



CROATIAN NATIONAL BANK

Economic policy challenges in CEE

Czech National Bank – Research Open Day
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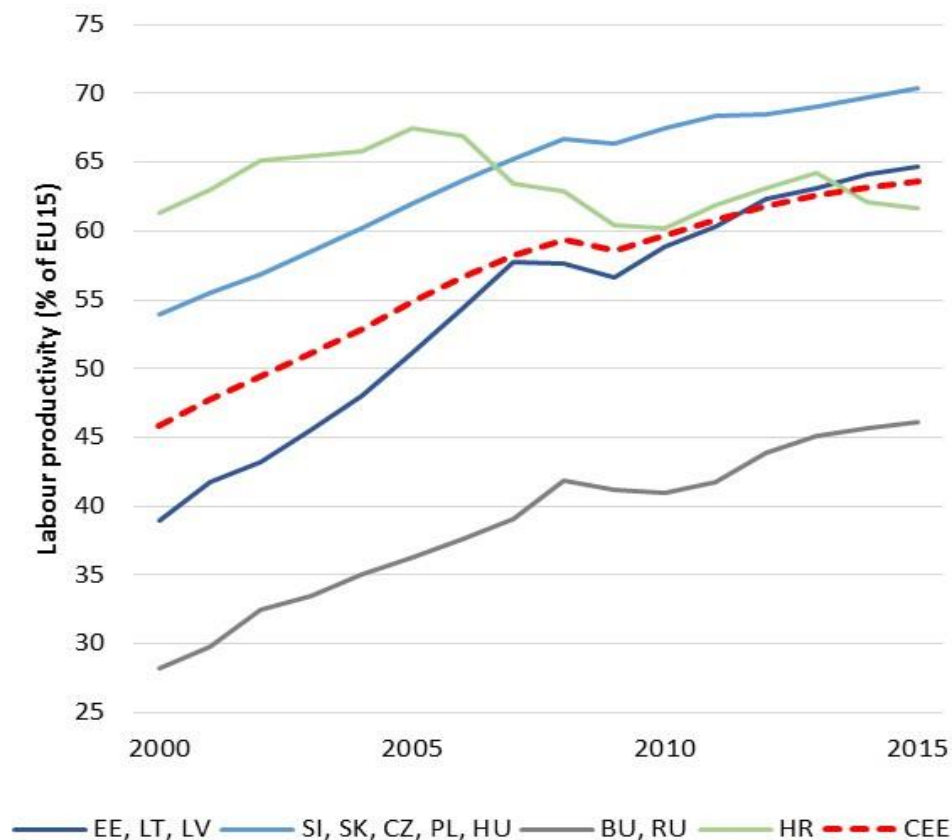
Outline

- 1) **Convergence of CEE countries - where do we stand?**
 1. Still catching-up, but losing momentum
 2. Where is the problem?

- 2) **Re-launching convergence - what options do we have?**
 1. Short term priorities and the role of macro policies
 2. Structural measures for long term growth

1. Convergence – where do we stand?

Still catching up, but losing momentum

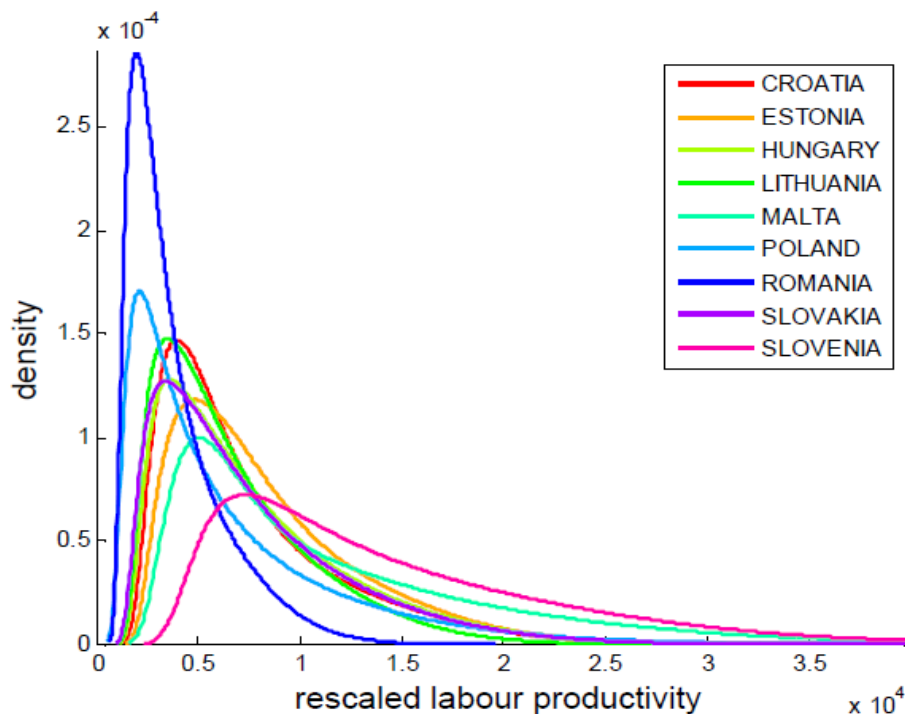


- Low initial productivity levels in CEE countries relative to EU15
- Fast convergence fuelled by foreign capital inflows and transfer of technology and know-how
- Early EU accession was especially beneficial

Note: CEE covers Poland (PL), Czech Republic (CZ), Hungary (HU), Slovakia (SK), Slovenia (SI), Bulgaria (BG), Romania (RO) and Croatia (HR).

Source: Total Economy Database, Conference Board (2015)

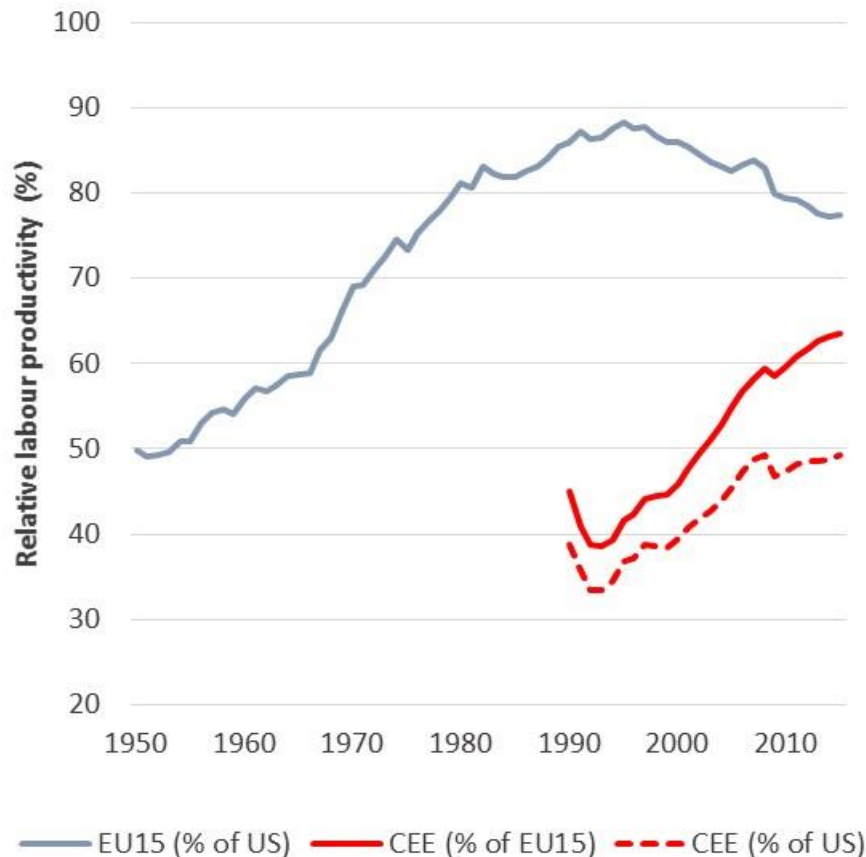
Uneven quality of convergence



- Productivity gains not equally distributed
- Significant differences not only between countries, but also within countries
- Most CEE countries feature a large mass of low productive firms and very few high productive firms
- Reallocation of resources can lead to productivity enhancements

Source: Lopez-Garcia et al. (2015), Assessing European competitiveness: the new CompNet micro-based database, ECB WP N.1764

... looking from a different perspective



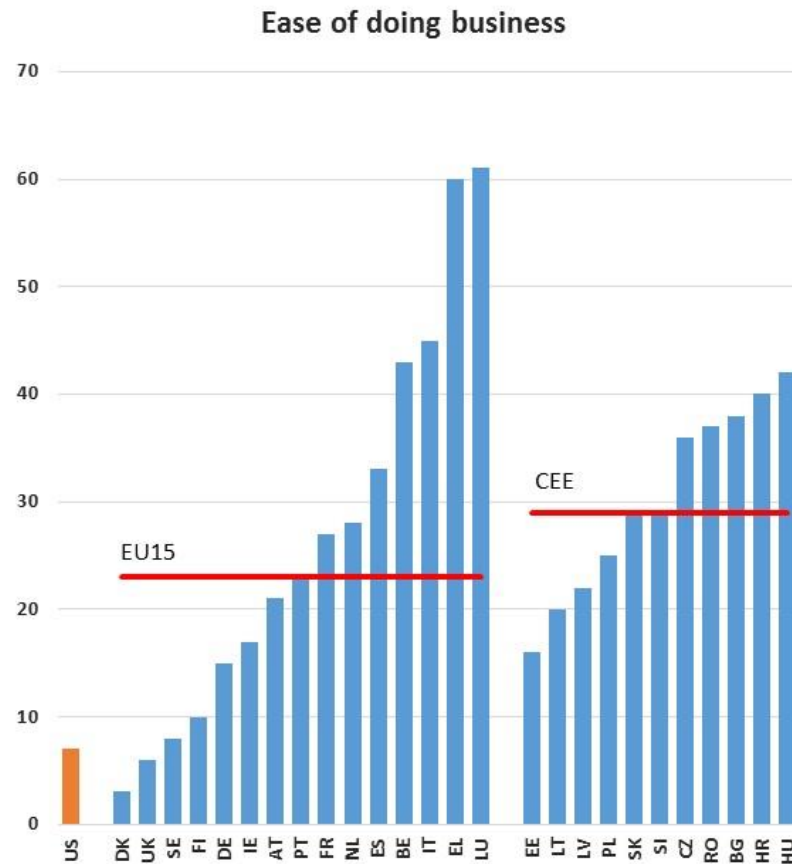
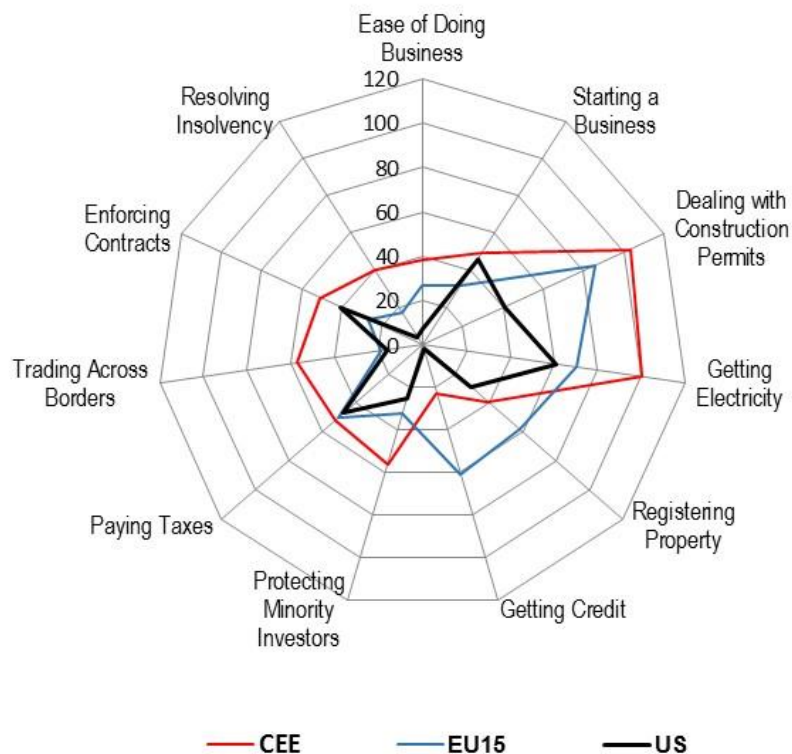
- Europe is generally falling behind the US
- Convergence of EU15 relative to the US stopped in the 1990s, and has been regressing since
- CEE convergence relative to the US stalled since the financial crisis

Source: Total Economy Database, Conference Board (2015)

Where is the problem?

- Former sources of productivity growth are exhausted (FDI)
- More complex sources are needed at higher development stages
- Significant vulnerabilities have accumulated in the meantime
- And there are many structural impediments to growth

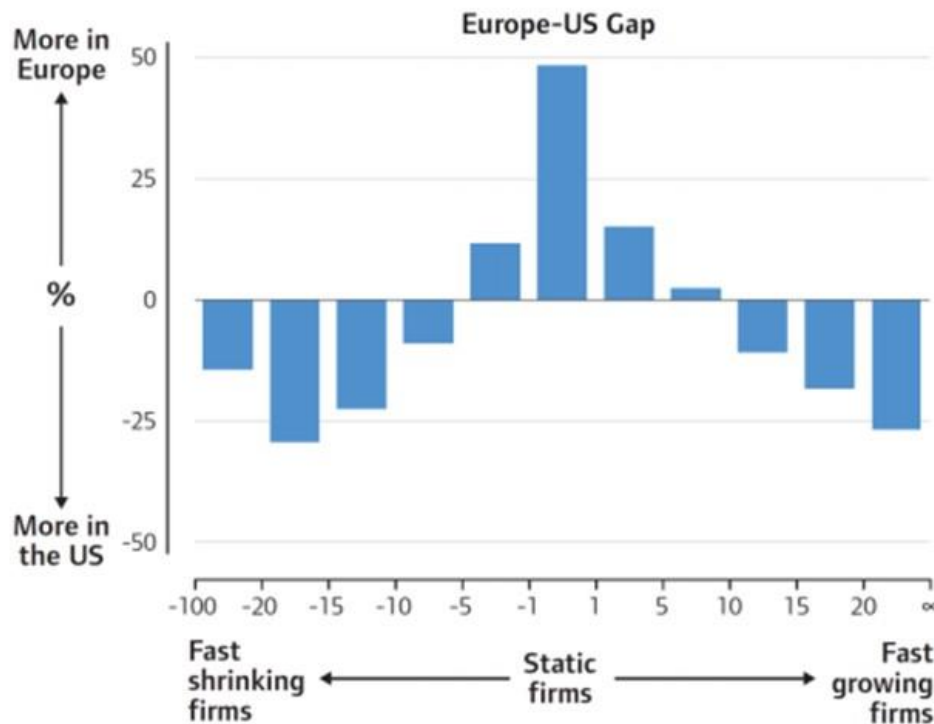
...it has a lot to do with „doing business”



Note: A high ease of doing business (a low numerical rank) means that the regulatory environment is conducive to business operation. EU-15 stands for average of “old” EU member countries.

Source: World Bank, Doing Business 2015

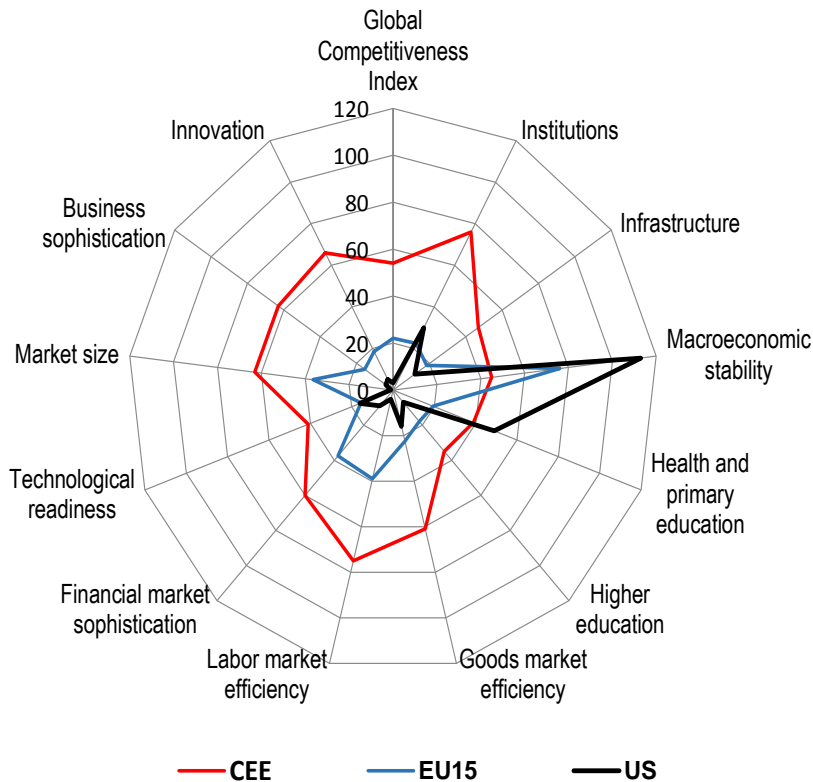
...and the lack of business dynamism in Europe



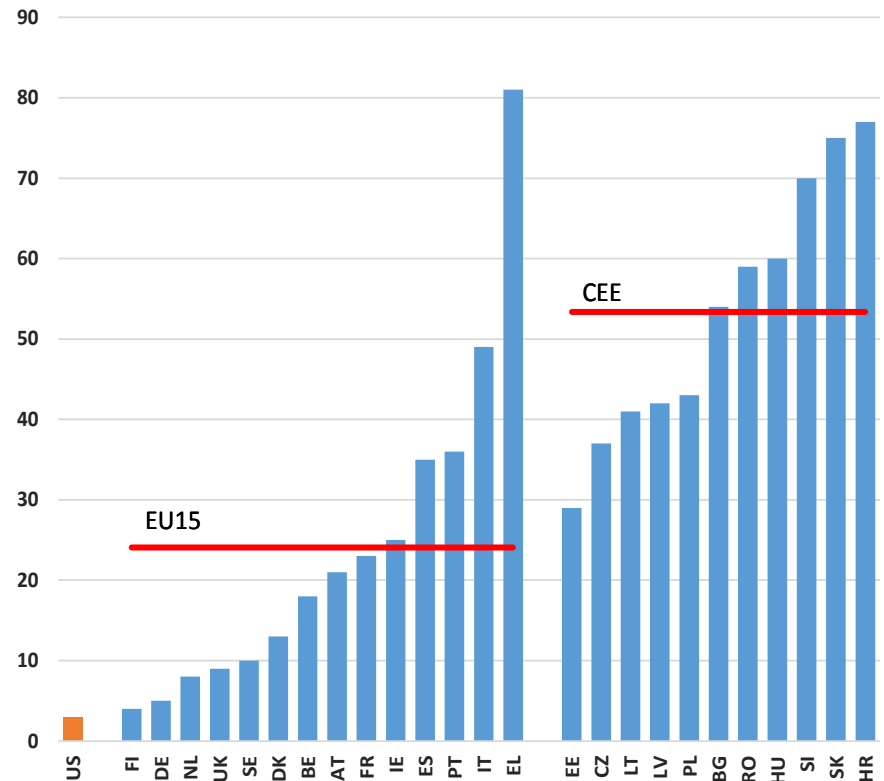
... today's largest and fastest growing companies, like Facebook, Google and eBay, were not created in Europe but in the US.

Source: Biosca, A. B., A look at business growth and contraction in Europe, 2011, 3rd European Conference on Corporate R&D and Innovation

Competitiveness has many aspects...



Global Competitiveness Index

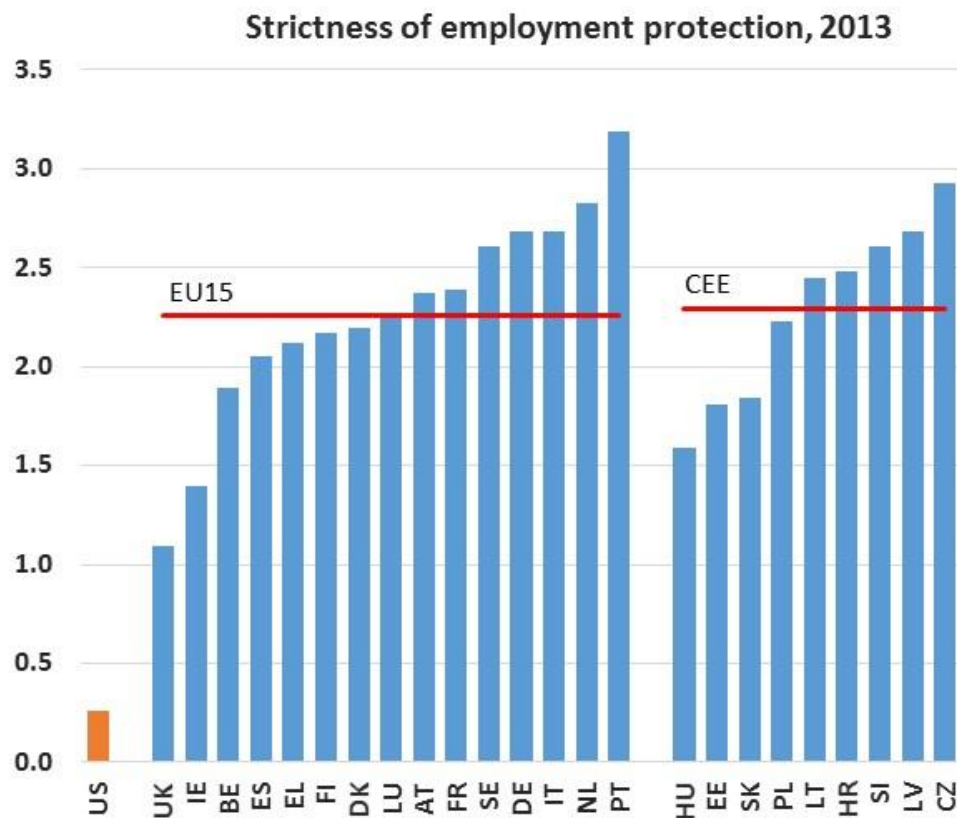


Note: High ease of Global Competitiveness Index (a low numerical rank) means higher degree of competitiveness.

EU-15 stands for average of "old" EU member countries.

Source: World Bank, Doing Business 2015

Labour market regulation

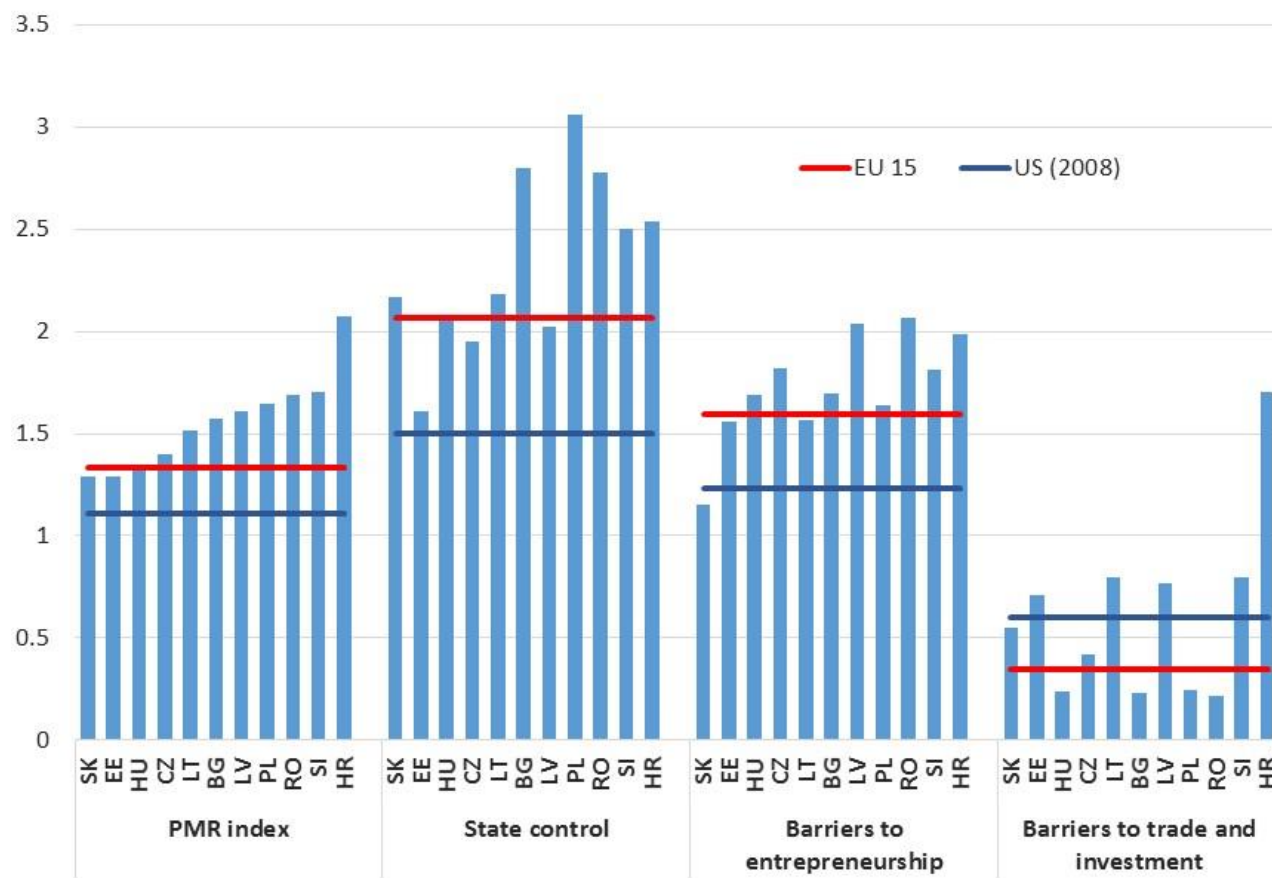


- CEE economies have aligned their labour regulation with the EU15... but both are still much more protective than the US
- Rigid labour markets discourage dynamic industries like the ICT

Note: Individual and collective dismissals - regular contracts are covered. Data for Croatia refers to 2015.

Source: OECD

Product market regulation



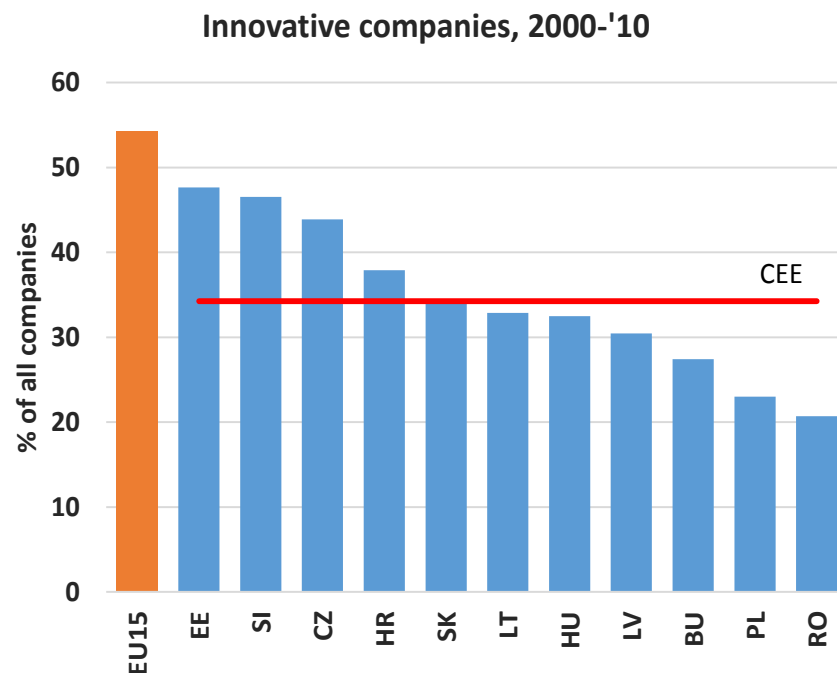
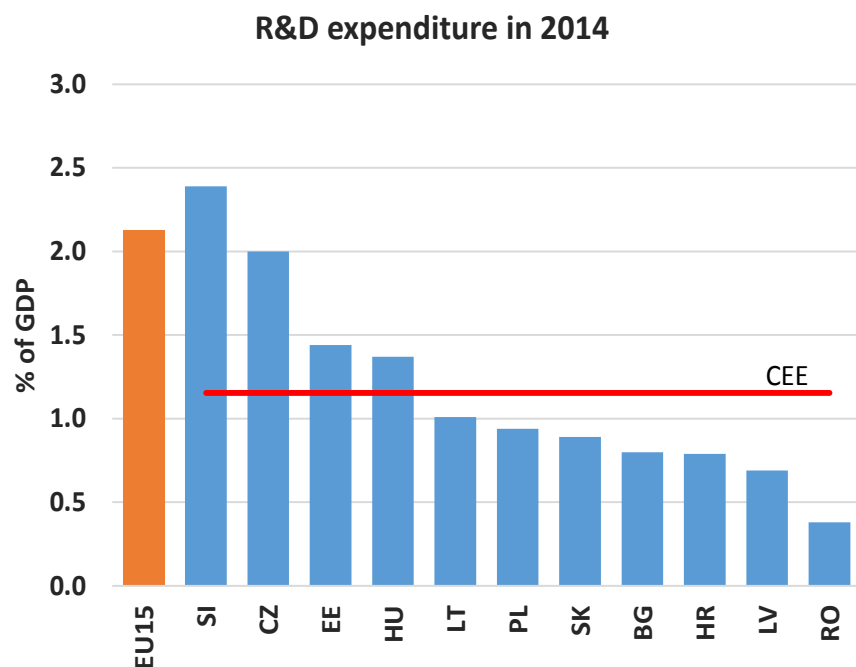
- EU accession – key process behind the product market liberalization in CEE
- Space for improvement in state control and barriers to entrepreneurship

Note: Data refers to 2013, except for the US (2008), due to unavailability. Lower value of PMR index reflects a more competition-friendly regulatory stance.

Source: OECD

Business sophistication and innovation

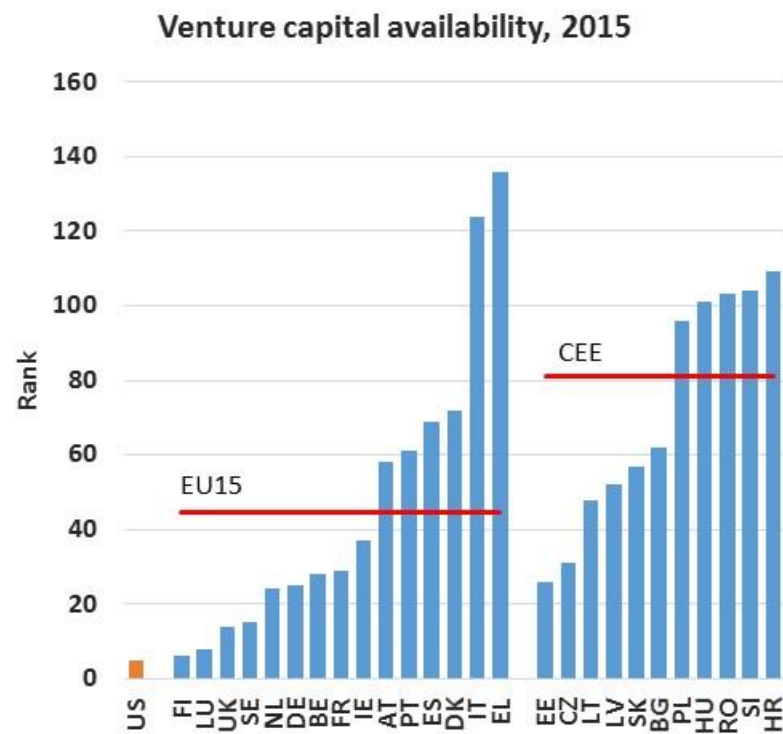
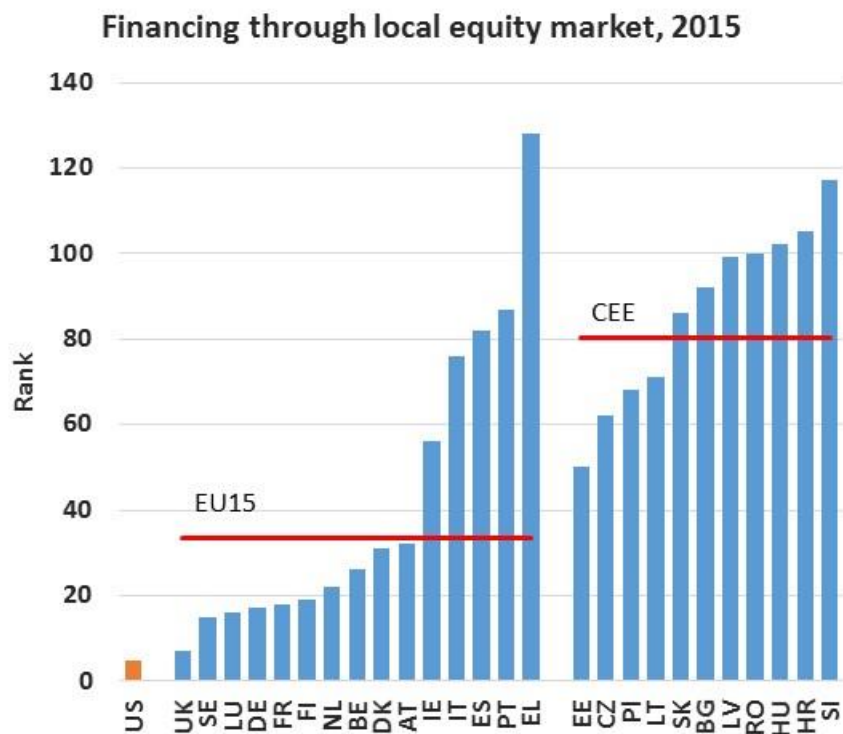
Investment in R&D comes together with innovative business practices.



Source: Eurostat

Access to finance

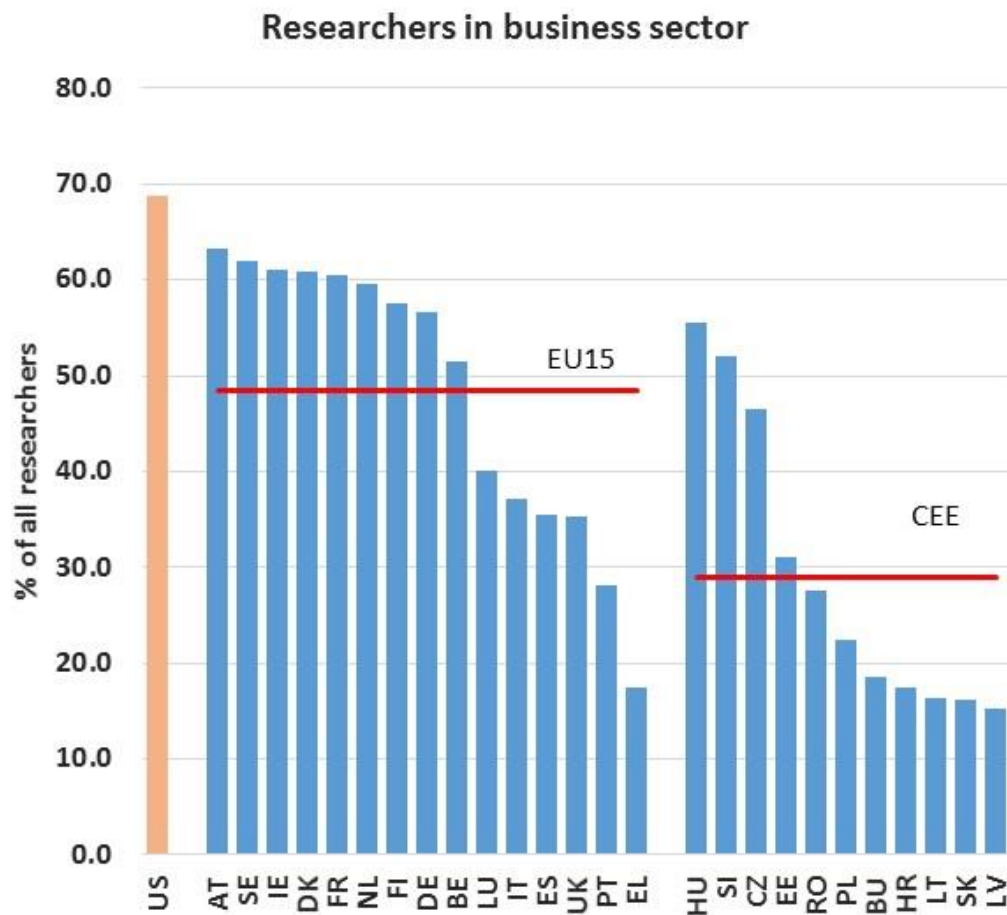
Diversified sources of finance would boost growth of young and innovative companies



Note: Groupings' ranks are based on GDP-weighted country rankings.

Source: Global Competitiveness Report 2016

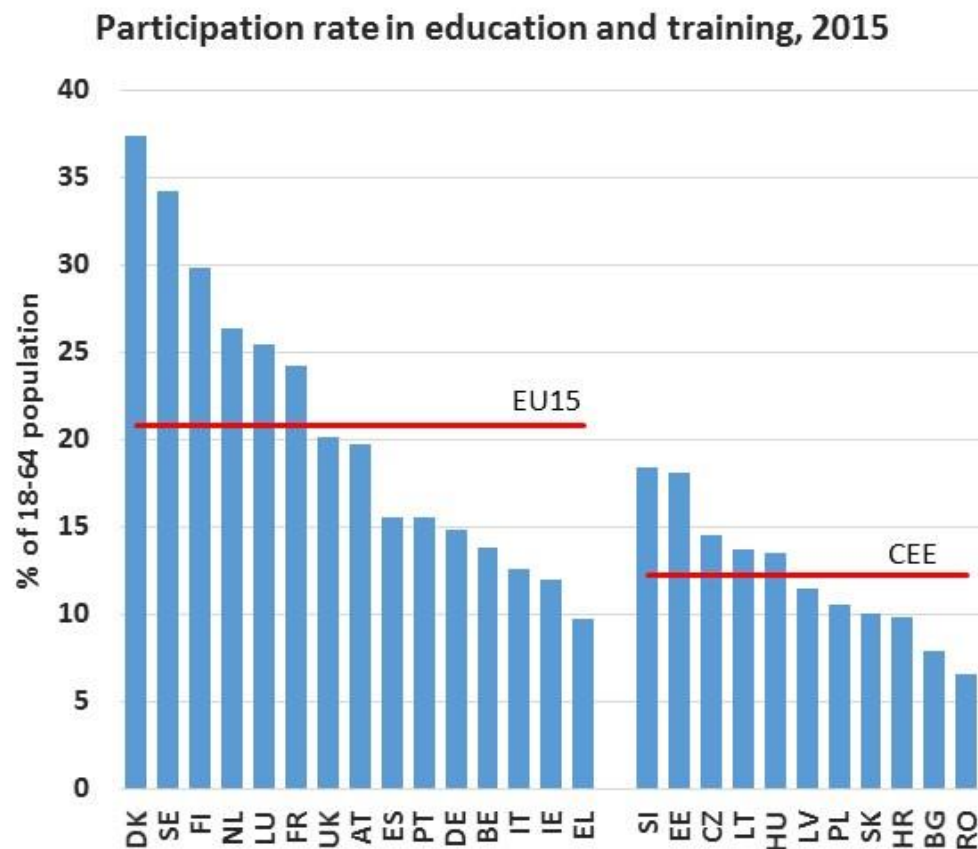
Education and business sector – disconnected



The integration of research activities into the business sector is still low in most CEE economies.

Source: Eurostat

Lifelong learning – underestimated in CEE



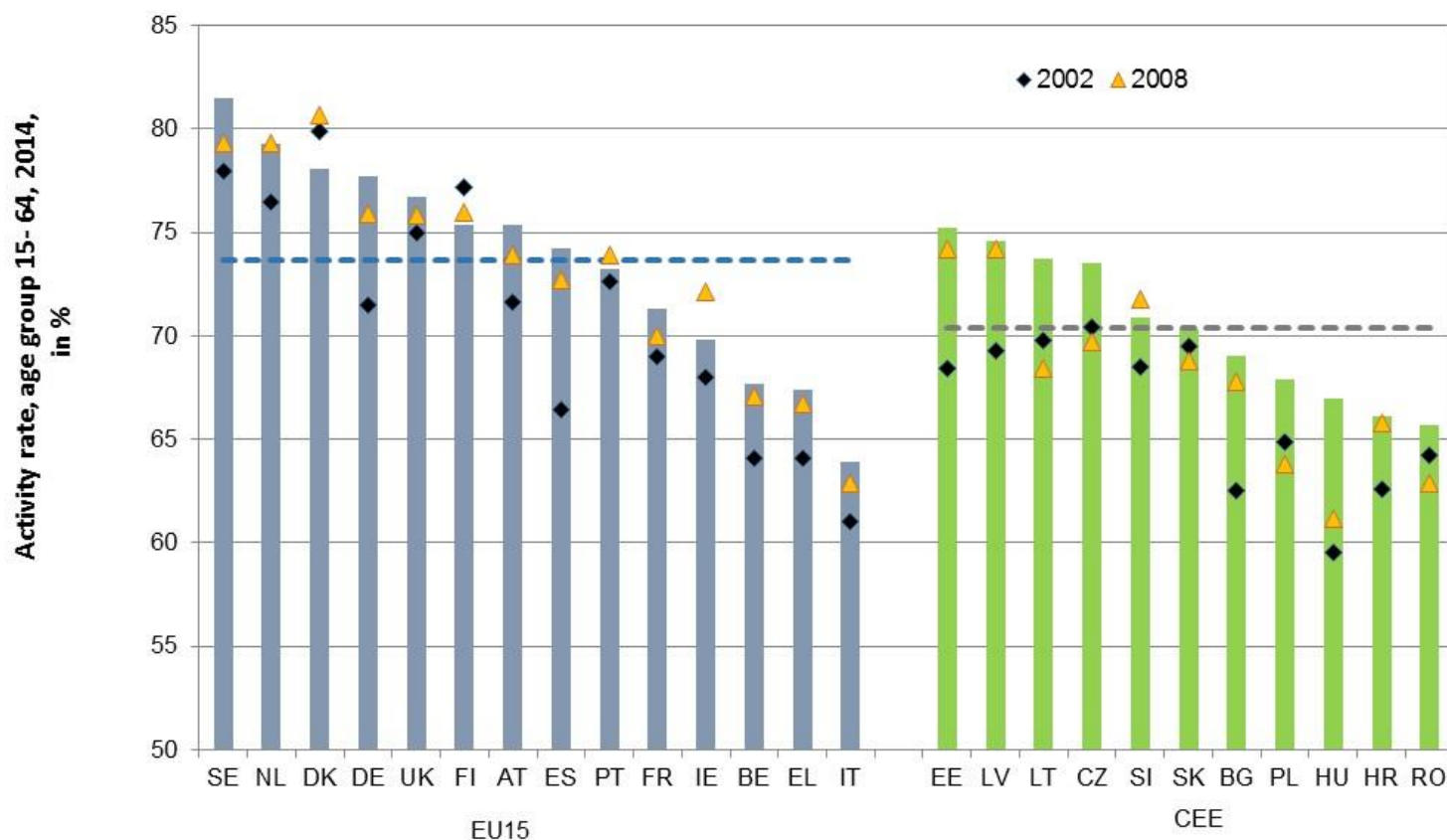
The importance of lifelong learning cannot be overemphasized

...in some CEE countries less than 1/10 of employees are enrolled in an educational program

Source: Eurostat

...accompanied with pressing challenges in the labour market

...in some countries more than 1/3 of work-age population inactive

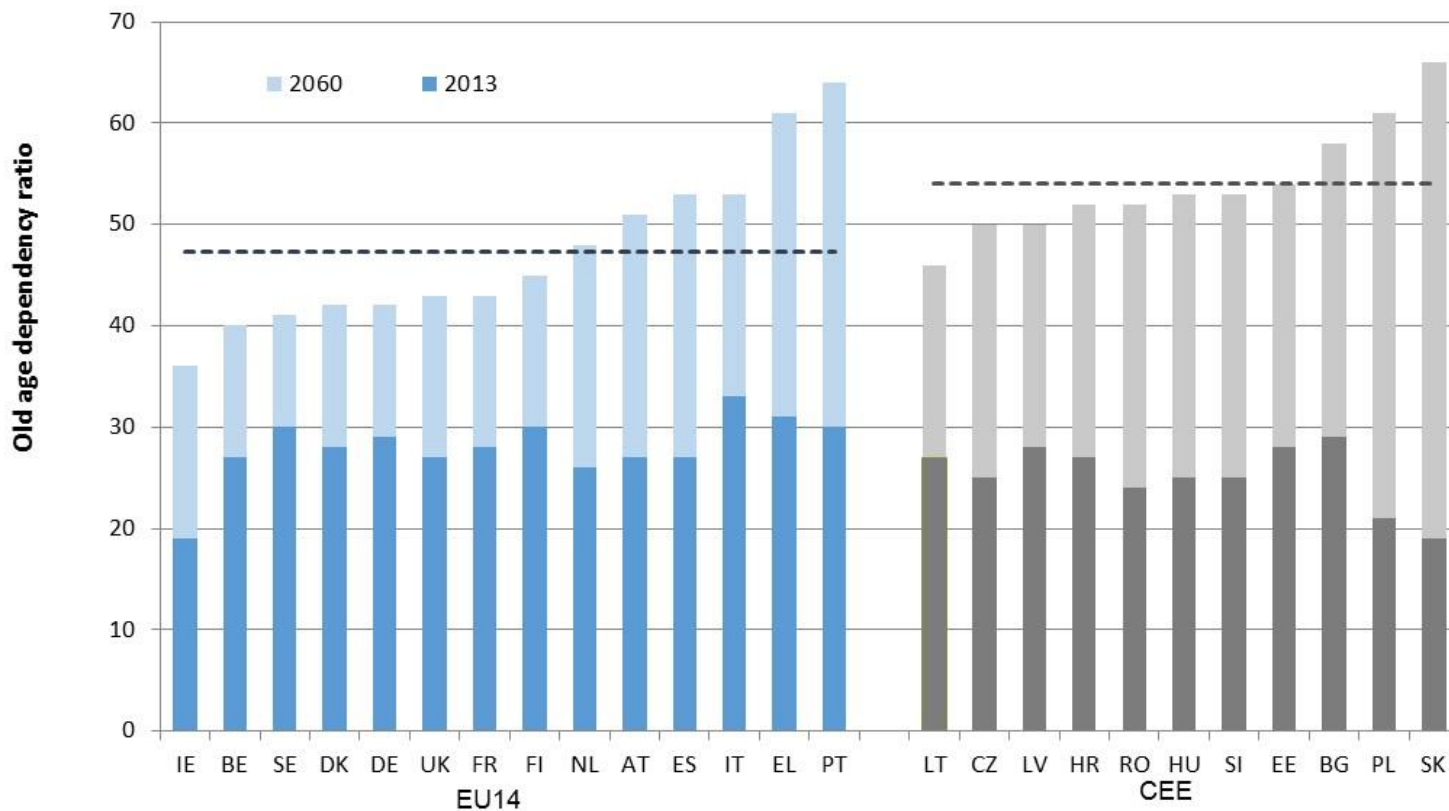


Source: Eurostat

Burden of old age pensions will also grow

Economic old-age dependency ratio (15-64) =

Inactive population aged 65+ as % of population aged 15-64



Source: Eurostat

2. Re-launching convergence – what options do we have?

In the short term...

- Activating new (domestic) sources of growth
 - Boosting private sector investments
 - Providing investment-friendly environment
 - Better allocation of scarce FDI (directing into tradable sector)
 - Better absorption of the EU funds
- Macro policies - focus on reducing vulnerabilities and rebuilding resilience (key for restoring investors' confidence and cost of financing)

In the long term, structural reforms are key

- Moving to more flexible and knowledge-based growth model
- Key reform areas
 - Business environment – reducing the complexity and cost of compliance
 - Product market reforms – removing barriers to entrepreneurship
 - Labour market reforms – promoting higher labour force participation
 - Human capital development – reconnecting education and business

Thank you!