Current economic challenges facing Central and Eastern Europe

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• Common features of the countries in the Central and Eastern European region
• Some differences among the countries under review
• Main challenges for the region
Region: Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Czech Rep., Estonia, Hungary, Kosovo, Latvia, Lithuania, FYR Macedonia, Montenegro, Poland, Romania, Serbia, Slovakia, Slovenia

Total population: 120.6 mil. (Poland: 40 mil., Romania: 19.6 mil., … Montenegro: 0.6 mil.)
Region: similarities among countries

- All these countries had to shed the burden of a communist dictatorship and a system of (more or less strict) central planning based on predominant state ownership

- After the fall of communism, all these countries embarked on a journey towards Western-style democracy and market economy

- The main goal of all these countries was EU (or euro area) and NATO membership

- The economic transition took about two decades; often a strenuous and very complex process with varying results (different “national” factors)

Despite the difficulties of the transition period, all countries in the region have recorded convergence towards the economic core of the euro area
Average growth rates 1995–2017

(GDP at market prices; y-o-y change in %)

Source: Eurostat, own computation


All these countries have grown faster than Germany over the long run and some even substantially faster
The ratio of the region’s GDP to that of EMU-12 has risen by 2 pp over the last decade.
Main factors of growth over long run

• Introduction of market economy, re-birth of private property and emergence of competition
• Trade openness
• Foreign direct investment lured by:
  • cheap (but relatively educated and qualified) labour
  • improving economic conditions (especially after joining EU)
  • geopolitical stability (entry to NATO)
• Intra-industry links (participation in global value chains)
• Inflow of EU structural funds
• Advancement of democratic institutions and rule of law
• Exchange rate fixation (EMU members) ⇒ replacement of exchange rate risks ⇒ trade gains

EU (and EMU) entry helped to boost economic growth and convergence vis-à-vis advanced economies
Some differences among the countries under review
Different patterns of institutional integration with Europe: while EMU members are most integrated, Kosovo is least
GDP per capita varies significantly across the region: it ranges between 29 in Albania and 89 in the Czech Republic.
### Competitiveness

**Overall ranking**

<table>
<thead>
<tr>
<th>Country</th>
<th>Rank</th>
</tr>
</thead>
<tbody>
<tr>
<td>Estonia</td>
<td>29</td>
</tr>
<tr>
<td>Czech Republic</td>
<td>31</td>
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<tr>
<td>Poland</td>
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<td>Hungary</td>
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<td>Romania</td>
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<tr>
<td>Croatia</td>
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<td>Albania</td>
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<tr>
<td>Montenegro</td>
<td>77</td>
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<tr>
<td>Serbia</td>
<td>78</td>
</tr>
<tr>
<td>Bosnia and Hercegovina</td>
<td>103</td>
</tr>
</tbody>
</table>

**Total number of countries: 137**

**12 pillars of competitiveness:**

- Institutions
- Infrastructure
- Macroeconomic environment
- Health and primary education
- Higher education and training
- Goods market efficiency
- Labour market efficiency
- Financial market development
- Technological readiness
- Market size
- Business sophistication
- Innovation

Source: Global Competitiveness Report 2017–2018; World Economic Forum

Baltic and Central European countries are typically ranked higher than countries of former Yugoslavia and Albania.
While some new EU members are doing better than some old EU members, several former Yugoslav countries are ranked between Turkey and Ukraine.
Students’ performance in science, reading and mathematics – PISA results 2015

<table>
<thead>
<tr>
<th>Performance in:</th>
<th>Science</th>
<th>Reading</th>
<th>Mathematics</th>
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</thead>
<tbody>
<tr>
<td>OECD average</td>
<td>493</td>
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<td>490</td>
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<tr>
<td>Estonia</td>
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<td>Montenegro</td>
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<tr>
<td>FYR Macedonia</td>
<td>384</td>
<td>352</td>
<td>371</td>
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<tr>
<td>Kosovo</td>
<td>378</td>
<td>347</td>
<td>362</td>
</tr>
</tbody>
</table>

- 540,000 students
- … representing about 29 mil. 15-year-olds
- 72 participating countries

While Estonia is the best performer, Kosovo is a laggard

Source: OECD
A worrisome long-run decline in population in the Baltic countries and in some countries of South-Eastern Europe
Main challenges for the region
Main challenges

The above-mentioned differences between countries imply the following main challenges:

- To improve education and enhance competitiveness especially South-Eastern Europe
- To lessen the scope of corruption especially former Yugoslavia (except Slovenia), Albania, Bulgaria, Hungary, Romania
- To avoid shrinking of population and reverse brain drain especially Baltic countries, Bosna and Hercegovina, Bulgaria, Romania

Nevertheless, there are also other challenges:

- To mitigate excessive dependence on the automotive industry especially Czech Republic and Slovakia
- To escape the „middle-income trap“ whole region

The less advanced countries of the region are challenged to follow their more advanced neighbours, who in turn are challenged to catch up with the EU’s best performers
The share of car production in CZ (and SK) is very high compared to many other EU countries (except Germany) ⇒ the economy is vulnerable in case of an asymmetric shock.
The concept of “middle-income trap“ is ambiguous
It claims that middle-income countries can be squeezed between higher-tech and lower-wage rivals on either side
Rich countries need advanced technologies and skills to offset high wages and poor countries need low wages to offset low levels of technology and skill
There are at least four possible sources of GDP growth:
  - Moving workers from overmanned fields to more productive factories (e.g. structural transformation in Polish agriculture)
  - Adding more capital per worker (capital deepening)
  - Augmenting capital or labour by making it more productive
  - Technological innovation (new products or services)

Challenge: to switch from middle-wage, middle-skill economies to higher-tech and knowledge-driven ones; in other words to upgrade in global value chains towards high-value-added stages (design, marketing, sale services rather than just production)
The average annual wage in Austria is about double that in most countries of the region except Slovenia; low wages $\Rightarrow$ reallocation of production from Germany

Source: OECD
The Czech Republic is a bit of an outlier: while its GDP per capita is higher than that of Slovenia and Poland, its wages are lower; this justifies the rather robust wage growth which we are currently observing.
Despite common history, the region is rather heterogeneous:

- While the more advanced countries are already well integrated to the EU, the less advanced countries are still pre-occupied with better geopolitical and economic anchoring in Europe and to „Western values“ (democracy, transparency, rule of law)
- There are also sizeable differences in terms of GDP per capita

Main challenges (especially for the less advanced countries):

- Improving education
- Enhancing competitiveness
- Reducing corruption
- Preventing brain drain
- Avoiding shrinkage of population
- Upgrading in global value chains, mitigating over-specialisation

With the benefit of hindsight: the transformation of some countries proved to be a success story (especially the Baltic countries)
Thank you for your attention

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