Ewald Nowotny: European integration in a global economic setting – CESEE, China and Russia

Opening remarks by Prof Dr Ewald Nowotny, Governor of the Central Bank of the Republic of Austria, at the Conference on European Economic Integration (CEEI) 2011: “European Integration in a Global Economic Setting – CESEE, China and Russia”, Vienna, 21 November 2011.

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Good morning, ladies and gentlemen,

It is a great pleasure for me to welcome you to the Conference on European Economic Integration 2011 on “European Integration in a Global Economic Setting – CESEE, China and Russia”. A particularly warm welcome goes to Governor Erkki Liikanen from Suomen Pankki – Finlands Bank and to all the representatives of the Finnish central bank who have joined us here in Vienna for the conference. Moreover, I am pleased to welcome, for the first time, all our viewers at Suomen Pankki who are watching a live webcast of the CEEI on screen in Helsinki.

In the history of the CEEI, this is a very special year. While there has been international cooperation in organizing the CEEI in the past, for example with the ECB or the IMF, this is the first CEEI we have jointly organized with a Eurosystem NCB – the Finnish central bank. Moreover, this is the first time we have extended the conference topic to include new economic areas – China and Russia.

Of course, there are several very good reasons both for this cooperation and for broadening the conference topic.

Some of you may know that the OeNB focuses its economic analysis and research on Central, Eastern and Southeastern Europe (CESEE), mainly because of Austria’s strong historical and economic links to the region. Similarly, Suomen Pankki – or more specifically the BOFIT, the Bank of Finland Institute for Transition Economies – has a regional research focus, namely on Russia and China, thus covering two of the most interesting and promising emerging markets of the world. Given this year’s conference topic, it was therefore only logical to invite our Finnish friends to organize the CEEI 2011 with us – and we were very pleased that they accepted our invitation and supported us with their valuable expertise.

For two decades, this conference series has been devoted to spreading and deepening the knowledge of European economic integration with a particular emphasis on CESEE economies in transition. Yet we decided to expand our focus this time. Of course, you might think that dealing with the CESEE region alone would provide topics for at least a dozen further conferences. Definitely, we would not run out of interesting CESEE-related topics, especially as the countries in this region are so different and there are so many aspects to look at: different stages in the catching-up process, different stages of EU integration, different stages of monetary deepening, etc.

At the same time, however, this country-by-country approach contains a certain risk: the risk of overlooking fundamental economic developments that take place elsewhere and might affect the CESEE region as a whole. Developments in Russia, and even more so in China, seem to fall into this category. Given their huge size and market potential alone, it is quite obvious that economic developments in these two countries would have an impact on the CESEE region. In turn, the CESEE region as a whole – and the euro area as well – may well have an impact on Russia and China, too.

So to be able to see – and understand – European integration in a wider context of global economic developments, expanding the focus of the CEEI 2011 to include two major emerging economies was not only an obvious, but also a highly necessary step.

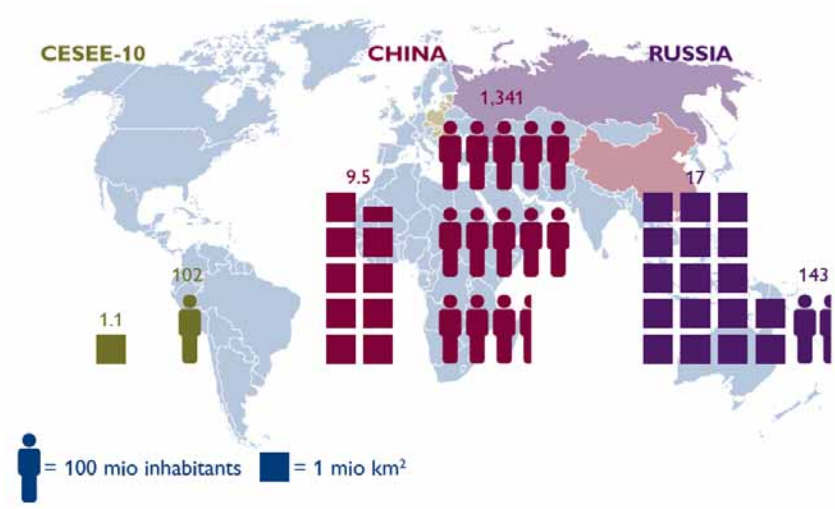
During the next two days, we will investigate the economic impact of China and Russia as emerging global economic players on the catching-up process in CESEE. In doing so, we will try to answer questions such as: Does competition from the two large and growing emerging market economies constitute a drawback for CESEE? Or do opportunities prevail?

Let me briefly address these questions by first comparing some key indicators for the three economic areas in question and then looking more closely at the economic impact of China and Russia on CESEE.

Although we all have an idea about the actual size of these areas, let us look at the figures.

Chart 1:

Country size and population in 2010

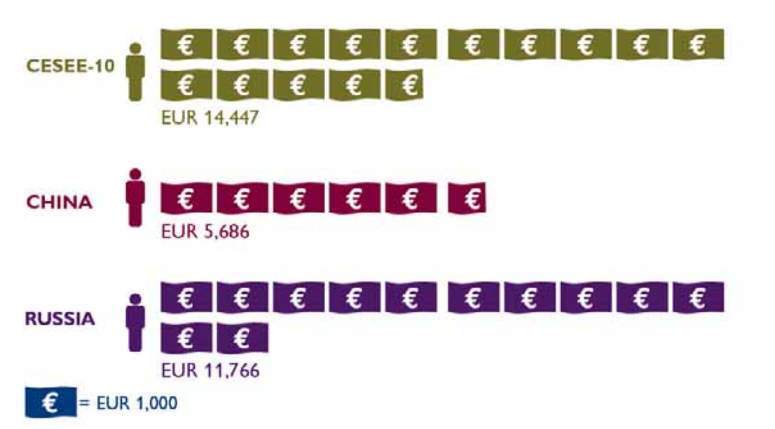


Source: OeNB calculations based on IMF data.

On this chart, we can see at first glance that the CESEE-10 – that is the group of CESEE EU Member States – are very small in terms of population and landmass compared to China and Russia. China stands out with its large population (almost 20% of world population) – which means, of course, that the country's workforce is enormous.

Chart 2:

GDP per capita in 2010



Source: OeNB calculations based on IMF data.

Note: Figures in purchasing power standards. CESEE-10 figures are GDP-weighted averages.

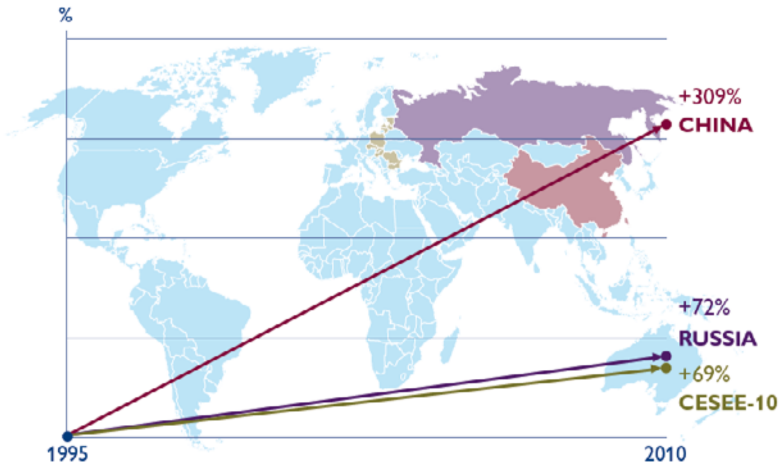
Turning to GDP per capita, we see a different picture. While the CESEE-10 cover a comparatively small area, in 2010 their GDP per capita in purchasing power standards was on average almost three times higher than that of China. As you can see, the income level in Russia was close to the GDP-weighted average in the CESEE-10. But does this mean that CESEE (and Russia) can lean back?

No, on the contrary: China's impressive growth path over the past 15 years constitutes a challenge to all other economies, including CESEE and Russia. Data on GDP growth show that China stands out with a remarkable real GDP growth of 309% over the period from 1995 to 2010. China had chosen a highly controlled opening-up strategy. The Chinese growth model relies upon a large pool of domestic savings and investment (which, to a large extent, comes from abroad), lower labor costs and thus labor-intensive exports.

By contrast, in CESEE and Russia, central planning was overthrown in the late 1980s and early 1990s, when a major shift in economic, political, cultural and sociological paradigms occurred in these countries. Russia's growth model has, to a large extent, rested on industrial production and, increasingly, on energy exports. In the CESEE-10, by contrast, capital inflows – mainly from Western Europe – together with institutional reforms and EU accession have spurred export-led growth. Even if CESEE and Russia started out from higher GDP per capita levels than China, their growth performance has still been remarkable. The financial crisis, however, has challenged the current growth models not only in these regions.

Chart 3:

Real GDP growth



Source: OeNB calculations based on IMF data.

Note: 1995=100.

While China has weathered the financial crisis quite well,[1] CESEE and Russia were directly hit.[2] Despite these differences, all three markets face common challenges both in the real economy and on the financial market, such as rising external imbalances and decelerating

1 Despite a decline in real GDP growth against precrisis levels, China nevertheless recorded positive annual growth rates of between 9% and 10.5% over the period from 2009 to 2010 (IMF). Most recently, however, real GDP growth slowed down again from 9.5% in the second quarter to 9.1% in the third quarter of 2011.

2 In 2009, GDP growth turned negative at –3.8% on average in CESEE and –7.8% in Russia.

external demand for goods, particularly in the face of downward-revised GDP growth forecasts in many export destinations.

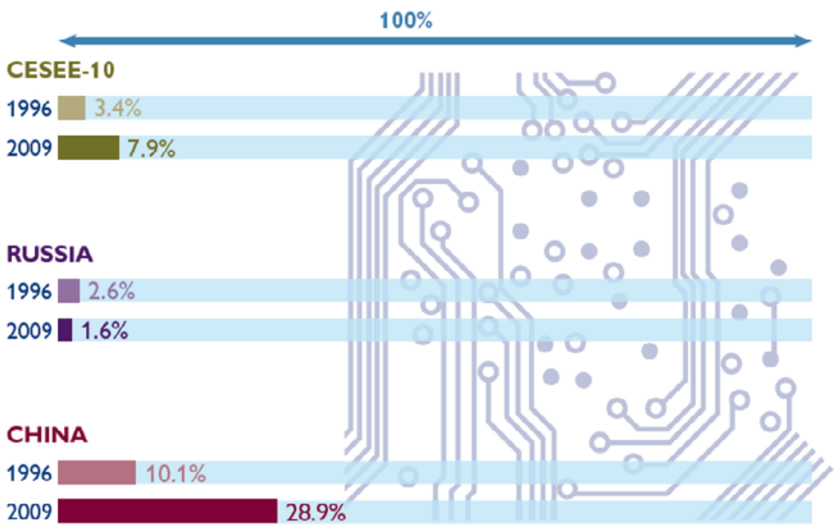
Tomorrow, we will have the opportunity to look at possibilities of how to achieve a sustainable catching-up process in these emerging market economies. In this context, let me just point out that the speed of growth and the quality of institutional and economic adjustment will determine who will be the leading economy in 20 to 30 years.

Against this backdrop, let me now briefly discuss the economic impact China and Russia might have on CESEE. In doing so, I will mainly focus on trade, FDI and financial interlinkages.

A closer look at the trade performance of the CESEE-10, China and Russia over the past 15 years shows that the CESEE-10 have doubled their share in world exports,[3] while Russia's market share has increased only slightly – and has, to a large extent, been driven by the increase in world energy prices. China is expanding its role as an exporter not only of traditional labor-intensive products, but also of high-tech goods.

Chart 4:

Share of high-tech exports in total exports



Source: OeNB calculations based on IMF and World Bank data.

Note: CESEE-10 exports include intra-CESEE-10 trade.

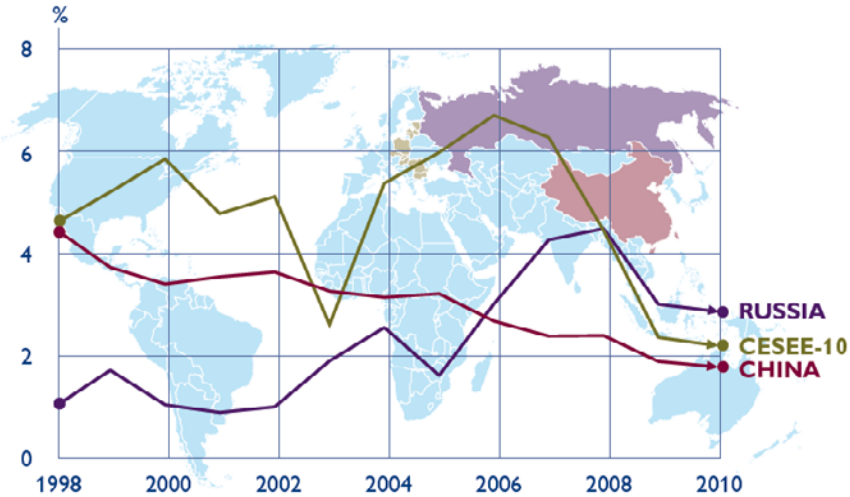
On the one hand, internationally operating firms have relocated the final production stage not only of labor-intensive goods, but also of high-tech products from industrial countries, other Asian tiger economies and possibly CESEE to China. On the other hand, not only this relocation but also the production or final assembly of new technology-intensive products in China accounts for this strong rise in China's export market share.

Whether this development will cause CESEE export market shares to decrease largely depends on whether the CESEE countries compete in similar product categories that have the same export destinations. This afternoon, we will discuss this question and related aspects at greater length.

[3] CESEE doubled its market share from 1.9% in 1995 to 3.9% in 2010.

Chart 5:

Annual FDI inflows in % of GDP



Source: OeNB calculations based on UNCTAD, IMF and national statistical offices data.

Note: CESEE-10 figures are GDP-weighted averages.

Let us now turn to a key term in this discussion: foreign direct investment (FDI). Particularly in CESEE and in China, increasing openness to FDI has contributed largely to growth performance. Many empirical analyses have provided evidence on the relationship between FDI and growth. However, not only the fact that capital inflows take place, but in particular the way this capital is put to use plays a major role in achieving sustainable convergence.[4] Direct FDI linkages between CESEE, China and Russia are very small in terms of volume.[5] Our business panel discussion in the late afternoon will give us an opportunity to examine FDI from a practitioner's perspective.

At this point, let me draw a first conclusion. The relocation of production sites, catching-up in technology-intensive production and dynamic export growth in general are challenges to any economy. At the same time, they can be seen as opportunities to adapt institutional settings to promote sustainable, growth-enhancing development in the home markets. In this sense, the emergence of China and Russia as global economic players offers clear opportunities. China and Russia can become attractive target markets for exports – from CESEE as well as from other regions. Not only is China expanding its role as a supplier of goods, but both China and Russia increasingly demand final products from abroad. Although the EU-15 remain the major trading partner for CESEE, the region should make active use of China's and Russia's growing demand for imported goods – particularly in the light of the recent economic and financial crisis. Russia's forthcoming accession to the WTO will open new possibilities to strengthen the linkages in the real economy via FDI and trade and to foster financial linkages as well.

So far, the financial ties between Russia and CESEE have been closer than those between China and CESEE. Chinese banks have started to invest in CESEE only recently. Moreover, China's increasing investment in several sectors in Europe proves that the financial linkages between these two economic areas will gain importance in the future.

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4 See e.g. Firdmuc, J. and M. Reiner (2011). FDI, Trade and Growth in CESEE Countries. In: Focus on European Economic Integration Q1/2011. OenB.

5 China's stock of FDI in CESEE is very small and has been decreasing since 2000.

In this context, I may add that only two weeks ago the OeNB and the People's Bank of China took a further step in strengthening their excellent long-lasting contacts by signing an important agreement that enables the OeNB to invest in Renminbi-denominated assets via the Chinese central bank.

Ladies and gentlemen,

I have tried to present a snapshot of recent economic developments of – and interlinkages between – CESEE, China and Russia. Of course, the relations among these three markets have to be seen in a much broader context of international policy cooperation and coordination, such as the efforts by the G-20 to rebalance their economies. We also know that it will be necessary to find solutions for pressing problems at the European level in order to maintain financial stability and regain fiscal strength.

But this is not enough.

It is about time to adopt a broader perspective. And we will do so at this year's CEEI, which is dedicated to European integration in a global economic setting. Governor Liikanen and I are looking forward to a fruitful exchange of views and ideas with academics, policymakers and financial experts and, of course, with the audience.

Ladies and gentlemen,

It is now a great pleasure for me to welcome, once again, Governor Erkki Liikanen from Suomen Pankki, who – if I may say that much – will also have a special announcement to make (*CEEI 2012 in Helsinki*). Erkki, the floor is yours.