

Q4/2015

CESEE Research Update

Foreign Research Division

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The CESEE Research Update is released quarterly by the Foreign Research Division of the Oesterreichische Nationalbank (OeNB). The aim of this newsletter is to inform readers about OeNB research and analysis output on Central, Eastern and Southeastern Europe (CESEE) as well as past and forthcoming CESEE-related events.

Foreign Research Division
OeNB

The Oesterreichische Nationalbank would like to inform you that, as from 2016, its quarterly "Focus on European Economic Integration" will be available online only at www.oenb.at/fee. To get updated on latest releases, please register at <https://oenb.at/en/Services/Newsletter.html>.

Highlights of this Issue

- **Conference on European Economic Integration and Conference on The Future of the European Economy** jointly organized by the Oesterreichische Nationalbank and Narodowy Bank Polski, October 15-16, 2015 in Warsaw (see p. 2)
- **Olga Radzyner Award Winners 2015** (see p. 4)
- **Kaushik Basu** on "Globalization and the art of designing policy". Summary of the 20th Global Economy Lecture (see p.4)
- **13th ESCB Emerging Markets Workshop** (see p. 6)
- **Studies in: Focus on European Economic Integration Q4/15** (see p. 7)

Joint conference with Narodowy Bank Polski on October 15 and 16, 2015, in Warsaw: “Boosting EU Competitiveness: The Role of the CESEE Countries” (CEEI/CFEE 2015)



Photo courtesy of Narodowy Bank Polski

The OeNB's *Conference on European Economic Integration (CEEI) 2015* took place in Warsaw on October 15 and 16 as a joint event with the *Conference on the Future of the European Economy (CFEE) 2015* of Narodowy Bank Polski (NBP), the Polish central bank. The two-day conference

focused on the numerous aspects of EU competitiveness: price and nonprice competitiveness, appropriate innovation, labor market and structural policies and the integration of production into global trade networks. Discussions centered in particular on Central, Eastern and Southeastern Europe (CESEE) and the region's contribution to total EU growth. Contributions to the debate came from high-ranking central bank representatives from Estonia, Croatia, Poland, Slovenia and Austria, from representatives of academia, such as Beata Javorcik (University of Oxford), Michael Landesmann (wiiw), Peter Sinclair (University of Birmingham), Hylke Vandenbussche (Katholieke Universiteit Leuven) and



Photo courtesy of Narodowy Bank Polski

Linda Yueh (London Business School), as well as from high-ranking representatives from the European Commission and from international think-tanks.

One of the main findings of the CEEI/CFEE 2015 was that demographic developments have a critical influence on EU – and in particular CESEE – economic growth. The “Crystal Ball” panel discussion identified migration issues, the future design of labor contracts and the next steps toward EU integration as major challenges for Europe. Product market reforms (also in the services sector) were seen as particularly promising together along with reforms in education and taxation.

Beata Javorcik focused her keynote address on FDI as a key driver of productivity growth in CESEE and emphasized the importance of promoting FDI also in research and development (R&D). In his keynote address, Michael Landesmann pointed to the conver-

gence process as a major element of EU integration and stressed that external imbalances, which arose as a consequence of the convergence process, constitute a major challenge for the EU. At the current juncture, weaknesses of the tradable sector have become manifest in “structural” imbalances in the EU, and exchange rates can do little to correct these imbalances as they must be understood as a consequence of previous trade performance rather than a determinant of future trade balances.



Photo courtesy of Narodowy Bank Polski

One conference session discussed innovation policy and emphasized the importance of innovation not only for the high-tech industries, but also for traditional industries. Innovation also means making mistakes and making experiments. Major preconditions for successful innovation are: high-skilled and well-trained labor, long-term strategies, and deploying the strengths of an economy and the comparative advantages of the private and public sectors.

With regard to labor market issues, the strong social dimension of labor market policy was highlighted. With the creation of national Competitiveness Boards in the euro area, a key element of the *Five Presidents' Report* has been implemented. The speakers emphasized that these Competitiveness Boards should respect the social dialog. The discussion also highlighted difficulties in finding a uniform policy mix for the various EU Member States.

Discussants pointed out that structural reforms are mostly unpopular and are therefore only implemented in the face of major pressures (from financial markets, unemployment, economic adjustment programs). Moreover, they have the disadvantage of being effective only in the long run. While the EU's overall external competitiveness is high (market share, current account), internal competitiveness (productivity) is decreasing. Major steps in the integration process (internal market, euro, Lisbon agenda, Europe 2020) did not produce

the desired results. For the CESEE countries, participating in a monetary union that is still incomplete therefore entails not only chances but also the risk of imbalances.



Photo courtesy of Narodowy Bank Polski

Europe is one of the economic areas that are most deeply integrated into global production networks; trade integration is particularly strong within the EU, above all between Germany and CESEE. Speakers in

the last session concluded that scientific analysis should increasingly focus on the importance of fragmented production processes within individual countries; the integration and interconnectedness of domestic enterprises is an important and indispensable precondition for global trade integration. Another topic was China, whose transformation has an enormous impact on global production networks and on world trade. It was pointed out that the Chinese authorities will continue to rely on foreign trade as a

growth driver and therefore might deploy aggressive trade strategies in the future.

Around 260 persons from more than 30 countries participated in the CEEI/CFEE 2015, among them high-ranking representatives from 21 central banks and 14 embassies as well as representatives from the European Commission, the EBRD, EIB, IMF, OECD, World Bank and WTO.

On the occasion of its 200th anniversary, the OeNB will host a joint conference on “Central banking in times of change” together with the Bank for International Settlements (BIS) on September 13 and 14, 2016. For this reason, the CEEI series will be interrupted in 2016.

Contributions to the CEEI/CFEE 2015 are available in English at <http://www.nbp.pl/homen.aspx?f=/badania/konferencje/2015/IM/main.html>.

The proceedings of the CEEI/CFEE 2015 will be published by Edward Elgar Publishing Ltd. in the course of 2016.



ANNOUNCEMENT

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Olga Radzyner Award Winners 2015

The Olga Radzyner Award has been bestowed annually on young economists from Central, Eastern and Southeastern Europe (CESEE) for excellent scientific work on European economic integration since the year 2000. The Oesterreichische Nationalbank (OeNB) established this award to commemorate the former head of the OeNB's Foreign Research Division, Olga Radzyner, who pioneered the OeNB's CESEE-related research activities.

In 2015, the OeNB received 16 submissions for the Olga Radzyner Award from candidates from 10 countries. Of this total, the jury of OeNB reviewers chose to award four papers that were considered outstanding in terms of originality, motivation and analysis as well as the use of state-of-the-art methods. On October 16, 2015, at the jointly held Conference on European Economic Integration of the OeNB and the Conference on the Future of the European Economy of Narodowy Bank Polski (NBP), Governor Ewald Nowotny presented the award to the following candidates (in alphabetical order):

Márta Bisztray (from Hungary), PhD student at the Central European University in Budapest, investigated the long-term impact of Audi's large-scale direct investment in Hungary in 1993 on firms operating in Hungarian supplier industries. While their sales and employment increased significantly, there was no considerable productivity-enhancing or export-promoting effect. The positive effects on sales and employment were mainly concentrated on foreign-owned, more productive and small or medium-sized firms. The methodological framework employed is well suited for studying the economic effects of other large-scale FDI in the CESEE region.

Zoryana Olekseyuk (from Ukraine), PhD student at

the University of Duisburg-Essen, studied the economic effects of the Deep and Comprehensive Free Trade Area (DCFTA) agreed between the EU and Ukraine. She finds that a combination of far-reaching trade and FDI liberalization yields the largest welfare gains; according to her simulation these gains would be substantial for Ukraine, while the EU would experience small gains. The simulation results also show that in order to mitigate deindustrialization impacts in Ukraine, it is essential to reduce the barriers for service suppliers.

Nadja Stanová (from Slovakia), PhD student at the University of Antwerp, showed that the way in which macroeconomic time series models account for public indebtedness is important for understanding the responses of macroeconomic indicators to fiscal policy shocks in CESEE economies. Her results indicate that output responses to spending shocks are smaller the larger the initial government debt-to-GDP ratio is, suggesting that expansionary fiscal policy measures are less effective in stabilizing the economy the more indebted a sovereign is.

Iva Tomić (from Croatia), research associate at the Zagreb-based Institute of Economics, demonstrated that, for a better understanding of the determinants of youth unemployment in Europe, it is not only relevant to focus on traditional macroeconomic variables but that it is also important to consider structural and institutional factors. According to Ms. Tomić's empirical results, youth unemployment in the EU appears to be more pronounced if the share of construction in gross value added is low, the country's trade dependence is low or, probably most importantly, corruption is wide-spread.

Kaushik Basu on "Globalization and the art of designing policy" Summary of the 20th Global Economy Lecture

The 2015 Global Economy Lecture was delivered by Kaushik Basu, Chief Economist and Senior Vice President of the World Bank. In his presentation at the OeNB on November 16, 2015, he illustrated how globalization influences national economic policies and how economic events in one country can have

repercussions in other countries, which may then feed back into the country of origin again. In his view, policymakers need to take into account the effects of their national policies abroad and to factor in foreign policy and market reactions when designing their policies.

He also pointed toward multiple equilibria which emerge in case of self-fulfilling prophecies and herding behavior. Using the example of credit markets, Basu illustrated that a small change in price signals (i.e. an interest rate rise) may induce a large and sudden fall in credit supply if the economy moves from a high-credit equilibrium to a low-credit equilibrium. In his talk he identified the following policy needs in a globalized world: better global economic governance through institutions like the G-20, the IMF and the BIS; strategic thinking in constructing domestic policies that takes into account foreign policy reactions; openness to new ideas.

In the discussion he recalled that trust is an important element for the functioning of societies.

However, in a globalized world, we need regulation to guide economies toward the desired behavior. Regulation can also help to rule out multiple (and undesired) equilibria. Finally, he compared the euro area to India, where many different states share a common currency and emphasized that one economy needs one currency. Although today's world is becoming a global economy, he does not consider all countries, and especially not all emerging economies, to be ready for sharing a world currency.

The Global Economy Lecture was jointly organized by the OeNB and the WIIW.

OeNB Course “Macrofinancial Stability in CESEE” at the Joint Vienna Institute, September 14–18, 2015

The annual seminar “Macrofinancial Stability in Central, Eastern and Southeastern Europe (CESEE)” organized by the OeNB's Foreign Research Division in cooperation with Reiner Martin from the ECB's Macro-Financial Linkages Division took place at the Joint Vienna Institute (JVI) on September 14–18, 2015.

This one-week course addressed key economic policy issues the CESEE countries are facing in a challenging domestic and global environment. The lectures and discussions covered macrofinancial stability issues specifically relevant to central banks, e.g. interactions between the real and the financial sector or between fiscal policy and the financial sector. A special focus was put on the evaluation of financial stability risks in CESEE. Several sessions addressed topical issues such as the resolution of nonperforming loans (NPLs) and the effectiveness of macroprudential instruments. Most of the lectures were prepared by OeNB and ECB experts, but the course also featured contributions from the JVI, the World Bank and the Council for Budget Responsibility of Slovakia.

During group sessions, which are always an essential part of the course, the participants engaged in negotiating a macrofinancial adjustment program. In other words, representing countries and international authorities, they drew up an adjustment program for sample countries subject to macrofinancial stress.

This course attracted not only experts and mid-level officials from central banks and ministries of finance or economics from CESEE and CIS countries, but also colleagues from the Vienna Institute for International Economic Studies (wiiw). Our participants came from a wide mix of countries ranging from Kazakhstan to Montenegro and from Latvia to Turkey.

Next year's seminar is scheduled to take place on October 10–14, 2016. The application deadline is July 10, 2016. To view the course description and to apply online, please go to <http://www.jvi.org/training/course-schedule-2016/course/16ON05.html>.

13th ESCB Emerging Markets Workshop

On November 5 and 6, 2015, the OeNB hosted the 13th ESCB Workshop on Emerging Markets. Since its inception in 2003, this workshop series has served as a platform for debate for researchers working on macroeconomic issues related to emerging economies. The program of the 13th workshop covered a wide range of diverse topics such as monetary and fiscal policy, macrofinancial stability and economic growth. Given the high relevance of the papers presented at the workshop, a lively discussion emerged in each session, providing useful insights and guidance for researchers and policymakers alike.

In her introductory statement, Doris Ritzberger-Grünwald, Director of the OeNB's Economic Analysis and Research Department, emphasized the increasing relevance of emerging markets for the global economy in general and for Austria in particular. Especially in light of the recent euro area recession, the question that inevitably arises is to what extent economic shocks in developed countries trigger recessions in emerging markets.

In the first keynote address, Enrique Alberola, Chief Representative of the BIS Representative Office for the Americas, talked about the structural shift of Latin American economies toward a more resilient and sustainable growth path. The overall expansion that lasted over several decades was strongly driven by internal and external factors, namely the commodity boom, wide access to external financing and increases in structural demand coupled with expansionary policies. Alberola provided several possible reasons for the recent crises in Latin America, like loose financial conditions and sharp increases in credit. According to Alberola, countries in the region now possess stronger lines of defense than in the past. The challenges that lie ahead include the generally lower level of economic growth and its impact on financial stability.

Against the background of the risks and challenges emanating from emerging markets' increasing importance on the global stage, as outlined in Ritzberger-Grünwald's introductory statement, the presented papers broadly covered four topics, namely

monetary policy and capital flows, financial and fiscal stability, economic growth and international economics. While the first two sessions were devoted to the credit channel of monetary policy and the driving forces of capital flows, the focus shifted to fiscal and financial stability after the lunch break. The afternoon session investigated topics such as the macroeconomic consequences of the recent partial default of Argentina, the determinants of foreign bank lending and the relationship between banking sector competition and net interest margins in Central and Eastern Europe.

The first part of the second day was almost exclusively devoted to economic growth issues. The second day kicked off with the workshop's second keynote speech, delivered by Michael Landesmann, Director of Research at the Vienna Institute for International Economic Studies (wiiw). In his talk, he explained that external imbalances are not a problem per se in the context of economic convergence but they may threaten further integration when they become unsustainable. Taking a forward looking stance, he identified the following areas as important determinants of competitiveness: moving toward higher income-elastic products, building a sufficient export capacity and diversifying the export structure to reduce vulnerabilities.

In the following session, three talks discussed several aspects of how key macroeconomic quantities influence economic growth, focusing, inter alia, on the relationship between the real exchange rate and economic growth and the main determinants of capital accumulation in politically unstable regions. Moreover, the question of whether existing output gap estimations for emerging economies should be augmented to account for the global financial cycle was answered.

The final keynote speech, which focused on the implications of an economic deceleration in China for the global economy, was delivered by Iikka Korhonen, Director of the Bank of Finland Institute for Economies in Transition (BOFIT).

According to Korhonen, the Chinese economy is currently characterized by three broad trends: economic growth is trending downward (2015: around 7%, 2016–17: an expected 6%), the structure of growth is changing (moving from investment- to consumption-driven growth), and the liberalization of financial markets is proceeding, regardless of recent market turbulence. The implications of this are: producers of raw materials as well as of machinery and equipment will continue to suffer from less demand and/or lower prices, the use of the renminbi in international transactions will increase, and more China-related capital flows will go in both directions (in and

out of the country).

The final session of the workshop on further selected topics related to emerging market economies featured two papers that dealt with the question of how to optimally nowcast GDP growth in selected Central, Eastern and Southeastern European countries and the relationship between imported intermediate goods and production innovation in India.

The next Emerging Markets Workshop will be organized by the Banco de Espana at the end of 2016.

Focus on European Economic Integration Q4/15

Studies

The mixed success of EU-IMF adjustment programs in Europe – why Greece was different, Riedl, A., Silgoner, M., Knollmayer, A., p. 52-70

The comparison of the economic, financial and fiscal conditions in four EU-IMF financial assistance countries shows that Greece's economy was hit much harder during the crisis than Ireland, Portugal or Spain. While Greece has fallen back into recession and still depends on financial help from the international community, the adjustment programs appear to have been more successful in the other three countries.

The ongoing calamities of the Greek economy are partly the result of especially adverse starting conditions marked by manifold structural problems: Departing from a fairly low level, private debt in Greece surged rapidly. Economic growth in the pre-crisis years was thus credit-financed and consumption-based. This also applies to Ireland and Spain, which started with already comparatively high household debt levels. But in contrast to the latter two countries, credit growth in Greece was also high in the public sector, providing a strong procyclical stimulus to disposable incomes. This boosted domestic demand, whereas the performance of exports remained weak: As a consequence of rapidly growing unit labor costs, the

export Sector in Greece lost competitiveness, just as in Ireland, Portugal or Spain. It is the plurality of imbalances that makes the Greek case unique.

The severity of the recession in Greece was also the result of the extremely strong and frontloaded consolidation efforts made in the middle of a balance sheet recession. These were prompted by the more stringent fiscal requirements in the Greek adjustment programs as compared to the other countries' programs. Austerity measures seriously curbed domestic demand and could not stop debt from rising. Tight credit conditions and wage cuts additionally weighed on domestic demand and thus aggravated the recession.

Overall, the past years have shown that it was important and right to support countries in economic and financial difficulties. But experience with the Greek case has also taught us the limits of established forms of support which were not sufficiently underpinned by investment programs to support domestic demand.

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Is there an added worker effect? – European labor supply during the crisis, Riedl, A., Schoiswohl, F., p. 71-88

This paper analyzes the responsiveness of an individual's labor supply to the job loss of his or her partner – the so-called “added worker effect (AWE).” While the bulk of empirical studies have utilized discrete choice models to identify its existence, we provide a macroeconomic indicator of the AWE in order to assess its economic significance for the labor force participation rate (LFPR). Our empirical analysis focuses on Europe in the period from 2002 to 2012, revealing that the AWE is negatively related to the business cycle and was particularly pronounced during the global financial crisis. While the LFPR increased by roughly 1

percentage point in Europe from 2009 to 2012, half of the effect is attributable to added workers. As our indicator is based on a rich micro dataset (European Labor Force Survey) we are also able to consistently present individual country results for nearly all EU Member States. Our analysis shows high increases in added workers in euro area countries that were strongly affected by financial market stress and in EU countries that experienced the bursting of housing bubbles. By contrast, we do not find an AWE in most Central and Eastern European countries.

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Recent Developments

Development in selected CESEE countries: Robust economic expansion in almost all CESEE EU Member States, fragile growth in Turkey and recession in Russia

Compiled by Josef Schreiner

[Focus on European Economic Integration Q4/15](#)

Outlook for selected CESEE countries: GDP growth steady at 3% in CESEE-6, recession to ease in Russia

Compiled by Julia Wörz

[Focus on European Economic Integration Q4/15](#)

Event Wrap-Ups

Conference on European Economic Integration 2015: Boosting EU Competitiveness – The Role of the CESEE Countries

Compiled by Maria Silgoner, Susanne Steinacher, Julia Wörz

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Toward a Genuine Economic and Monetary Union: Workshop hosted by the OeNB in Vienna on September 10 and 11, 2015

Compiled by Andreas Breitenfellner, Lukas Vesely

[Focus on European Economic Integration Q4/15](#)

Macrofinancial linkages and current account imbalances: a synopsis

A joint conference of the CEPR, IMF, Deutsche Bundesbank, JVI and OeNB, July 2 and 3, 2015, Vienna

Compiled by Luis A. V. Catão, Martin Summer

[Focus on European Economic Integration Q4/15](#)

Miscellaneous

Olga Radzyner Award Winners 2015

Compiled by Markus Eller

[Focus on European Economic Integration Q4/15](#)

Call for Applications: Visiting Research Program



The OeNB invites applications from external researchers for participation in a Visiting Research Program established by the OeNB's Economic Analysis and Research Department. The purpose of this program is to enhance cooperation with members of academic and research institutions (preferably post-doc) who work in the fields of macroeconomics, international economics or financial economics and/or pursue a regional focus on Central, Eastern and Southeastern Europe.

The OeNB offers a stimulating and professional research environment in close proximity to the policy-making process. Visiting researchers are expected to collaborate with the OeNB's research staff on a pre-specified topic and to participate actively in the department's internal seminars and other research activities. They will be provided with accommodation on demand and will, as a rule, have access to the department's computer resources. Their research output may be published in one of the department's

publication outlets or as an OeNB Working Paper. Research visits should ideally last between three and six months, but timing is flexible.

Applications for 2016 should be e-mailed to eva.gehringer-wasserbauer@oenb.at by May 1, 2016.

Applicants will be notified of the jury's decision by mid-June 2016. The following round of applications will close on November 1, 2016.

See also: [Visiting Research Program 2016](#)

Applications (in English) should include

- a curriculum vitae,
- a research proposal that motivates and clearly describes the envisaged research project,
- an indication of the period envisaged for the research visit, and
- information on previous scientific work.

Upcoming Events

The following events are organized by the OeNB and cover CESEE relevant topics. Please note that attendance is by invitation only. If you are interested in participating in one or more of the events, please send an e-mail to ceec@oenb.at.

January 28, 2016	Press conference: Presentation of the EBRD Transition Report 2015-16 "Rebalancing Finance" by Ralph de Haas at the OeNB. By invitation only!
February 26, 2016	78 th East Jour Fixe of the Oesterreichische Nationalbank jointly organized by OeNB and wiiw: "Ukraine – Progress of Reforms and Challenges Ahead." By invitation only!

OeNB Courses at the Joint Vienna Institute (JVI)

For further details see: www.jvi.org and [Program JVI 2016](#)

January 18-21, 2016	Advanced Course on Financial Stability Stress Testing for Banking Systems
April 11-15, 2016	Integration in Europe: European Union and Eurasian Economic Union
May 9-13, 2016	Challenges for Candidate and Potential Candidate Countries in the EU and EMU Accession Process
October 10-14, 2016	Macro-Financial Stability in Central, Eastern and Southeastern Europe
November 21-23, 2016	Cash Circulation and Payment Systems in Austria
November 28-December 2, 2016	Monetary and Financial Statistics Collected and Compiled by the ESCB

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Postal address: P.O. Box 61, A 1011 Vienna, Austria

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