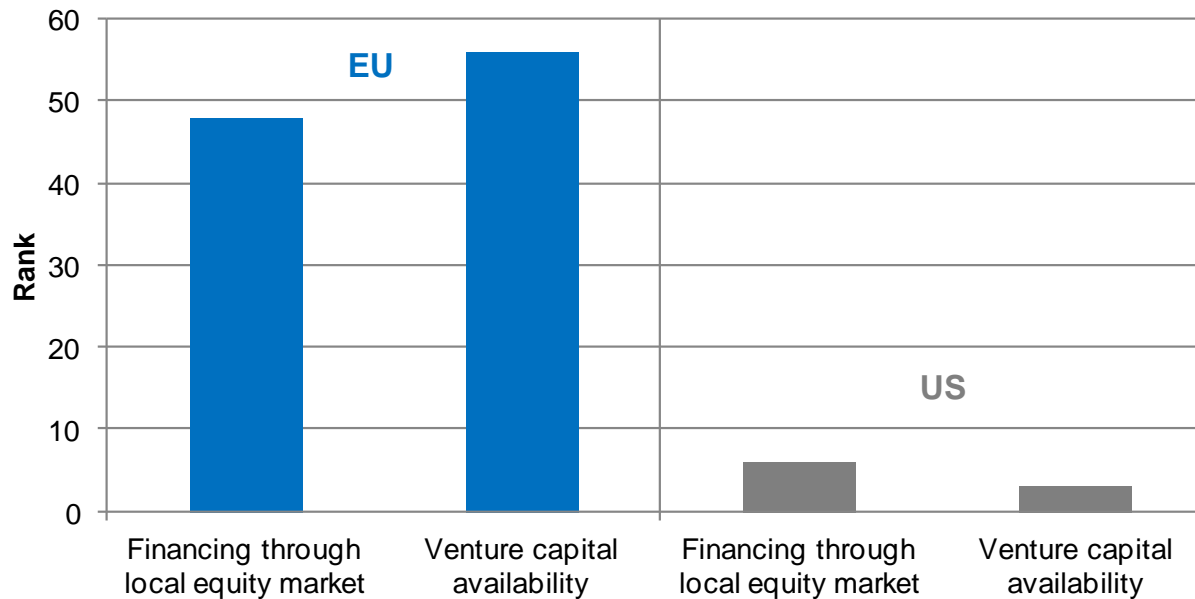
Labour productivity growth in ICT intensive sectors



Source: Bartelsman, Eric J, Pieter A Gautier, and Joris de Wind (2010), "Employment Protection, Technology Choice, and Worker Allocation", IZA DP No. 4895

Availability of non-bank financing needed to boost growth of young firms ...

Access to finance

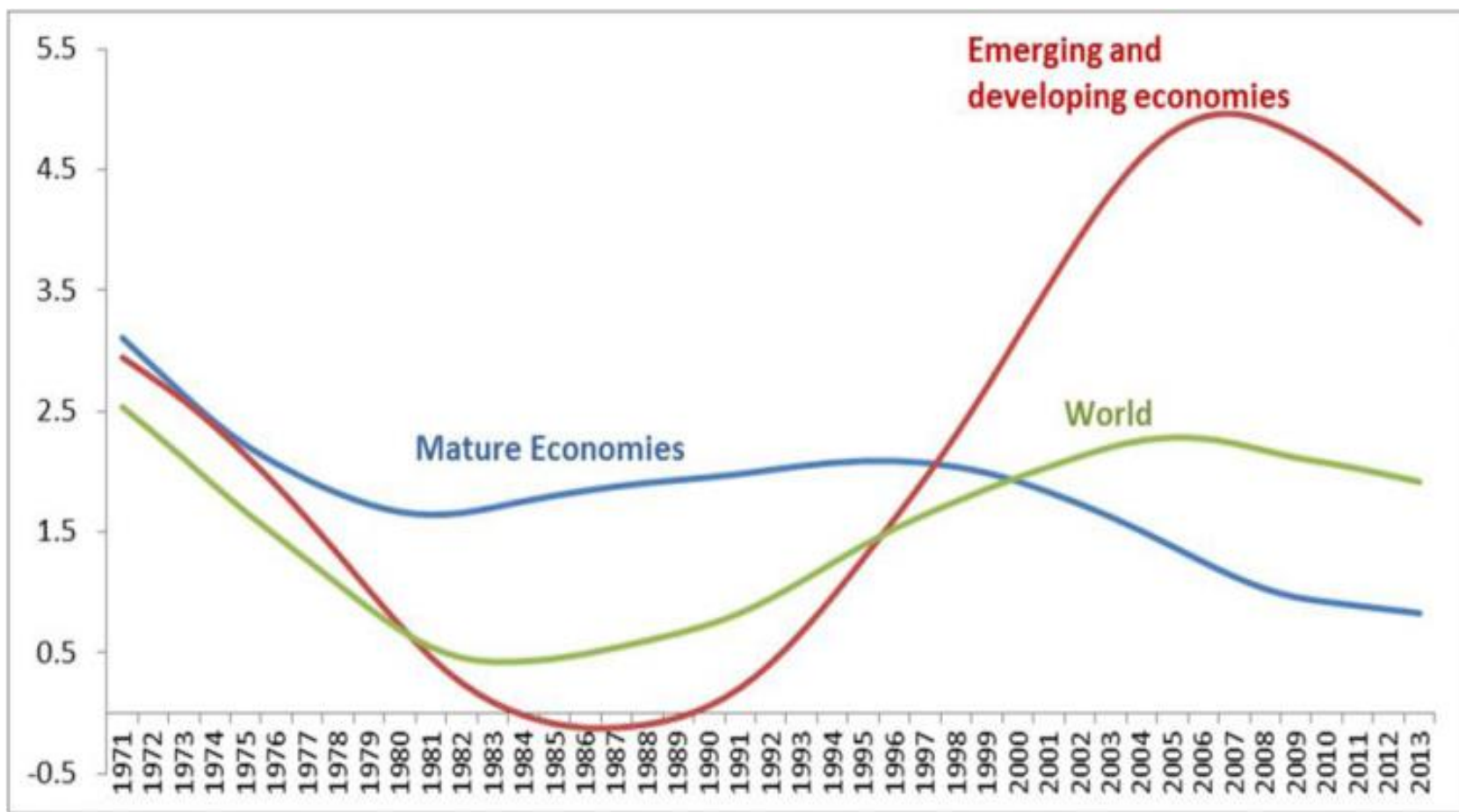


Note: EU is a GDP weighted average of EU28 country rankings

Source: Global Competitiveness Report 2014-2015

Going forward

... EMs revolution in productivity gains over the last 15 years has significantly increased competitive pressures..



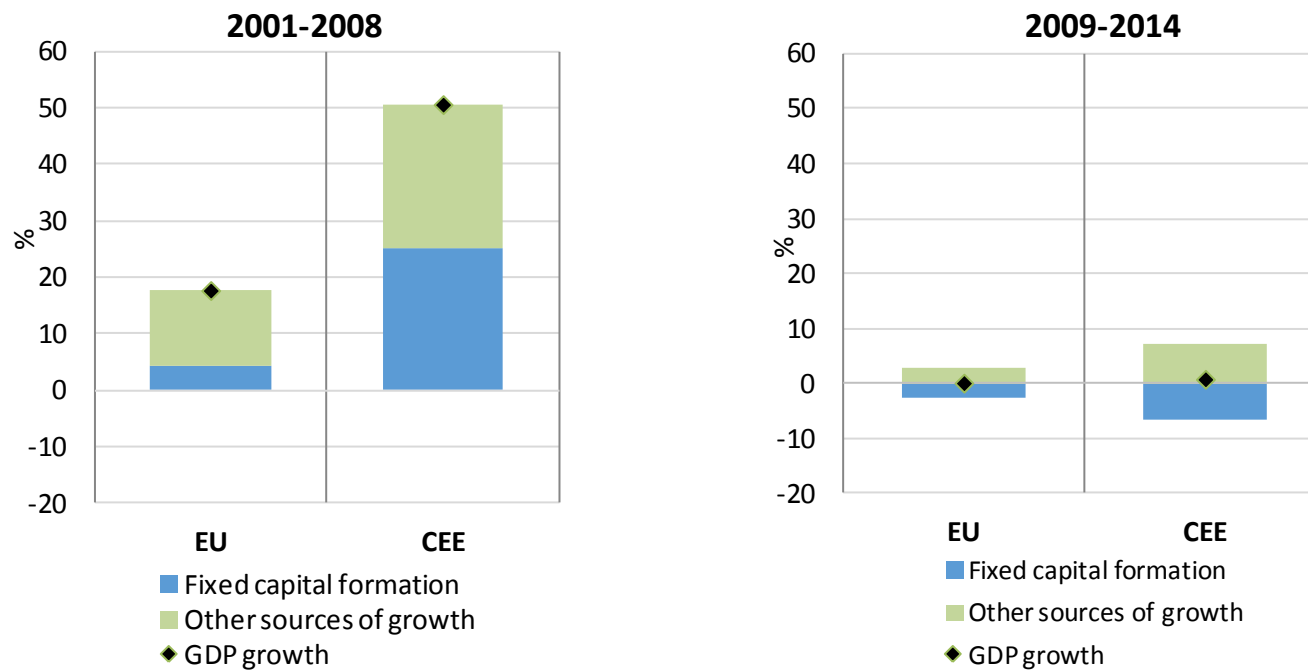
Source: The Conference Board.

..which might have had a number of consequences..

- Globalization and increased trade integration have reduced barriers to market access
- Globalization has led to the relocation of production → the relative price of tradable goods declines → their fall has contributed to lower overall inflation
- More intense global competition prevents firms from raising prices and puts downward pressures on wages in many sectors ;
- However, in the absence of wage flexibility and/or productivity response, labour market outcome, due to the relative increase in ULCs, leads to higher unemployment/public debt
- Globalization may have reduced the strength of the cyclical response of inflation to domestic output fluctuations
 - prices of many items that are produced or consumed at home are increasingly determined by foreign demand and supply factors rather than local factors.
 - financial integration allows for larger trade balance deficits or surpluses and, thereby, weakens the relationship between domestic output and demand

...crisis has brought an end to investment-driven growth model

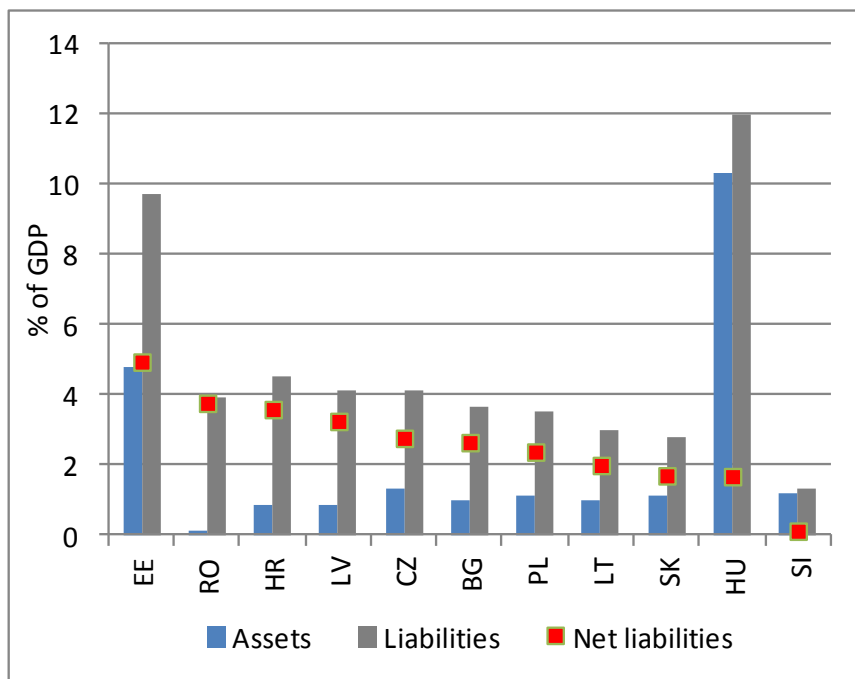
Investment contribution to GDP growth, %



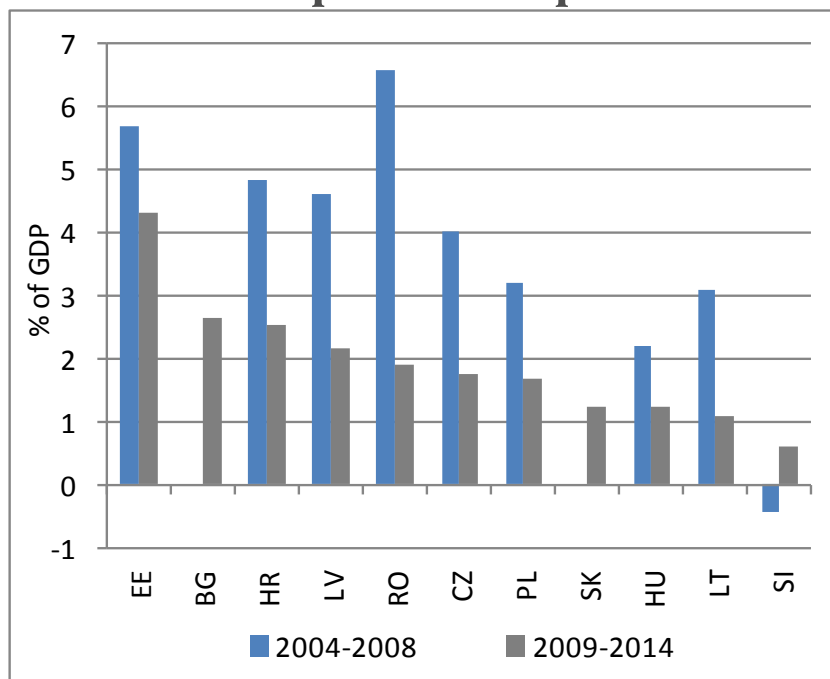
Source: Eurostat

...FDI inflows declined after the crisis...

Average in 2004 – 2014 period



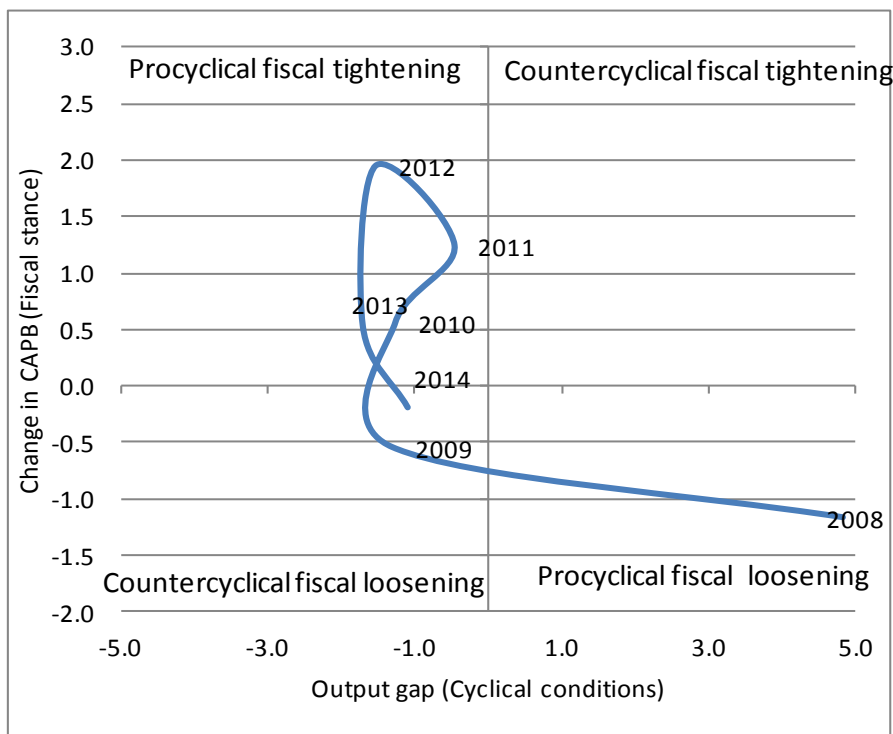
Net FDI, average in the pre-crisis and post-crisis period



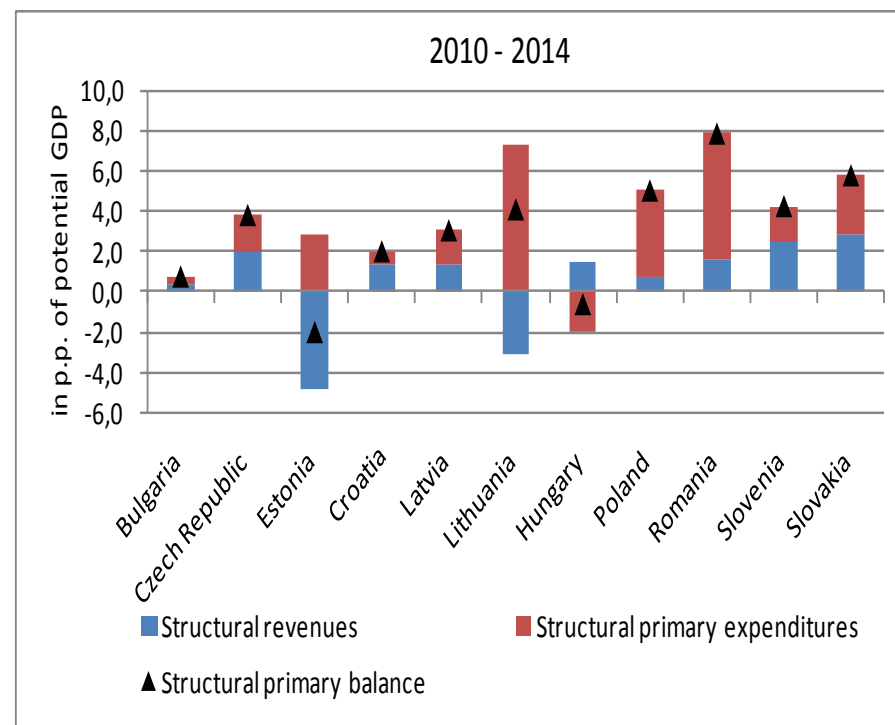
Note: Average values for Bulgaria are obtained using 2010-2014 data and for Slovakia using 2008-2014. Net liabilities are calculated as difference between liabilities and assets. Therefore, positive sign refers to net investment inflow.

Sources: Eurostat; HNB

Fiscal policies in EU CEE – contractionary since the wake of the crisis



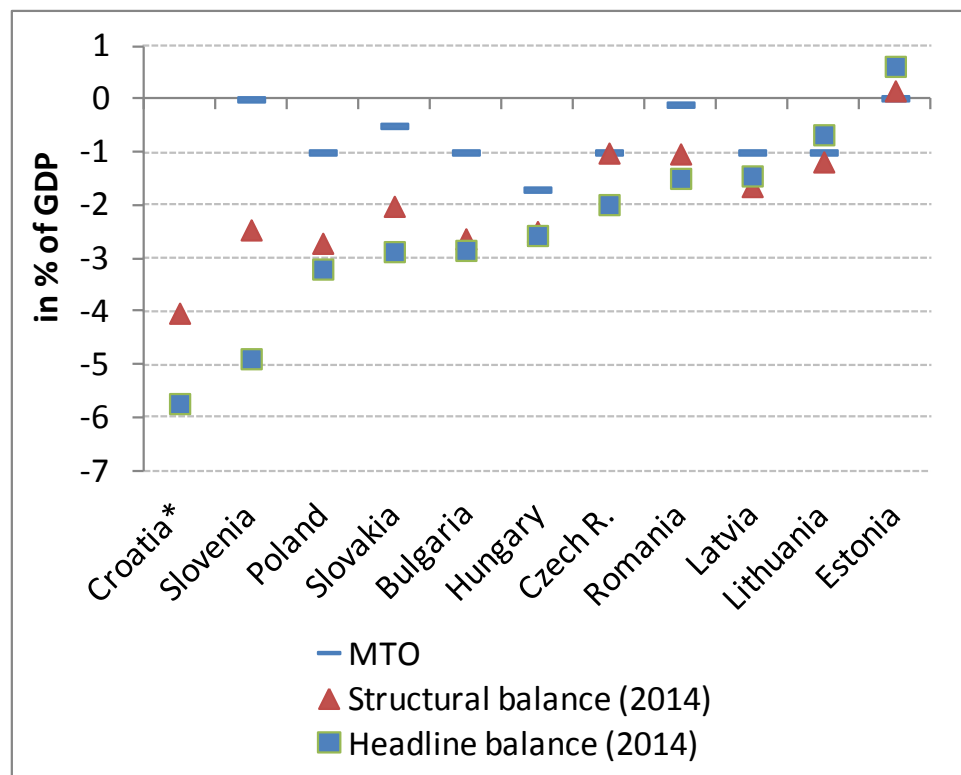
Note: Output gap and change in CAPB are computed as GDP-weighted averages of EU CEE countries. The impact of government assistance to the financial sector is excluded from the calculation of cyclically adjusted primary balance (CAPB). Sources: EC (AMECO database); CNB.



Note: One-off measures are not available for 2009. Sources: EC (AMECO database); CNB for Croatia.

Little or no space for fiscal stimulus

- ❑ Most countries have not yet reached their MTOs
- ❑ Still, growth could be supported through improvement of the quality of public finance
- ❑ **Investment rebound in CEE will have to rely on private sources**



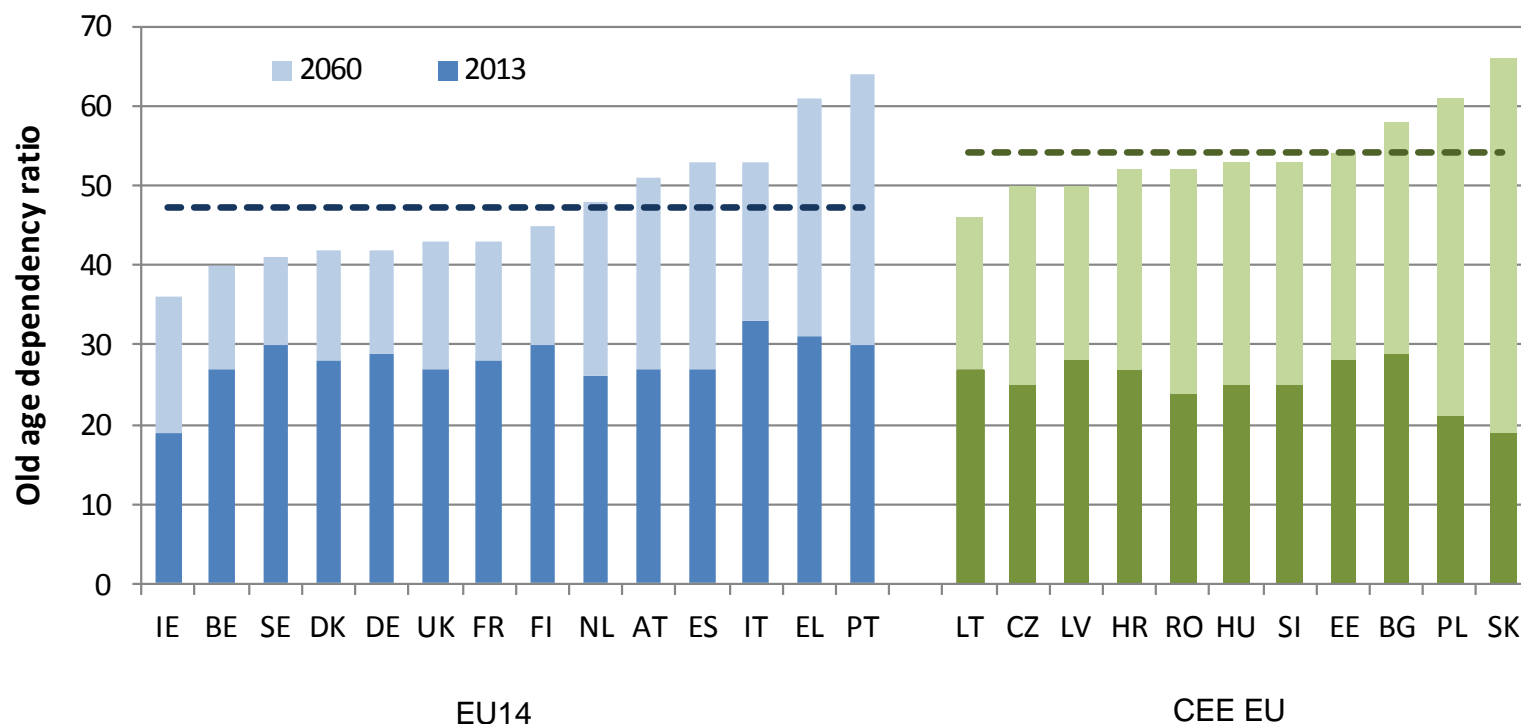
*MTO for Croatia has not yet been determined.

Sources: Eurostat; EC

Longer term issue - burden of old age pensions to grow rapidly, more in CEEs

Economic old-age dependency ratio (15-64)

= Inactive population aged 65+ as % of population aged 15-64



Source: Aging Report 2015.

Going forward what can be done to spur growth?

- ❑ Monetary and even plain fiscal policies do not seem to be an answer to current challenges
- ❑ Monetary might have already done enough, if not too much (getting out of the quantitative easing might prove to be much more difficult than getting in)
- ❑ There's little or no fiscal space in most of the countries, particularly given the monetary policy constraints to support cheap government financing in the long run
- ❑ Too long period of extremely low interest rates might become counterproductive, as it might induce more savings, rather than spending

So, the most promising, if not the only, path are the structural reforms

- ❑ Political economy problem: findings show that short-run effects of structural reforms are small.
- ❑ Albeit, significant economic gains emerge in the medium and long run.
- ❑ Great importance of product/services market reforms and labour market related education and tax reforms are some of the most promising areas of structural policy interventions.
- ❑ Adjustment speed to global changes is becoming a key issue
- ❑ What is the benchmark? And how politically acceptable it is?

Thank you!