ELEC CONFERENCE

The challenges for Eastern Europe in the present turmoil in the EU and EMU : persevering in the reforms and investing for the future

Bucharest, June 8th 2017

SUMMARY

The European League for Economic Cooperation (ELEC) organised on June 8th 2017 a conference in Bucharest on a most timely subject: how can the Eastern part of the EU safeguard its economic future now that EU and the EMU are conf-onting a number of existential turmoils such as Brexit, the euro crisis, the refugee crisis, populism etc. The conference did not hide the many challenges that are ahead, but nevertheless ended on an optimistic tone, trying to formulate answers for the many question marks that still remain.

In his opening address **Radu Deac,** president of ELEC Romania, reminded that this was the 7th conference that ELEC Romania organised together with the National Bank of Romania (NBR). He thanked all the institutions and individuals that helped to prepare this meeting.

Liviu Voinea, vice-governor of the National Bank of Romania, applauded in his welcoming address the strong cooperation between the NBR and ELEC and expressed the hope that it will continue. Since Romania joined NATO and the EU, convergence has increased and Romania's economy is in all aspects better off. But a major imbalance remains: the fruit of growth is not equally distributed. GDP has increased substantially, but budget revenues remained low. There is still a lot of progress to be made. We face a challenge that is far greater than Brexit, a Globalis-exit. For Romania, a major challenge will be its presidency for the EU in one year and a half.

Joining the euro

The conference, which was chaired by **Wim Boonstra**, president of ELEC's Monetary Commission and chief economist of Rabobank, was split up into four panels. The first panel examined the question whether reforms in Eastern European member states and in the EMU converge to pave the way for their accession to the euro. Boonstra reminded the audience that the Dutch guilder was for a long time de facto linked to the Deutsche Mark and that countries should think about costs and benefits before they enter the European Monetary Union.

Anton Jevcak, senior economist at the euro adoption section of the European Commission, looked at the different convergence indicators of the EU member states that do not belong (yet) to the euro area. In general Central and Eastern European countries perform well on inflation and budget deficit and on a public debt below 60%, but the quality of institutions is

low. Bulgaria and Croatia have major macroeconomic imbalances. Jevcak recalled that the euro area accession is an open and rule-based process. At the same time the euro area architecture will further be developed. He concluded that Central and Eastern European countries perform well in their nominal convergence, but the question is whether it is sustainable. A proper institutional framework is crucial to ensure more resilience to economic shocks

György Szapary, former deputy governor of the Hungarian National Bank and former IMF representative in Budapest, claimed that the centrifugal forces in the EU and EMU are not economic, but political and social in character. Young people are no longer aware that making an end to the devastating wars between European nations was a prime motivation of an ever closer Europe, so the narrative has to be changed. Migration is one of the main reasons for the dissatisfaction with the EU, with Brexit as the most obvious case. The cohesion of the euro area, one of the flagship achievements of European integration, is threatened. However, there is no alternative. Between 1973 and 1993, 36 exchange rate adjustments took place and interest rate levels were very divergent. A lot of measures were taken since the euro crisis, but more are needed. The most important is that new rules are respected by strong and responsible governments. All Central and Eastern European countries are in theory able to enter the euro zone. It is mainly a political decision in a Europe that as Merkel says has to take its destiny into its own hands.

Vasile Puşcaş, former ambassador to the EU and chief negotiator for Romania's EU accession in 2007, referred to the EMU reflection paper of the European Commission. Macroeconomic stabilization, that already began when the internal market was created, should be pursued now. If we wait for another five years, it will be too late. The completion of the Banking Union is central to the viability of the EMU. When Central and Eastern European countries negotiated their accession to the EU, their aim was to increase economic performance. But once they were in, the new member states changed their policy. Romania did not want to continue the reforms that are necessary for the EMU. Eastern European countries do not see their integration - that should normally be a win-win situation - as a two way negotiation. The new member states should undertake economic reforms to comply with nominal, real and financial convergence. The epistemic debate should be broadened. Social issues and the opinion of citizens, universities, and researchers should be taken into account.

In the broad discussion that followed, several topics were raised: the possibility of an alternative such as a currency board with the euro instead of full membership; the delicate choice between fulfilling the Maastricht criteria and/or taking a political decision on EMU membership; the possibility of creating a European unemployment scheme and related to that the feasibility of a social union.

The Juncker plan

Before the second panel, a keynote speech was given by **Wilhelm Molterer**, managing director of the European Fund for Strategic Investments (EFSI) and former vice-chancellor of Austria. The investment plan for Europe to which European Commission president Jean-Claude Juncker gave his name is needed to improve the investment gap, the low growth, employment and competitiveness. The Juncker plan tries via the EFSI to tackle the investment gap with a comprehensive approach. It is not a fund, but a guarantee facility. Its aim is to mobilise at least 315 billion euro in investments. It uses several multipliers, whereby the European Investment Bank is the creditor and the EFSI the guarantor. Its priority are investments in infrastructure. It is a market driven instrument, aimed at midcap investments that are too big for regional banks and too small for capital markets. There are no geographical or sector quota's. The plan is on track, also in social investments and SME's. Molterer stressed the need for a clear political will to follow an investment strategy, for strong partners in the different countries and for strong commercial banks that can work via investments platforms. The EFSI might be a test case for capital markets and regulations that still have a long way to go.

Mr. Molterer's keynote speech was an introduction to the second panel, that focussed on the role of new financial instruments and the question whether the Eastern European member states are making good use of the financing opportunities to enhance their resilience.

A good case study of these opportunities was presented by **Robert Rekkers**, CEO of Agricover, a Romanian holding company that combines agri-business with agri-finance. "We sell both fertilisers and money", Rekkers said. Since Agricover finances farmers, it can be considered to be a "non-bank financial institution", similar to a bank. It brings an additional source of finance to farmers, in addition to banks and government. Agricover also intervenes when farmers want to buy land and on irrigation projects. Via EFSI some 500 Romanian farmers now get cheap funding. The EFSI financing was completed in four months and followed by roadshows to promote the use of it, resulting in Romania taking more EFSI money. Rekkers admitted that the investments in modernisation had the side effect of lowering employment.

Mirela Iovu, vice president of CEC Bank and also secretary general of ELEC Romania, analysed what the implications of the Juncker plan could be for the Romanian economy. She recalled that the Juncker plan is built on three pillars: mobilise finance for strategic sectors and SME's; the EFSI; the investment climate. Romania has a poor record on infrastructure and technological development. The interest of the private sector for investments is low. There are few investment platforms and public private partnerships (PPP's). Romania is in danger of not getting the funds. It should take policy measures, such as transforming state banks into promotional banks. Iovu concluded that a viable strategy to attract investments is urgent and that the infrastructure plan should be updated. Romania should follow the latest recommendation of the European Commission to develop its infrastructure, transport and investments projects. All this can be done via the Juncker plan.

During the debate it was deplored that some Eastern European countries prefer to live not on loans but on gifts, which is a poison. Grants should be combined with PPP, financial instruments and government money. A problem in Romania is the underdeveloped bond market. It was also argued that the rich EU countries take the biggest part of the European funds and that there are few incentives for member states to enhance cross border cooperation.

Improving capital markets

The third panel focussed on capital markets and private pension funds in Eastern European member states: how can we put local retail savings at work, improve the functioning of local financial markets and make fixed income markets more attractive to retail investors?

Filip Keereman, head of unit "national financial systems" of the European Commission, underlined how institutional investors can contribute to economic growth. They are a factor of financial stability. In the EU, capital market financing is less important than bank financing, contrary to the US. In Central and Eastern Europe institutional investors and pension funds lag behind, mainly investing in bonds and bills. Most household savings end up in banks. The European Commission has therefore unfolded a Capital Markets Union (CMU) development plan, including European personal pensions. The relative modest development of capital markets in Central and Eastern Europe has to do with the preference for banks in saving behaviour, financial education and the regulatory environment.

Vassil Karaivanov, professor at the university of Sofia and also secretary general of ELEC Bulgaria, went deeper into the small role capital markets play in the EU compared to the US. As far as corporate equity is concerned, there is a clear division in the US between shareholders and managements. Shareholders, even minority shareholders, can sue the management. In the EU small shareholders are not protected, whereas in the US small shareholders can weigh up to big ones. On the other hand bonds are issued in the EU under 28 different legislations, whereas there is only one scheme in the US. So financing via capital markets versus banks is not a question of education, but of incentives and protection. "If you are not sure about your money, you will not give it to anyone". So the solution is that the 28 (or 27) corporate laws in the EU should be harmonised and registered under EU law.

According to **Sergiu Oprescu**, CEO of Alpha Bank Romania and president of the Romanian Bankers Association, Romanian capital markets clearly lag behind. Banks provide 95% of financing and the listed fixed income market is almost inexistent. Household financial assets represent only 71% of GDP, versus 214% in the EU. For pension funds' assets it is 4% versus 22%. So there is room for an accelerated catching up, as was the case in Poland, the Czech Republic and Hungary, where the functioning of regional financial markets was improved by the upgrade to the status of "emerging market". Oprescu pointed to a paradox: capital markets do not need to be helped in bad times but in good times. An integrated approach should take into account demand, supply and market infrastructure. The upgrade to the emerging market status creates demand by lowering the institutional investors risk curve and putting local stocks on the radar of foreign investment funds. The expansion of pension funds can be supported through more IPO's, higher transparency and improved corporate governance.

During the discussion, conference chairman Boonstra pointed out that the sizable Dutch pension funds are run in the same way as investments funds. But even if a country succeeds in having a large saving surplus, there is no guarantee that it will be invested in its own country. Also a participant warned that if all countries would succeed in having pension funds such as in the Netherlands, the danger is real that they would all be chasing the same assets.

Regional cooperation

The fourth and final panel was devoted to possible initiatives or contributions of the Bulgarian (first half 2018), Austrian (second half 2018) and Romanian (first half 2019) EU Presidencies to the current economic, migration and security challenges faced by the EU. Also the question was asked how the Bulgarian-Romanian cooperation should work in a broader regional cooperation context

Franz Nauschnigg, counsellor to the board of the National Bank of Austria and also secretary general of ELEC Austria, said that finalising the Brexit negotiations will be high on the Austrian agenda. More general priorities will be deepening the single market, investing in the future, deepening EMU (Banking Union and Capital Markets Union) and perhaps even the creation of a Security Union. On regional strategy the Danube area strategy will be continued and one of the topics will be a link of the Danube region to the Chinese Silk Road. The challenges will be to identify good projects and to organise a flow of fund into the Danube region, including SME access to finance and promoting risk capital.

Branimir Botev, executive director of the European Institute for Strategy and Analyses in Sofia, analysed how a regional Bulgarian-Austrian-Romanian cooperation can support the EU's economic, migration and security challenges. The three countries have a common history and have the Danube in common. The nine EU countries in the entire Danube region count 150 million inhabitants, 30% of the EU's population. The EU has developed a European strategy for the Danube region. Apart from the Danube itself as a means of transport, the region is developing transport corridors that include motor highways, railways, air and maritime transport. The region is also important for tourism. Special attention has to be given to migration management. In its millennial of mostly Christian history and culture, Europe has often been faced with external dangers. It is our duty to do everything we can to preserve Europe's values, but also to ward off the abuse of European tolerance and openness.

Petrisor Peiu, director for economic studies at the Black Sea University Foundation, underlined the many characteristics that Romania and Bulgaria have in common. They are situated in a very exposed region with a permanent security issue. They have a similar "life experience", both during Soviet times as afterwards when they integrated the EU and NATO at the same time. The two countries are still out of Schengen and are suspected for large corruption. Romania and Bulgaria belong to the poorest countries of the EU, have a low competitiveness and human development and have a very complex composition (religion, minorities, neighbours). Their mutual trade and investment is intense, but it is by far not as important as the economic relations they have with countries such as Germany, Italy, Turkey or Russia. Compared to Romania and Bulgaria, Austria is a completely different story. In the priorities of the Romanian and Bulgarian EU presidencies, there is hardly any attention to

regional cooperation. Both countries should urgently promote joint infrastructure and energy projects, such as the "via carpatica".

During the discussion the question was raised whether Romania and Bulgaria should not follow the Benelux example and first of all aim at mutual economic integration. There are only two bridges that cross the Danube, the 600 km border between the two countries. The two countries and their inhabitants often keep contact via Brussels, or even Vienna or Paris. Since the migration crisis, security of borders is high on the agenda.

*In his closing remarks ELEC president **Bernard Snoy** made a roundup of the different topics that were addressed during this conference. He said he came out of the meeting with optimism. Of course there are big challenges ahead, but we had answers to each question mark. Yes we can! Let us be consistent in projecting a way out and use the window of opportunity. Now that the conference is over, we should all do our homework. Finally president Snoy once again thanked Radu Deac, ELEC Romania and the National Bank of Romania for all their efforts to make this conference a success.*

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