

Ardian Fullani: China-Europe economy – future challenges and opportunities

Address by Mr Ardian Fullani, Governor of the Bank of Albania, at the China-Europe Economists Symposium on “China-Europe economy – future challenges and opportunities”, Tirana, 17 January 2013.

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Dear Mr. Chairman,

Dear Colleagues,

Ladies and Gentlemen,

It is a great pleasure for me to participate in this Symposium. The rapidly evolving economic landscape of the past few years poses to policy-makers a demanding set of challenges and opportunities. I am sure that the honest and productive exchange of ideas will facilitate a deeper understanding of the problems we are facing and will allow us to design more appropriate strategies for overcoming them.

Introduction

Our topics of discussion today focus on the performance and prospects of China and Europe, the two economic regions which probably are at the opposite ends of the spectrum of contagion from the global crisis. While China has remained largely unaffected, Europe has suffered significantly. The crisis exposed fundamental structural and institutional weaknesses in the Eurozone and the EU.

In my short address, I will concentrate on the current state of Europe's economic and financial situation. It would be almost an understatement to define the past, the current and the expected developments in the Europe, as difficult and short-term. The so-called “Great Depression” tested the Eurozone and the European economy. EU convergence process proved to be incomplete, from economic and institutional point of view. From a longer term perspective, the process of globalization and the adverse demographic trends have challenged the sustainability of the economic and social systems of the EU. In spite of these problems, I remain firmly convinced that Europe will continue to be a dynamic and prosperous region in the future. The short term costs of structural reforms will be far outweighed by their targeted long-term gains. A more competitive and integrated Europe, underpinned by stronger institutions and governed by more sustainable economic and financial policies, will benefit the whole global economy. The remaining part of my speech will address these points in more detail.

Europe through the crisis

Europe has been one of the worst hit regions from the global crisis. The initial impact of the subprime market crash in the US was felt across the European financial sector, with stock markets plummeting and banks facing huge losses on their balance sheets. The resulting decrease in asset prices and the drying up of bank credit, the decline in global trade activity as well as the collapse of business and consumer confidence, were immediately reflected in a widespread recession during the 2008–2009 period, followed by a period of uncertain and slow growth. Unemployment shot upwards while fiscal balances deteriorated rapidly. The decline of the economic activity fed into further uncertainty in the financial sector, originating a negative feed-back loop which became difficult to overcome in the presence of private sector deleverage, widespread risk aversion and public finance constraints.

Most of the aforementioned features were shared with other economies, such as US and Japan. The balance sheet recession they describe remains tractable, at least in theory, with a combination of short term economic stimulus, long term commitment to macroeconomic stability, structural reforms, and patience. However, there have been several idiosyncratic issues which set the European experience apart from the other economies. They were manifested into severe public sector problems in several Eurozone countries, widespread lack of trust in institutions and authorities, and the strengthening of centrifugal forces which risked breaking the euro apart.

What were the factors that exacerbated the crisis in the Eurozone? While an exhaustive list would be long, I would like to highlight three of them.

- *First*, the inter-dependence between sovereign credit rating, financial sector risk premia and the real economy was exacerbated by incomplete financial market integration. While the region as a whole suffered from capital outflows, financial integration within EU went in reverse during the past four years. The repatriation of cross-border financial flows created further problems in the Eurozone economies and neighboring region. In fact, the subsequent cross-border deleveraging and de-risking has been one of the main crisis propagation channels that has affected eastern European countries, Albania included.
- *Second*, the divergence in intra-regional economic policies resulted in a divergence of competitiveness within the EU and Eurozone. This accentuated existing intra-regional balance of payments issues during the crisis, highlighting the need for long overdue economic and fiscal reforms.
- *Third*, the absence of a fiscal union has meant that the policy response has been lacking, especially in the presence of a monetary policy dealing with the zero lower bound of interest rates. Furthermore, doubts about the long term fiscal position of certain Eurozone countries, such as Greece, Ireland, Italy, Portugal and Spain, increased to unsustainable levels their sovereign risk premia and their public and private sector borrowing costs.

What has been the policy response within the EU?

The EU crisis management policy aimed to contain and overcome its effects, but, to a large extent, it has been conditioned by some of the constraints I mentioned before.

Monetary policy took the lead in providing countercyclical stimulus to the economy, with the ECB rapidly lowering its policy rate and injecting huge amounts of short and long term liquidity. Lastly, the announcement in September of the Outright Monetary Transactions by the ECB has been a turning point in regaining the trust of the financial markets.

On the other hand, given the lack of space for stimulating fiscal policies, the public sector has been more interested in controlling long-term public debt trajectories, subtracting rather than adding to economic stimulus. To this end, the agreed fiscal compact and macroeconomic surveillance policies aim to put the Eurozone public finances into a sound and credible long-term footing. On the financial side, the EU has revised its financial architecture by establishing the EFSF (European Financial Stability Fund) and European Stability Mechanism, by agreeing to establish a single banking system supervisor. Lastly, there have been several structural measures undertaken, aiming to revive both the EU and country-specific competitiveness. Among others, these measures include increasing labor market flexibility, reforming the pension system, further liberalizations in the goods and services markets.

What remains to be done?

While arguably late, I think the policy response within the EU has gone in the right direction and has been rather comprehensive. Nevertheless, further work is required in the future.

I would like to highlight two of these areas.

- *First*, the reform agenda identified by four presidents (of the European Council, of the European Commission, of the Eurogroup and of the ECB) aims to complement the monetary union with a financial union, a fiscal union, an economic union and some higher degree of political *union*. This is an ambitious goal, but I am fairly convinced it will be accomplished within a reasonable time-scale. In this context, it is not much a wish list as it is a prerequisite for long term growth. It would indicate to the world that Europe has answered the dilemma about its role in the global economy of the 21st century.
- *Second*, I think that efforts to increase EU integration should extend to include a deeper cooperation with candidate and potential candidate countries in the Eastern and Southeastern Europe. These economies are very much connected to the EU, from an economic and financial perspective. They have undertaken structural reforms to liberalize their economies, to increase their competitiveness and to coordinate their policies. EU efforts should concentrate in aiding and speeding the convergence process in the design of markets and institutional frameworks while minimizing the related short term costs. This would be to the mutual benefit of both the EU and the region.

I would like to add that in realizing such an agenda, the policy-makers need to pay special attention to the time dimension. Reforms that need to be made should be made in time. Furthermore, such reforms have to be made with the whole of the EU project in mind. Individual countries have much work to do, but a lasting solution to the challenges will be a comprehensive reform that looks beyond specific borders and aims at raising the competitiveness and sustainability of the EU as a whole.

Europe in the future

Ladies and gentleman, to conclude my address allow me to restate my belief in the future of Europe.

A brief glimpse at some figures would illustrate this point. EU comprises roughly 7% of world population but accounts for a quarter of global GDP. It has a mature social and economic model, which in spite of long-term challenges remains a viable paradigm of economic development. The external position of both EU and Eurozone is broadly balanced, with current account deficits of less than 1% of GDP. The public debt to GDP ratio of 83% compares favorably with that of other advanced economies and competitors such as the US and Japan, respectively at 103% and 230%. EU is one of the core areas of global innovation. In terms of Research and Development expenditure it is not far behind the US, while in terms of number of researchers and patent application actually outperforms it.

Europe and the EU offer a mature legal environment, with adequate protection for investors and intellectual property. Its macroeconomic policies remain stability-oriented and its financial system is both mature and sound. Five out of the ten highest ranked countries in the latest Global Competitiveness Index are EU countries.

Furthermore, I would like to emphasize, apart of Eurozone, there are other countries in the Eastern and Southeastern Europe which offer a qualitatively different picture. Up to 2008 they included some of the fastest growing emerging economies. These are fast growing economies, with better demographic trends. They offer untapped growth potential, in terms of qualified work force, business friendly environment and stable institutions. European integration process has been the main anchor and major driving force of growth and convergence. Therefore, I strongly urge countries of the SEE region to dedicate substantial efforts towards a closer regional integration in infrastructure, markets, education and legal framework. Deeper economic regional integration will increase the competitiveness of the region from European and global perspective.

Lately, efforts have been made towards a closer regional integration, making the region more attractive to potential foreign investors. With a deeper regional integration, a better anchoring in the EU convergence process and more funding, the Eastern and Southeastern Europe has much to offer to Europe and to the global economy.

The periphery of the euro zone or the future new members provide many attractive investment opportunities in development projects in infrastructure, trade, exploitation of natural resources, energy and production capacities. Most importantly the development of these strategic sectors is designed within the framework of the European development plans and the future to be larger European economy. Therefore investing in the region would mean to invest in the future of the European economy itself.

Dear Participants,

A prosperous and integrated European Economy and confident single currency provides a better anchor for the future of our economic, financial and institutional convergence and therefore additional benefits for the European economy itself. European economy is an important partner in global scale, accounting for a substantial share of global demands, financing, education and technology advancement. The strength of European economy is mutually beneficial for Europe and its partners, including China.

Considering the past and the present state of economic, social political and intellectual affairs, I remain firmly convinced in the ability of the Europe to rise up to current and future challenges to reintroduce itself as the land of opportunity and prosperity. Europe will be an important partner for China and the global economy. Before I leave the floor I would like to bring to your attention a very old Chinese proverb: "No one who can rise before dawn 360 days a year fails to make his family rich".

Thank for your attention.