The OeNB's 83rd East Jour Fixe: Catching the wind: current challenges and opportunities for European integration and convergence[1]

On the occasion of Austria's Presidency of the Council of the European Union

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On September 18, 2018, the Oesterreichische Nationalbank (OeNB) hosted its 83rd East Jour Fixe on the topic of "Current challenges and opportunities for European integration and convergence." The event was dedicated to the presentation of selected articles from a special edition of the OeNB's publication *Focus on European Economic Integration (FEEI)*, issue Q3/18. This issue was released in early September and was conceptualized to reflect selected topics from Austria's Presidency of the Council of the European Union – with a special focus on Central, Eastern and Southeastern Europe (CESEE). The speakers at the 83rd East Jour Fixe came from diverse backgrounds and presented academic, political and other professional expertise to a selected, multinational audience.

In her introductory statement, *Doris Ritzberger-Grünwald*, Director of the OeNB's Department for Economic Analysis and Research, reflected on the evolution of topics associated with convergence and economic integration over time. Over the past ten years, new topics – such as inclusiveness, structural reforms, migration, macroprudential regulation, sanctions and digitalization – have entered the stage and challenged policy makers in the region. Referring to her contribution to the special FEEI edition, co-authored with Josef Schreiner, Ritzberger-Grünwald emphasized that convergence has significantly slowed since the 2008–2009 global financial crisis, as potential output has been affected by weaker productivity and stet investment rates. While full convergence in GDP per capita by 2030 seemed a realistic scenario in the boom years prior to the 2008 crisis, this goal has since shifted further into the future.

The keynote speech was given by *István Pál Székely*, Director at DG ECFIN at the European Commission. He argued that convergence has been a success story, but that the speed, sustainability and equity of future convergence of the CESEE region would crucially depend on renewed and continuous reform efforts. Moving from the traditional convergence model to an innovation-based system requires reforms focusing on (1) the accumulation of human capital in order to support innovation, (2) allocative efficiency and (3) the quality of public and private institutions. He stated that well-designed and -implemented reforms in these areas would allow the CESEE region to benefit fully from the deepening of European integration. Székely pointed to bottlenecks for innovation-based convergence that currently arise, among other things, from marginalized societal groups who do not have sufficient access to education and from still comparatively high levels of corruption that lead to adverse selection. Being a member of the EU or having an EU accession perspective holds huge potential for promoting convergence. This is not only due to access to the single market and to sizable transfers, but also because several EU countries (e.g. Austria, Denmark, the Netherlands and Sweden) are –

[1] *The presentations and workshop program are available at www.oenb.at/en/Monetary-Policy/Research/workshops.html.*

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according to Székely – global innovation leaders, and positive know-how spillovers can thus be expected.

Session 1, chaired by *Dubravko Mihaljek*, Head of Macroeconomic Analysis at the Bank for International Settlements, focused on the EU budget and structural reform priorities. *Zsolt Darvas*, Senior Fellow at Bruegel, presented evidence on the EU's Multiannual Financial Framework. In his speech, Darvas discussed several priorities regarding a reform of the EU budget. First, he argued that a more thorough assessment was needed to identify which spending areas constitute European public goods that should best be provided at the EU level and which should be addressed at the national level. Concerning the former, he named areas with "clear pan-European implications," such as border protection, migration and climate policy. Second, given these separating lines, he made the point that EU spending on the Common Agricultural Policy (CAP, 38% of the current budget) and Structural and Cohesion Funds (34% of the current budget) should be made more efficient and effective. CAP spending, for example, is de facto an income support scheme for farmers, and it is questionable why it must be organized at the EU level and not at the local level. Third, Darvas emphasized that Brexit will leave a hole in the EU budget, but stated that a nominal freeze on CAP and cohesion spending would more than compensate for this and provide resources for new priorities. The second speaker in this session, *Andreas Breitenfellner*, Lead Economist at the OeNB, discussed some aspects of the widely used term "structural reforms." Breitenfellner first made a distinction between structural reforms and cyclical features of the economy and discussed their interaction. He then distinguished between input and output convergence, with the former meaning convergence in structural factors such as labor market institutions and the business environment. Input convergence is related to output convergence in terms of synchronizing business cycles, but not in terms of converging income per capita levels. Breitenfellner also discussed the economic literature on the short- and long-term impact of structural reforms on growth. Finally, he presented three ways of framing the link between institutional reforms at the level of Economic and Monetary Union (EMU) and structural reforms in EU Member States: they are seen as either substitutes, complements or components of each other.

Session 2 dealt with EU enlargement and neighborhood policy and was chaired by *Reiner Martin*, Lead Economist at the Joint Vienna Institute. *Wolfgang Petritsch* and *Philipp Freund* gave the introductory speech, highlighting the key political challenges currently faced by the Western Balkans and the involvement of major external players (such as the EU, the U.S.A., Russia, China, Turkey and the Gulf States) in the region as well as these players' varying interests and policy tools. The lack of a convincing strategy on the part of the EU in the past ten years has opened space for other external actors to step in. The presenters called for a consistent and committed approach to the integration of the Western Balkans into the EU. Ambassador Petritsch pointed out that there is currently a window of opportunity: for the first time in many years, the EU has produced a Western Balkans strategy with a more concrete time horizon for EU accession, while at the same time political solutions are increasingly being offered locally within the region (e.g. the name dispute in FYR Macedonia and negotiations between Serbia and Kosovo). This window of opportunity must be used, as it could close once a new European Commission is in charge. Asked about Chinese investment in the Western

Balkans and a potentially beneficial impact on physical capital stocks, Petritsch stressed that Chinese investment not only provides an economic boost, but that it is also rooted in geopolitical interference and should thus be monitored critically. However, the EU does not yet have a clear, joint position on China. According to Petritsch, reinforcing European regulation and rule of law in the region is more important than focusing on short-term economic gains. In the presentation that followed, *Laura Solanko*, Senior Advisor at the Bank of Finland Institute for Economies in Transition (BOFIT), took a closer look at the sanctions imposed on Russian entities by the EU, the U.S.A. and others, as well as at Russia's countersanctions. She acknowledged that the pure effects of the sanctions are difficult to capture given various parallel developments (such as the large drop in the price of oil and a change in the monetary policy regime). Nevertheless, she showed that the sanctions have had a clearly negative effect on the Russian economy, although the decline in the price of oil affected Russian GDP much more strongly. Russia's countersanctions, on the other hand, have affected exports of foodstuff from the EU, but macroeconomic effects in the EU are generally very small. Solanko concluded that sanctions are primarily a foreign policy tool, and their effectiveness should be measured not only in economic terms, but also against the original foreign policy goals. *Peter Backé*, Deputy Head of the OeNB's Foreign Research Division, and *Sandra Dvorsky*, Senior Advisor in the OeNB's Communications, Organization and Human Resources Department, discussed the enlargement of the euro area toward CESEE since 2010. They started by reviewing the Baltic countries' accession to the euro area. They then addressed the current playing field and the impact of institutional changes within EMU on future convergence assessments. They highlighted that nominal convergence has advanced substantially over the past decade. At the same time, they reasoned that experience from the crisis had underpinned the focus on the sustainability of the convergence process. Moreover, Backé and Dvorsky emphasized that the deepening of EMU's institutional setup, which occurred as a reaction to the crisis, also has ramifications for the euro area accession process, for example in the area of banking union: joining ERM II will necessitate close cooperation with the Single Supervisory Mechanism. Going forward, they emphasized that it is key to strike a balance between lessons drawn from the crisis and the continued application of equal treatment, for the mutual benefit of all stakeholders in the process.

Session 3 focused on financial sector development and macrofinancial stability and was chaired by *Peter Backé*. *Markus Eller*, Principal Economist at the OeNB, presented evidence on credit-to-GDP ratios calculated in line with macroeconomic and financial fundamentals and compared them with actual credit-to-GDP levels. According to the estimations, credit-to-GDP ratios have declined to levels that are more in line with the fundamentals observed in countries where they were too high before the crisis, and credit-to-GDP ratios are often below fundamentally justified levels in countries that did not experience a bubble before the crisis. Eller stressed that adding direct cross-border credit to domestic private-sector credit matters considerably, as it results in larger gaps between fundamental and actual credit levels in most cases, indicating that the adjustment back to fundamental levels has not yet been accomplished in some countries. Given the significant role of cross-border credit in CESEE, Eller pointed out that deepened and well-aligned cooperation between home and host country supervisors is an important policy implication of the analysis. *Frank Dierick*, Adviser at the European Systemic Risk Board (ESRB), gave a presentation on the ESRB's mandate and implementation of macroprudential policy across the EU. He discussed some of the main macroprudential tools used across the EU: the countercyclical capital buffer, targeted at cyclical credit expansion, and the systemic risk buffer, targeted at long-term, noncyclical risks. Dierick also showed that many countries are already using instruments to contain risks related to (residential) real estate lending. In addition, he discussed the linkages among cross-border banking groups and the concept of voluntary reciprocity. As the macroprudential toolkit grows and becomes more widely applied, the need to assess the effectiveness and consequences of macroprudential policy increases.

Finally, session 4, chaired by *Helene Schuberth*, Head of the OeNB's Foreign Research Division, was dedicated to the topic of labor markets and migration. *Andrea Weber*, Professor at the Central European University, presented empirical evidence on the evolution of migration to Austria from the CESEE countries that have joined the EU since 2004. She showed that the inflow of migrants from these countries increased somewhat after EU accession, but accelerated much more sharply once free movement of workers was permitted after the seven-year transition period. Weber also discussed the change that took place after free movement was permitted: the average immigrant became younger, stayed for shorter periods and received lower wages. A large share of migrants works in seasonal service and tourism industries and in Austrian border regions closest to their countries of origin. In the final presentation of the East Jour Fixe, *Richard Grieveson*, Economist at the Vienna Institute for International Economic Studies (wiiw), addressed the same issue of east-west migration from the point of view of the sending countries. He showed that CESEE countries have seen GDP grow and both population in general and the working-age population decline, all of which has contributed to existing or looming labor shortages in the region. Grieveson also noted that the shortage of skilled labor in conjunction with higher wages could induce some companies to move away from the CESEE region. He also argued that immigration from non-EU countries and the return of emigrants (e.g. following Brexit) are not a solution in the medium to long term, but that increased automation and productivity growth could possibly provide some relief. Hence, labor-saving technological progress could make up for demographic developments, thus brightening the longer-term prospects for the CESEE region.