The role of foreign trade in the economic transformation for V4 and CLMV countries

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Outline

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2. The importance of foreign trade and FDI in a transition process
3. Challenges of transition for V4 countries
4. Trade relations of V4 (Patterns of FDI)
5. Trade relations of CLMV countries
6. Conclusions and potential implications of V4's experience

Similarities of V4 and CLMV

- Both groups of countries are new members of an economic organization.
- Similar size of population within the organisation (CLMV: ≈ one quarter, V4: 13%) – much lower share of GDP compared to total
- Higher growth rate than the average level of the integration (as a result of developing trade relations and large influx of foreign investment)
- Strong economic connections to their 'big neighbors' (V4: Germany, CLMV: Thailand and China)
- Similar to the V4 region the intra-trade relations (but increasing) within the CLMV region are relatively low.
- Laos' and Myanmar's high share of trade within the ASEAN Economic Community (80% and 50% respectively). The corresponding data for Slovakia's and Czech Republic's trade with the EU-15 even exceed 80%.

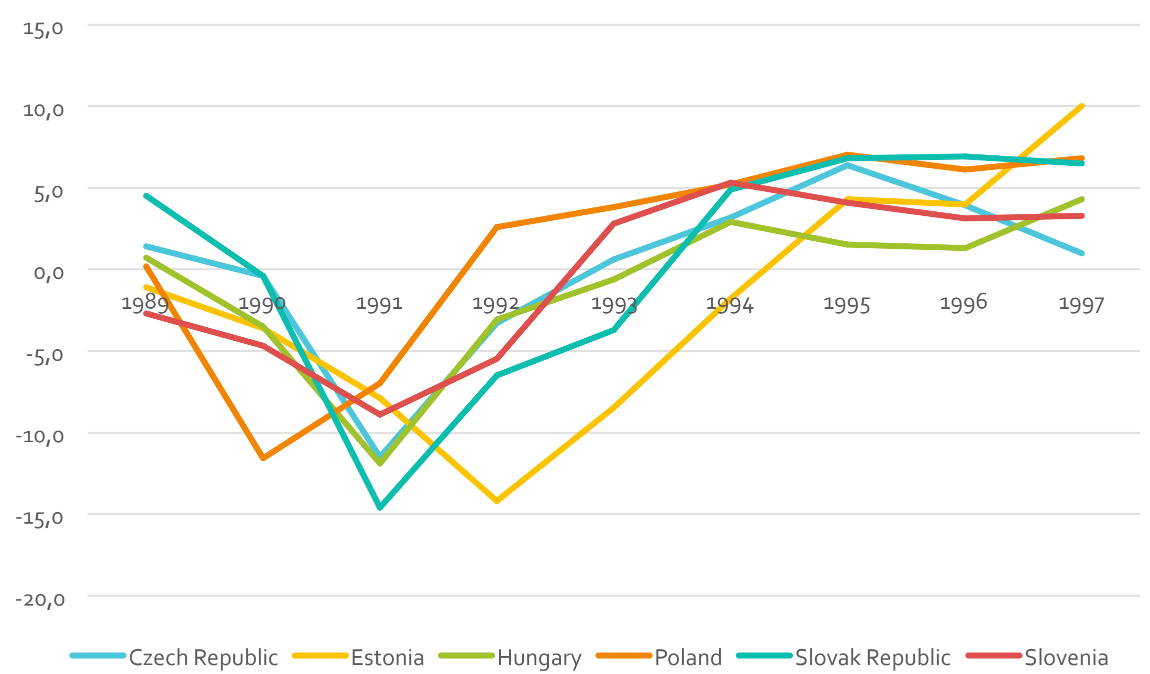
The importance of foreign trade and FDI in a transition process

- Foreign trade and FDI: catalysts promoting economic growth and integration of transition countries with the world economy
- The transition from central planning to market economy in the CEE countries has been resulted in large inflows of FDI and expansion of international trade.
- FDI is essential in augmenting domestic capital stock and in technology transfer which contribute to the long-run growth of an economy.
- The opening-up of transition countries and their trade integration with the European Union (EU) has brought about large increases in trade between the two groups of countries and the substantive trade creation has gone hand in hand with vast increases in FDI flows.
- ***DO NOT FORGET THE INITIAL CHALLENGES!***

Three major challenges of transition for V4 countries

- the elimination of most price subsidies,
- the end of full employment,
- and the transformation of state-owned enterprises into profit-making companies.
- These shocks, accompanied with growing social need and economic reforms caused a *massive recession*

Real GDP growth rate in CEEcs (1989-1997)



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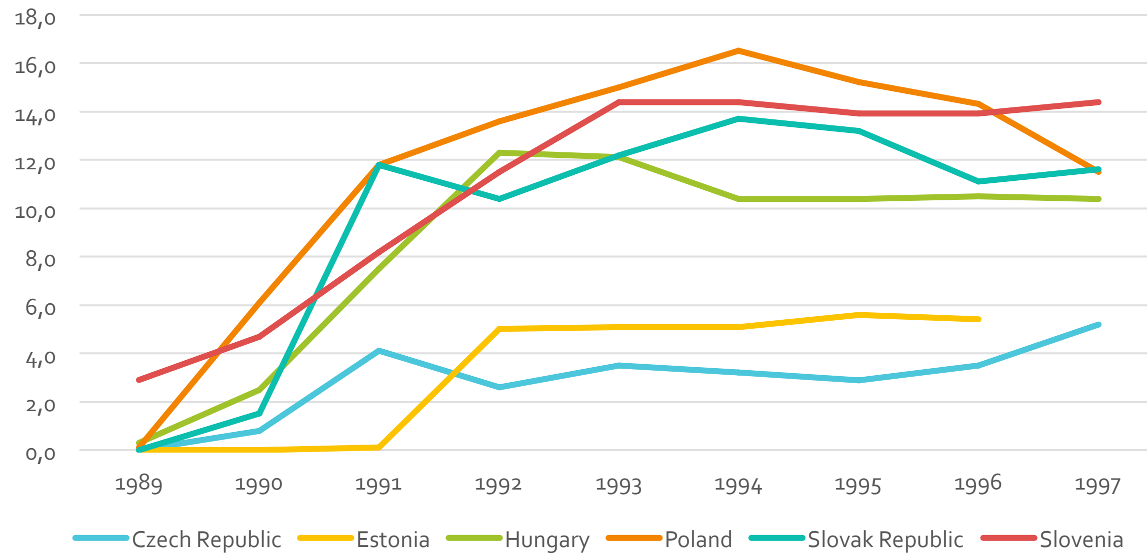
Negative impact on socio-economic environment

Unemployment rate in CEECs (1989-1997)



Inflation rate in CEEcs (1989-1997)

	1989	1990	1991	1992	1993	1994	1995	1996	1997
Czech Republic	1.5	18.4	52.0	12.7	18.2	9.7	7.9	8.6	10.0
Estonia	n.a.	n.a.	303.8	935.5	35.6	42.0	29.0	15.0	12.0
Hungary	18.9	33.4	32.2	21.6	21.1	21.2	28.3	19.8	18.4
Poland	639.5	249.0	60.4	44.3	37.6	29.4	21.6	18.5	13.2
Slovak Republic	1.5	18.4	58.3	9.3	25.1	11.7	7.2	5.4	6.4
Slovenia	272.0	105.0	247.1	92.9	22.9	18.3	8.6	8.8	9.4

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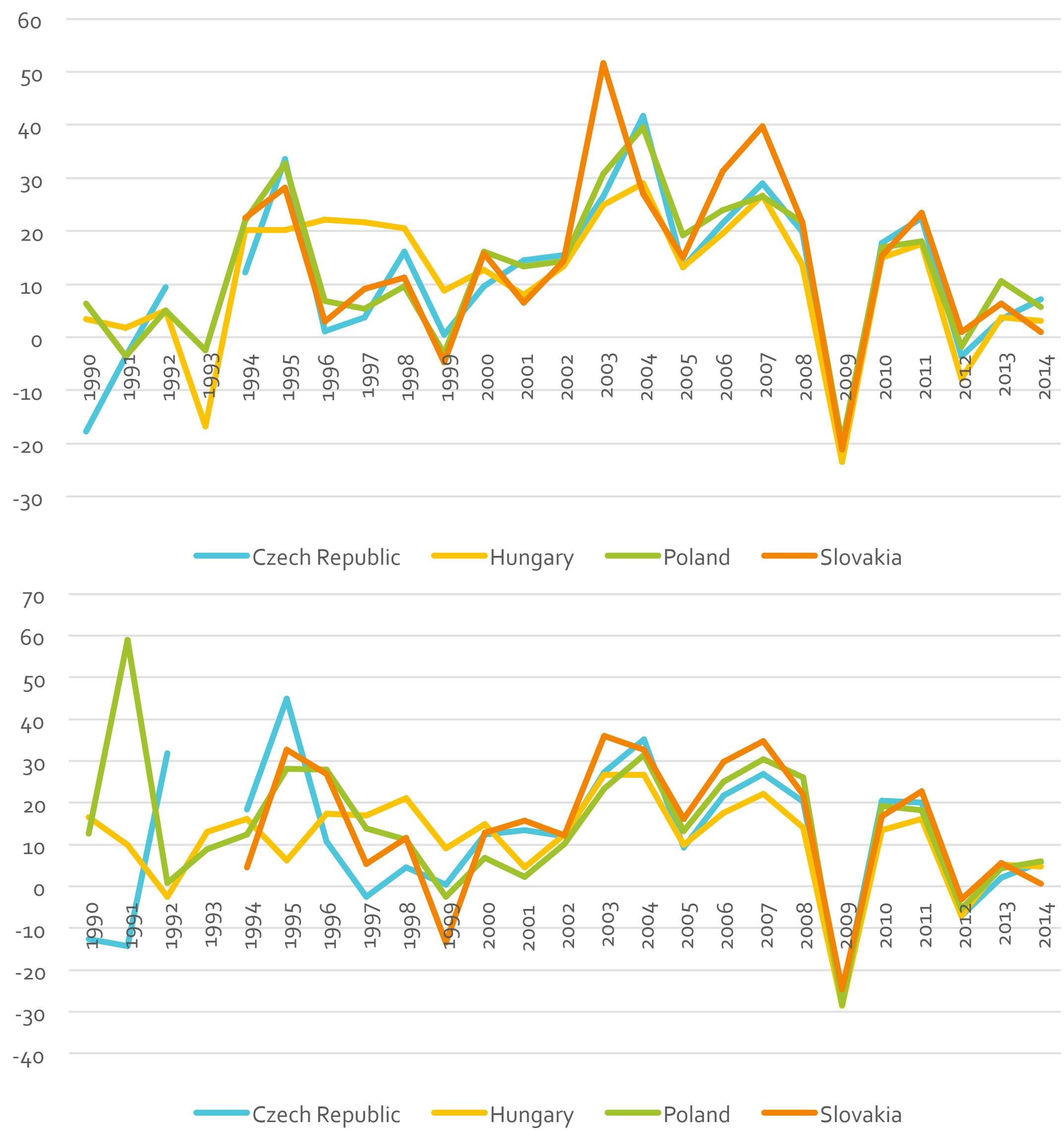
Trade relations of V4

Annual average growth rate of export and import



Source of data: UNCTAD

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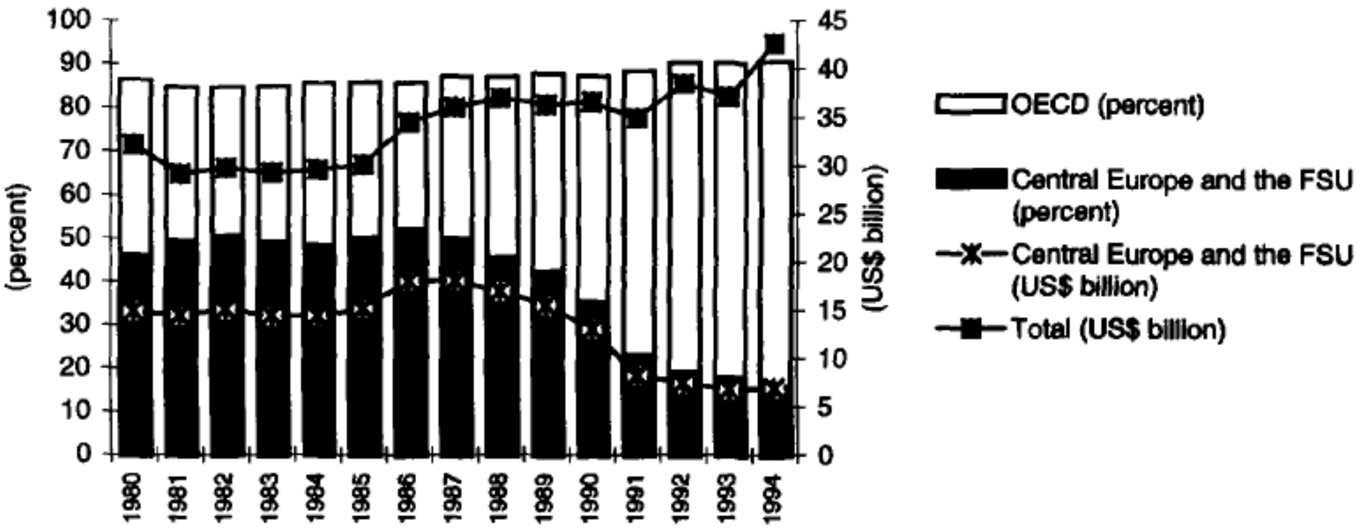
Trade relations of V4 cont.

- There are three phases of trade performance of V4 after transition
- Before transition: Hungary and Poland already made progress in decentralizing foreign trade regime (in Czechoslovakia less effective – currency devaluation)

1. Transition and its aftermath: V4 reorientation of trade – total export(1980-1994)



Source: Kamiński et al. (1996): Foreign Trade in the Transition: The International Environment and Domestic Policy. Studies of Economies in Transition, 20. The World Bank, p. 20

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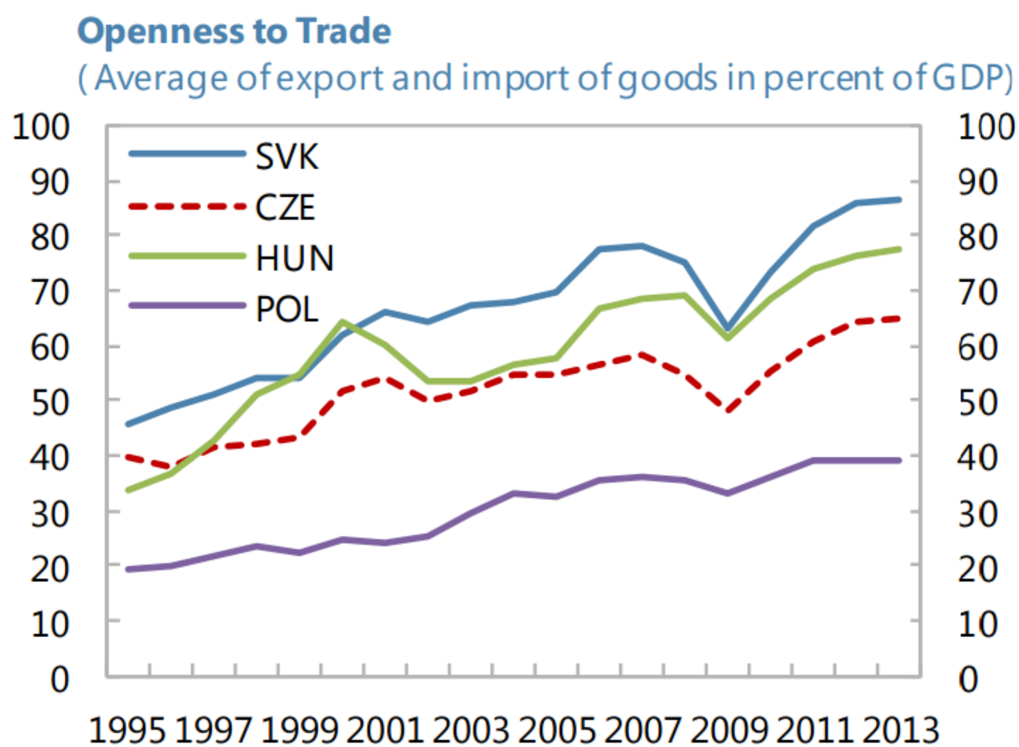
Trade relations of V4 cont.

2. From late 1990s until the crisis: significant trade creation with EU partners (average growth rate: 14.1 % per annum much faster than extra-EU trade)

- The importance of international transactions has increased significantly even before EU accession



Source: IMF, 2014

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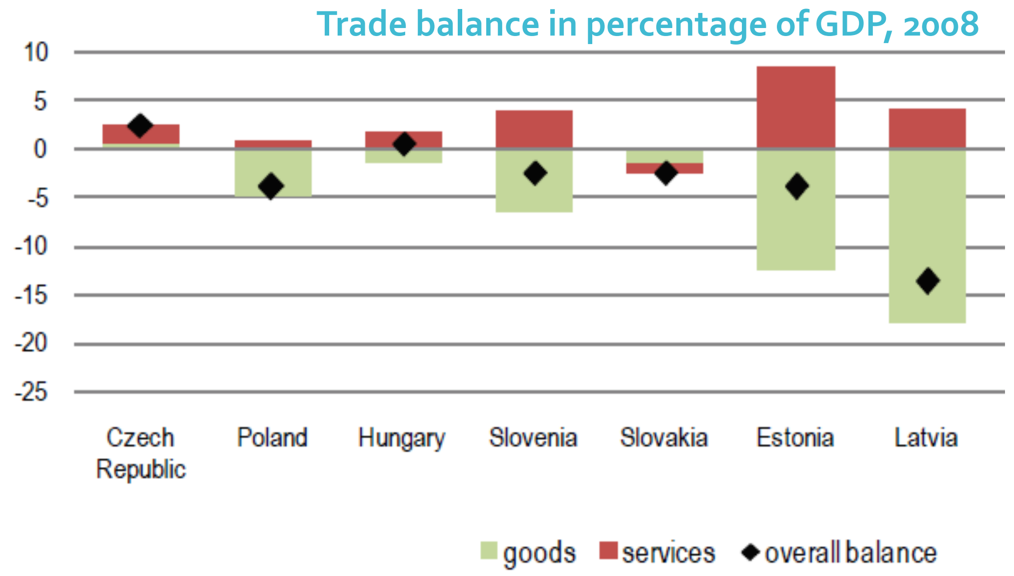
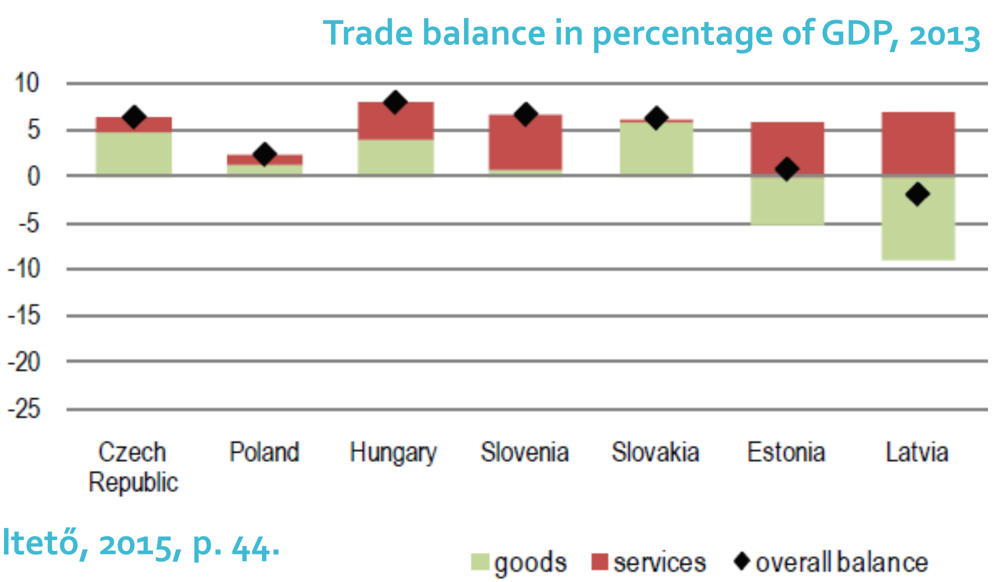
Trade relations of V4 cont.



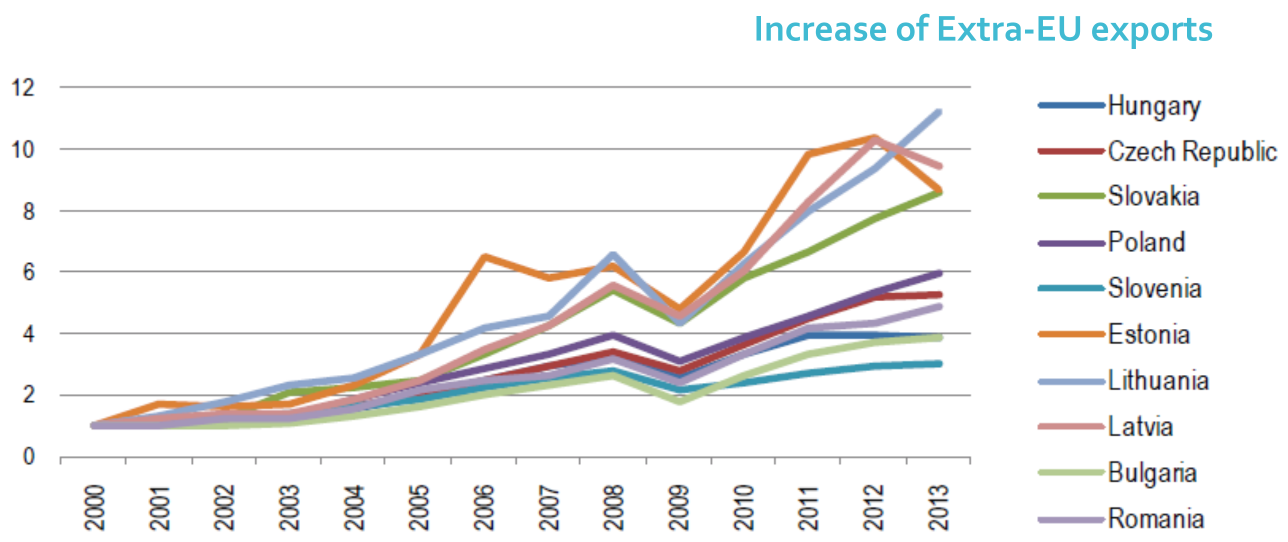


Source: Éltető, 2015, p. 44.

Trade relations of V4 cont.

3. Salient drop in trade volume which was worsened was by the general credit crisis

- The effects of the crisis: extra-EU exports increased (China, Russia, Turkey)
- Crisis resulted in reorganisations, relocations of firms in order to improve their competitiveness for V4 (negative and positive effects)



Source: Éltető, 2015, p. 46.

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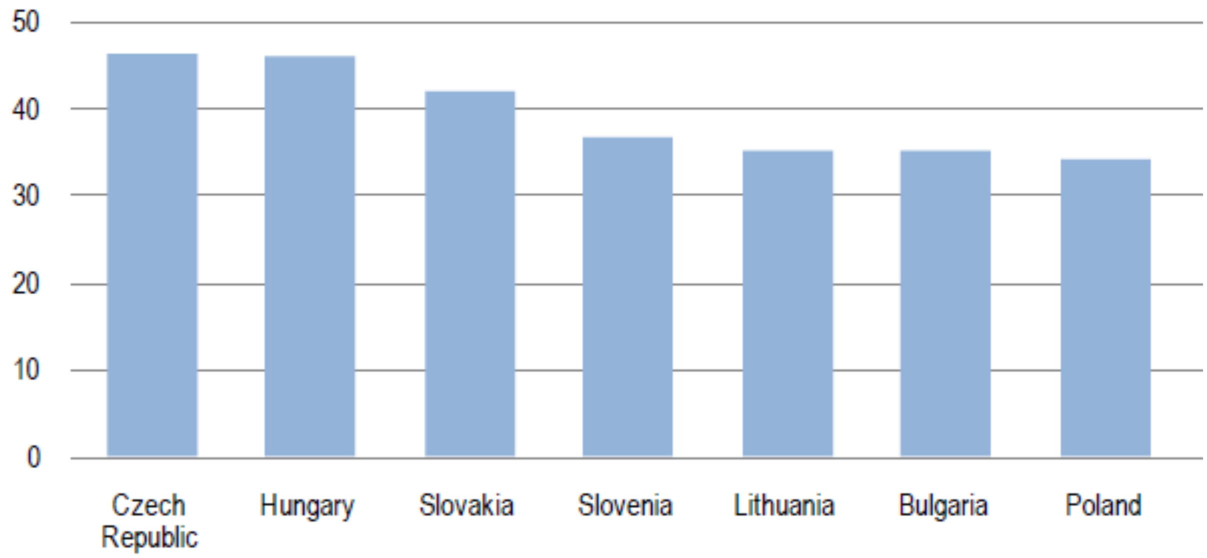
Trade relations of V4 cont.

- Hungary, the Czech Republic and Slovakia are especially strongly linked to Global Value Chains, for Poland it is less strong
- German companies integrated these economies into their production networks (already before legal accession to the EU)
- GVCs as rapid transmission of shocks: the reason behind relocation (positive and negative effects)

Share of foreign vale-added in exports, 2011



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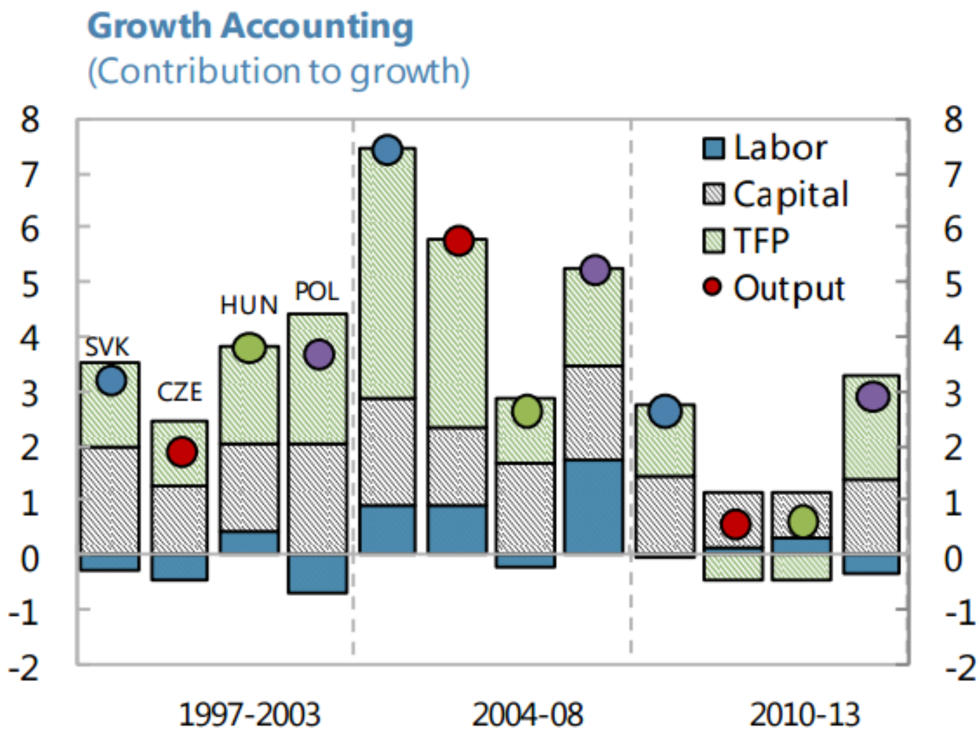
Trade relations of V4 summarized

- V4 countries: small and open economies (Poland is somehow exception but not much different)
- Trade plays a crucial rule in their growth performance
- Strongly integrated in the global value chains that shape their trade structure, dynamics and volume.
- Their exports are relatively high-tech intensive.
- The most vulnerable among these economies is Slovakia, because its trade pattern is extremely concentrated on motor vehicle exports (high share for Hungary as well)
- Fruitful participation in the global value chains depends largely on the local capacities to absorb foreign technology, thus on the quality of human capital (emigration of well qualified people?).
- Efficient development of human capital and education system would be essential to provide a long-term base for good export performance and growth

Main drivers of growth for V4 region

- Capital accumulation and total factor productivity (how efficiently and intensely the inputs are utilized in production) have been the main drivers of output growth
- The contribution of TFP sizeable in the aftermath of EU entry, reflecting major restructuring and reform of the corporate sector
- Crisis: decline in HUN and CZE



Source: IMF, 2014

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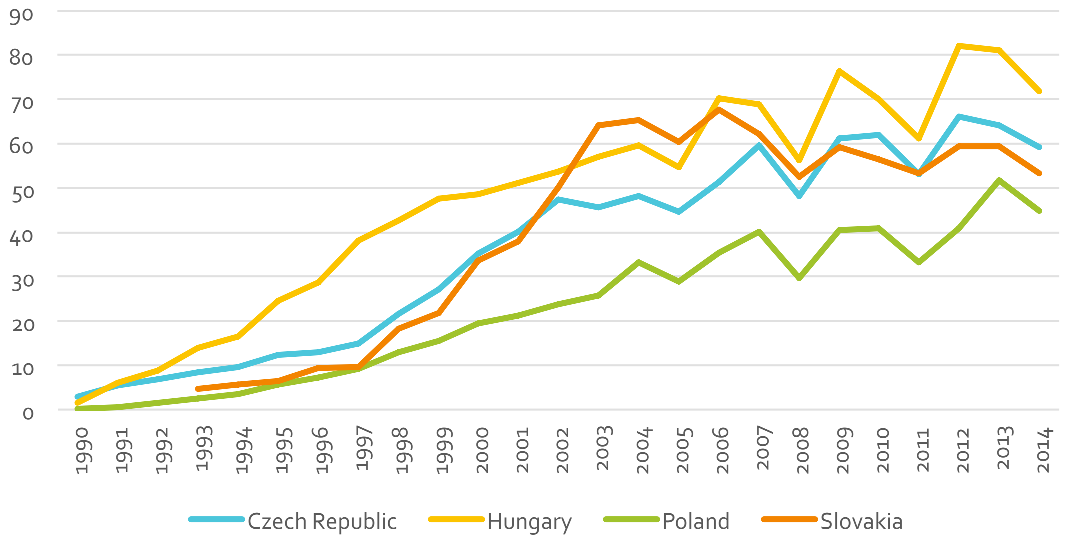
Patterns of FDI in the V4 region

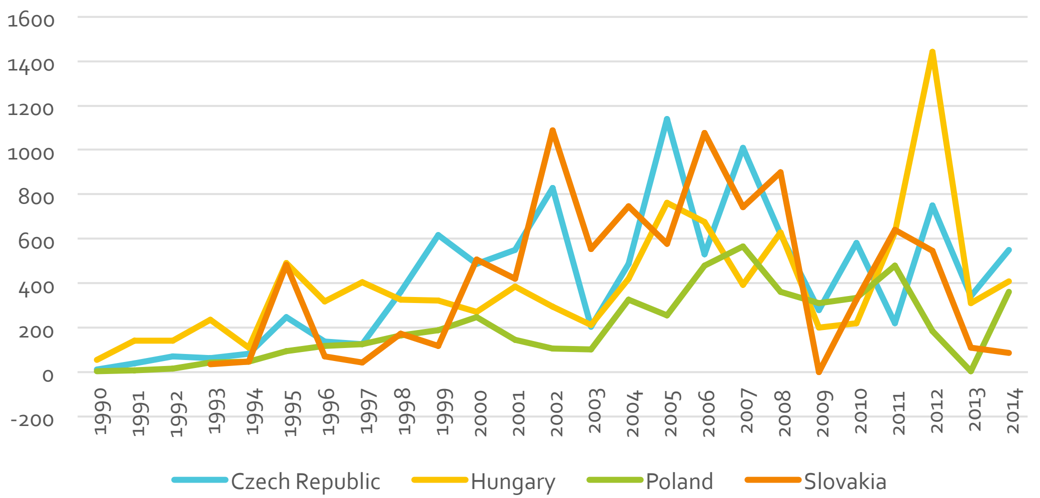
- Attractive region for FDI (1. privatization, 2. market access, relatively low wages, 3. skilled workers)
- Openness to trade is significantly linked to FDI inflows
- FDI in V4 economies dropped significantly after the financial crisis.
- Visegrad countries are competition states, which means that they became structurally dependent on foreign capital, which controls access to technology, know-how and distribution networks (Drahokoupil, 2007)
- Vulnerability to crisis: economies' significant reliance on external financing
- Domestic investments? OFDI (Hungary)

Patterns of FDI in the V4 region

Inward FDI stock as Percentage of Gross Domestic Product



Inward FDI flow (USD at current prices and current exchange rates per capita)



Source of data: UNCTAD

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Trade patterns of CLMV countries

- ASEAN membership: increase in both amount and volume of intra-regional trade for CLMVs
- Decline during the Asian crisis, but afterwards salient growth of trade
- Trade deficit (imports of capital goods, owing to infrastructural developments in the region

International Trade of CLMV Countries, US$ billion

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Exports	32.9	39.8	49.1	58.2	74.8	69.4	87.5	114.9	134.1	161.9
Imports	38.1	43.7	52.9	73.2	94.0	82.8	97.2	129.6	142.1	180.1
Total Trade	71.0	83.5	102.0	131.4	168.8	152.2	184.7	244.5	276.2	342.1
Trade Balance	-5.2	-3.9	-3.8	-15.0	-19.1	-13.4	-9.6	-14.7	-8.0	-18.2

Annual average growth rate of total trade for CLMV Countries

	2005 - 2010	2010 - 2014
Cambodia	10.6	18.5
Lao's PDR	17.0	12.4
Myanmar	20.3	31.5
Viet Nam	17.9	14.4

Source of data: UNCTAD

Trade patterns of CLMV countries cont.

- In 2013, Vietnam alone accounted for 11.1 percent of total ASEAN trade, while the combined share of Cambodia, Lao PDR and Myanmar was 2.7 percent.
- CLMV region has proliferated since the establishment of the ASEAN Free Trade Area
- The share of the CLMV region in total ASEAN trade has increased from 6.6 percent in 2004 to 8.8 percent in 2008 and to further 13.4 percent in 2013.
- Trade openness is over 100% for Cambodia and Viet Nam, less moderare for Myanmar and Lao's PDR
- In recent years, the CLMV region has benefited from increased FDI inflows, primarily to the infrastructure sector (trade deficit)
- An area of critical importance for CLMV region is infrastructure development.
- The financial sector in the CLMV region which is still relatively underdeveloped due to its isolation from global banking system, also present opportunities for collaboration.
- The CLMV region is considered as one of the fastest growing tourism destinations in the world.

Conclusions?

- The transition from central planning to the market has been more difficult and more time-consuming than many democratic governments anticipated. (gradual process)
- The dilemma is how to speed up economic recovery while maintaining political stability (interconnected and self-strengthening processes)
- Attractive region for trade and investment (labour-cost advantage for effeciency-seeking investments)
- In attracting FDI structural changes crucial (FDI is shifting towards knowledge-and skill-intensive manufacturing and services)
- Importance of sub-regional intergation
- Advantages of an own currency
- „competition state“?