Danuta Hübner
Chair of the Committee on Regional Development

"Emerging from the crisis: Risks and Opportunities for Europe and the V4"

Keynote speech at the Community of European Management Schools and International Companies fourth annual conference
8 April 2014
Warsaw

We are certainly living in exciting times, with 2014 promising to be remembered for all of us Europeans. In the context of the Ukraine crisis and of the Russian episode, 2014 clearly indicates that we must by no means take peace for granted. And finally, 2014 is the year of the European elections as well as the year which marks a cautious recovery from the crisis.

Europe changed dramatically over the last few years

The EU is certainly a different Union today relative to what it was a mere ten years ago, at the time of the big enlargement. In 2004 the new entrants had already had behind them more than a decade of democracy, respect of the rule of law and market economies. They have enlarged the territory of peace and stability of the Union and, as emerging economies, have provided the EU with an excellent location, a skilled labour force at a low cost, as well as an attractive environment for foreign investment.

We must of course also look at the flipside of the coin. While some of the old divisions between East and West have faded along with economic progress after the enlargement, the CEE still retains a weaker economic and political role in the EU in terms of the level of influence. It takes time to reach critical mass, at which point one can really have a say.

When we look at Europe, we do not only see a striking difference with what it looked like 10 years ago. We can go back into the recent past, of a mere few years ago and see the radical change that the onset of the crisis brought about.

From economic governance to financial sector reforms, from a harsh lesson in austerity to a gradual shift towards growth friendly measures, Europe today is a different Union. The crisis has led to deep and far-reaching changes.

A first strand of reform focused on the financial sector. Reforms on this front were urgently needed, as financial sector spillovers were felt on the real economy. Access to funding for growth was impaired, the bank lending channel was dysfunctional. A strong link had also emerged between banks and sovereigns, creating a vicious connection between banking crisis and government debt.

The lack of financial sector regulation was met by a plethora of regulations targeting the banking sector, financial market infrastructures, consumer protection etc. Many of these reforms are still on-going, with the banking union in particular standing out as a key piece of legislation for the financial stability of the EU.

With work in motion on financial sector reform, attention shifted also to economic governance. The reforms focused on the euro area, although some of them encompassed the 28 member states. This was also a matter of urgency, as the crisis had revealed some worrying loopholes in Europe's existing fiscal arrangements. Fiscal discipline had not been obeyed by a number of member states over recent years, leading to excessive deficits and unsustainable debt levels. Moreover, macroeconomic imbalances, both positive and negative, had not been kept under control.

The reforms which were implemented after 2008 aimed primarily to enforce stronger fiscal discipline (controlling deficits and reducing debt) and keep macroeconomic imbalances under control by preventing those imbalances in the making and addressing existing ones. They also placed an emphasis on better coordinating policies at the Union level. To improve this coordination, both the budgetary aspect and the national reforms efforts of the member state, with a view to enacting efficient structural policies, were pushed for through the so-called European Semester, an annual cycle of economic policy coordination. A stronger focus was put on the single currency area, with the Commission delivering once a year recommendations not only to individual member states, but also to the euro area as a whole.

The global world was at the same time undergoing dramatic change

Looking beyond European borders, we are also struck by the image of an increasingly globalised world, which over the past few decades has brought onto the world stage new players. Politically, the world has become rather messy, unpredictable, without a functioning global system of governance. Globalisation is no longer built around a transatlantic consumer and a Chinese producer. Gradually, a demand driven growth model in emerging economies generates new demands from millions, if not billions, of new consumers coming to the world market. Consumption habits change in Europe, they change across the world. If Europe is to remain competitive in the world of tomorrow, it will have to keep its windows open and measure its competitiveness against the global backdrop. The global world will be one of giants with many new competitive pressures.

Where does the V4 fit from this point of view?

V4 economies need to think of themselves as belonging to an evolving European and global context. They need to wisely internalize these changes and see how they can best mitigate the risks they bring along.

The V4 are not a homogenous group.

The V4 must take a stance with regards to its relation with the euro area and avoid the risks that come with a multitier Europe

The development of the V4 area and its leadership potential are inextricably linked to that of Europe, and with it, to those of the euro area. We all know that the euro area has undergone tremendous changes since the start of the crisis and that EMU integration has made an unprecedented leap forward. The decision of how to position oneself relative to the closer common currency integration is not insignificant. Looking at the Visegard region, this is of course not a question for Slovakia, but very much so one for Poland, Hungary and Czech Republic, which are the only member states from the 2004 enlargement still outside the euro area.

We know that multi-tier Europe is here to stay. It is in our interest to see more profound integration of the euro area . Taking this into account, we must be alert about the risks that come along with remaining outside the euro area. And these certainly abound. They range from a lack of impact in the decision-making process, to falling onto a second track of EU membership, to a loss of market confidence in the area. Not being in the euro area, member states would face higher transaction costs, might be subject to speculative attacks and might be tempted to use their exchange rate policy tool to bring about artificial improvements in competitiveness. While their status as emerging economies comes with promises of rapid growth, it also comes with risks, which make these economies more vulnerable on the global scene. Living up to the challenges of a globalised world will be increasingly harder. As the global world is messy and unpredictable, politically, even the neighbourhood can be a source of uncertainty and conflict.

In this context, a very important decision when it comes to joining the euro area is the issue of timing. In particular, the time must be ripe for non-euro member states to join the ERM II. This entails entering the mechanism at a moment when the risks of speculative attacks, which may force devaluations of the national currency, are at a minimum. Slovakia provides some lessons learnt in this regard.

Thinking about what non-euro member states need to do, it is clearly desirable for them to join the on-going reforms of the Union, which up to now, have been and will continue to be largely euro-centred. While the euro area is often perceived solely as a monetary union, the trend of current reforms is clearly taking us further, into the realm of fiscal, financial and political union.

As the entrance of non-euro economies into the ERMII and the euro area later on will unfortunately take some time, these member states will have to start thinking carefully about how to mitigate other risks coming their way. The risks of staying outside cannot be ignored.

Non-euro member states might be susceptible to the middle-income trap.

The trap refers to growing economies which end up stagnating at middle-income levels and fail to graduate into the ranks of high-income countries. Economies often get stuck in between as they do not have access to the best technologies (reserved to rich economies) and over time also lose the advantage of lower wages (reserved to the poorest ones). This is where most new member states are today.

Typically, such a trap materializes after the growth benefits of labour and capital productivity are exhausted and the focus should shift more on innovation and does not. And it is indeed the case that since the 90s, countries such as Poland, the Czech Republic, Slovakia and Hungary have used labour and capital productivity increases as their main growth drivers. The worry of the trap materializing is also accentuated by an ageing population and low investment.

How can the CEE avoid falling into the middle income trap and promote sustainable growth?

Those countries can be seen as having at their disposal two options for growth. One is aiming at a growing convergence in living standards with more developed EU societies. We feel tempted to see this as our goal. A second is working on a home-grown growth model with different patterns of ambition, although in line with the EU incentives for progress.

What kind of home-grown model could we expect to have?

Of course each home-grown model should be tailor-made to the economy in question. Nonetheless, we can also identify some overarching features which can be applied across the V4 economies.

Thinking of a home-grown growth models to be pursued in the future, one can certainly envisage a strategy focused on quality of life, sustainability, education, knowledge and innovation.

The home-grown model should exploit a country's competitive advantages, while also bearing in mind the policies identified by researchers and policymakers up until now as helping against the middle income-trap.

These policies all relate to a holistic outlook on competitiveness, which includes a number of factors. One is given by efficient institutions. Governments need to build and operate successful institutions, with adequate property rights, economic freedom and effective enforcement. Good quality institutions can stimulate an entrepreneurial culture, combining good quality institutions with an entrepreneurial culture, which nurtures and protects innovators. On this front we have achieved a lot but much more must be done.

Allow me to stay for a few minutes with the topic of innovation.

Innovation today is not anymore about having a great idea, going down to the garage and then to the market. It requires smart public policies But public policy is certainly not the only driver of innovation. To be effective, what is needed is a network of strong partners. A successful innovation strategy ultimately hinges upon a fruitful government-industry-academia partnership.

Technology development does not have to take place in the capitals only and very frequently it does not. If we look at the most dynamic technology industries, the common factor is not a location in or near capital cities but one close to the most innovative technological universities. This was true in the United States, first with the Boston area and the famous Route 128 and then in Silicon Valley itself - both of these regions house many excellent universities. Many of the technologies which were the basis of entrepreneurial success were spun out of these universities. Gradually major companies developed in these regions but the importance of the university-business interface has remained. And it can only grow in the future.

It is however certainly true that Europe still lags behind the US and perhaps even some of the more dynamic countries of south-east Asia on the innovation front. The climate for innovation would significantly benefit from having more strategic industry-university partnerships. This comes very slowly.

There is certainly room for improvement. And we must concentrate all our efforts on making progress on this front. Our "home-grown" knowledge based growth models would benefit immensely from this.

We already have some seeds of success, which we hope will deliver fruit over the years to come, in Poland. Just last week, in Warsaw we inaugurated the Digital Economy Lab, a state of the art centre for the development of innovation and the use of advanced ITC technologies in the CEE economies and societies, developed jointly by Google and the University of Warsaw. More projects of this type will allow us to make a leap in the region on the innovation front and I hope to see more such initiatives blossom over the years to come.

Looking ahead, if the V4 economies are to remain fit for the future, they will really need to capitalize on its privileged dual status, as catching-up economies which are at the same time EU member states. The catching-up element gives them dynamism and a competitive advantage in terms of growth potential, while the EU membership comes with many opportunities. V4 countries now need to fully leverage this potential in a smart way.