

*Post-Crisis Growth and Integration in Europe
Catching-up Strategies in CESEE Economies*

edited by Ewald Nowotny, Peter Mooslechner and Doris Ritzberger-Grunwald
Edward Elgar Publishing Limited, 2011, pp. 324, ISBN 978 085793 290 7

reviewed by Fotios M. Siokis¹

This book - edited by Nowotny, Mooslechner and Ritzberger-Grunwald - is a collection of papers with the primary objective of answering the following question: what will the economic consequences be of the post crisis period for the Central, Eastern and South-Eastern European countries (CESEE). The volume consists of twenty-eight papers and it was compiled in the midst of a very serious financial crisis, with Europe standing at a major crossroads. The sovereign debt crisis, and to a lesser extent the banking crisis, have pushed Europe towards reestablishing itself through the creation of a fiscal union, with the inclusion of strict and enforceable “new” rules. But, at the same time, the debt crisis is catapulting the union along a path of disintegration. These extreme events not only affect the member states dramatically, but have significant temporal spillover effects on the economic growth and on the catching-up process of the CESEE countries. The authors provide a good deal of information about the state of the CESEE economies, with a forward-looking view. They all agree that post-crisis recovery will be a painful and sluggish process. The editors have done an excellent job and artfully structured the book into four attention-grabbing parts, each part dealing with its own theme.

The first part is devoted to answering the fundamental question of whether economic growth in the aforementioned countries will keep the dynamic momentum it had prior to the crisis, and if not - then what will the new model look like?. It consists of eight well-written papers, which complement one another well. Firstly, there is a consensus among the authors that all CESEE countries were greatly impacted by the current crisis, with growing fiscal imbalances and concerns over a slowing-down of the process of integration. Indeed, owing to the crisis these economies have felt pressure to intensify the integration process, which must go hand in hand with prudent macro and financial sector policies, while there is an urgent need to design coherent policy frameworks and to implement stability-oriented policies. The authors

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state that there will be a positive side of the economic crisis for the CESEE countries. A sustained growth path may be possible, since the slowing-down of growth rates will in fact constrain excessive consumption as well as the boom reported in credit markets, with much of the financing coming from foreign currency loans. Current account deficits will decrease, but a necessary condition of this reduction will be to effectively control unit labour cost and improve their competitiveness level. The rest of the first chapter deals with the 1990s Nordic crisis and how valuable lessons can be learned, while the catching-up process will have to be intensified, as all of the CESEE countries will be forced to take additional structural reform measures. Lastly special emphasis is attached to the Balkan area, where the authorities failed to design the appropriate policies in order to weather the crisis. The debt crisis created significant growth risk for most Balkan economies and although substantial process has been made in the area of structural reforms, there is much more to be done. We should state however, that most of the Balkan economies had made a modest recovery in 2011, compared to 2010, and were set to expand further in 2012.

The second part of the book begins with a review of the role played by Central Banks. The first two papers examine the importance of the Central Banks in the areas of macro policies. Regulation and supervision have taken central stage, again, after the eruption of the financial crisis in the United States and its transmission to the economies of the European countries. It is stated, as far as the CESEE countries are concerned, that Central Banks have taken the necessary actions to continue the macro-prudential policy, to confront the challenges coming from slower capital inflow and the catching-up process and lastly, to supervise domestic financial liberalization. But certainly the need to address the importance of financial stability in the middle of a spreading financial crisis is paramount. Therefore monetary frameworks should be adjusted in order to accommodate financial stability objectives and to combat asset price inflation. This part of the book casts ample light on the aforementioned issues and the reader will enjoy reading three country case studies, specifically on Poland, Romania and Croatia, in the areas of central banking and how monetary policy works in searching for economic growth, price stability and financial soundness.

The third part of the book, on the new role of financial integration, growth financing and exports, is a collection of seven papers focusing mainly on the importance of capital inflow as one of the main factors in economic growth. It starts by attaching the appropriate emphasis to the need for more European financial integration and the creation of a Eurobond market that will endorse greater harmonization and financial integration and reinforce the euro's future. The continuation of financial integration and therefore the immediate access to external finance are considered crucial for the economic growth of the CESEE countries, and consequently for individual companies. Access to finance and FDI inflow are considered important for the economic growth engine which ignites exports. And the authors are certainly right to seriously doubt

whether economic activity and exports will continue to grow at the same pace in the post-crisis period. They maintain that the financial crisis was transmitted to the CESEE countries through the trade and financial channels. Consequently, capital inflow has declined significantly as investors stepped to the sidelines or channeled their capital to “safe havens”. This will have a negative impact on economic growth, as empirical evidence demonstrates a positive correlation between FDI and industrial production.

The last part of the book studies the effects of the crisis on the banking systems of the CESEE countries and the challenges lying ahead. The banking crisis and its transmission to some of the European countries have raised the issue of strengthening further financial regulation and supervision in order to avoid future crisis. But do we really need more regulation and supervision, and if so then at what cost? What will the cost of opportunity be? But one thing is certain: that the CESEE region was not impacted as much as the other European countries. Possibly because the foreign banks’ presence in this region is very strong and parent companies’ support was continuous, with the financial convergence process between the region and western economies still lacking. The authors are stating that today’s business model for the banks has to be challenged harder, while supervision and regulation, along with more cross-border coordination, should be strengthened further. Issues like liquidity crunch, credit quality problems and the substantial decline in lending demand should be appropriately addressed. The final two papers of this part give us a view from the inside. Two foreign banks that operate in the CESEE region have maintained their exposure despite the financial crisis, giving a vote of confidence and loudly stating that “we are here to stay” because we believe in the dynamics of this specific region. Although profitability was impacted by the financial crisis and future growth will not be the same as before, there is a wide agreement that banks need to support sustainable growth based on increased exports, productivity and innovation

In conclusion, although the book was published before the end of the crisis, it presents a distinctive perspective that is a valuable contribution to the literature. I recommend this book to those interested in learning about the economies of CESEE, and, more importantly, to those thinking of teaching a course in the area of transition economies and European integration.