

Robert Holzmann
Governor
Oesterreichische Nationalbank

WELCOME REMARKS

Vienna, November 22, 2021

Check against delivery!

Recalibrating tomorrow's global value chains – prospects for CESEE

Conference on European Economic Integration (CEEI) 2021

Good afternoon Ladies and Gentlemen. It's my great pleasure to welcome you to the Conference on European Economic Integration (CEEI) 2021. This year's conference is organized in cooperation with the European Investment Bank (EIB), and I would like to extend a particularly warm welcome to EIB Vice-President Mr. Ricardo Mourinho Félix.

Also, let me particularly welcome our keynote speakers

- Ricardo Hausmann from Harvard University; and
- Hylke Vandenbussche from KU Leuven;

as well as our dinner speaker

- Richard Baldwin from the Graduate Institute Geneva;

and my esteemed central bank colleagues.

Turning to the topic of this year's conference, you may wonder why we care about the future of global value chains, or GVCs for short?

The advantages of GVC integration are well established and manifold, ranging from efficiency and productivity gains for firms and countries to the creation of new jobs.

Before the global financial crisis, the level of globalization rose continuously over the long term, as measured by the share of world trade in GDP. After 2008, however, globalization experienced

some hiccup, before stagnating, as the global financial crisis and the subsequent steep decline in trade called into question the role of GVCs in times of turbulence.

The economies of Central, Eastern and Southeastern Europe (CESEE) are deeply integrated into GVCs and have benefited a great deal from it. In fact, CESEE's forward GVC participation has increased significantly since the beginning of transition.

Empirical research¹ suggests that exports have contributed at least half of the value-added growth in most CESEE countries since the mid-1990s. In Bulgaria, Czechia, Hungary and Slovakia, more than 70% of GDP growth has been driven by exports.

But it has not been exports of final goods that has been key to economic growth. Rather, it has been exports of intermediate goods. This highlights the importance of deep GVC participation of CESEE firms, especially as international production processes have become more fragmented.

However, recent events revealed the vulnerability of GVCs and risks associated with GVC integration. The COVID-19 pandemic, in particular, has brought about significant disruptions in global supply chains, resulting in shortages of raw materials, inputs and intermediate goods, such as face masks, pharmaceutical products or microchips. The lack of semiconductors was most visible in the car industry, with thousands of unfinished cars parked in temporary parking lots, such as airport runways.

The risky flipside of global interlinkages must therefore not be neglected, above all not by the CESEE region. In a recent study, researchers at the Vienna Institute for International Economic Studies have developed a product riskiness index allowing them to identify possible vulnerabilities of industry sectors and dependencies on trading partners. Based on the index, the authors find that about 30% of EU imports and almost 35% of Austrian imports from non-EU countries are accounted for by products that are at high risk of being unavailable in the event of trade disruptions. In some CESEE countries, such as Czechia, Hungary and Slovakia, the share of risky products even comes to almost 40%.

The vulnerabilities of GVCs have come to the fore in an unprecedented interplay between pandemic-related and structural frictions. At the beginning of the third quarter of 2021, some 32% of Austrian firms complained about material bottlenecks. In the German economy, this figure reached almost 64%, and was as high as 77% in September – a figure not seen in the last 30 years.

According to OeNB calculations, supply bottlenecks have reduced economic growth in Austria by about 0.3 percentage points in the second and third quarters of 2021. In Germany, the impact of the shortage of raw materials and inputs is estimated to be approximately twice as large as in Austria in terms of GDP loss. This also has to do with the strong focus of the German industry on the car sector, particularly the assembly of cars. Similar holds true for the CESEE economies, which are closely connected with Germany.

¹ [Export-led growth in Central and Eastern Europe | VOX, CEPR Policy Portal \(voxeu.org\)](https://voxeu.org/article/export-led-growth-in-central-and-eastern-europe)

Another implication of dysfunctional supply chains are ballooning producer prices, particularly of imported goods, which have been to some extent reflected in consumer prices.

GVC disruptions and resulting price increases have been driven by several factors. These factors have been largely, but not exclusively, related to the pandemic. Isolated one-off events, such as the blockage of the Suez Canal, also added to the disturbances on the supply side. The supply side shocks have been paralleled by a strong rebound in demand on the back of a recovering global economy.

On top of these factors, the world is increasingly bound and determined to tackle climate change. This, as well as the impact of climate change itself, could possibly induce a super cycle of high demand for energy and raw materials, such as copper, magnesium, steel and many more, for e.g. the production of electric vehicles and associated infrastructure. At the same time, the price of carbon is likely to continue rising.

To wrap up, tight integration into global production networks has been a crucial element of the catching-up process in CESEE and has become a key catalyst for economic growth and development in the region. But around the time of the global financial crisis, GVC expansion slowed down, raising questions about the role of GVCs in times of turbulence.

At the outset of the COVID-19 pandemic, there were even more questions, for example: Do gains from deepening and expanding international specialization in global production networks outweigh the risks and instability associated with GVCs? A related question is whether deep GVC integration amplifies, or mitigates, large swings in economic activity in times of crisis.

And how can we find the right balance between relocating strategic production and creating a more diversified and robust world trading system – particularly against the backdrop of significant GVC-related vulnerabilities and the heavy dependence of European countries on production in China and Southeast Asia?

Moreover, the COVID-19 pandemic might have triggered attempts to reshore or nearshore production from more distant locations. It remains to be seen whether this will become a major trend and to what extent the CESEE region will benefit from it.

Another issue of particular relevance for the CESEE countries is their positioning within GVCs. Are they caught in a functional specialization trap, particularly with respect to the car industry?

We have seen that the pandemic-induced shock to GVCs has not only had a strong impact on the real economy, but also on (relative) prices, which have been increasingly amplified by the consequences of climate change itself as well as climate change policies. This is also where monetary policy comes into play, and we have to fully understand its role amid supply chain frictions and strengthening decarbonization trends.

These and many other questions will be addressed at this year's CEEI, and I'm very much looking forward to two afternoons of thought-provoking discussions. Let me now hand over to my esteemed colleague, EIB Vice-President Mr. Ricardo Mourinho Félix.

Dear Ricardo, the floor is yours.