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## Welcome remarks

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### Looking back on 30 years of transition – and looking 30 years ahead

#### Opening Remarks Conference on European Economic Integration (CEEI) 2019

Ladies and gentlemen,

Welcome to this year's Conference on European Economic Integration, the first in this OeNB conference series that I have the honor to open in my capacity as the Governor of the central bank of Austria. Let me particularly welcome

- Professor Beata Javorcik, Chief Economist of the European Bank for Reconstruction and Development (EBRD) and
- my central bank colleagues
  - Vice-Governor Ana Ivković, from Serbia;
  - Governor Jiří Rusnok and Deputy Governor Marek Mora, my former student, from the Czech Republic;
  - Governor Gent Sejko, from Albania;
  - Governor Boštjan Vasle and Deputy Governor Primož Dolenc, from Slovenia;
  - Governor Boris Vujčić, from Croatia.

This year's Conference on European Economic Integration (CEEI) marks a very special occasion. Exactly 30 years ago to this day, communist leaders in what was then Czechoslovakia bowed to the pressure of hundreds of thousands of protesters in the streets led by former political prisoner and the country's later president Václav Havel. Yet, it was not just frustrated citizens during the Velvet Revolution in Czechoslovakia who rose against political suppression and central planning, which had produced shoddy economic outcomes, but people throughout the entire former Eastern bloc. As a result, the remarkable events of 1989 helped bring down the single most concrete – in every sense of the word – symbol of the 40-year division of the European continent: the Berlin Wall.

In 1989, I was in Warsaw, working with the International Monetary Fund (IMF). I remember very well spending weeks on end in a room filled with cigar smoke in a lush but shabby hotel, calculating spreadsheets on the fiscal situation of Poland together with a junior Argentine colleague (and later division head at the IMF's Fiscal Affairs Department). As a European, I had the advantage of having had better training on public finances than many of my American colleagues. Nevertheless, this was not an easy task, given the lack of available data. But we managed to deliver meaningful projections for a scenario of radical reforms. However, my hope of leaving behind the issue of pensions – a topic that I had spent most of my professional life on – and being able to deal with broader fiscal and macroeconomic policy issues was in vain. Given the impact of Poland's dismal pension system on the country's fiscal accounts, I was thrown back to deal with my unloved special field – pension reform. By including measures such as minimum social welfare provisions in my recommendations, I was able to convince the skeptics in the Polish government.

It was a very busy time with just a few hours of sleep a day. Jeffrey Sachs, who advised the new noncommunist government of Poland, appeared frequently at our team dinners to convince our mission chief of rapid privatization ensuing the closure of many uncompetitive factories. But as I predicted, economic shortages and inflation were short lived, and the offer of consumer goods improved very soon – unfortunately, at the cost of Cuban cigar supply. Looking at images of Warsaw from before and after transformation makes me sure that Poland did most things right. Despite a nonnegligible number of nostalgics lamenting the demise of the “good old days”, this year's 30<sup>th</sup> anniversary of the fall of the Iron Curtain is a cause for unqualified celebration.

The CEEI 2019 will pay tribute to this historic event by revisiting the political and economic transformation that has taken place in Central, Eastern and Southeastern Europe (CESEE) over the last 30 years. Even though in 1989, Francis Fukuyama called the bold victory of economic and political liberalism the “end of history”, he later revised his judgment. Indeed, history has not ended yet, and the future will certainly have a few more tricks in store. This is why, during the next two days, we will also explore key challenges CESEE will be facing in the years and decades to come.

Vienna is a perfect location for this debate. Why? Because Austria has traditionally served as a bridge between the eastern and western half of the European continent due to its geographical position at the heart of Europe and its strong historical and cultural ties with the CESEE region. At the same time, Austria has benefited a great deal from the economic and political transition in the region. Having identified the economic potential in CESEE at an early stage, Austrian business expanded into the new markets and many of them developed into key players there, especially in the banking sector. Given the exposure of Austrian banks to CESEE, the OeNB not only has an interest in thriving economies and stable financial markets in CESEE but is, I believe, also in a good position to help contribute to reaching these goals. I will come back to this later.

In the remainder of my opening remarks, let me first briefly review the past 30 years of transition in CESEE so we understand what a long way these countries have come and what a resounding success they have achieved. Against this background, I would then like to sketch some of the challenges the future holds for the region and discuss the role the OeNB could play in helping CESEE authorities face these challenges.

With the fall of the Iron Curtain, a long and difficult, yet unavoidable journey of transition began for the CESEE countries – a transition from centrally planned state socialism to modern democracies, market mechanism and capitalism. Unlike many Asian economies that adopted a more gradual approach – as we will hear about tomorrow – the CESEE countries applied a “shock therapy” of rapid change. This meant that the initial economic tremor took its toll in the 1990s – in the form of deep recessions, soaring prices, currency depreciations, bank failures and mass unemployment. The CESEE countries’ intrinsic strengths came to the fore only later, as privatized industries were restructured and reforms were implemented. The capital and foreign investment thus attracted propelled productivity and competitiveness, which in turn boosted economic growth.

This unprecedented social, political and economic metamorphosis was paralleled and supported by the process of European reunification. Today, 11 former Eastern bloc countries are united with their former ideological opponents under one European flag, and some of them also under the umbrella of a common currency. While being emancipated and self-confident partners, the EU countries share democratic and legal values as well as institutional principles. We must point out, however, that the European Union constitutes a crucial stabilizing anchor and, of course, provides budgetary support even for countries that are not yet members of the club.

Catalyzed in several cases by prospective EU membership, reforms in CESEE eventually started to work. The CESEE economies established a record of significant economic growth and convergence as CESEE became one of the world’s fastest-growing regions in the first half of the 2000s. Then, however, with the outbreak of the global financial crisis, the blessing of ever-closer trade and financial linkages with Western Europe turned into a curse for CESEE. The economic shock quickly spilled over and harshly hit most of the CESEE countries despite their heterogeneity. Countries where the strong – and, in several cases, excessive – pre-crisis expansion had been driven by unsustainable levels of consumption and borrowing were affected the most.

In this context, I would like to stress the crucial role of the so-called Vienna Initiative, to which Austrian authorities also made significant contributions. At the peak of the crisis, all relevant stakeholders came together to coordinate their actions and thus prevent the imminent risk of a large-scale and chaotic withdrawal of cross-border bank groups from the CESEE region, which could have triggered massive systemic bank crises.

It goes without saying that the three decades of transition have not been just a walk in the park. Despite great and respectable achievements, the transformation path has been perceived by many as too long, too difficult and too painful. Failures and uncertainties regarding the shift to capitalist liberal democracies, unfulfilled promises and unrealistic expectations have caused various social, economic and political ramifications. While their form and extent vary from country to country, such consequences are reflected to an unforeseen extent in nostalgia and mounting attacks against democratic institutions and liberal values.

This brings me to what I see as the major challenges in CESEE when looking ahead. The national populism that has increasingly been taking hold in the CESEE countries resonates particularly well with those who feel “lost in transition.” While the CESEE countries have caught up impressively toward Western European income levels over the last 30 years, partially substantial income gaps persist. Moreover, since economic growth has slackened as a legacy of the global

financial crisis, convergence has slowed down. Therefore, it is of utmost importance for the region to continue fostering convergence by spurring inclusive economic growth. To increase dampened productivity and capital formation, efforts should focus particularly on investments in infrastructure, human capital endowment and innovation but also on improving the institutional, legal and business environment that supports a Schumpeterian process of creative destruction.

This is all the more important as potential growth will additionally be strongly limited in the medium to long run by adverse demographic developments, which pose another big challenge for the CESEE countries. In most of the region, the population is shrinking, mainly due to low life expectancy and low birth rates but also negative net migration. Whatever the causes, one important answer to future challenges will be to keep older people in the workforce. Fortunately, the trend toward earlier retirement has been reversed over the last decade, but more needs to be done in all countries concerned. Reforms have markedly improved the sustainability of public pension systems, but old-age poverty continues to be a problem in some CESEE countries, particularly for women. Pension reform is, perhaps, a trial and error process, which reminds me of the famous quote by Friedrich von Hayek, “The curious task of economics is to demonstrate to men how little they really know about what they imagine they can design.”<sup>1</sup> Indeed, designing a stable pension system without jeopardizing people’s confidence requires both science and art. I tried to contribute to both fields with some – but overall quite modest – success (in particular in my own country) but I remain determined and optimistic also in my new function.

Whereas CESEE pensioners are staying in their countries, people of working age are emigrating. And even worse: The first to leave are the young and the most skilled, which threatens public health and productivity growth in their home countries. The challenge for CESEE countries with high emigration is to turn this brain drain into a brain gain by attracting people back or recruiting immigrants from third countries. The good news is that economic history provides numerous examples of emigration countries managing to become destinations of re-migration. Since economic development only becomes a pull factor when a certain minimum income threshold is reached, however, good governance and specific policies that improve people’s quality of life will be essential to win and keep talents.<sup>2</sup>

Good governance – an elastic concept, admittedly – applies not only to individual countries but also to European institutions. Indeed, European economic integration proceeds between the poles of deepening and enlargement, as we have seen from the recent disagreement about the timing of accession talks with candidate countries before securing the EU’s absorption capacity. The Brexit experience suggests that not even the direction of deepening and enlargement can be foreseen with precision. “Prediction is very difficult, especially about the future” – apparently, this truism of Niels Bohr also applies to the negotiations among the EU Member States about the deepening of Economic and Monetary Union (EMU). A resilient common currency needs integrated markets. Completing the banking union and developing a capital markets union seems less controversial than the creation of a fiscal union. Indeed, the example of the U.S.A. – which is not a perfect optimal currency area either – suggests that most of the interregional risk-sharing necessary in a common currency area takes place via financial markets and not via

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<sup>1</sup> Friedrich August von Hayek. 1988. *The Fatal Conceit: The Errors of Socialism*. University of Chicago Press. 76.

<sup>2</sup> <https://cor.europa.eu/en/engage/studies/Documents/addressing-brain-drain/addressing-brain-drain.pdf>

budgetary transfers. Still, the EU budget is dwarfed by the U.S. federal budget. And moreover, fiscal flows lead and facilitate financial flows – not least via safe assets – and thus add a qualitative component to their quantitative contribution to risk-sharing.

Whatever the outcome of this debate, the development and integration of financial markets is the order of the day, both in EMU and in CESEE. Without neglecting the important role of banking in providing finance, particularly to medium-sized businesses, it will be crucial to deepen capital markets. To improve the role of financial supervision, euro candidate countries in CESEE have been encouraged to consider joining the Single Supervisory Mechanism (SSM) at an early stage.

While the OeNB stands ready to help develop financial markets in CESEE, we also have a cautiously affirmative stance on further EMU enlargement. When drawing lessons from the so-called euro area sovereign debt crisis, we can say that euro introduction arguably went too fast, but that dismantling or retrenching EMU now would be extremely costly. For new euro area candidates, this means that even if the Treaty obliges all EU members to introduce the euro at some stage, they must fulfill the Maastricht criteria in a sustainable manner before being able to adopt the euro. Additionally, given that EMU has changed since the crisis, candidates are expected to enter the SSM before introducing the euro. On the other hand, we must recognize that there is no “one size fits all” approach to how soon countries should give up their independent monetary policy – a decisive macroeconomic tool – in favor of joining monetary union. Also, public support for such a move differs across CESEE countries although it has become increasingly favorable.

Ladies and gentlemen, let me conclude. One message that I have tried to convey is that despite a number of setbacks, high costs and various shortcomings, the CESEE countries deserve our deep respect for their successful transition from dysfunctional command economies to flourishing market economies. However, transition – in the sense of adjustment to a changing and challenging environment – is a permanent process. There are always new challenges ahead – not only in CESEE but all over Europe and all over the world. We will have to transit to – or through – aging societies, low carbon economies, digital finance and further economic, financial and monetary integration. Facing all these transitions, it will be key to cooperate in the spirit of the European Union’s official motto, “United in diversity.” Precisely in this vein, I believe that the Austrian central bank should closely collaborate with our partners in CESEE to be able to better cope with many of the challenges that we will face. We can help each other develop financial markets by sharing our experience with products, regulation and supervision, and the regional offices of the IMF and the World Bank here in Vienna will certainly lend us their support. At the same time, the OeNB stands ready to act as a fair broker for European economic integration. If we all sustain our commitment, I am positive that the success story of the past decades in CESEE will continue for many years to come.

To kick-start our discussions on the past and the next 30 years in CESEE, we invited two highly renowned keynote speakers.

Unfortunately, one of them, the iconic Israeli-American economist Professor Stanley Fischer, had to cancel his trip to Vienna at short notice for very personal reasons.

The other has fortunately made it to Vienna and I now have the pleasure to welcome and introduce to you Beata Javorcik, Chief Economist at the European Bank for Reconstruction and

Development, who will deliver the first keynote lecture.

Before Ms. Javorcik took up her position at the EBRD, she was the first woman to hold a Statutory Professorship in Economics at the University of Oxford. Prior to that, she worked at the World Bank (at the same time I was there but our paths seldom crossed). She holds a Ph.D. in economics from Yale University and in her research has focused mainly on international trade.

As I am looking forward very much to her keynote lecture, let me close here, without any further ado, by wishing you an interesting, productive and also entertaining conference and by giving the floor to Ms. Javorcik.

Dear Beata, the floor is yours.