

# Catching-up and Economic Integration: Unresolved Problems in the Light of the Recent Crisis

Michael Landesmann

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Economic Integration and Competitiveness: Challenges created by the Global Crisis

## Economic Integration and Emerging Economies: Pitfalls revealed in Repeated Crises

- The role of (deep) financial market integration
- The nature of external and internal imbalances
- The crucial role of exchange rate regimes
- European and other emerging economies – do they differ?
- The E(U)ropean integration model of catching-up
- Constrained policy choices in different environments
- Have we found solutions?

## Comparing emerging market economies (EMEs)

- **CE-5:** Czech Republic, Hungary, Poland, Slovakia, Slovenia
- **B-3:** Estonia, Latvia, Lithuania
- **SEE-2:** Bulgaria, Romania
- **WB-6:** Albania, Bosnia and Herzegovina, Croatia, Former Yugoslav Republic of Macedonia, Montenegro, Serbia
- **B-SEE:** B-3 + SEE-2 + WB-6
- **EU-COH:** Greece, Portugal, Spain, Ireland
- **Turkey**
  
- **ASIA-6:** Indonesia, Korea, Malaysia, Philippines, Taiwan, Thailand
- **LATAM-8:** Argentina, Brazil, Chile, Columbia, Ecuador, Mexico, Peru, Uruguay
- **MENA-6:** Egypt, Jordan, Lebanon, Morocco, Syria, Tunisia

## Comparing emerging market economies (EMEs)

- **European EMEs:**  
CE-5; B-SEE (B-3, SEE-2; WB-6); EU-COH; Turkey
- **Non-European EMEs:**  
ASIA-6 (w/o China, India); LATAM-8; MENA-6 (non-oil)
- **Focus areas:** specific characteristics of European integration; European vs. global capital market integration; evolution of disequilibria; policy environment and policy choices

## The European integration model of catching-up

- targeted at **integration with the EU/Euro area**
- associated with very far-reaching internal and **external liberalization** (trade, capital transactions, financial market integration, labour mobility)
- **benefits**: ‘downhill’ capital inflows, trade integration, ‘technology’ transfer; institutional convergence
- the model worked - ‘convergence process’ – **but** emergence of severe **structural imbalances** in important groups of European EMEs; **heterogeneity** of pre- and post-crisis experience of European EMEs

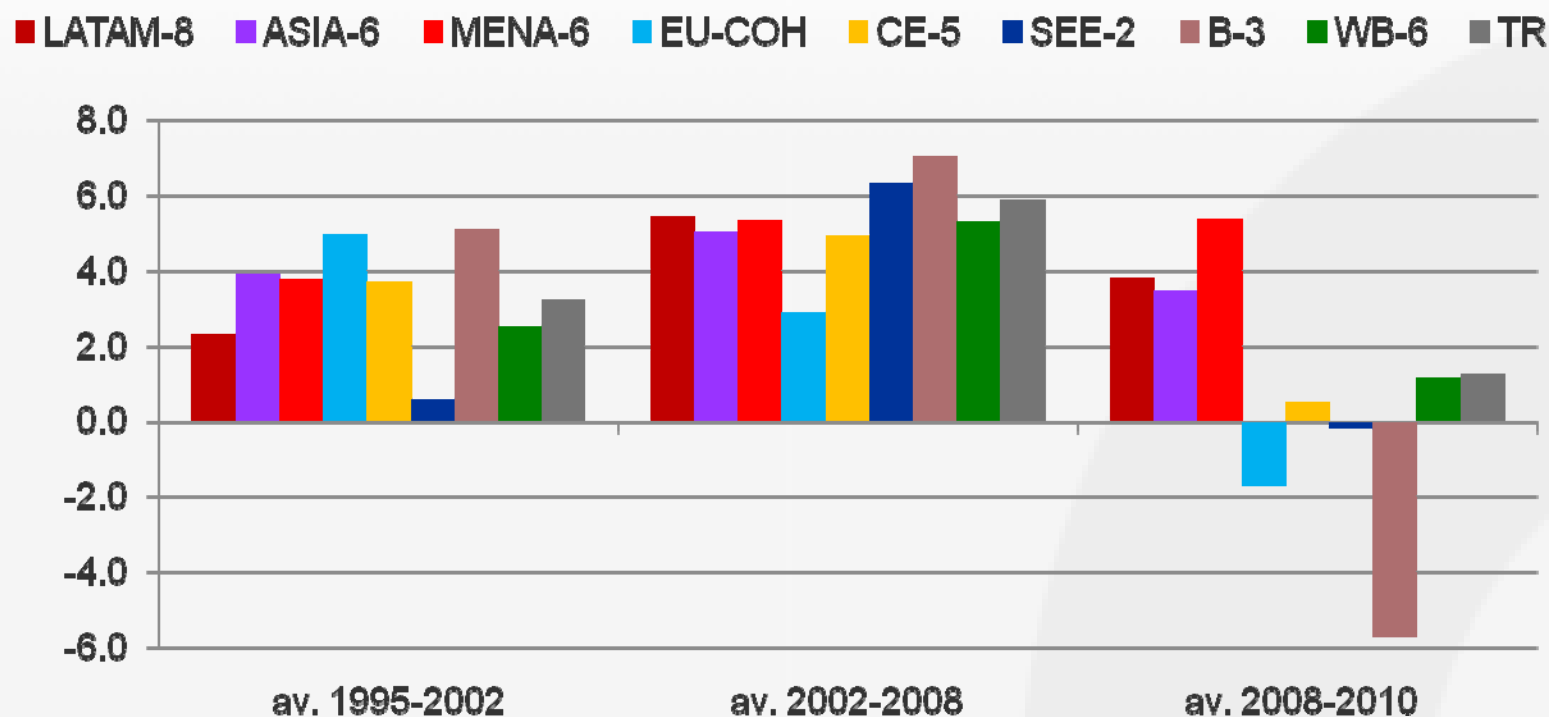
## ‘Growth models’ in emerging economies

- The question of ‘downhill’ vs. ‘uphill’ capital flows in the global economy (see e.g. Prasad/Rajan/Subramanian, 2006; Gourinchas/Jeanne, 2009; Abiad/Leigh/Mody, 2009)
- The issue of financial and monetary integration and catching-up economies (‘threshold’ effects, ‘institutional anchoring’)
- The nature of external disequilibria and the composition of capital (in)flows; role of exchange rate regimes
- Which disequilibria are ‘sustainable’ and under which external circumstances?
- The available spaces for policy choices

## Growth performance and characteristics of the different EMEs before and during the crisis

## Growth - GDP at constant prices

Average annual growth rates, 1995-2010, in %



Source: IMF World Economic Outlook, October 2010.

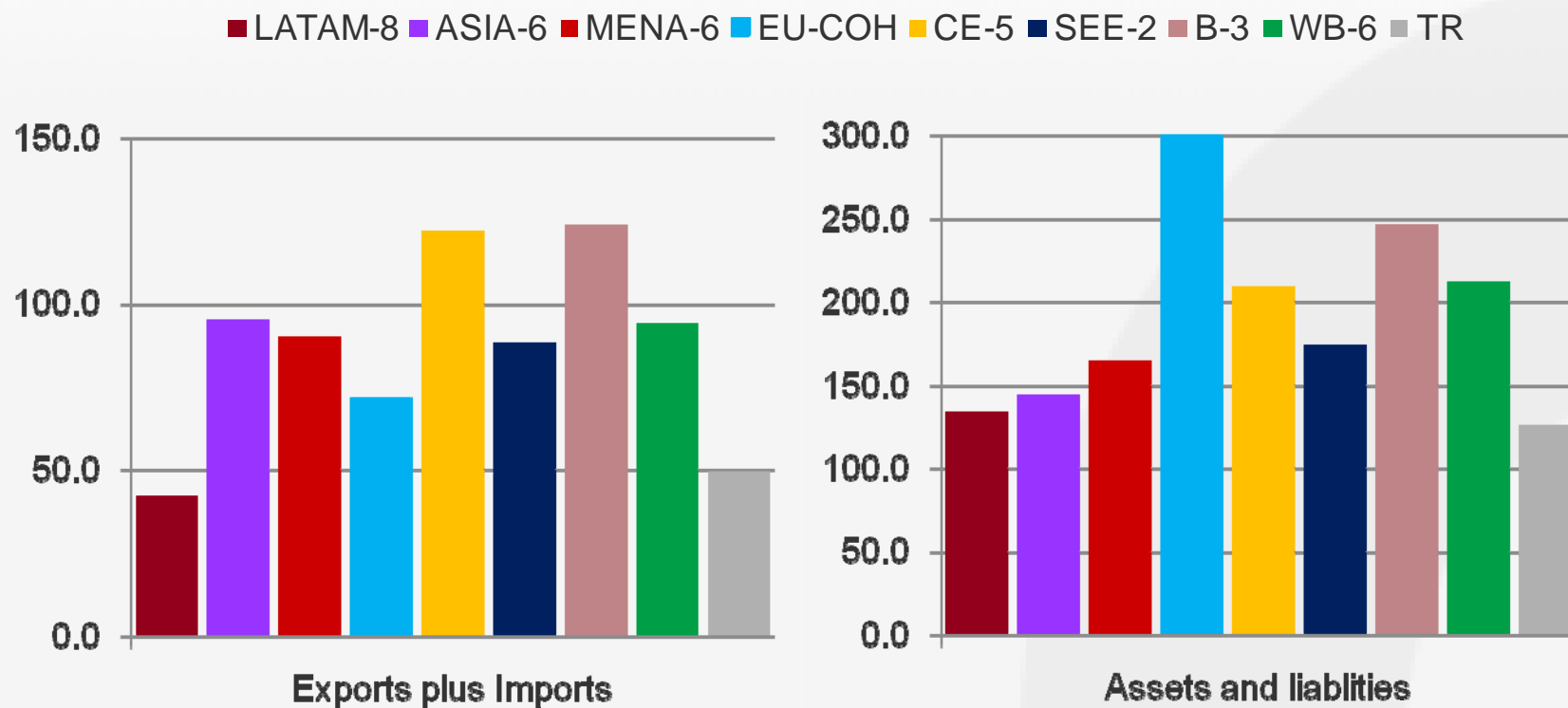
EBRD and wiiw Annual Database incorporating national statistics, Eurostat..



## Differentiating features of EMEs

- Degree of openness:
  - trade integration; financial market integration
- Private sector borrowing and debt
- External disequilibria: current accounts, composition of capital flows; real exchange rate developments
- Sectoral 'distortions' (tradable/non-tradable sectors); FDI allocation
- Fiscal policy during the crisis
- Recovery from the crisis

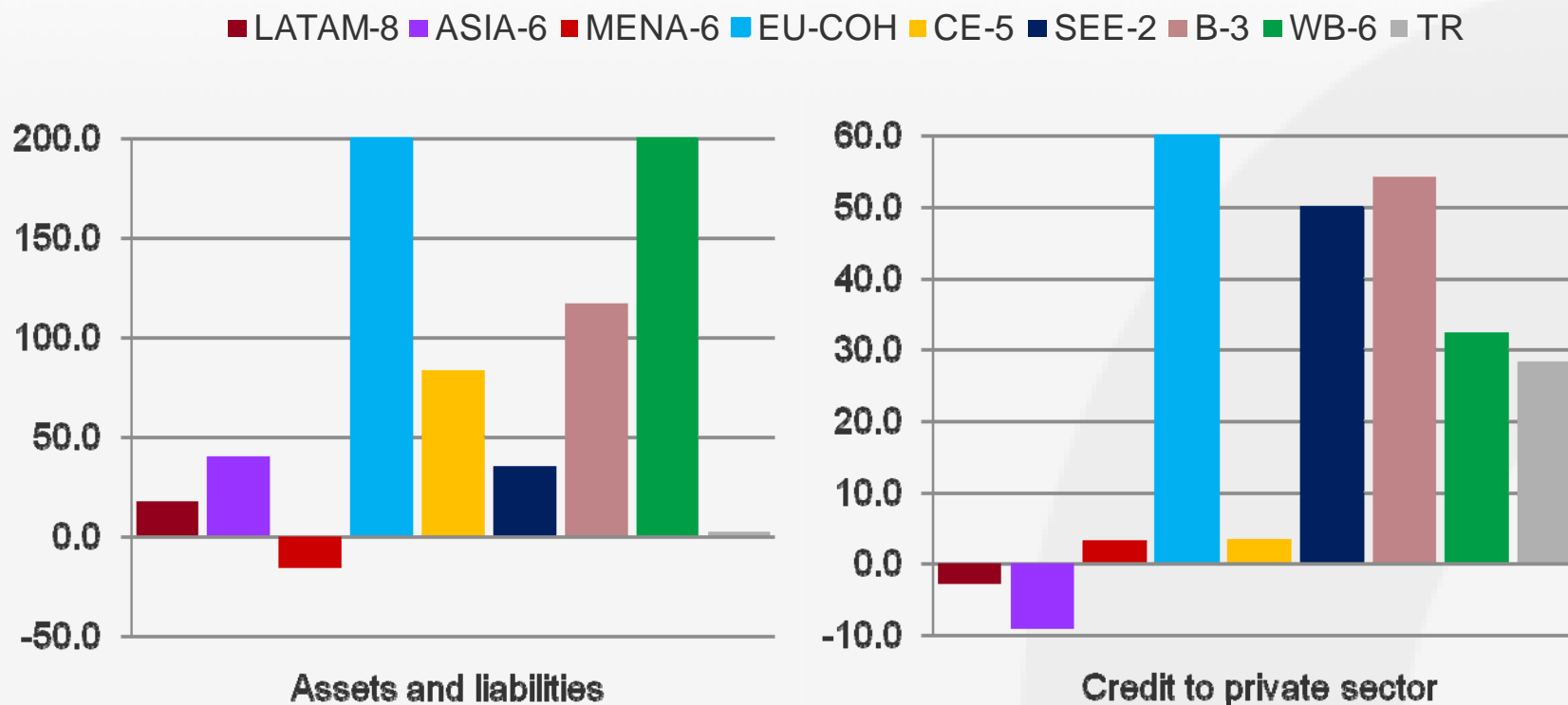
# Openness indicators: trade and financial integration, 2007 in % of GDP



Note: Assets and liabilities: EU-COH: 618.1%; ASIA-6 excl. Taiwan, MENA-6 excl. Lebanon.

Source: IMF International Financial Statistics.

## Financial integration - Changes in: (i) assets plus liabilities; (ii) credit to private sector in % of GDP (percentage point change), 2001-2007

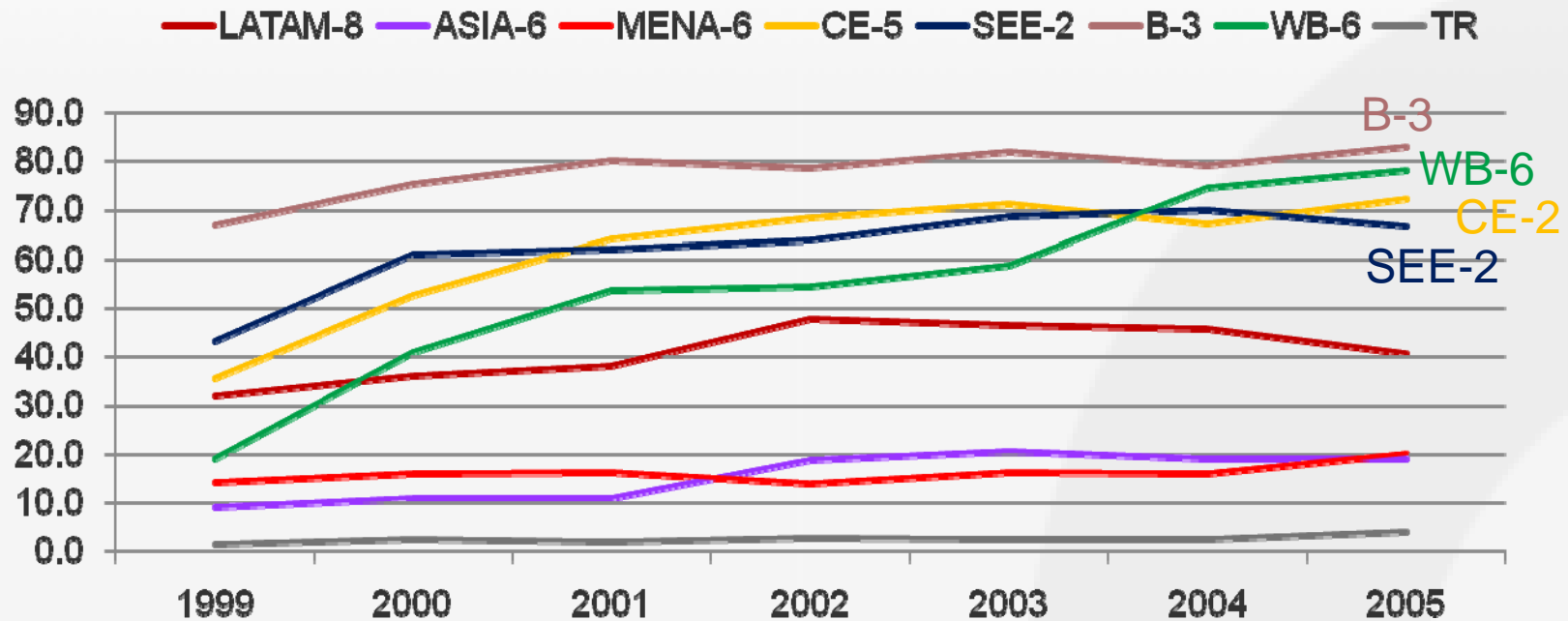


Note: Assets and liabilities: EU-COH: 265.82%; WB-6: 212.14%.

Source: IMF International Financial Statistics. ASIA-6 excl. Taiwan, MENA-6 excl. Lebanon.

## Foreign bank ownership, 1998-2005

(assets owned by foreign banks as % of banking system assets)



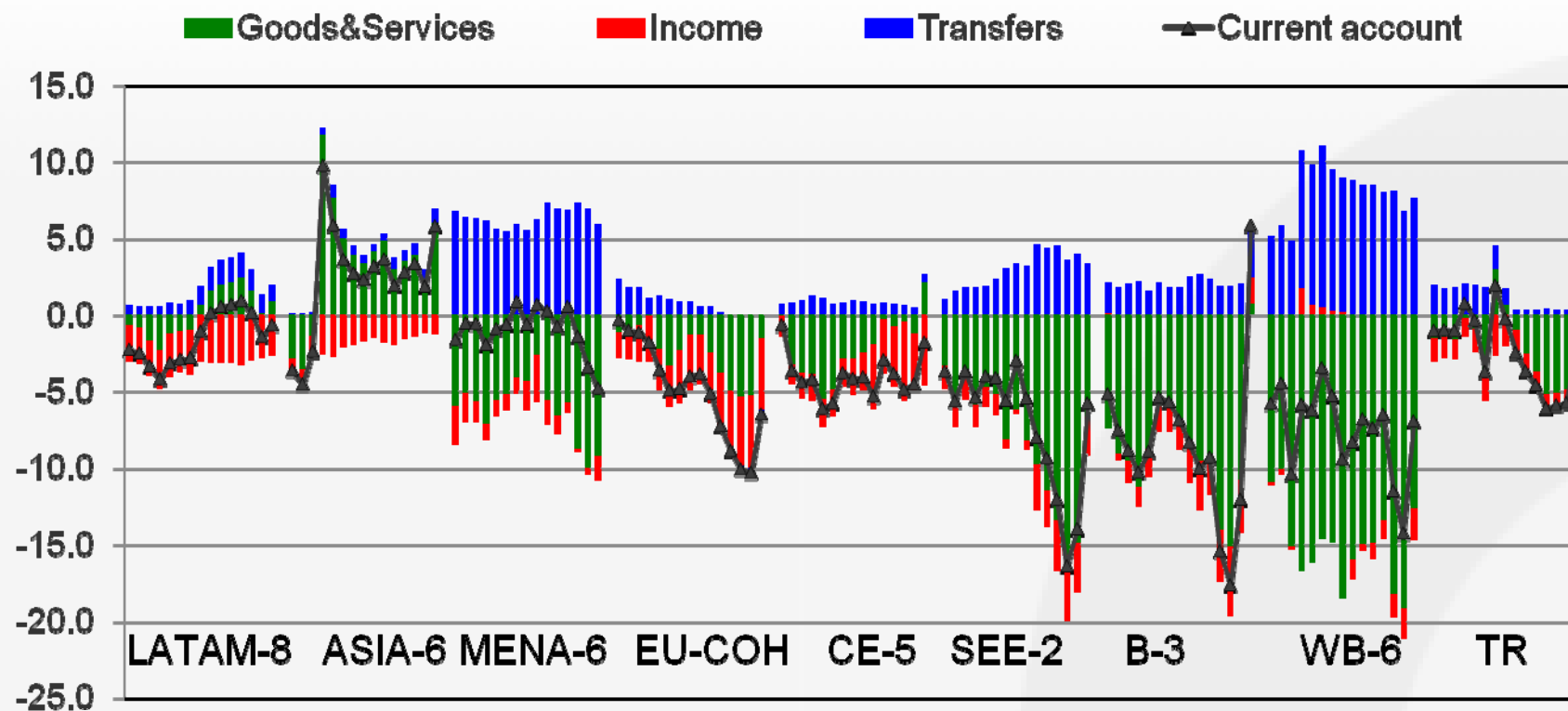
Note: ASIA-6 excl. Taiwan, MENA-6 excl. Syria.

Source: from Claessens et al (2008).

## Summarizing some of the features of European EMEs compared to other EMEs

- High growth prior to the crisis
- High indicators for openness: trade and particularly strong growth in international financial integration
- Much greater role of foreign banks in European EMEs compared to other EMEs
- Fast growth of credit to private sector in European EMEs
- The build-up of significant disequilibria before the crisis

## Composition of the current account of the balance of payments, 1995-2009

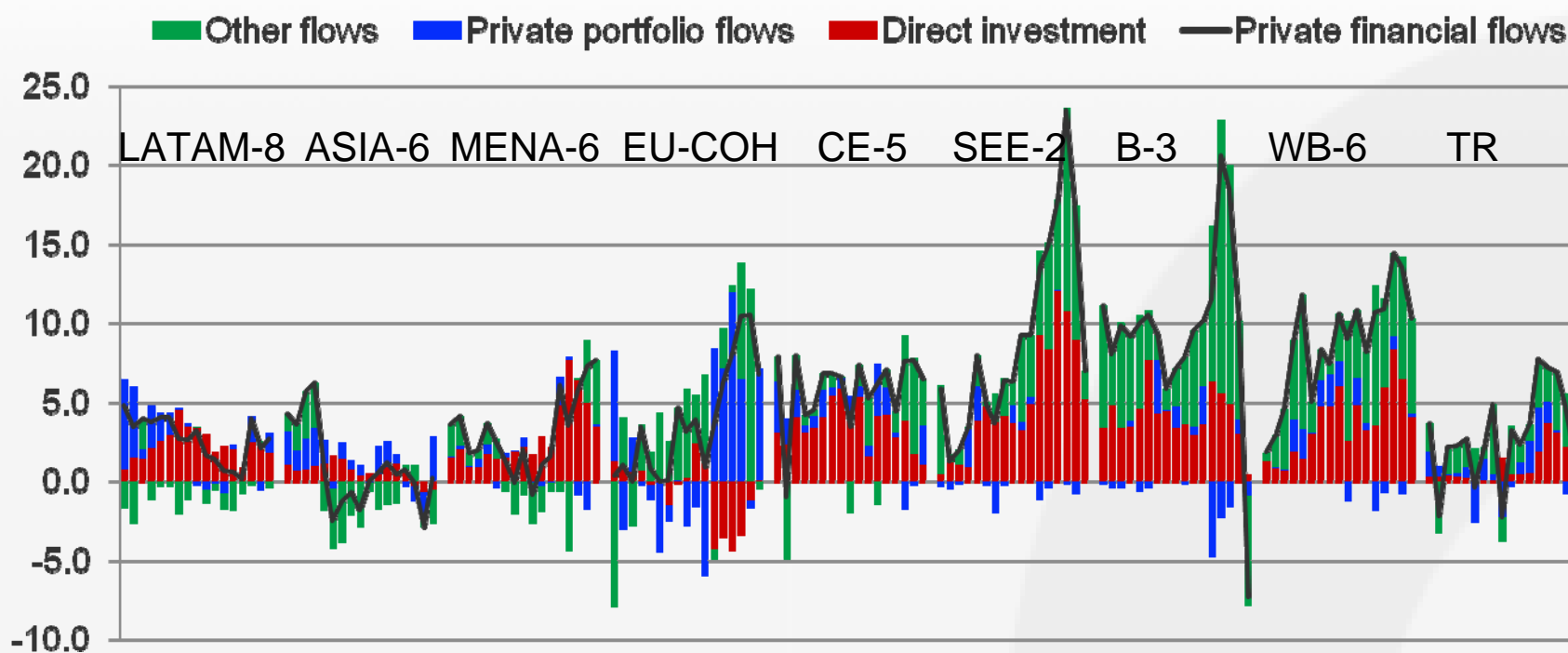


Note: ASIA-6 excl. Taiwan.

Source: IMF International Financial Statistics and IMF WEO October 2010.

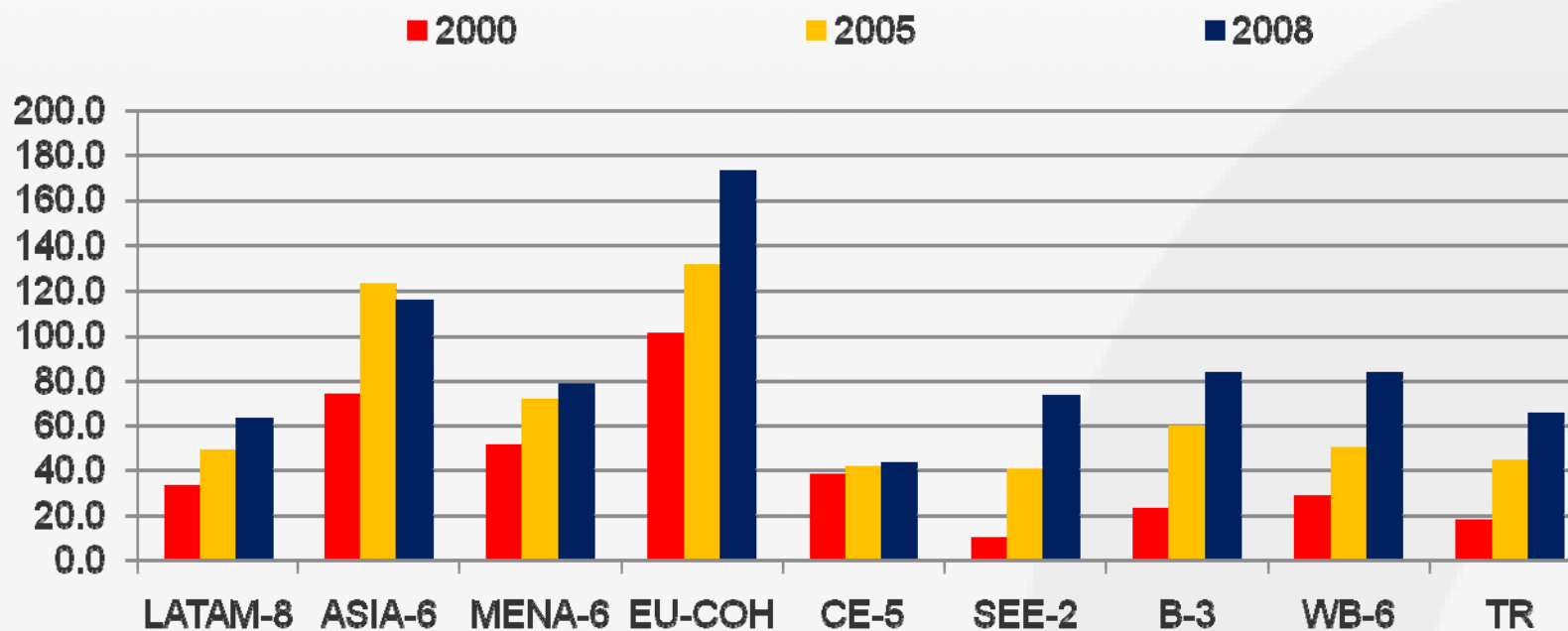
# Net private financial flows

in % of GDP, 1993-2009



Source: IMF Balance of Payments Statistics. ASIA-6 excl. Taiwan.

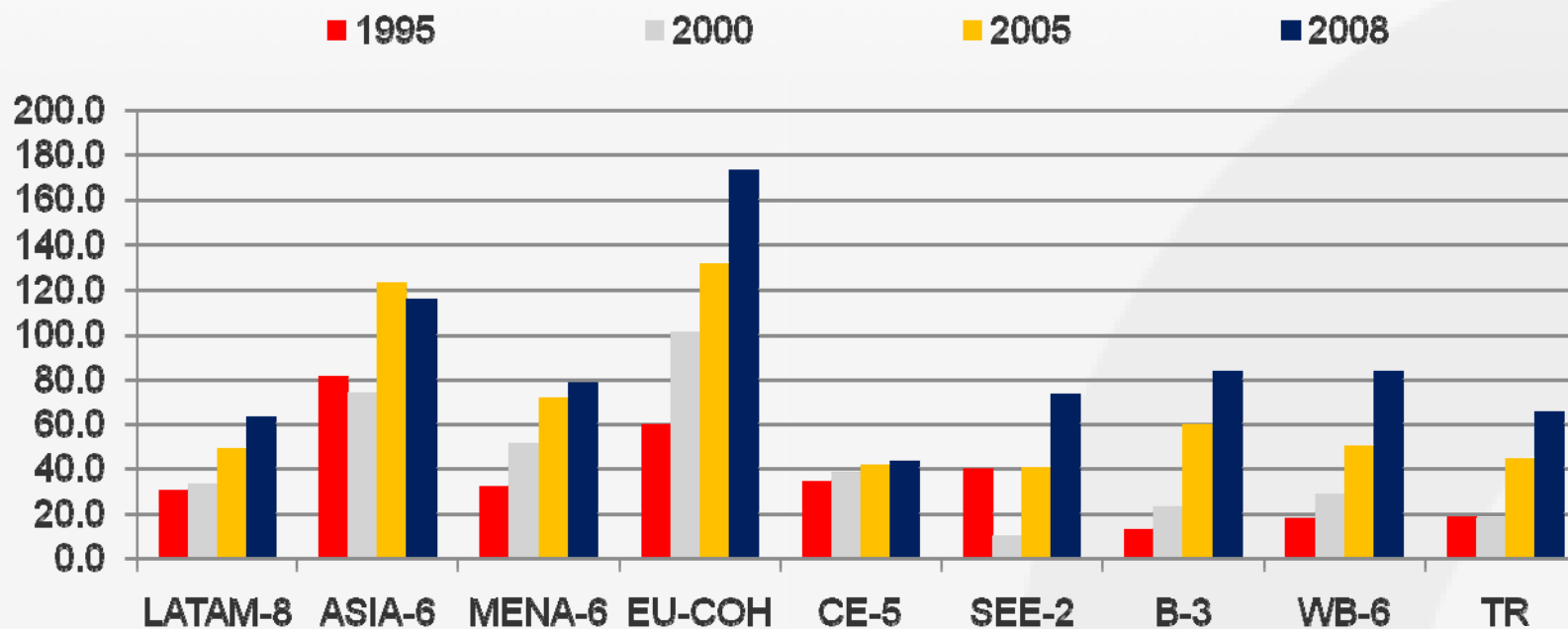
## Credit to the private sector, 2000-2008 in % of GDP



Source: IMF International Financial Statistics. ASIA-6 excl. Taiwan, MENA-6 excl. Lebanon.

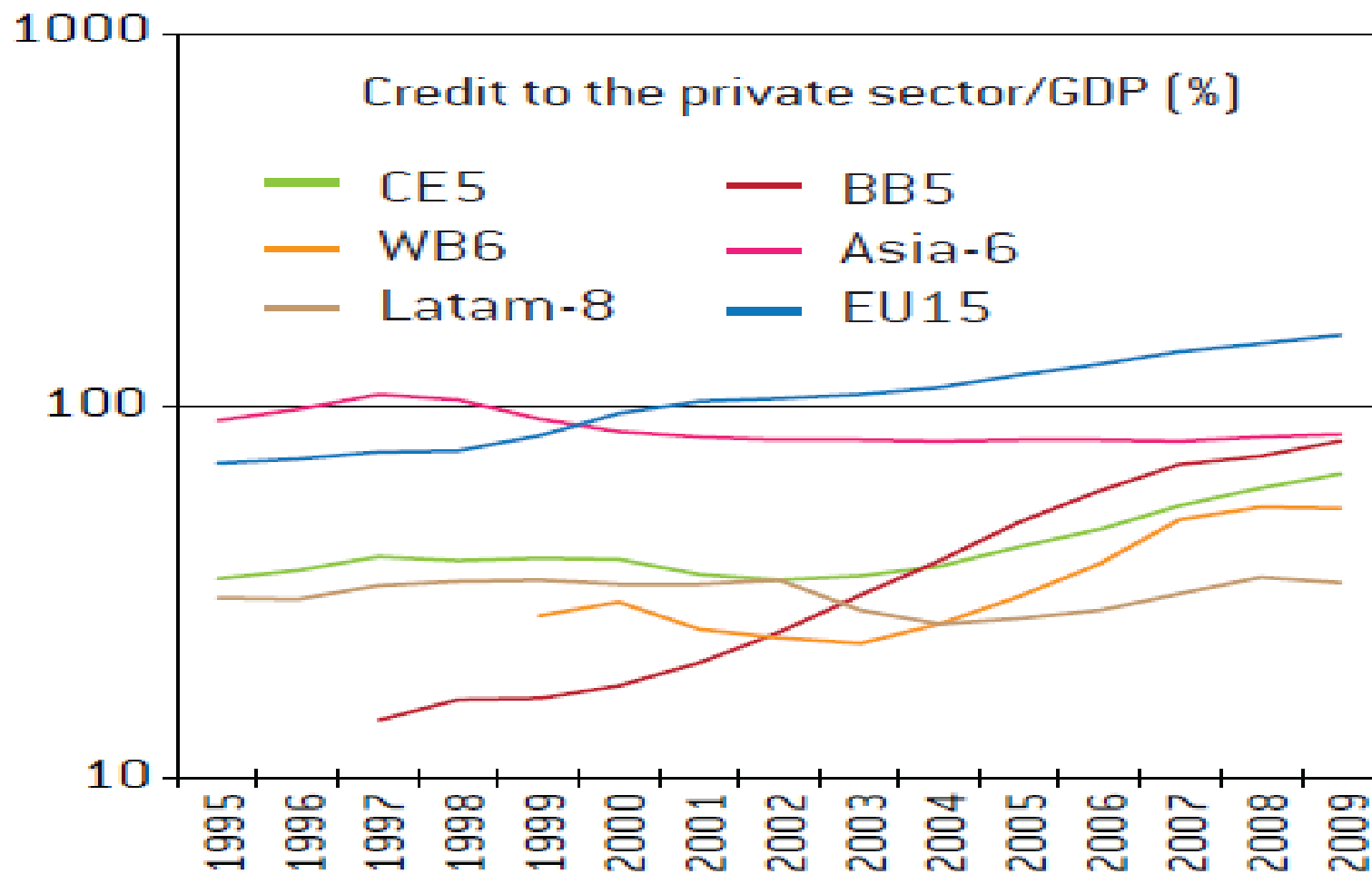


## Credit to the private sector, 1995-2008 in % of GDP

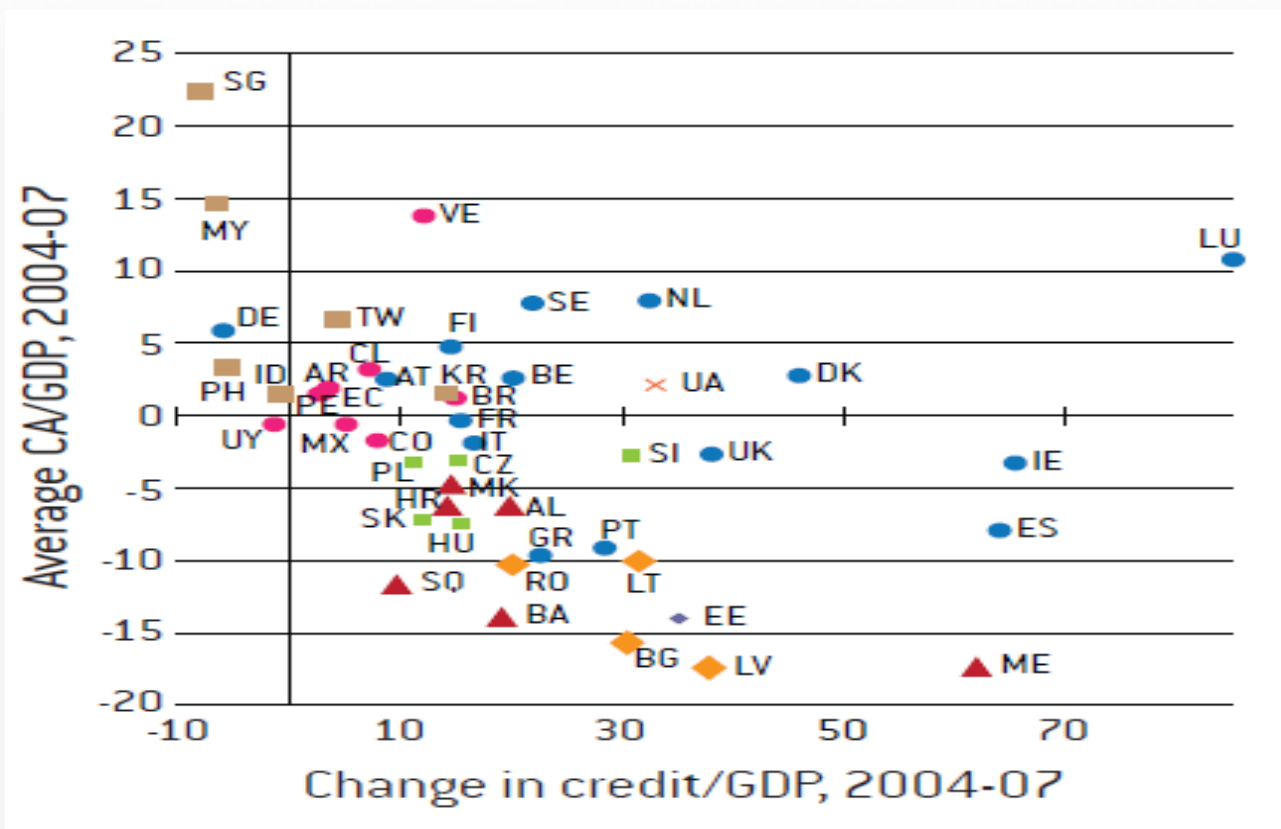


Source: IMF International Financial Statistics. ASIA-6 excl. Taiwan, MENA-6 excl. Lebanon.

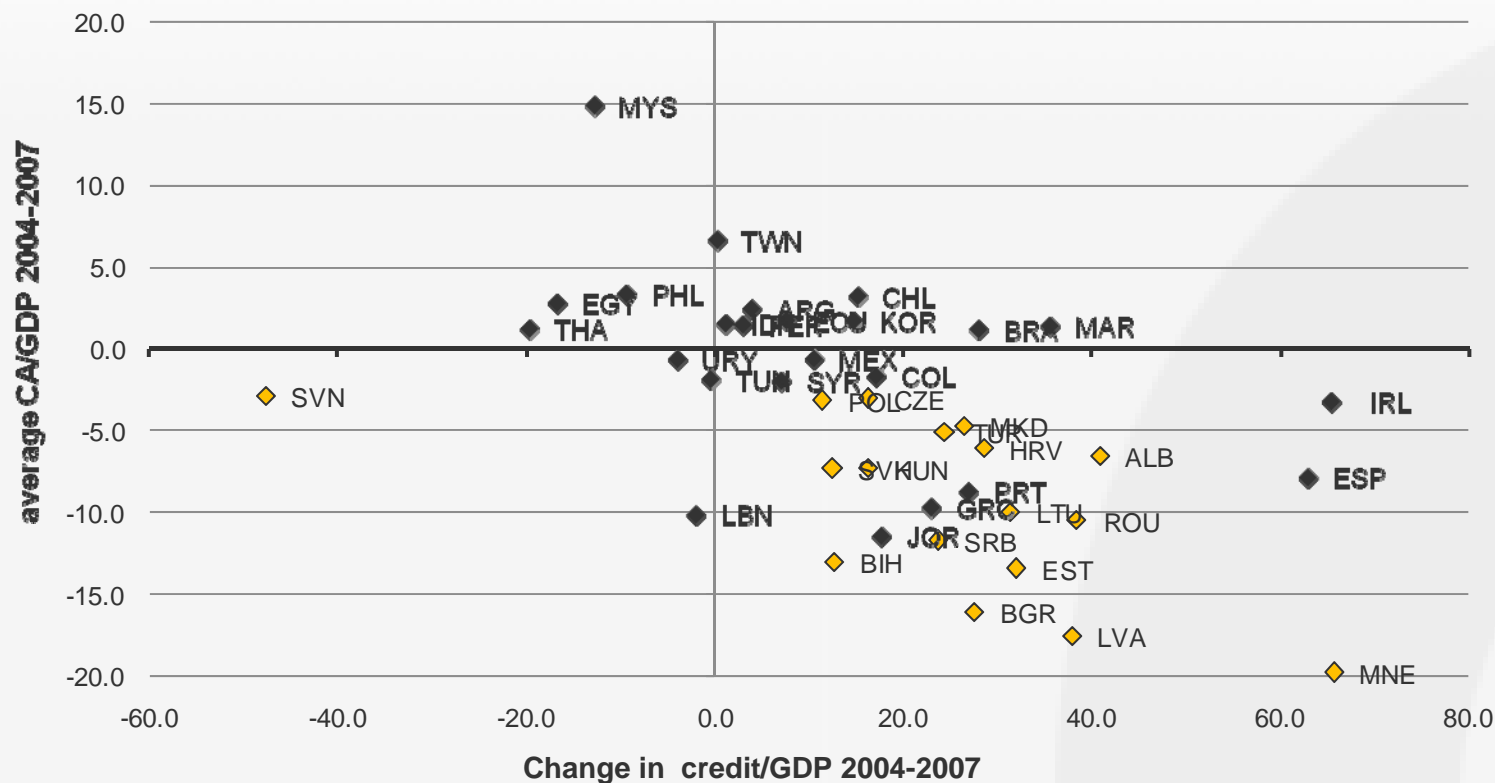
## Credit to the private sector (%GDP, 1995-2009)



# Relationship between pre-crisis credit growth and current account balances

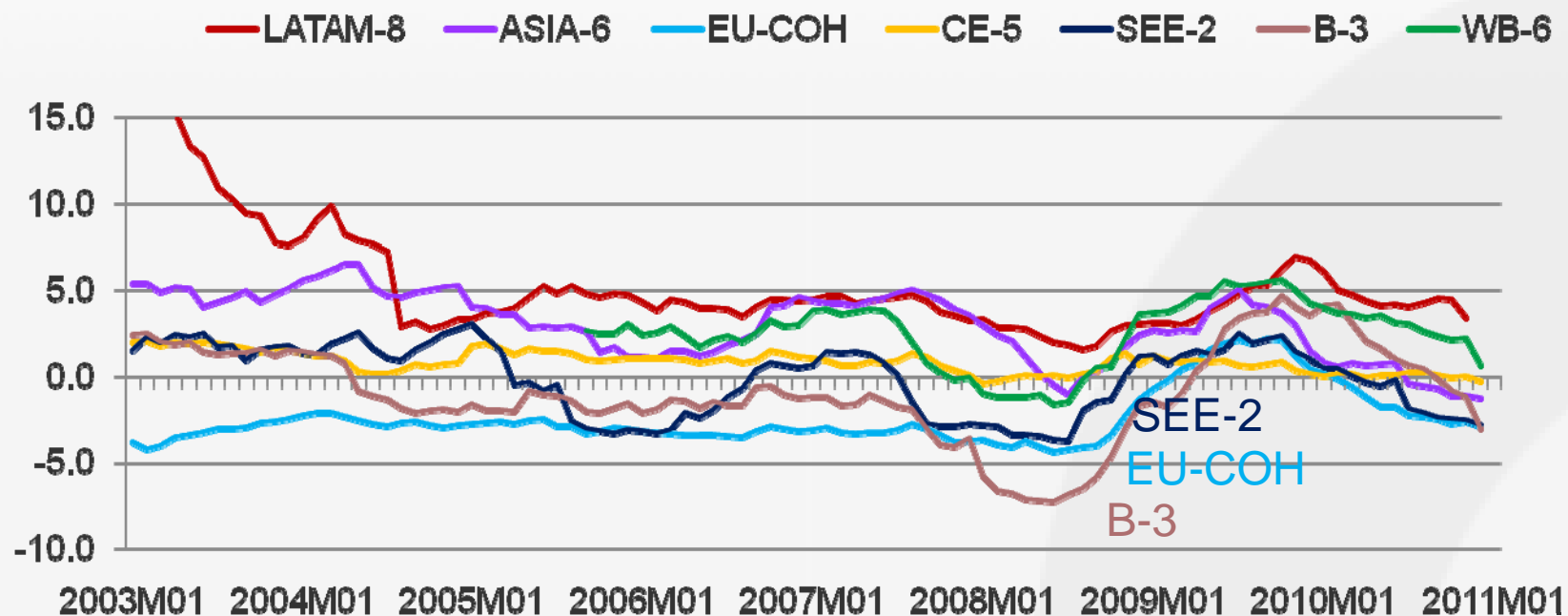


# Relationship between pre-crisis credit growth and current account balances



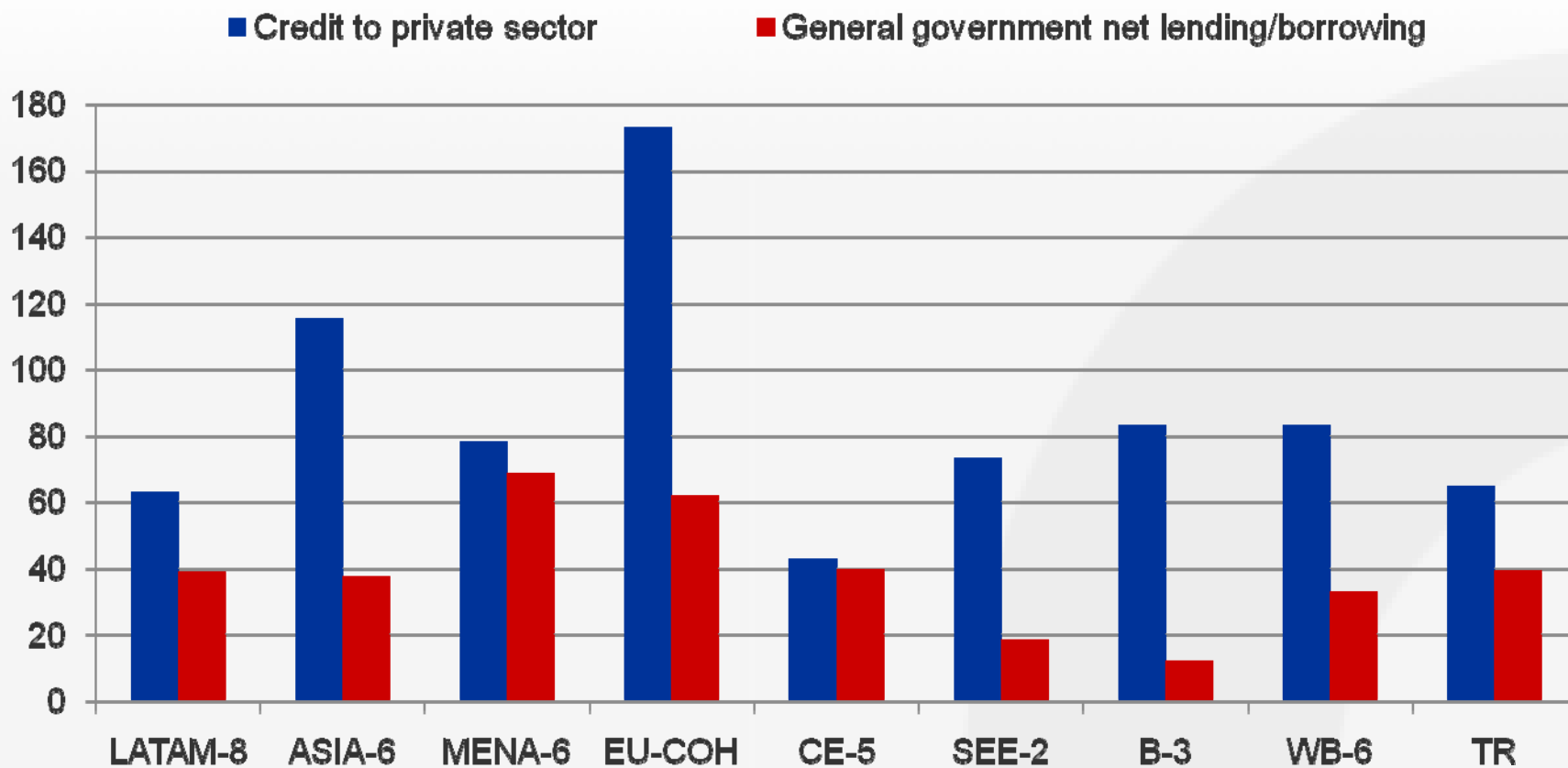
Source: IMF World Economic Outlook.

# Real lending NB/ECB interest rates, 2003-2010 CPI-deflated, in % p.a.



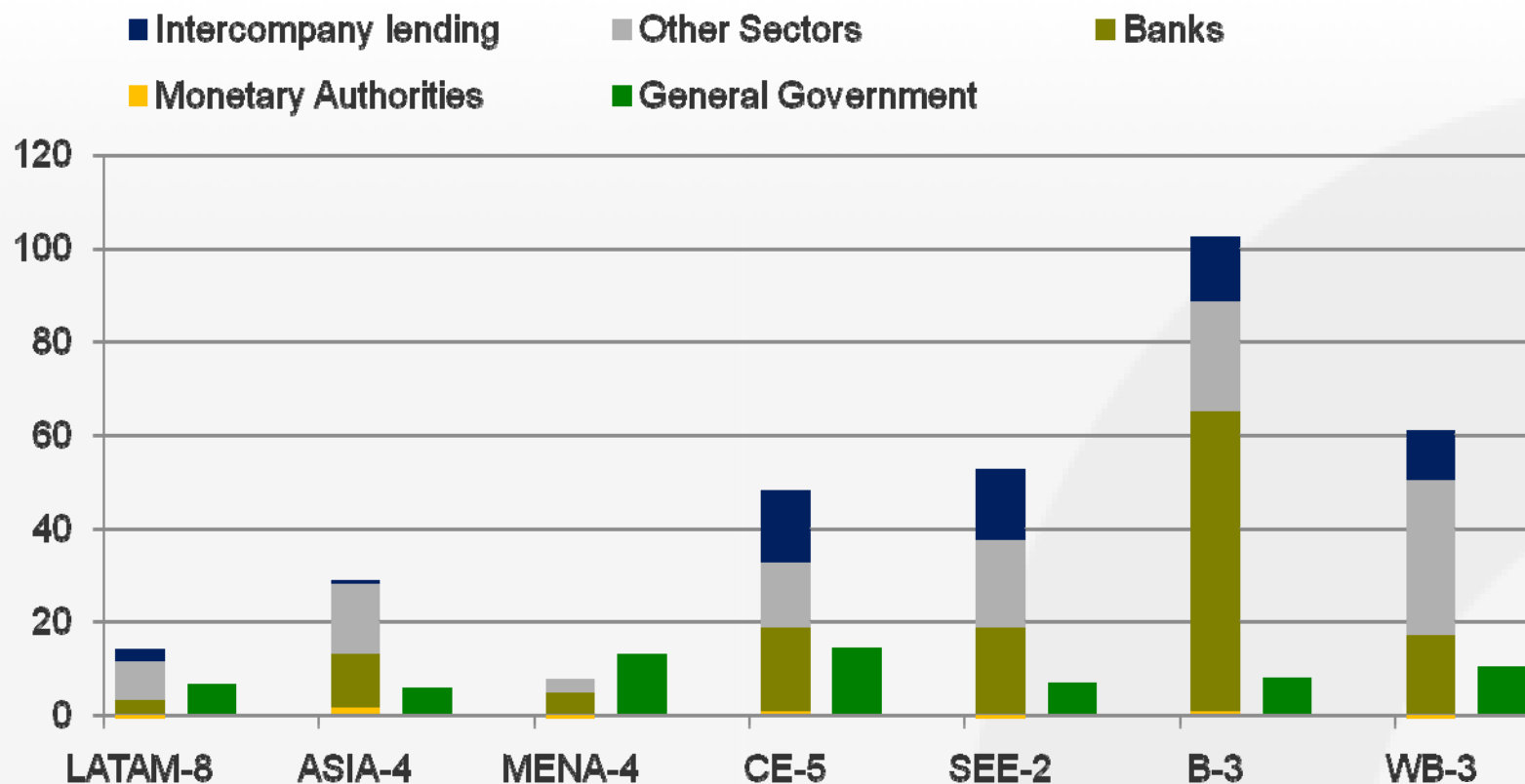
Source: IMF International Financial Statistics. ASIA-6 excl. Taiwan, MENA-6 excl. Lebanon.

## Gross private and public debt in % of GDP, 2008



Source: IMF International Financial Statistics. ASIA-6 excl. Taiwan, MENA-6 excl. Lebanon.

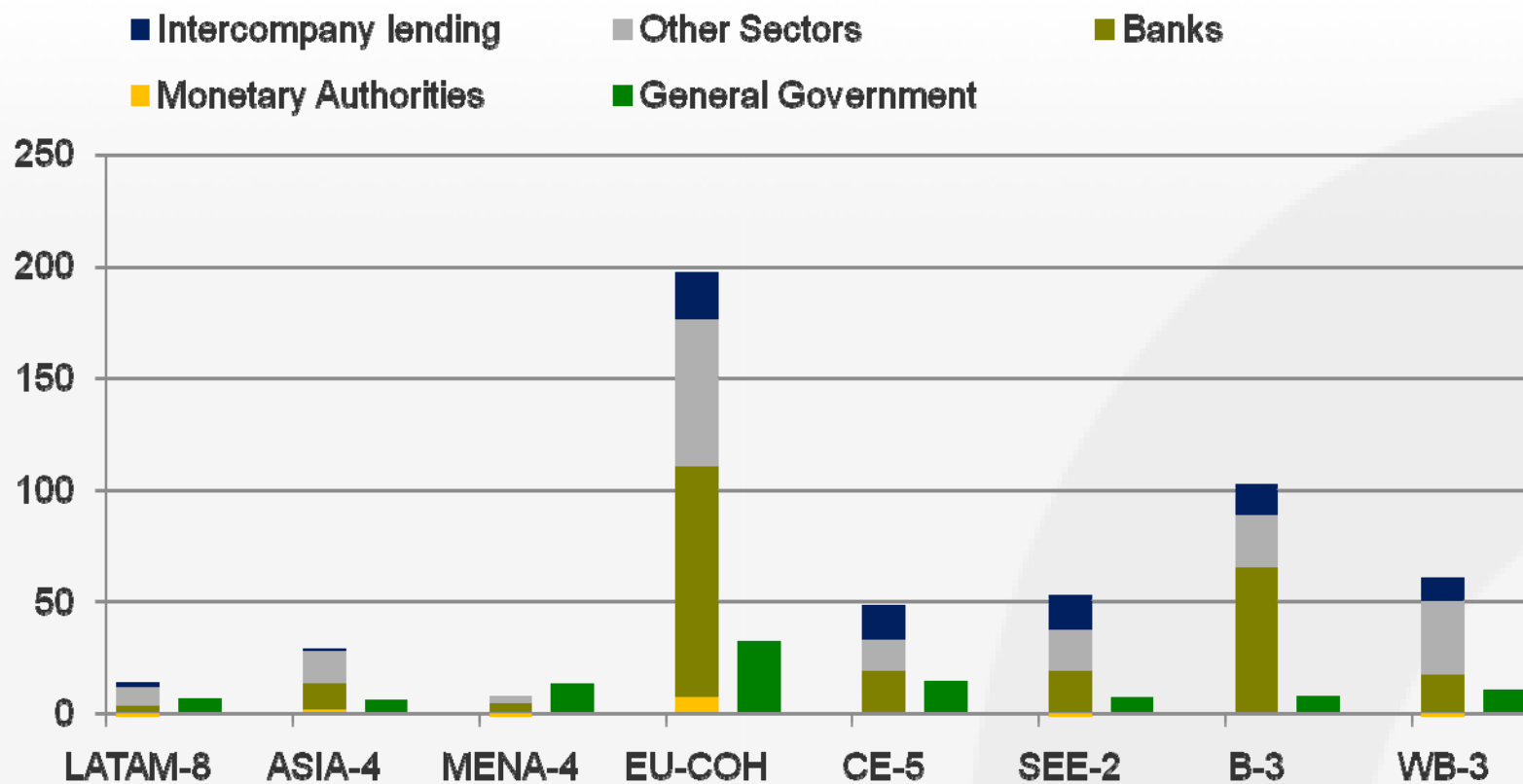
## External debt: public and private (% of GDP), 2008



Note: ASIA-4 excl. PH, TW. MENA-4 excl. LB, SY. B-3 excl. FYROM, BA, RS.

Source: World Bank, World Databank.

## External debt: public and private (% of GDP), 2008

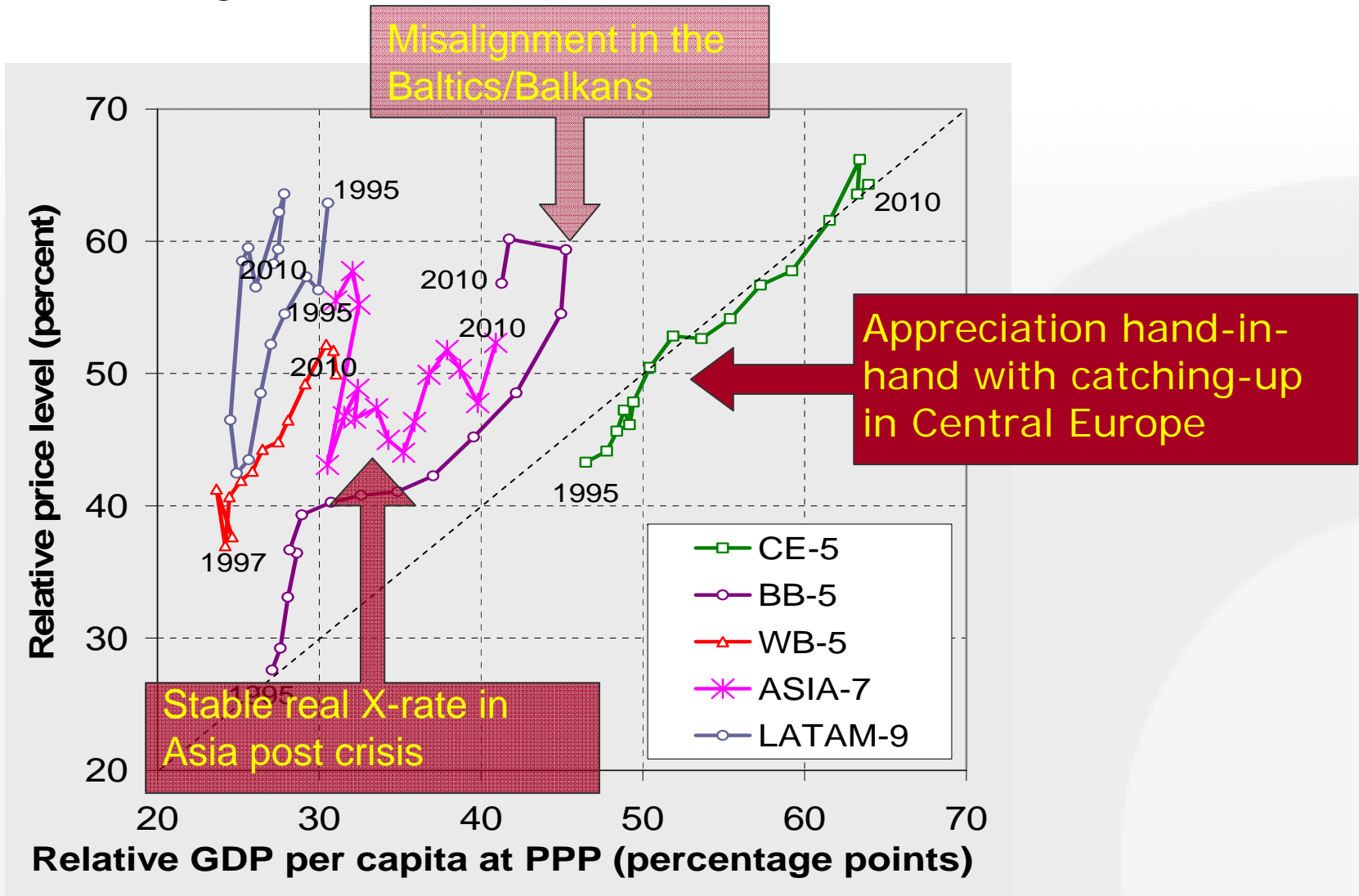


Note: ASIA-4 excl. PH, TW. MENA-4 excl. LB, SY. B-3 excl. FYROM, BA, RS.

Source: World Bank, World Databank.



# Real exchange rate developments, 1995 to 2010



## Structural features: European and other EMEs

	LATAM-8	ASIA-6	MENA-6	CE-5	EU-COH	B-SEE
Credit/GDP, change from 2004 to 2008 (percentage points)	15.85	-8.97	7.02	6.68	56.88	39.21
Real interest rate average, 2005-2007	4.33	3.17	-0.09	1.10	-3.10	-0.26
Current account balance/GDP, 2007 (%)	0.14	3.35	-1.42	-4.88	-10.09	-15.21
Gross external debt, 2009 (% of GDP)	20.8	34.8	20.9	62.7	229.6	80.4
GDP growth, 2008-2010	3.82	3.47	5.38	0.50	-1.67	-1.55

## Summarizing the build-up to the crisis – differentiated patterns in the EMEs

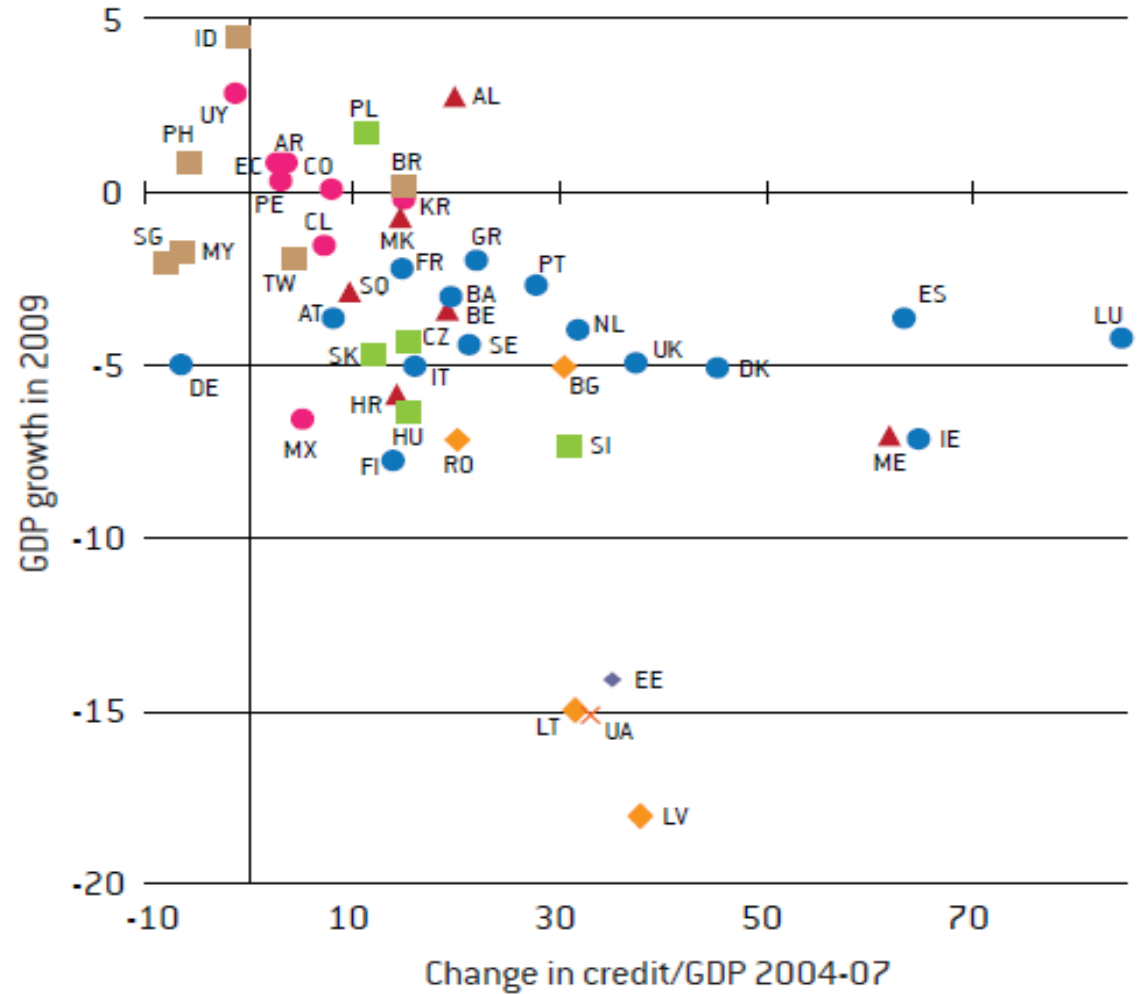
- Sharp deterioration in some European EME's current accounts; strong real exchange rate appreciation
- Fast credit growth to the private sector; low (partly negative) real interest rates
- Public debt situation not that different between European EMEs and other EMEs
- Clear link between private credit growth and current account deterioration

## Summarizing the build-up to the crisis – differentiated patterns in the EMEs (Part 2)

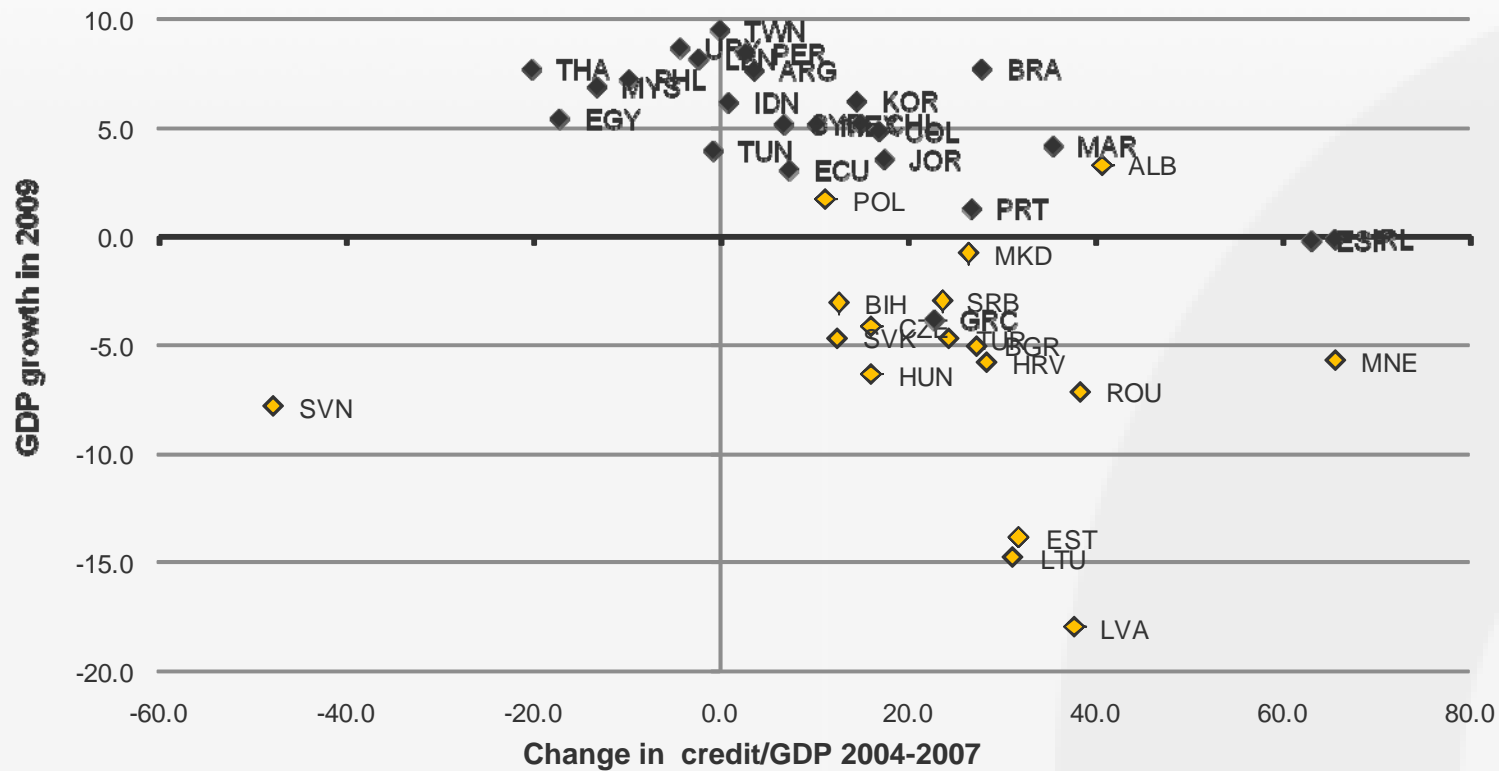
- Different developments amongst European EMEs  
EU-Coh, CE-5, B-SEE and compared to other EMEs
- Current account developments; real exchange rate appreciation
- Composition of net capital inflows
- Credit growth to the private sector; low (partly negative) real interest rates
- Public debt situation not that different between European EMEs and other EMEs
- Clear link between private credit growth and current account deterioration

## The impact of the crisis and patterns of recovery

# Pre-crisis credit growth and GDP growth in 2009

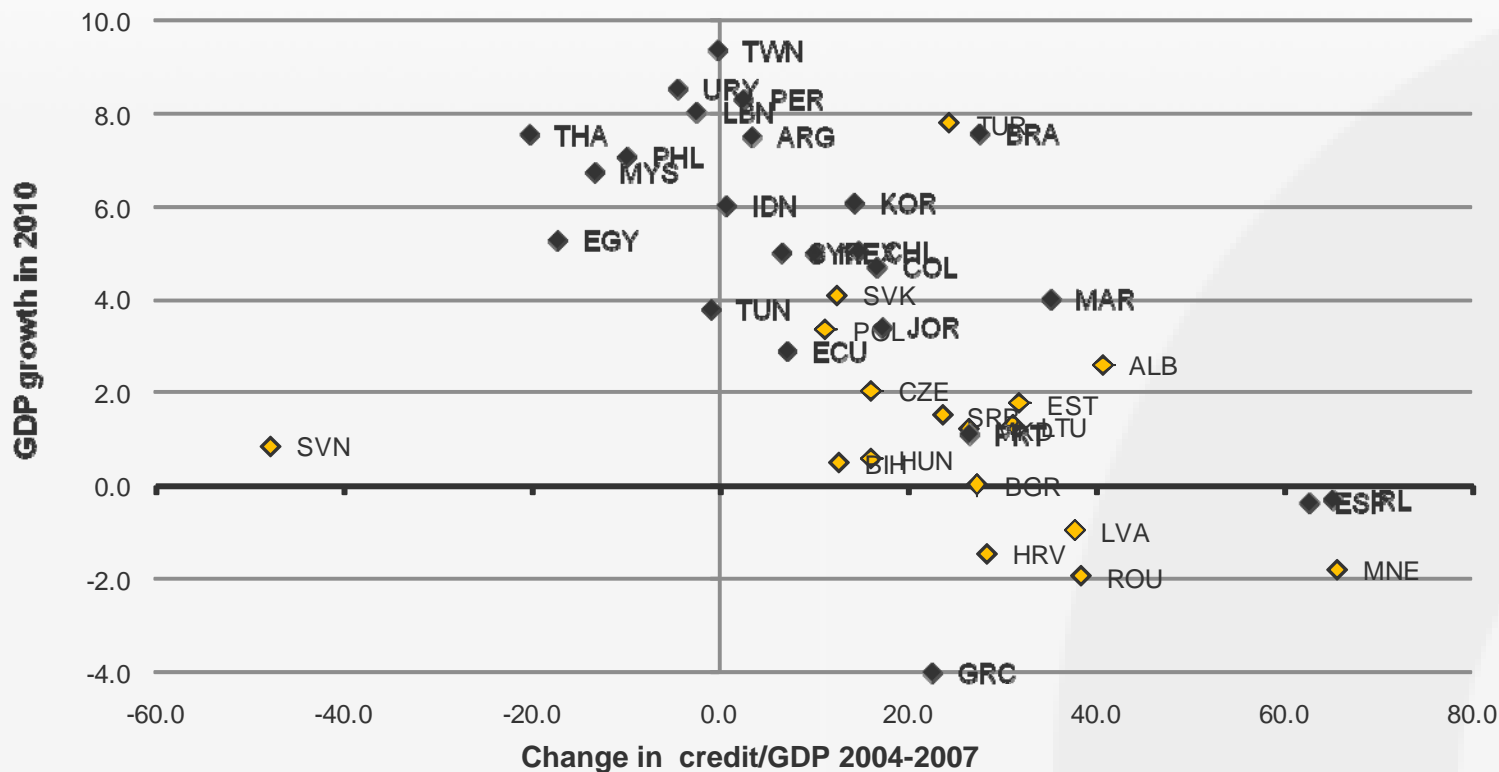


# Pre-crisis credit growth and GDP growth in 2009



Source: IMF World Economic Outlook.

# Pre-crisis credit growth and GDP growth in 2010



Source: IMF World Economic Outlook.



## Structural features: the role of exchange rate regimes 'Fixers' and 'floaters' amongst the CESEEs

	CESEE float	CESEE fix
Credit/GDP, change from 2004 to 2008 (percentage points)	20.5	32.8
Real interest rate average, 2005-2007	1.6	-1.6
Current account balance/GDP, 2007 (%)	-6.6	-11.8
Gross external debt, 2009 (% of GDP)	78.8	95.6
GDP-growth, 2008-2010	1.18	-1.78
FDI to finance and real estate sectors, 2007 (per cent of total FDI stock)	26.5	40.2
Change in unemployment rate from 2007 to 2010 (percentage points)	1.5	3.9

## Fiscal policy reaction: huge adjustment in CESEE

Average annual changes in total general government expenditures, 2008-2010

	Nominal per cent change			Real per cent change		
	2008	2009	2010	2008	2009	2010
CE-5	3.7	1.4	4.1	10.3	-9.0	9.4
B-3	20.5	-4.4	1.4	6.5	-7.9	0.2
SEE-2	27.7	2.9	4.0	7.1	-12.0	-1.7
WB-6	16.8	4.5	6.0	4.7	-5.8	-2.2
EU-15	6.3	5.4	1.8	2.8	4.8	0.6
ASIA-6	14.2	6.9	4.7	7.3	5.3	1.4
LATAM-8	20.8	13.0	10.1	12.7	8.0	5.2

*Note:* Nominal from data in EUR.

*Source:* IMF World Economic Outlook, wiiw Database and Eurostat.

## Summarizing the crisis impact

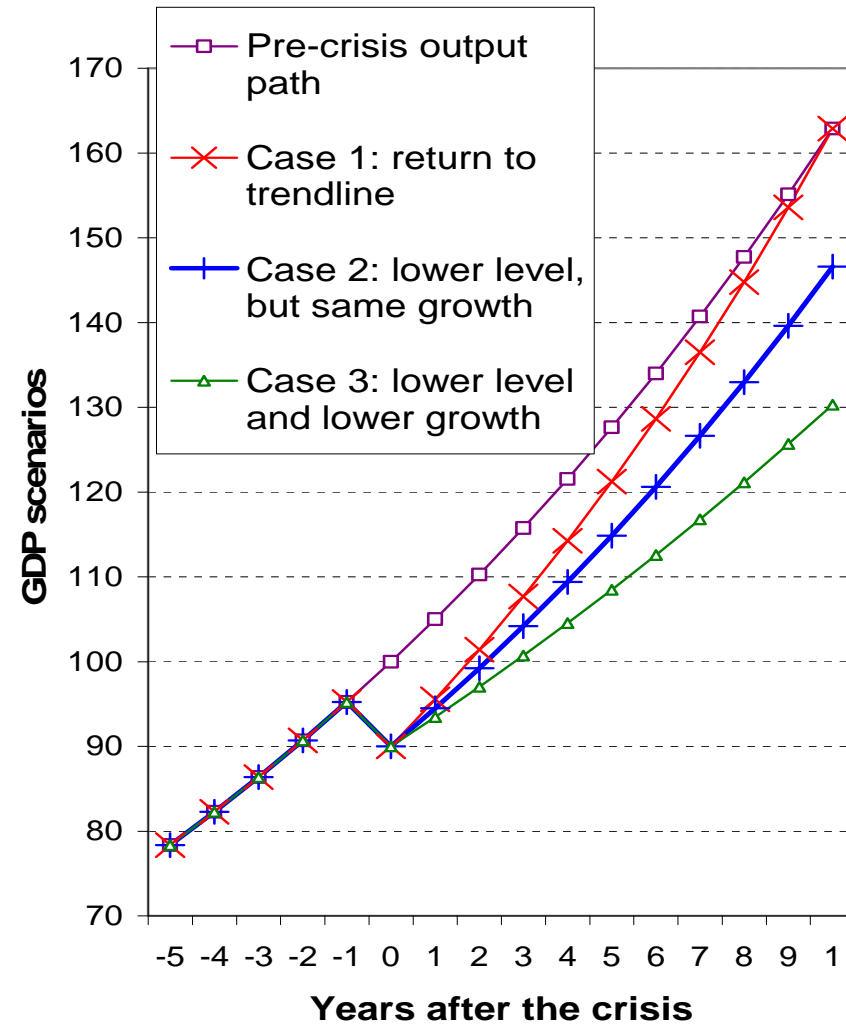
- Stronger impact of the crisis on European EMEs than on other EMEs
- Countries with high current account deficits and high credit growth prior to the crisis have stronger downturn
- Significant differences between ‘fixers’ and ‘floaters’ amongst European EMEs
- Substantial pro-cyclical contraction of real government spending in European EMEs during the downturn

## The aftermath of the crisis

# Crucial question: output prospects

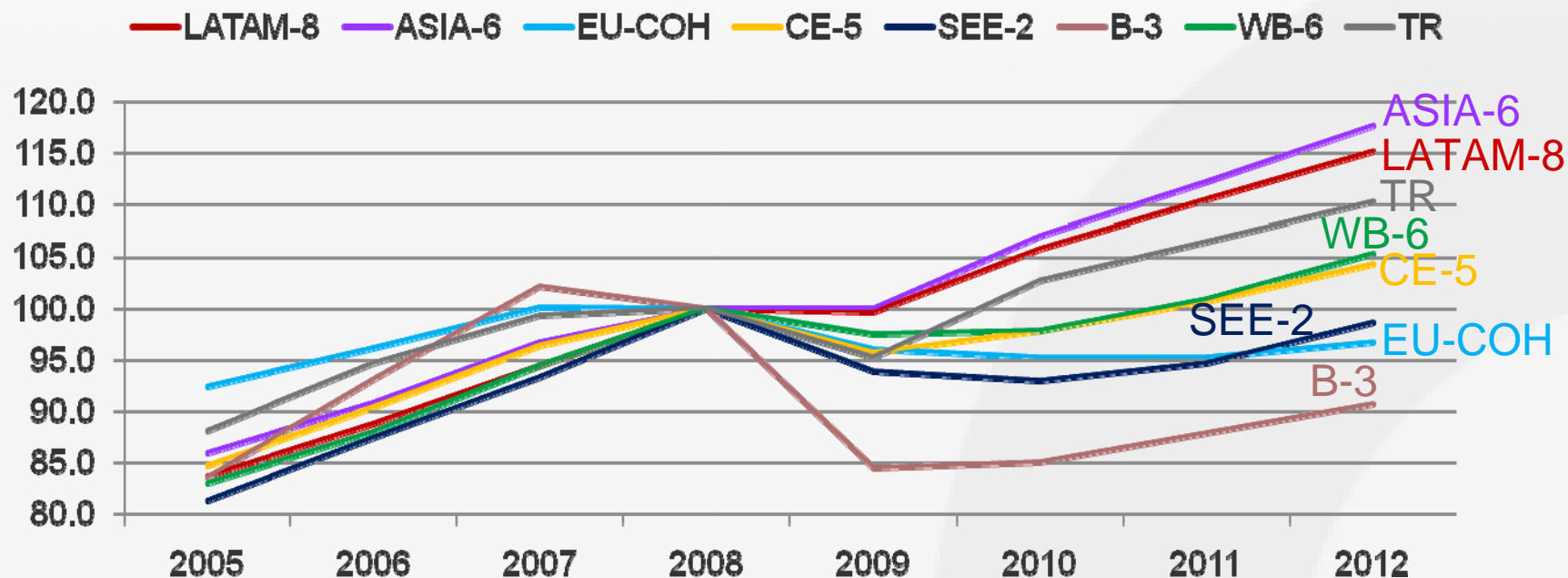
Three options:

1. downturn is *purely cyclical* and GDP will return to the pre-crisis trendline
  2. part of the downturn is permanent, but the potential *growth rate* is unaffected
  3. part of the downturn is permanent and the potential growth rate is also reduced
- ⇒ 1 may characterize Asia, CESEE will likely follow 2 or 3



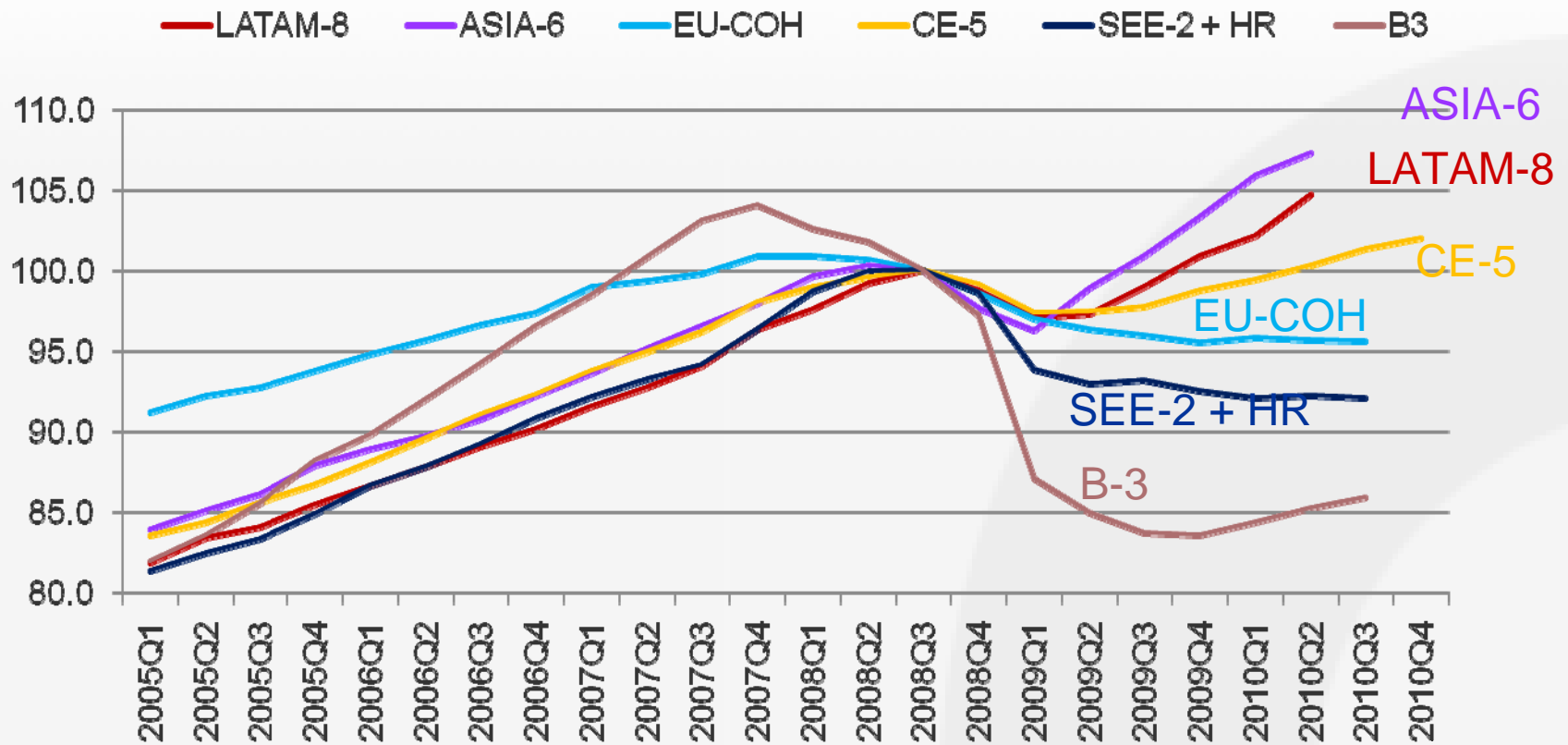
# GDP development, 2005-2012

2008=100



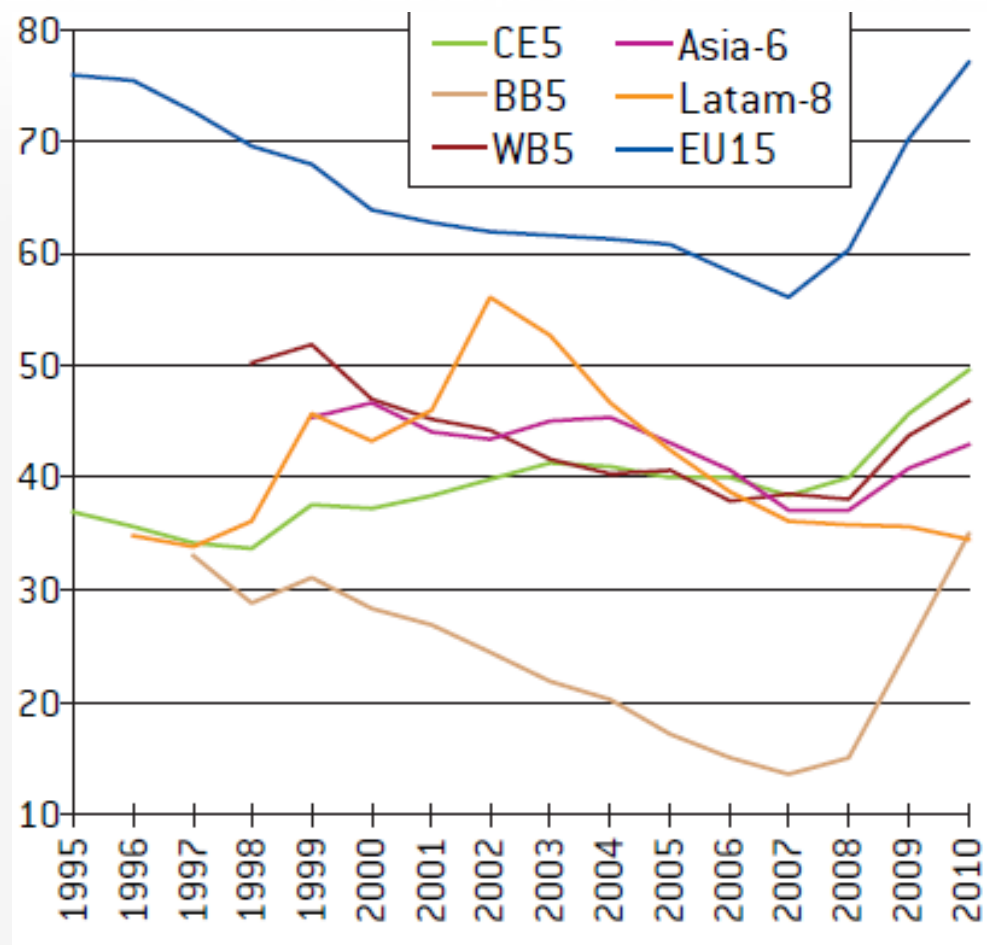
# Quarterly GDP developments

3rd quarter 2008 = 100



Source: Eurostat, wiiw calculations.

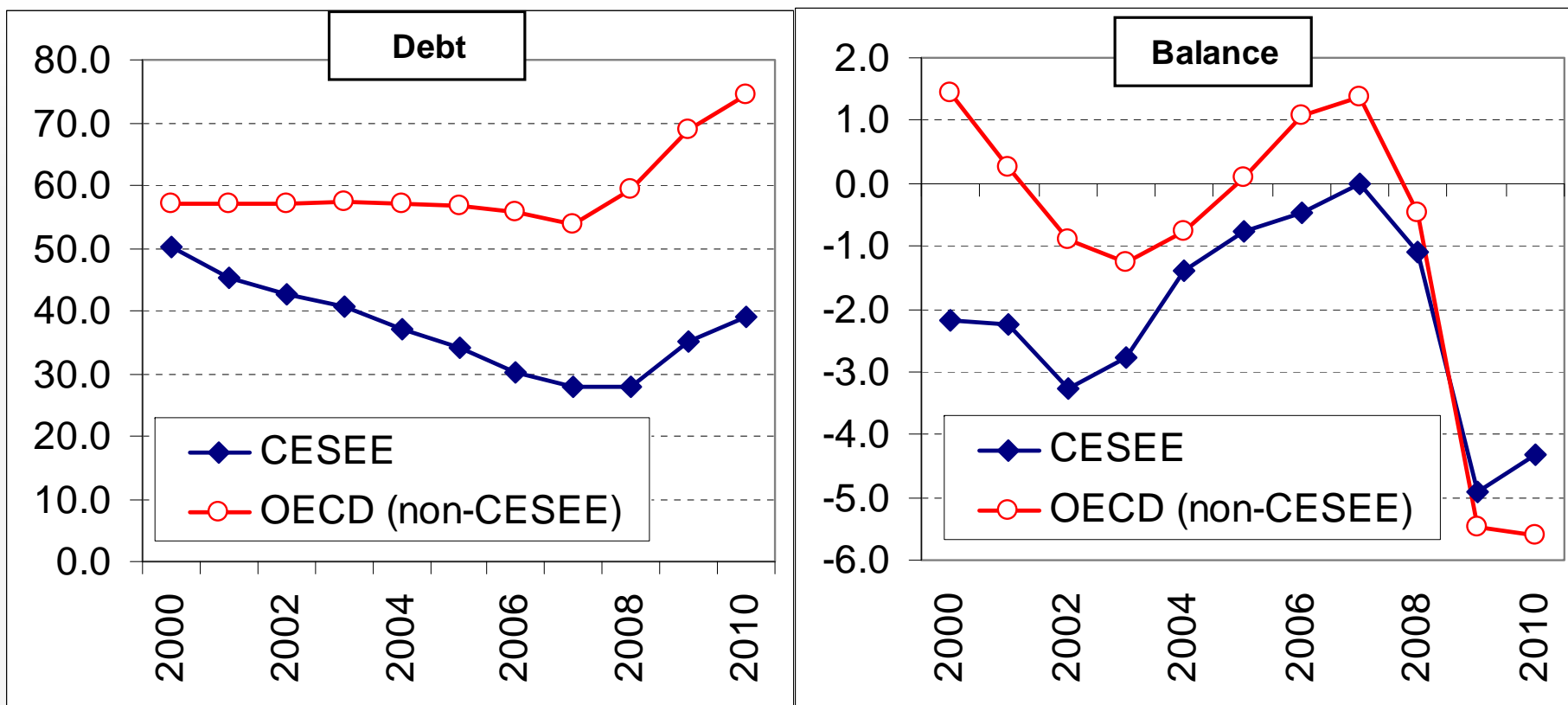
# General government gross debt (% of GDP), 1995-2010



Source: IMF World Economic Outlook.



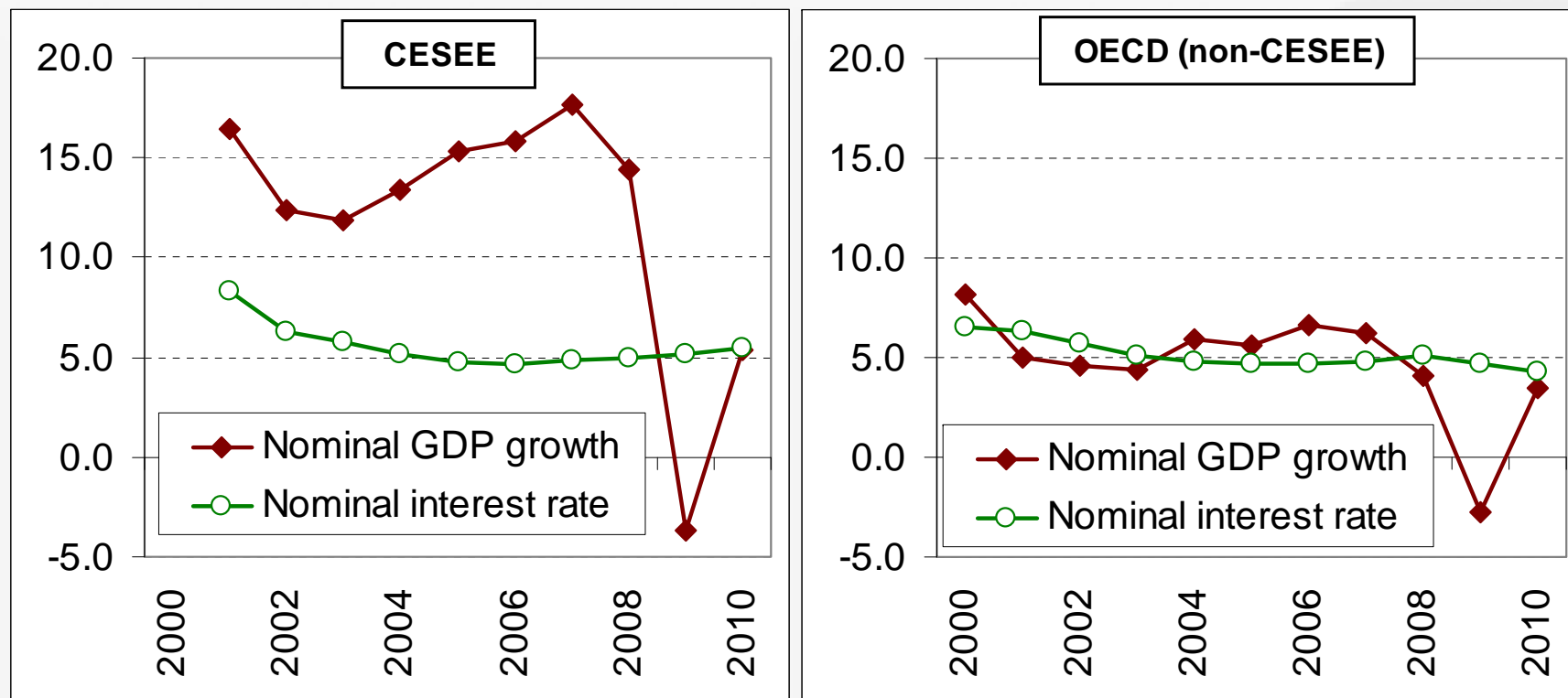
## General government balance and gross debt (% GDP), 2000-2010



CESEE: low debt (on average), even after the crisis

## CESEE: GDP growth was well above the interest rate before the crisis

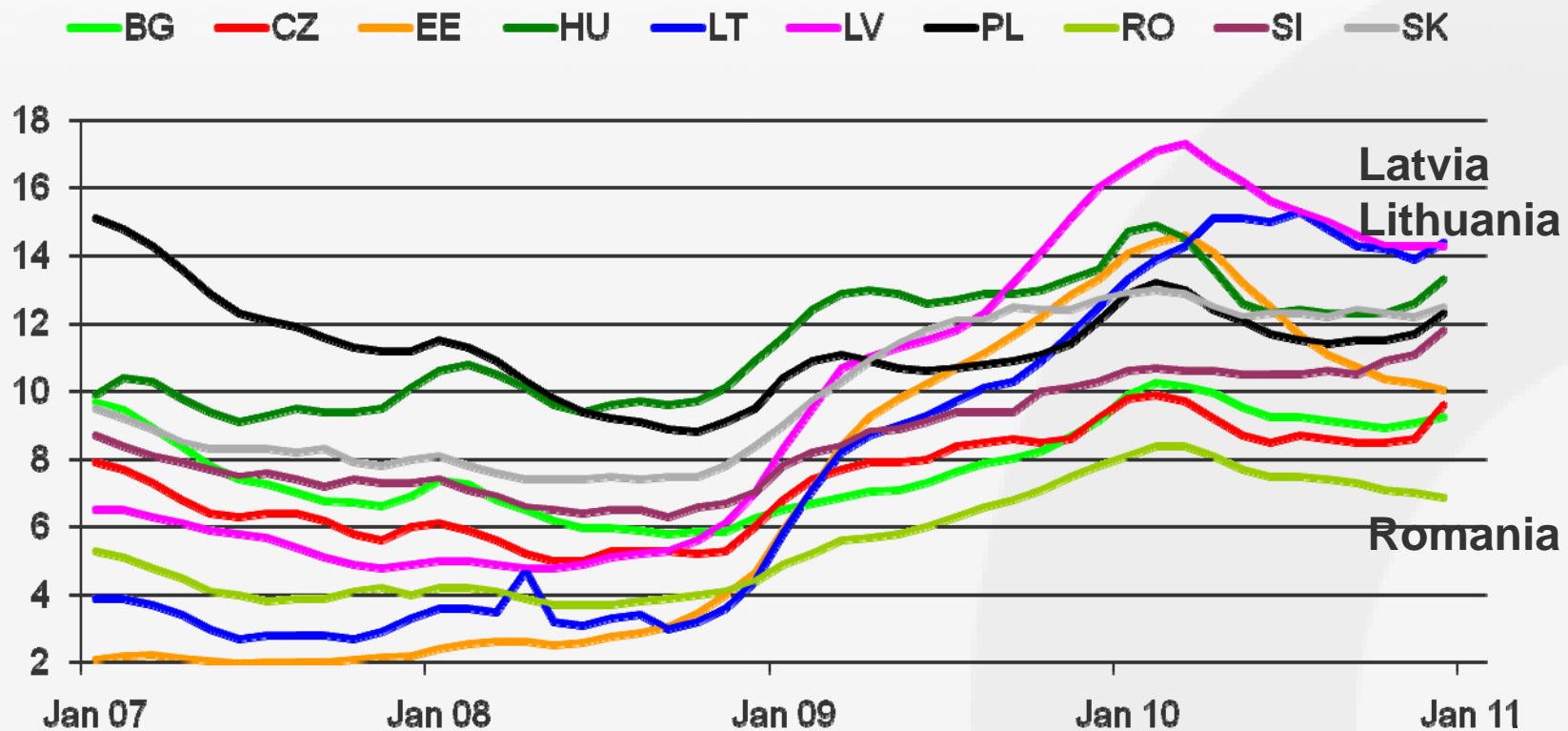
Nominal interest rate on government debt  
and nominal GDP growth (%), 2000-2010



Note: Interest rate = government interest expenditures / previous year gross debt.

# Unemployment at high levels

registered unemployment rates in %



Source: wiiw Monthly Database.

## The outlook on recovery after the crisis

- Which pattern of recovery after the crisis? European EMEs show level and (likely) trend effect of crisis impact
- Fiscal policy: less room for manoeuvre because of reduced growth expectations and higher interest rates
- Household deleveraging process and fragile banks
- Unemployment: previous gains lost

## Summary: Specific features of European EMEs

- Opening of the capital account: a rule of the game in the EU; deep financial integration
- Reliance on massive imports of capital; only 4 CESEE-countries could avoid skyrocketing external (private) debt
- Bank credit: the overwhelming source of external funding
- Financial integration: major channel for transmitting shocks (EU-Coh, B-SEE regions hit hardest by the crisis)
- In general no meltdown of financial systems (advantage of the presence of foreign banks? Implies also less socialization of private debt in CESEE – i.e. lower public debt effects); difference to EU-Coh

## Principal policy lessons:

- In national and EU policy frameworks: neglect of private sector debt build-up relative to public sector
- Financial market regulation severely underdeveloped; but very high degree of financial market integration; specific issue in CESEE region: high level of cross-border banking
- Fixed exchange rate regimes bear high risks; but what are the options of highly euroized EU members and candidates?
- Scope for counter-cyclical fiscal policy was used much less in European CE-EMEs during crisis; post-crisis: task to restructure public finance in growth-enhancing manner
- Impact of evolving eurozone support systems on European EMEs; implications of current reforms

## Indicators - country groups: Pop, GDP, GDP per capita 2008

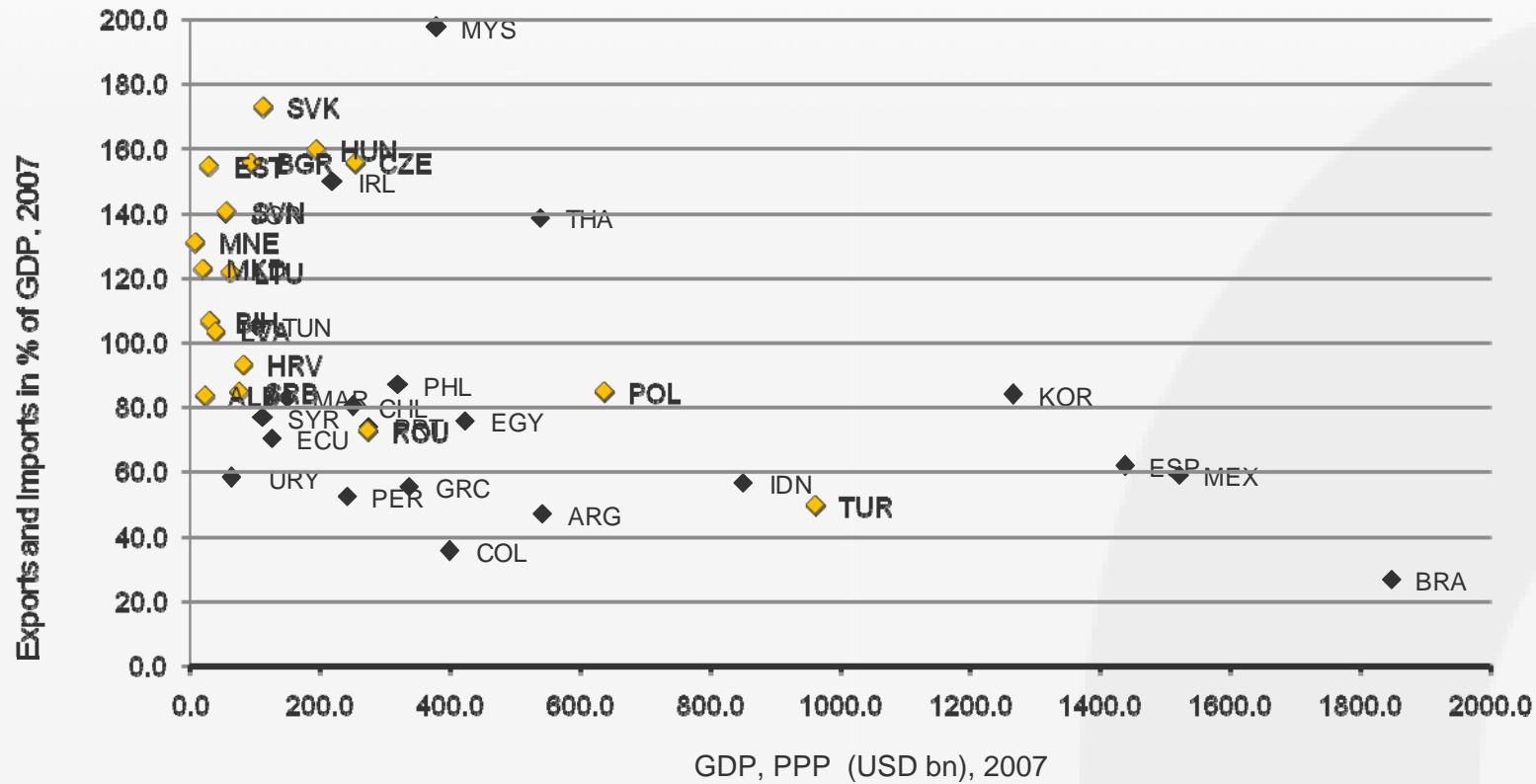
	Population, total (mn)	GDP (USD bn)	GDP, PPP (USD bn)	GDP per capita (USD)	GDP, PPP per capita (USD)
	2008	2008	2008	2008	2008
LATAM-8	445.673	3682.786	5253.562	8263	11788
ASIA-6	460.701	2102.759	3478.175	4564	7550
MENA-6	154.048	399.710	844.183	2595	5480
EU-COH	71.841	2462.928	2304.365	34283	32076
CE-5	66.016	1051.935	1352.786	15934	20492
SEE-2	29.137	251.896	429.674	8645	14747
B-3	6.965	104.495	137.463	15003	19737
WB-6	21.364	163.707	263.539	7663	12335
Turkey	73.914	730.337	1039.858	9881	14068
B-SEE	57.466	520.098	830.676	9050	14455

## Indicators: Pop, GDP, GDP (per capita) averages per country in group, 2008

	Population, total (mn)	GDP (USD bn)	GDP, PPP (USD bn)	GDP per capita (USD)	GDP, PPP per capita (USD)
	2008	2008	2008	2008	2008
LATAM-8	55.7	460.3	656.7	8263	11788
ASIA-6	76.8	350.5	579.7	4564	7550
MENA-6	25.7	66.6	140.7	2595	5480
EU-COH	18.0	615.7	576.1	34283	32076
CE-5	13.2	210.4	270.6	15934	20492
SEE-2	14.6	125.9	214.8	8645	14747
B-3	2.3	34.8	45.8	15003	19737
WB-6	3.6	27.3	43.9	7663	12335
Turkey	73.9	730.3	1039.9	9881	14068
B-SEE	5.2	47.3	75.5	9050	14455

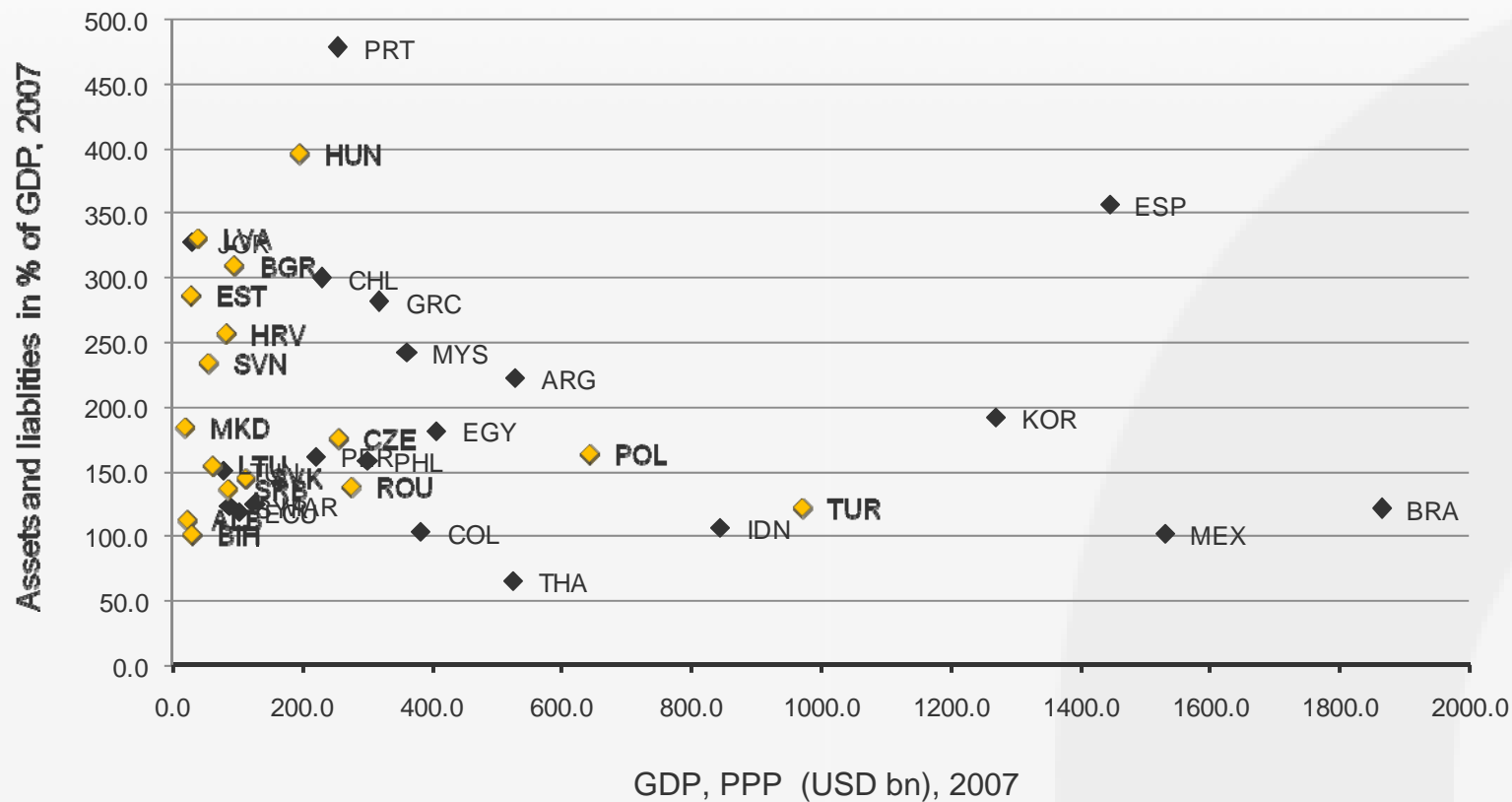


# GDP, PPP and Exports plus Imports in % of GDP, 2007



Source: IMF International Financial Statistics, World Bank, World Databank, wiiw calculation.

# GDP, PPP and Assets plus liabilities in % of GDP, 2007



Source: IMF International Financial Statistics, World Bank, World Databank, wiiw calculation.