The Future of the Euro (and Europe) – CASE 25th Anniversary Conference

By: Paul Lirette

The CASE 25th Anniversary Conference opened with a star-studded panel of guest speakers, who met to discuss the future of the euro (and Europe more generally). The welcoming speech, provided by CASE President, Dr. Christopher Hartwell, discussed how CASE has evolved from being the first think tank in the region to one that now spans across Europe. As Dr. Hartwell illustrated, CASE has been the flashlight that has helped navigate European policy makers through an uncertain world over the years, as they aim to uncover better and necessary policies.

The panel discussions then kicked off with a keynote address by Professor Leszek Balcerowicz, Professor of Economics at the Warsaw School of Economics, former Chairman of the National Bank of Poland, and Deputy Prime Minister in Tadeusz Mazowiecki’s government. In his presentation, titled “Institutional systems and the quality of life,” Professor Balcerowicz highlighted the unquestionable importance of economic freedom, which encompasses free trade through to a limited regulatory framework, as an institutional necessity in fostering sustainable economic growth and prosperity.

The first guest speaker, Dr. Anders Aslund, Senior Fellow at the Atlantic Council, changed gears by turning the audience’s attention to the EU’s current low growth environment and raised the question: what should be done? In short, Dr. Aslund sees seven key issues that need to be addressed in order to improve the functioning of the EU market, namely: easing fiscal burdens; opening the trade of services; promoting digital trade; reducing labor market burdens; improving higher education and innovation; promoting venture financing and establishing an innovative ecosystem; and reforming pensions to make them transparent and actuarially sound. While some of these reforms may seem obvious, they remain as key hindrances to robust EU growth, and, as Dr. Aslund illustrated, the primary responsibility to make these changes lies with national governments.

This opened the door for a presentation from Professor Ryszard Kokoszczynski, Associate Professor at the University of Warsaw and a Member of the Management Board of the National Bank of Poland, who discussed how political
feasibility can often limit economists’ solutions to European problems. Expanding on this point, Professor Kokoszczynski discussed how asymmetric information at the Member State level often creates difficulties in motivating collective action, which can be the case even when there are clear benefits at both the EU and national levels. In the absence of a proper incentive system, or a more compulsory framework, which can be much more difficult to implement, this type of moral hazard will, unfortunately, continue to exist.

Professor Nauro Campos, Professor of Economics and Finance at Brunel University London, approached the topic of the future of the euro (and Europe) from a different angle, discussing the evolution of “core” and “periphery” economies. The main hypothesis under consideration was the possibility that the European Monetary Union could exacerbate this divide, given that there are sometimes imbalances between core and periphery economies. However, by studying post-European Monetary Union data and generating an index of “core-ness content,” Campos illustrated that what was once considered “periphery” appears to be shrinking, that there is an increasing number of “core” countries, and that these positions are becoming increasingly entrenched.

Professor Andre Sapir, Senior Fellow at Bruegel, Professor of Economics at Université Libre de Bruxelles, and a former Economic Adviser to the President of the European Commission, shifted the conversation to more of a historical overview, reflecting on the state of the EU 25 years after its launch. In doing so, Professor Sapir underscored that the EU project is far from complete, characterized by heterogeneities across Member States and weak structural frameworks (even in some founding Member States). While the EU has benefited from the removal of borders and the greater integration of the goods market, the recent euro crisis has exposed the shortcomings of its blueprint. Now, more than ever, the EU requires structural reforms that are capable of homogenizing fundamentals across Member States before deepening their integration into the EU, which Professor Sapir claims as necessary for the future of the euro (and Europe) to be truly sustainable.

The Future of Europe is Ukraine

By: Krzysztof Glowacki

CASE’s expertise in the transition of post-communist states has been central to the organization since its very beginning in 1991. Twenty-five years later, CASE paid tribute to this heritage by devoting one of the first sessions of its 25th Anniversary Conference to a comparative analysis of the transition of Ukraine and Poland. In response to the leading question of the conference, what is the future of Europe, the session on Poland and Ukraine answered resoundingly that the future of Europe IS Ukraine.

Session speakers included Dr. Christopher Hartwell, President of CASE, Mr. Ivan Mikloš, former Finance Minister of Slovakia, Dr. Alexander Pivovarsky, Lead Economist at the European Bank for Reconstruction and Development, Professor Andrzej Kondratowicz, Professor of Economics at the SWPS University in Warsaw, and Dr. David Snelbecker, CEO of the International Development Group.

The speakers emphasized the importance of institutions to economic and social development. Dr. Hartwell presented the results of his recent research, which demonstrate that the presence of checks and balances in the Polish political
system has, historically, led the country to flourish, while deficiencies in those mechanisms invited stagnation and chaos.

Mr. Mikloš, who is currently a strategic advisor to the Ukrainian government, provided an in-depth look at the current state of affairs in Ukraine. Although reforms are being implemented at a slow pace, more progress has been made since the Euromaidan Revolution in 2014 than in the two decades that preceded it. Recent successes include a significant reduction of the fiscal deficit and the deregulation of energy prices, and the remaining problems are corruption, an inflated state sector, and a hybrid constitutional system caught in limbo between the presidential and the parliamentary models.

Dr. Pivovarsky noted that despite macroeconomic similarities at the onset of the transition, Poland and Ukraine, in reality, have very different backgrounds, and the latter is still at the nation-building stage. While admitting that the judiciary and law enforcement in Ukraine are still highly politicized, Dr. Pivovarsky pointed to positive new trends, such as the development of local government, spearheaded by the western Ukrainian city of Lviv. He also stressed the importance of the European Union to Ukraine in compensating for the markets lost in the east.

Professor Kondratowicz extended this institutional analysis to the realm of informal institutions. Although difficult to define and measure, informal institutions, such as cultural values and convictions, are the backbone of any society. Moreover, they are crucial to the development of formal institutions, including free markets and property rights, in countries that were previously governed under a communist regime.

Dr. Snelbecker examined this issue from a governance perspective. Both Poland and Ukraine had periods of good and bad governance in their histories, and traces of it have been preserved in their institutional memories. Dr. Snelbecker concluded the session by addressing the leading question of the conference, the future of Europe: “the future of Europe is Ukraine.”

Russia: A Transition Success or Failure? Or Both?

By: Krzysztof Głowacki

“The situation in Russia is not about economics. It’s about politics,” noted Professor Sergey Aleksashenko during the session dedicated to Russia – a key player for the future of Europe. The session featured Professor Marek Dąbrowski, CASE co-founder and longstanding fellow, Professor Sergey Aleksashenko, former Deputy Chairman of the Central Bank of Russia, Dr. Alexey Kuznetsov, Deputy Director at the Primakov National Research Institute of World Economy and International Relations, and Dr. Christian Bluth, Project Manager at Bertelsmann Stiftung.
Professor Marek Dąbrowski opened the session by discussing Russia’s institutional and macroeconomic fragility. He noted that there had been a significant decrease in output after 2007 and named several misguided policy responses, such as the heavy use of bailouts, a relaxation in fiscal policy, and renationalization. Professor Dąbrowski also distinguished three events that profoundly affected the Russian economy: the break-up of Yukos, the global financial crisis, and annexation of Crimea in 2014.

Professor Sergey Aleksashenko noted that in discussing the Russian transition, a broader perspective should be adopted, which encompasses various dimensions of society, culture, and politics. He discussed the damaging effect of inflation on Russia’s economy and the country’s substantial dependence on natural resources.

In turn, Dr. Alexey Kuznetsov focused on the successes of Russian economic liberalization in recent years, using examples from the automotive industry and agriculture. He also noted that Russia’s FDI outflows are largely politically driven, which explains their concentration in places such as North Korea and Central Asia.

Dr. Christian Bluth emphasized that Russia had been using trade as another instrument of foreign policy, which explains its effort towards integration within the Eurasian Economic Union. At the same time, Russia’s performance as a WTO member has been overshadowed by its willingness to implement only those WTO regulations that serve the country’s own interests.

Although the speakers were able to find common ground in the discussion, it was clear that differences in the interpretation of Russia’s modern economic history still exist after over two decades of the functioning of a free market. The Q&A round at the end of the session provided an opportunity to draw conclusions. The closing remarks reflected the recurring theme of the conference: the importance of institutions to social and economic development.

The Future of the European Job Market

By: Paul Lirette

In the last panel session of CASE’s 25th Anniversary Conference, CASE Vice President, Dr. Izabela Styczyńska, and a panel of distinguished guests discussed a range of challenges prevalent in the EU job market and how they relate to the European policy agenda. To set the stage, Dr. Styczynska illustrated how the EU labor market has improved over the past year, with slight drops in both youth and overall unemployment in many Member States. However, despite these improvements, and the launch of programs such as the European Commission’s Youth Guarantee program, significant labor market challenges remain.

Professor Sue Maguire, Honorary Professor at the Institute for Policy Research at the University of Bath, built on this point by indicating that while youth unemployment has
declined, it remains stubbornly high. Further, youth populations face increasing levels of precarious employment, which is particularly challenging for younger women, creating a tendency towards becoming discouraged workers. Professor Maguire stressed that while the Youth Guarantee program, introduced in 2013 at a cost of around 9 billion euro, is a welcome step in addressing this problem, less than three-quarters of these funds have been spent to date. Further, the program tends to address those that are ready to take a job and not necessarily those that are the most vulnerable, meaning there is a necessity to be more robust in the program’s outreach to all groups, especially the most vulnerable. 

Youth programs aside, labor mobility can also play a vital role in European job creation, as indicated by Professor Martin Kahanec, Professor at the Central European University in Budapest. With an EU that is characterized by lagging innovation and an ageing population, as well as job vacancies and unemployment, it is clear that promoting more fluid dynamics in matching job supply with job demand is required. Professor Kahanec argues that labor mobility, across sectors and countries, may be a key solution in bridging these job market gaps. His research shows that, in general, migrants are relatively more fluid than natives when it comes to labor movement, and, hence, could help address labor market skill shortages. In this respect, initiatives such as the Commission’s Erasmus programs can play a key supporting role.

In discussing the effectiveness of the European Commission’s Entrepreneurship 2020 Action Plan, Dr. Jaan Masso, Senior Research Fellow at the University of Tartu, Estonia, discussed a recent study, in which he participated, that conducted interviews with self-employed Europeans. One result of the study showed that working conditions can be difficult for the self-employed, and particularly for the youth self-employed, but that they are relatively optimistic about future opportunities. In the study, financial issues (such as labor costs) were reported as the biggest hindrance for younger entrepreneurs in employing new people and growing their businesses. Dr. Masso underlined that there is significant potential for job creation in this segment of the labor force; one that remains largely untapped, and where targeted entrepreneurship education could be a potential solution.

CASE Vice President, Dr. Izabela Styczyńska then put forward the question of whether or not Europe is on the right path to becoming a leader in job creation, relative to other major advanced economies. Professor Maguire admitted that this was a rather difficult question, but stated that competitiveness in the sense of labor exploitation would not be the right path for Europe. Instead, Europe should focus on competitiveness in its education system in order to create a better high-skilled labor force. Dr. Kahanec agreed with this assessment and added that welfare states in these types of comparisons should also be taken into consideration. A category in which the EU is doing relatively well, as demonstrated by the number of people wanting to live in Europe, is voting with their feet.
At a glance

Earlier this week, the Central Statistical Office in Poland published quick estimates of GDP growth in Q3 of 2016. During the last quarter, GDP increased in real terms by 2.5% year over year. The estimates are far below previous forecasts. While private consumption has been increasing, due in large part to accelerating wages and higher welfare spending, investment activity remains subdued, weighing on growth expectations. CASE experts forecast 2016 growth at 2.8%, anticipating that the economy may accelerate slightly in 2017, reaching 3.4% growth, due in large to a pickup in investment. However, high deficit levels, forecasted at 2.9% of GDP in 2017, could create significant roadblocks for the new government’s inflated social spending promises.

According to the Federal State Statistics Service, Russian GDP annual growth rate for Q3 was -0.4% (y/y), a slight improvement compared to the Q2 (-0.6% y/y). Preliminary estimates of October’s inflation rate are also optimistic, declining to 6.1% (y/y) - the lowest level in 3 years, surpassing market expectations. On the other hand, the Russian State Duma has amended the budget and the deficit, which is expected to amount to 3.7% of GDP (against the initial rate of 3%). However, according to President Putin, it is likely to be slightly exceeded. Despite generally positive forecasts, the World Bank adds a note of caution that Western sanctions over Crimea and intervention in Ukraine could still be an obstacle for Russia’s economic recovery.

Despite strains linked to the banking sector, Germany remains Europe’s economic powerhouse, as shown in both the ZEW Indicator of Economic Sentiment and the Bundesbank’s Financial Stability Review. A 7.6 point month to month improvement in economic sentiment, largely linked to positive economic developments in the US and China, put ZEW’s indicator at 13.8, a major improvement following July’s -6.8 (though the index remains below its long-term average of 24 points). Meanwhile, the German Council of Economic Experts shows underlying growth momentum unchanged. Its recent annual report forecasts real GDP growth at 1.9% over 2016 and at 1.3% during 2017, a decline attributed largely to seasonal effects.
On November 9th, the National Bank of Ukraine (NBU) announced that all the solvent banks that had benefited from stabilization loans and liquidity support loans had reduced their debt to the NBU by 13% in total in Q3. Their total outstanding debt was thereby reduced to UAH 4.2 bln (€144 million). The previous day, the NBU released updated macroeconomic forecasts, which left 2016 GDP growth forecasts unchanged at 1.1%. Growth for 2017 and 2018 were both revised down to 2.5% and 3.5%, respectively. The NBU kept headline inflation expectations unchanged at 12% for 2016, 8% for 2017, and 6% for 2018, further supporting the Central Bank’s decision to cut key interest rates by 100 bps to 14% on October 27, reflecting decreased price stability risks. In October 2016, headline inflation stood at 2.8% month to month, while accelerating to 12.4% in annual terms.

In Q3 2016, the Czech economy experienced slower pace of growth (1.9% y/y) compared to the previous quarters of the year according to the latest estimates by the Czech Statistical Office. Quarter over quarter, the growth amounted to 0.3%. This moderate pace was attributed predominantly to slowdown in the industry sector. In the meantime, in the revised forecasts also published this week, the Czech Ministry of Finance revised up its expectations for GDP growth (from 2.2% to 2.4% in 2016 and from 2.4% to 2.5% in 2017) and for a current account surplus (from 1.5% to 2.3% of GDP in 2016 and from 1.2% of GDP to 1.8% of GDP in 2017). Moreover, the unemployment rate is now expected to be 1 percentage point lower both in 2016 and in 2017, settling at 4.0% and 3.9% respectively (down from 4.1% and 4.0%). The “Fiscal Outlook of the Czech Republic” has also been released this week; the general government balance was estimated to reach negative 0.2% of GDP in 2016.

Preliminary figures from the Hungarian Central Statistics Office show that Hungary’s economic growth slowed in Q3, as expected, to 2.0% y/y, down from 2.8% y/y in Q2. This tepid news follows a recent bond rating boost, from Ba1 to Baa3, and a stable outlook forecast from credit rating agency Moody’s, who credit declining government debt burdens and significant overall reductions in external vulnerabilities as the motivation for the upgrade. Moving forward, the economy should benefit from growing business capital accumulation, inward FDI and increasing demand. EU structural funds have also played a role in mitigating weak domestic investment caused by barriers to entry for SMEs and ever-changing regulations.
Polish Economy: CASE forecasts

Source: CASE forecasts, updated November 14, 2016

Polish Online CPI

Source: CASE, most recent observation Nov 21, 2016

Czech koruna and Polish zloty
(currency units per U.S. dollar)

Source: IMF, most recent observation November 12, 2015

Polish Trade: CASE forecasts
US$bn - annual total

Source: CASE forecasts, updated November 14, 2016

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