

# Monthly Report

**Higher Minimum Wages? Not Necessarily the End of the World**

**Connectivity Strategies for Europe**

**The Current Debate on China's Rise**

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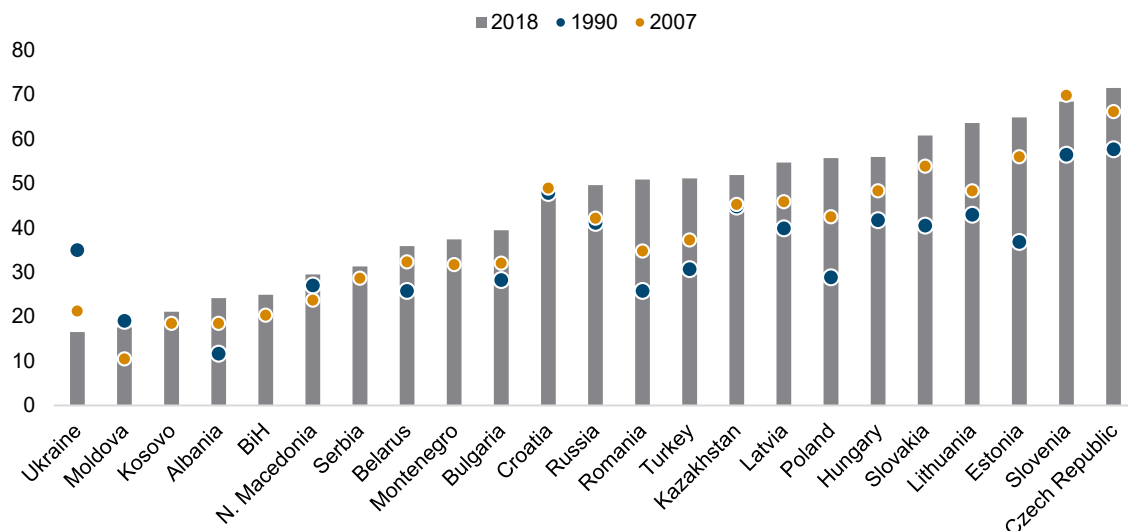
# Chart of the month: 30 years of transition and convergence in CESEE

BY RICHARD GRIEVESON

On November 9<sup>th</sup> 2019 it will be 30 years since the Berlin Wall fell. For many in Central, East and Southeast Europe (CESEE) looking back, feelings will be mixed. Memories of the time are difficult for various reasons, but not least the deep recessions that almost all countries experienced at the start of transition. Poland's economy contracted by 11.6% in 1990 and a further 7% in 1991. Between 1990 and 1998, Russia posted full-year positive real GDP growth only once.

Since then, things have improved for most. However, looking back 30 years on, it is very hard to make a general statement about economic convergence since 1989. As the chart below shows, in terms of both levels and trends, the state of convergence in the region is highly heterogeneous.

## GDP per capita at PPP, Austria = 100



Source: wiiw. Note: Data for Kosovo, Bosnia and Herzegovina, Serbia and Montenegro not available for 1990.

Taking current levels (as of 2018), five countries in CESEE have per capita GDP in PPP terms at 60% of the Austrian level or above: Slovakia, Lithuania, Estonia, Slovenia and the Czech Republic. At the opposite end of the scale, however, Ukraine, Moldova, Kosovo and Albania have not yet reached one quarter of the Austrian level.

Convergence momentum over the whole period was also highly differentiated. Between 1990 and 2018, Estonia went from 37% of the Austrian level to 65%, a 28 percentage point (pp) gain. Gains of 20pp or more were also recorded for Poland, Romania, Lithuania, Turkey and Slovakia. For other countries, however, the period was far less successful. Ukraine is the most famous case, having regressed by

18pp over the whole period versus Austria. Moldova also went backwards (-1pp), while the gain was less than 10pp over the whole period for Croatia, North Macedonia, Kazakhstan and Russia.

For some countries, the period since the global financial crisis has been particularly difficult. While Romania, Lithuania, Turkey and Poland have all recorded double digit gains in convergence levels versus Austria since 2007, Ukraine (-5pp) and Slovenia (-1pp) have gone backwards. Several other countries, especially in the Western Balkans, have also recorded very meagre rates of convergence with Austria since the crisis.



## Opinion Corner\* : Higher minimum wages? Not necessarily the end of the world<sup>1</sup>

BY LEON PODKAMINER

*In September the Polish government announced a sharp increase in the minimum wage. For most economists this spells trouble. However, it is suggested that a similar wage hike administered in Hungary back in 2000 did not have the feared consequences in terms of inflation, unemployment, economic growth, and the profit share.*

In September, the Polish government announced a sharp increase in the minimum wage in three steps: it will be hiked by some 16% starting from next year, 15% in 2021 and 11% in 2022. This announcement is upsetting for most economists. There are widespread concerns that this will slow down economic growth, increase unemployment and, possibly, bring about a return to high inflation. These concerns are based on prevailing theoretical beliefs and should be taken into account with due attention. This, however, does not relieve us of the obligation to carry out an in-depth assessment of the available facts.

One of the facts to be mentioned is the experience of Hungary. In 2000, the Hungarians took the risk of drastically hiking the minimum wage – from about 1/3 of the median wage in the private sector to a level exceeding 50% of the median. The minimum wage in Hungary was later increased every year: according to the latest available estimate by Eurostat, it stood at 58% of the median wage in 2014. For comparison, according to the same source, in Poland the minimum wage in 2014 was about 52% of the median and about 62% in France and Slovenia.

### THE HIKE IN THE MINIMUM WAGE DID NOT HAVE A NEGATIVE IMPACT ON UNEMPLOYMENT...

Figure 1 illustrates the history of the unemployment rate in Hungary (as well as in Poland) over the period 1995-2018.

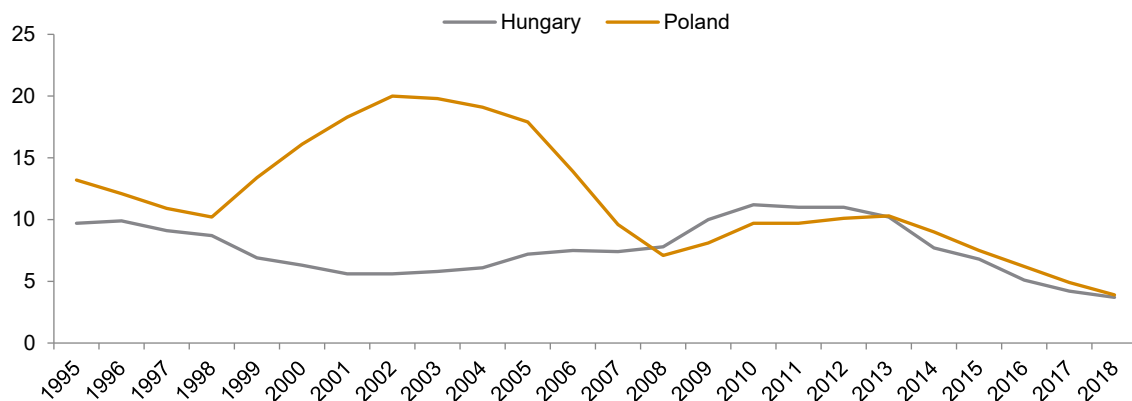
As can be seen, the surge in the minimum wage in Hungary – already in place in 2001 – did not affect the unemployment rate. On the contrary, for nearly four years (2001-2004) the unemployment rate in Hungary was decreasing. It averaged 5.8% in that period. It was only later that it increased to 7.4% (on average between 2005 and 2008). In 2009, the unemployment rate 'went off the charts' – and remained above 10% until 2014. However, it is difficult to suspect that this episode was due to a delayed effect of minimum wage increases at the beginning of the century. It should be noted that the unemployment rate in Poland also increased in this period (after a rapid fall in 2005-2007). In both cases, we are inevitably dealing with the effects of a slowdown in growth (in Poland) and a deep recession (in Hungary) manifested under the influence of the global financial and economic crisis. After 2013, unemployment

\* Disclaimer: The views expressed in the Opinion Corner section of the Monthly Report are exclusively those of the authors and do not necessarily represent the official view of wiiw.

<sup>1</sup> The original version of this text (in Polish) was published in Rzeczpospolita.

rates in both countries fell dramatically – regardless of differences in the minimum wage levels (in relation to the average wage levels).

**Figure 1 / Unemployment rate: Hungary versus Poland, in %**

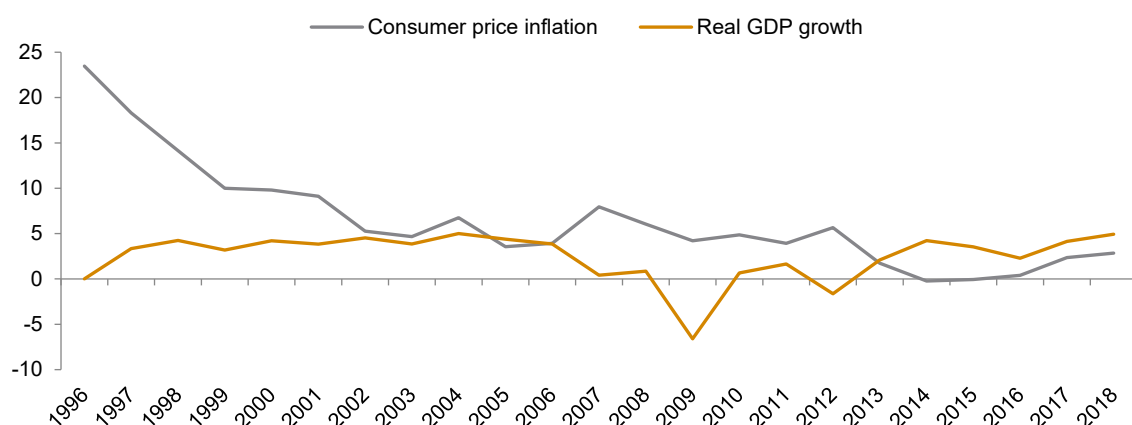


Source: AMECO (Eurostat).

### ...NOR DID IT SLOW DOWN ECONOMIC GROWTH OR FUEL INFLATION

Like most CESEE countries in the first half of the 1990s, Hungary struggled with high inflation. In 1996, the inflation rate there was 23.5% (in Poland it was close to 20%). Still in 2000, the inflation rate in Hungary was close to 10% (Figure 2). After the hike in the minimum wage, not only did inflation not increase, but it even decreased. In 2002, it amounted to slightly over 5%. The inflation rate oscillated around this level until 2012. Later, it decreased to very low levels. Thus, the hypothesis that raising the minimum wage will accelerate price increases is not confirmed by the facts.

**Figure 2 / Inflation and GDP growth in Hungary, in %**



Source: AMECO (Eurostat).

The facts do not support the claim that raising the minimum wage will slow down economic growth either. Economic growth in Hungary had been stable – and relatively high – since 1998 and even

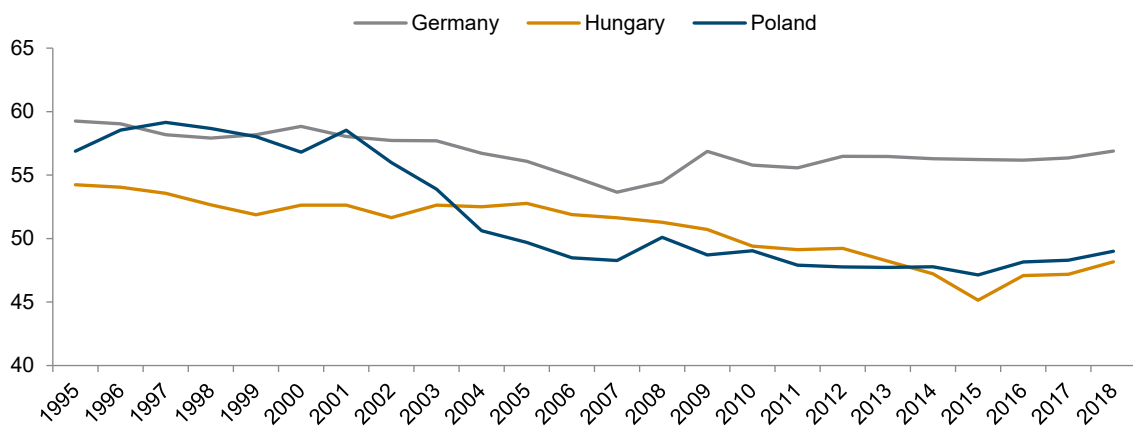
accelerated slightly after 2000 (Figure 2). The recession came much later – and was, as elsewhere, mainly due to the global financial and economic crisis and the related crisis of the Euro Area in 2012. On average, Hungarian GDP grew by an impressive 4.3% annually between 2001 and 2006.

## ‘BUSINESS’ IS DOING EXTREMELY WELL

It is part of the daily ritual to publicly complain about the fate of ‘the oppressed entrepreneur’ (especially ‘small’). This ritual is especially celebrated by respectable ‘chief economists’ employed in rather large companies. It is claimed that higher minimum wages will cause an avalanche of wage increases generally – and ‘further erosion’ of business profits.

A glance at Figure 3 shows that raising the minimum wage in Hungary did not have any noticeable impact on the share of wages – and thus, approximately, profits – in GDP. Moreover, a policy of gradually raising minimum wages has not prevented a rise in the share of profits (starting from 2005). It is worth noting that in the period 2001-2005 the share of wages in the GDP of Germany and Poland decreased: gradually in Germany gradually and rather sharply in Poland. The downward trend in wage share in Germany was halted after 2009 while only after 2015 in Hungary and Poland. It should be noted that the share of wages in the GDP of Hungary and Poland is currently almost 10 percentage points lower than in Germany. Business in both Poland and Hungary has – objectively – fewer reasons to complain than in Germany.

**Figure 3 / Share of wages in GDP: Hungary, Germany and Poland, in %**



Source: AMECO (Eurostat).

In conclusion, concerns that raising minimum wages will automatically lead to the erosion of profits do not seem justified. Neither do the hopes that this will automatically increase the share of the nationwide ‘cake’ for employees seem justified. Increasing the share of wages in GDP is unlikely to be achieved without awakening trade unions from their current lethargy. Moreover, for this to happen it is essential that economic policies are fundamentally changed throughout the European Union. Without a paradigm shift in the EU policies, business will be winning the battle over the GDP share with the labour – rising minimum wages notwithstanding.

# Connectivity strategies for Europe

BY JULIA GRÜBLER

*Within six years, China's Belt and Road Initiative (BRI) has become a global project, anchored in its strategy to open and modernise its economy. In Europe, the Balkan region could profit the most from infrastructure development, in particular if the EU manages to optimise the complementarity between Chinese and European infrastructure investment plans.*

The BRI<sup>1</sup> was announced by China's President Xi Jinping in 2013 and has been known throughout Europe since 2016 at the latest, when the China Ocean Shipping Company (COSCO) acquired a 67% majority share of the largest Greek harbour in Piraeus. In April 2019, Greece was again in the spotlight when it officially joined the '16+1' (now '17+1') cooperation format between China and sixteen economies in Central, East and Southeast Europe (CESEE)<sup>2</sup>.

The massive infrastructure financing and investment initiative in the transport, energy and telecommunications sectors is important for China's internal development as well as external diplomatic and economic relations. This was emphasised during the 19th National Congress of the Communist Party of China in October 2017 and reiterated in the course of the recent celebrations on the occasion of the 70th anniversary of the People's Republic of China in October 2019<sup>3</sup>.

'Openness brings progress, while self-seclusion leaves one behind. China will not close its door to the world; we will only become more and more open. We should pursue the Belt and Road Initiative as a priority, give equal emphasis to 'bringing in' and 'going global,' follow the principle of achieving shared growth through discussion and collaboration, and increase openness and cooperation in building innovation capacity. With these efforts, we hope to make new ground in opening China further through links running eastward and westward, across land and over sea. We will expand foreign trade, develop new models and new forms of trade, and turn China into a trader of quality.' *Xi Jinping, 18 October 2017*

## RESEARCH ON INFRASTRUCTURE INVESTMENT: CRAVING DATA

One might argue that the BRI triggered the evolution of a new research field – as the title of the recent World Bank report 'Belt and Road Economics' (2019) could suggest. The geographical scope, nature of investments and financing as well as the wide range of potential economic and political effects continue to raise many questions to be answered.

<sup>1</sup> The BRI encompasses the overland Silk Road Economic Belt and the 21<sup>st</sup> Century Maritime Silk Road. See wiiw Monthly Report No. 10/2016 (<https://wiiw.ac.at/p-3983.html>) with contributions by Waltraut Urban, introducing the New Silk Road, and by Stephan Barisitz, reviewing the Ancient Silk Road.

<sup>2</sup> The '17+1' encompass all eleven EU Members having joined the EU since 2004, five Western Balkan economies (i.e. Kosovo is excluded), Greece and China (i.e. '+1').

<sup>3</sup> See e.g. 'Measuring China's rise' on the development of some key economic indicators for China, the EU and the US: <https://wiiw.ac.at/n-398.html>

However, there is no clear-cut definition of which projects fall under the BRI<sup>4</sup>, neither is there transparency on the progress of projects, financing conditions, duration of implementation nor the involvement of local companies and labour forces. Information is scattered and available databases are collections of investment announcements from media reports and corporate and governmental documents<sup>5</sup>. Estimations on the current total sum of BRI projects therefore vary considerably. The World Bank (2019) estimates that costs for transport projects alone range between USD 144 and 304 billion. In addition, figures continuously change as established Chinese policy banks<sup>6</sup>, commercial banks such as the Industrial and Commercial Bank of China (ICBC)<sup>7</sup>, relatively new institutions like the New Development Bank (NDB) or the Asian Infrastructure Investment Bank (AIIB) and special funds including the Silk Road Fund or the China-CEE fund are devoted to supporting the BRI.

The BRI is becoming increasingly important in Europe, yet, at present the EU constitutes a much more significant source for infrastructure funding than China, in particular for EU Members in Central and Eastern Europe. Information on EU projects and funds can be obtained from the website of the European Commission. However, the intricate system of investment and financing instruments makes it difficult to get an overview of the EU's engagement within its borders and in its neighbourhood: The Connecting Europe Facility (CEF) provides funding (primarily grants) of more than EUR 30 billion over the period 2014-2020 to EU Members and some other European economies, such as the Western Balkans, for strategic investments in transport, energy and telecommunications. The European Fund for Strategic Investment (EFSI) is financed by the European Investment Bank (EIB) and the European Investment Fund (EIF) and aims at triggering investments of up to EUR 500 billion in the EU<sup>8</sup>. The European Structural and Investment Fund (ESIF, easily being confused with EFSI) includes the Cohesion Fund (CF) which allocates EUR 63 billion to fifteen EU members that show a gross national income per capita below 90% of the EU average; partly it acts through the CEF. The European Regional Development Fund (ERDF) has a budget of EUR 279 billion over the period 2014-2020. Funding the Instrument for Pre-accession Assistance (IPA) amounts to EUR 11.7 billion for the period 2014-2020 and targets the six Western Balkan economies and Turkey. Furthermore, the Western Balkans Investment Framework (WBIF) has awarded EUR 1 billion in grants and leveraged EUR 5.5 billion in loans since its establishment in 2009<sup>9</sup> (WBIF, 2018). In general, however, EU Members have better access to grants, while loans dominate financing for the Western Balkan countries.

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<sup>4</sup> 'One of the main observations from the research is that nobody really knows what a BRI project is and what it is not.' Vakulchuk Roman on a recent research project of the Central Asia Data-Gathering and Analysis Team (CADGAT). - <https://www.nupi.no/en/News/New-CADGAT-Data-Reviews-on-261-Belt-and-Road-BRI-Projects-in-Central-Asia>

<sup>5</sup> See e.g. the MERICS Belt and Road tracker (<https://www.merics.org/de/bri-tracker>) or the AEI China Global Investment Tracker (<https://www.aei.org/china-global-investment-tracker>)

<sup>6</sup> Export-Import (EXIM) Bank of China, China Development Bank (CDB), Agricultural Development Bank of China (ADBC)

<sup>7</sup> ICBC Austria Bank GmbH was granted a licence to conduct banking business by the European Central Bank as of August 2018.


<sup>8</sup> The Investment Plan for Europe – the so-called 'Juncker Plan' – aimed at triggering EUR 250 billion during the three-year period 2015-2018. The extension until 2020 was presented during the speech on the State of the Union in 2016.

<sup>9</sup> The WBIF is a joint initiative of the European Commission, the Council of Europe Development Bank (CEDB), the European Bank for Reconstruction and Development (EBRD), the European Investment Bank (EIB) and bilateral donors. The World Bank Group, the Kreditanstalt für Wiederaufbau (KfW) joined subsequently. In December 2018, the Agence Française de Développement (AFD) became a participating organisation as well.

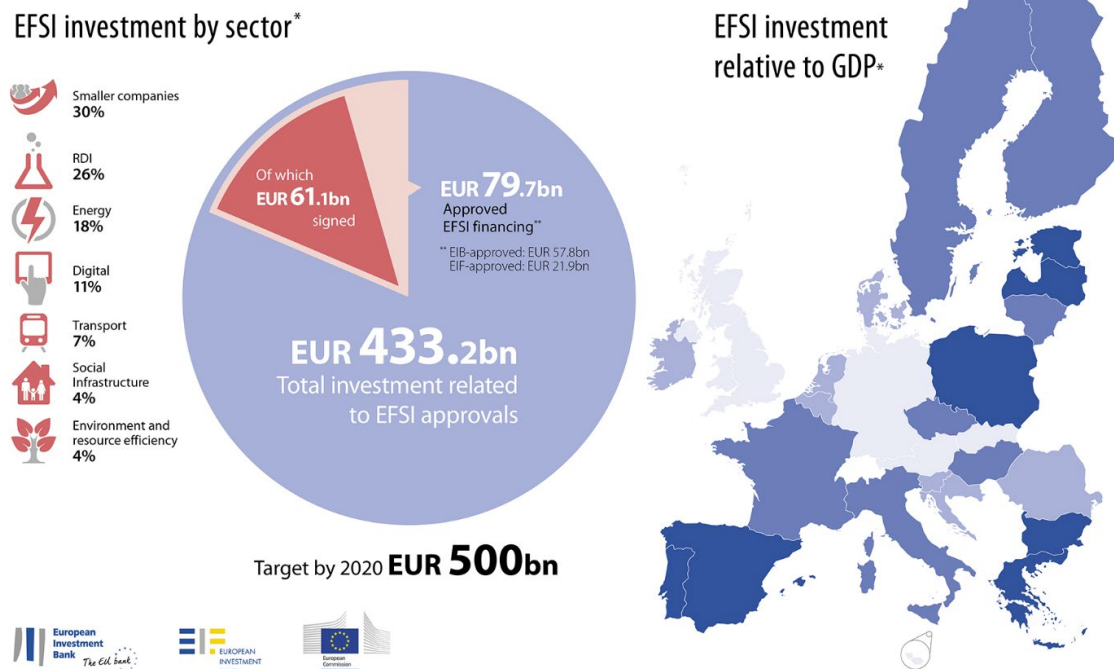
## NEW EU INITIATIVES FOR IMPROVED CONNECTIVITY

In addition to funds outlined above, the EU published multiple strategies last year to foster physical and digital connectivity within Europe and beyond: (1) the flagship initiatives for the Western Balkans, (2) the InvestEU Programme for EU Members and (3) a strategy for connecting Europe and Asia.

**The six EU flagship initiatives for the Western Balkans** published in May 2018 include the target to increase connectivity, both within the region as well as between the Western Balkans and the EU (EC, 2018a). The flagship initiatives are based on the strategy for ‘A credible enlargement perspective for and enhanced EU engagement with the Western Balkans’, adopted in February 2018 (EC, 2018b). The annex shows the action plan for achieving increased connectivity, including

- |           |   |   |
|-----------|---|---|
| TRANSPORT | <ul style="list-style-type: none"> <li>› the increased use of the Connecting Europe Facility (CEF) in the Western Balkans [which would imply a shift from loans to grants available to the Western Balkan region];</li> <li>› the increased participation in the Trans-European Network for Transport (TEN-T) committee and the integration of the region via a new rail strategy into the EU Orient East-Med and the Mediterranean Core TEN-T corridors [see Figure 1 which highlights how the current TEN-T misses the Western Balkan region];</li> <li>› the removal of barriers at road and rail border crossings;</li> </ul> | <p><b>Figure 1 / TEN-T surrounding the Western Balkans</b></p>  <p>Source: EC-DG MOVE, EC-GISCO, EuroGeographics (2018).</p> |
| ENERGY    | <ul style="list-style-type: none"> <li>› the expansion of the Energy Union to the Western Balkans;</li> <li>› the integration of the region into the EU Electricity Market;</li> </ul>  |   |
| ICT       | <ul style="list-style-type: none"> <li>› the support for the implementation of EU regulations regarding the Digital Single Market;</li> <li>› help for the development of eGovernment, eHealth and digital skills; and,</li> <li>› support for the deployment of broadband.</li> </ul>  |   |

**The InvestEU Programme** was proposed in June 2018 as part of the long-term EU budget 2021-2027 and is a successor of the European Fund for Strategic Investments (EFSI) at the heart of the ‘Juncker Plan’, bringing together multiple EU loan and guarantee financing instruments (EC, 2018c). Guarantees of EUR 47.5 billion (out of which EUR 38 billion constitute EU budgetary guarantees while the rest should be borne by financial partners such as the EIB) are expected to pack in more than ten times as much private and public investment, resulting in total investment within the EU of EUR 650 billion. This instrument does not expand to non-EU economies. According to information provided by the EIB group (Figure 2), the current EFSI triggered investments of more than EUR 433 billion, with 18% directed towards the energy sector, 11% targeting digital infrastructure and 7% focusing on the transport sector. In absolute terms, major beneficiaries of EFSI approved financing were France (EUR 13.7 billion), Italy (10.6), Spain (9.6) and Germany (7.7). Yet, relative to GDP, Greece ranks first, followed by economies in the Baltics, Poland and Southern Europe (see the map in Figure 2).

**Figure 2 / EFSI (triggered) investments**

Notes: EIB Group figures as of 10 September 2019; based on approved operations. RDI refers to Research, Development and Innovation. Darker colours in the map signify higher investments in relation to GDP.

Source: EC (2019).

A few months later, in September 2018, the EU presented a document on (building blocks towards) an EU strategy for **Connecting Europe and Asia** (EEAS, 2018). Again, it focused on the three 'BRI fields' of transport, energy and digitalisation. As a key action, the Commission wants to step up cooperation within the **EU-China Connectivity Platform** 'to promote the digital economy, efficient transport connectivity and smart, sustainable, safe and secure mobility, based on the extension of the TEN-T network, and promote a level playing field in investment.' The fourth meeting of the EU-China Connectivity Platform took place in the course of the 21<sup>st</sup> EU-China Summit in April. For the first time, it was explicitly stated that the EU and China are looking for ways to create synergies between the EU's efforts to improve connectivity (e.g. the TEN-T) and China's Belt and Road initiative<sup>10</sup>.

## FINDING COMMON GROUND FOR A WIN-WIN SITUATION

It is in the self-interest of both the EU and China to promote political stability, environmental sustainability and economic growth in Eurasia – not least in order to develop (new) markets for their own goods and services and for security reasons. It is obvious that the CESEE region would profit the most if Chinese and European investments complement each other in an economically and environmentally sustainable way.

So far, the picture presented to the European public by the media – fuelled by warnings of businesses and advocacy groups – is primarily one of unfair competition exerted by China and a race for economic

<sup>10</sup> wiiw pushed this idea in its research on the BRI; most explicitly by calculating economic effects of a hypothetical 'European Silk Road'; see Heimberger et al. (2018).

and political influence in CESEE. Discussions surrounding the dispute ('infringement proceeding' launched in 2016) on non-compliance with EU public procurement rules by Hungary in the context of the modernisation of the railway line between Budapest and Belgrade were very prominent. The case with Hungary has only been recently (superficially) solved, with the project being awarded in equal shares to Chinese and Hungarian companies after a public tender<sup>11</sup>.

There is reason to believe that more transparent communication of Chinese and EU projects to the public would contribute to increasing trust, reducing anti-EU sentiments and making other investment projects – including the BRI – a success. The current complex financing structures make it practically impossible for citizens to know about and hence embrace investment initiatives by the EU or other donors/creditors. Informing the public requires political will, research and a communication strategy. The monitoring and communication on the progress of projects, the reduction of transport time and costs and the potentially positive effects on local employment affect the perceptions of the public as well as the actions that investors actually take.

In this respect, it is worth highlighting that the EU and China set up a six-point action plan for 2019 at the fourth meeting of the EU-China Connectivity Platform which includes the ambitions to formally sign cooperative projects by the end of 2019, to carry out policy exchanges to improve the understanding of investment rules and to carry out a **joint study on sustainable railway-based transport corridors between the EU and China**<sup>12</sup>.

In addition, the **stand-alone investment agreement currently negotiated between China and EU** could help to build a common ground for infrastructure initiatives in Europe and across Eurasia. Negotiations started in 2013, the same year the BRI was announced. The 23rd round of negotiations took place in Beijing in September 2019, with a 24th round being planned for November this year. The parties aim at concluding an ambitious agreement by 2020. According to the European Commission, discussions have advanced in the fields of financial services, capital movements and commitments towards national treatment (i.e. non-discrimination). Exchanges continue in particular on state-to-state dispute settlement and sustainable development. Negotiations also cover topics such as transparency and procedural fairness during competition procedures. As wiiw repeatedly pointed out in its research on the economic effects of the BRI for CESEE<sup>13</sup>, the behaviour of China's state-owned enterprises – in particular regarding the acquisition of projects and employment of the local work force – has a considerable influence on how beneficial the BRI can be for the region. Indeed, a rule-based bilateral agreement should dampen the fear in Europe that high EU standards could be undermined and public procurement procedures circumvented. A similar rationale applies to trade agreements: EU-China trade – which currently amounts on average to EUR 1 billion per day – is based on a Trade and Economic Cooperation Agreement dating back to 1985, which is everything but appropriate to govern today's trade relationship.

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<sup>11</sup> „Ownership of the CRE Consortium is split 50:50 between Chinese-owned and Hungarian companies. China Tiejiju Engineering & Construction Hungary and China Railway Electrification Engineering Group (Hungary) will work with RM International, founded by R-Kord and Mészáros és Mészárs.' International Rail Journal: <https://www.railjournal.com/regions/europe/budapest-belgrade-upgrade-contract-signed>

<sup>12</sup> The Terms of Reference are part of the Annex of the Minutes of the meeting: [https://ec.europa.eu/transport/sites/transport/files/4th\\_chairs\\_meeting\\_minutes\\_en.pdf](https://ec.europa.eu/transport/sites/transport/files/4th_chairs_meeting_minutes_en.pdf)

<sup>13</sup> See e.g. Grübler et al. (2018).



It is fair to say that there are multiple options for cooperation between the EU and China, and that the first pithy steps have been undertaken by both sides since mid-2018. However, it is still too early to judge whether these political rapprochements will translate into fruitful economic cooperation for CESEE in the near future.

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# The current debate on China's rise

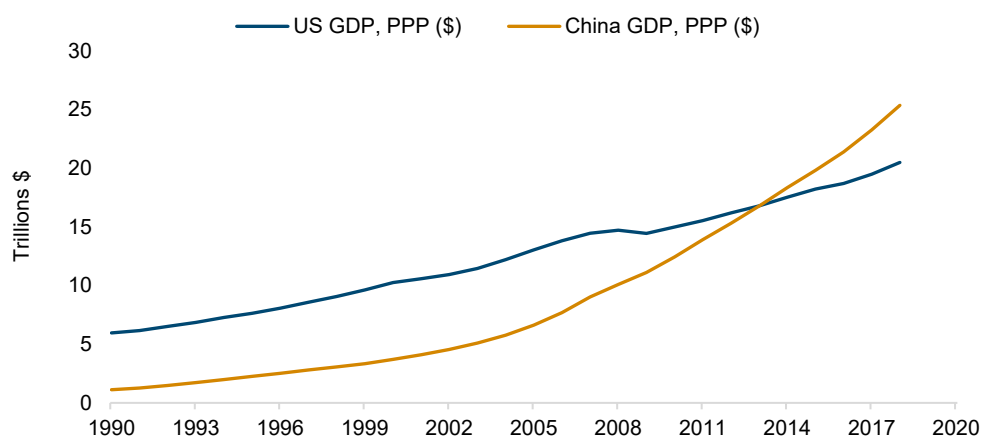
BY SEBASTIAN PETRIC<sup>1</sup>

*The recent increase in tensions between the United States and China, foremost with respect to their trade relations, is a sign of the fear that the rise of China entails. China's peaceful rise over the last decades is not a guarantee that this will continue to be the case in the future. This article describes the different dimensions of China's rise and gives the reader a detailed account of the current debate on the nation's emergence.*

## CHINA'S RISE

With the realisation of fundamental, policy-induced and institutional fragilities of the Soviet Union, an era of unipolarity began. The United States became the sole dominant force after the end of the Cold War and US power was based on the institutions built after the Second World War. With respect to Asia, it was not clear how the region would evolve after this historic turning point. The outlook was mixed, nevertheless, the Asian countries made significant steps in terms of material wellbeing. China's rise has been a cornerstone of Asia's success story, is a key determinant of the region's future and has implications on a global basis. This was shown by Quah (2011) who visualised the shift of the global economic centre of gravity eastwards. Lee Kuan Yew once noted that 'the size of China's displacement of the world balance is such that the world must find a new balance. It is not possible to pretend that this is just another big player. This is the biggest player in the history of the world' (Lee Kuan Yew 2013). As a matter of fact, China itself had not anticipated its steep rise and thus the power transition from West to the East was a surprise for most observers (Breslin 2013: 625).

**Figure 1 / China's rise relative to the United States**



Source: Datastream, World Bank WDI

<sup>1</sup> Sebastian Petric is an EM Strategist with Raiffeisen Bank International, Vienna.

China's rise is taken for granted by many given the country's historic trajectory since the late 1970s. Straight-line extrapolations point to an ever-brighter future for the country and its local population (Sharma 2016: 7). Given that the Chinese population is approximately four times that of the United States, it is only a matter of time and resources until China's GDP overtakes that of the US. Indeed, by some measures the Chinese economy has already overtaken the US (Allison 2015) – see Figure 1.

However, the linear extrapolation of historic trends can be misleading, as can be seen in the case of Japan in the 1980s (Shambaugh 2014: 39). Pritchett and Summers (2014: 2) described this by saying, 'history teaches that abnormally rapid growth is rarely persistent, even though economic forecasts invariably extrapolate recent growth'. Crises often derail countries in their growth trajectories and the decline in economic growth entails a loss of legitimacy for the nation's leadership. Can the current 'trade war' between Beijing and Washington be such an inflection point?

## ECONOMIC UNDERPINNINGS

The long-term trajectory of a country is significantly related to institutional strengths and weaknesses. Fundamental factors alone are insufficient for predicting the path of a country; policy-induced and institutional variables must be included as crucial determinants as well. Countries that solely rely on factor accumulation, mostly on capital accumulation (Miles et al. 2018), often experience a short-term growth spurt. However, the long-term growth rates are not sustainable. The decline of the growth rates entailed a reduction in legitimacy for the leadership, which led to significant economic and political volatility in the former Soviet Union. China learned through observation of past crises and tries to avoid its own Gorbachev moment (De Jonquieres 2014: 6).

China's transformation, which started at the end of the 1970s, is an on-going process reflecting the nation's gradualist approach towards transition from plan to market. It can sometimes be described as experimental which is one core strength of China's transformation. Policy experimentation facilitates institutional innovation which supported China's development process.<sup>2</sup> Nevertheless, the fragilities of China given its on-going transition are severe and pose significant challenges to the Chinese leadership.

Another important factor of China's development has been its progressive integration into the world economy. As Yueh (2010: 9) put it, 'China's size and integration with the world economy have contributed to altering the global inflationary environment; its currency has been a subject of contention; its exports have raised concerns for workers and firms in both developed and developing countries; its demand for energy and commodities has led to competition and conflict; it has rivalled the United States and the UK as a destination for foreign direct investment (FDI); and the effects of its own overseas investments have begun to be felt across the world'. In particular, the inclusion of China in the WTO in 2001 led to a significant growth spurt in the country. The nation became an export-leader in low technology products such as textiles and clothing and later in more sophisticated products such as electrical equipment and machinery. Special Economic Zones helped the country to experiment with different institutional set-ups, which ultimately led to China's current account opening and facilitated its export-led growth strategy (Blanchard and Giavazzi 2006; Naughton 2007: 52). In addition, the

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<sup>2</sup> For further information regarding policy experimentation in China, please see <https://blogs.lse.ac.uk/internationaldevelopment/2019/02/21/policy-experimentation-in-china/>.

concentration of economic zones limits the market impact of foreign firms, while at the same time allows China to benefit from international trade (Yueh 2010: 13).

Exchange rate policy has been instrumental in China's economic success too. Its currency was originally pegged against the US dollar; however, since 2005 China has claimed to manage its currency against a basket (Yueh 2010: 21). The latter helped the country's export driven growth model significantly as in the aftermath of China's accession to the WTO, the undervalued renminbi propelled China's economy (Lardy 2012), as well as led to the accumulation of substantial FX reserves. The latter must be regarded as a buffer to smooth unforeseen market pressures, and thus, contributes to safeguarding the stability of the Chinese system.

The development of China followed certain success factors that are visible across many other rising nations. It begs the question: why was China never derailed by a crisis even though other emerging markets were? This is due to its limited openness on the country's capital account side. Capital controls are still one cornerstone of the country's institutional set-up and refer to legal requirements on monetary flows ranging from simple registration procedures to hard restrictions on transactions (Prasad 2017: 37-38). Historic crises episodes from other countries teach policy-makers to be wary of premature capital account liberalisation before a country has determined an appropriate sequencing strategy.

## A CHALLENGE TO THE INTERNATIONAL SYSTEM

The empowerment of China is a contested notion and must be analysed on an absolute and relative basis. First of all, the question pertains to whether the incumbent hegemon, namely the United States, is in decline. This was analysed in detail by Michael Cox (2012) in his paper 'Power shifts, economic change, and the decline of the West?' and was rejected by the researcher due to structural features of the United States. The head of LSE IDEAS describes the United States as 'a country that still prints the universal dollar, to which millions are still looking to emigrate, whose capacity to innovate remains deeply impressive, whose long-term stability is assured and around which the rest of the world economy continues to rotate' (Cox 2012: 419). To add to this, the Information Revolution has enhanced US productivity significantly over the last decades (Levy 2008: 19) which shows that it cannot be automatically assumed that growth levels off.

Another perspective focuses on China's rise, which is not only related to the absolute standing of the country, but also refers to the relative power of China compared to the United States. Internationally, the significance of China's rise is related to the idea that power transitions cannot happen peacefully as the rise of a new power poses a challenge to the dominant nation. This notion emerged from empirical research and is generally known as the Thucydides Trap (Allison 2015).<sup>3</sup>

The term dates back to the Athenian historian who described a number of events from the Peloponnesian War to the rise of Athens, as well as the fear caused by the rise of Sparta. The Thucydides Trap refers to the danger of war 'caused by a rapid shift in the balance of power between two rivals' (Allison 2015). As mentioned in the introduction to this article, recent struggles between the

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<sup>3</sup> One notable exception was the United States overtaking the British nation as the global hegemon in the late nineteenth/early twentieth century. Academia argues that this is because economic, political and institutional factors between these two countries were alike and thus the discontent from the side of the British Empire was contained (Levy 2008: 14).

United States and China are a sign of the fear that the rise of China entails. Allison (2015) refers to this fear by an established power, which tends to escalate into war, as a trap and hard to escape from. As the gap between the United States and China has been decreasing, the Thucydides Trap has been mentioned increasingly often (BBC 2019). Mearsheimer (2010: 389) noted on the issue, 'I expect China to act the way the United States has acted over its long history'. This view is contested as laid out below.

Xi Jinping himself said that there is nothing like a Thucydides Trap (CRI 2015). Since the reform era that started in China at the end of the 1970s, the country has been a status quo power by refraining from using force to significantly challenge the international system. The Chinese government closely followed the doctrine of 'All Under Heaven'. 'This has been allied to a strong interpretation of non-intervention, non-discrimination [...] Chinese exceptionalism is inward looking and closed, broadly summed up in the much-used phrase 'with Chinese characteristics' when describing almost any social, economic or political policy' (Buzan and Cox 2013: 121). In contrast to this, the United States has been highly revisionist over the last decades and the nation continues to spend a substantial part of its budget on defence. In this respect, Hurrell (2014: 83) notes, that 'the United States has rarely been a status quo power but has often sought to mould the system in its own image. Since the end of the cold war it has been a strongly revisionist power'.

Against the realist view of Mearsheimer (2010), Buzan and Cox (2013) analysed the notion of China's peaceful rise. The country committed itself to the notion in the early years of the reformist era. This was a consequence of the nation's opening via its export-led growth model. The researchers noted on China's peaceful rise that, 'the minimum condition for peaceful rise is that a growing power is able to make both absolute and relative gains in both its material and its status positions, in relation to other great powers in the international system without precipitating major hostilities between itself and other great powers' (Buzan and Cox 2013: 112). The logic behind China's determination with its peaceful rise was that the country's leadership envisioned the need for modernisation after the failures of the Maoist period. Nonetheless, the nation is far away from abandoning its determination with inward orientation, which can be classified as a legacy of China's history. Steger and Huang (2019) put this as follows, 'Beijing's recent pronouncements have also been peppered with key historical markers deemed important to its narrative of China as a country with an ancient and proud past that has been humiliated at the hands of Western powers in its recent history'.

## CONCLUDING REMARKS

Even though China is partly integrated in the global system, 'man's capacity for folly' must not be underestimated as noted by Allison (2015). China's peaceful rise over the last decades is not necessarily an indication for the country's future trajectory; as noted above, the extrapolation of past trends is often misleading. The current economic conflict between the United States and China is one sign of the increased tensions between the two nations. In my opinion, China's future trajectory is unlikely to be as peaceful as over the last decades. This can be attributed to both countries, China and the United States. The empowerment of China has led to a rise in its assertiveness, as well as to US fears triggered by a rising rival and the US backsliding in relative terms. Situations of heightened tensions are the natural consequences of these factors.

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### Conventional signs and abbreviations used

%	per cent
ER	exchange rate
GDP	Gross Domestic Product
HICP	Harmonized Index of Consumer Prices (for new EU Member States)
LFS	Labour Force Survey
NPISHs	Non-profit institutions serving households
p.a.	per annum
PPI	Producer Price Index
reg.	registered

The following national currencies are used:

ALL	Albanian lek	HRK	Croatian kuna	RON	Romanian leu
BAM	Bosnian convertible mark	HUF	Hungarian forint	RSD	Serbian dinar
BGN	Bulgarian lev	KZT	Kazakh tenge	RUB	Russian rouble
BYN	Belarusian rouble	MKD	Macedonian denar	TRY	Turkish lira
CZK	Czech koruna	PLN	Polish zloty	UAH	Ukrainian hryvnia

EUR euro – national currency for Montenegro, Kosovo and for the euro-area countries Estonia (from January 2011, euro-fixed before), Latvia (from January 2014, euro-fixed before), Lithuania (from January 2015, euro-fixed before), Slovakia (from January 2009, euro-fixed before) and Slovenia (from January 2007, euro-fixed before).

Sources of statistical data: Eurostat, National Statistical Offices, Central Banks and Public Employment Services; wiiw estimates.



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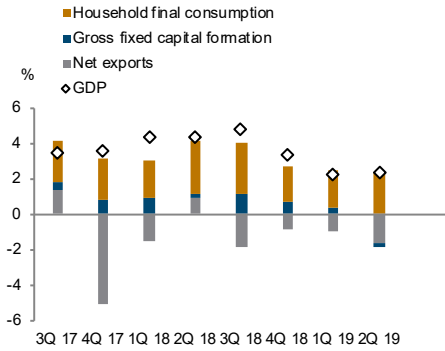
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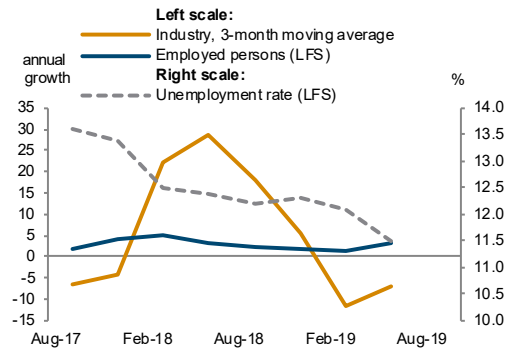
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# Albania

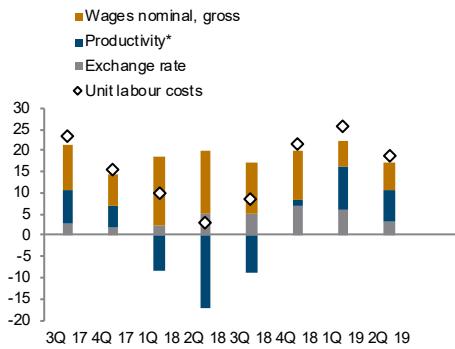
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year-on-year



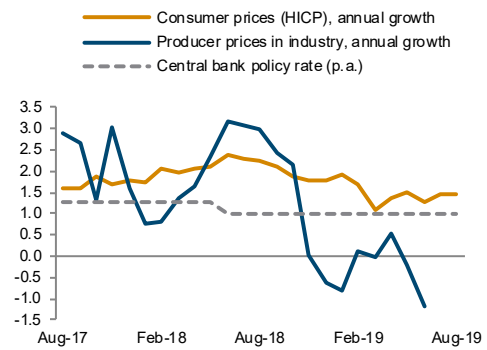
**Real sector development**  
in %



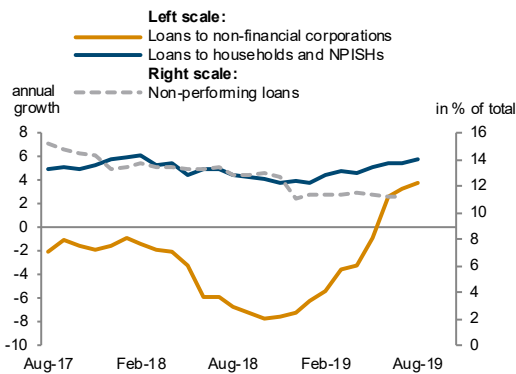
**Unit labour costs in industry**  
annual growth rate in %



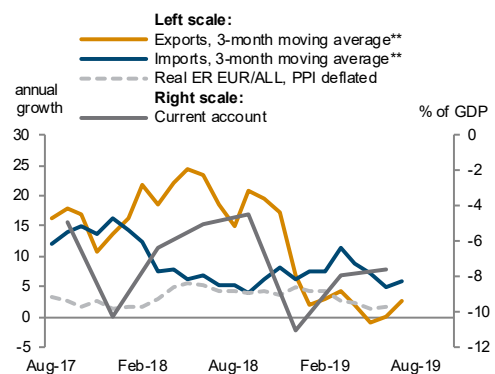
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %

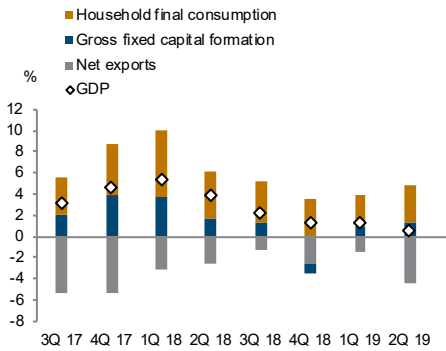


\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
\*\*EUR based.

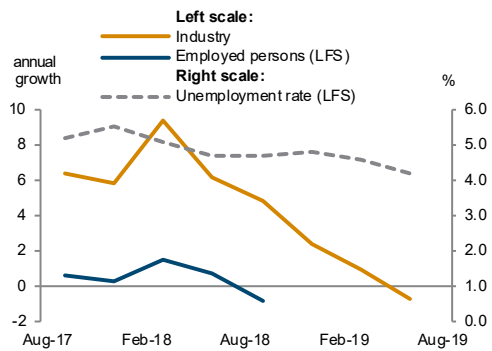
Source: wiiw Monthly Database incorporating Eurostat and national statistics.  
Baseline data, country-specific definitions and methodological breaks in time series are available under:  
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# Belarus

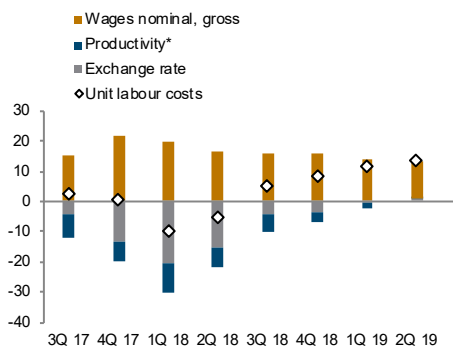
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year-on-year



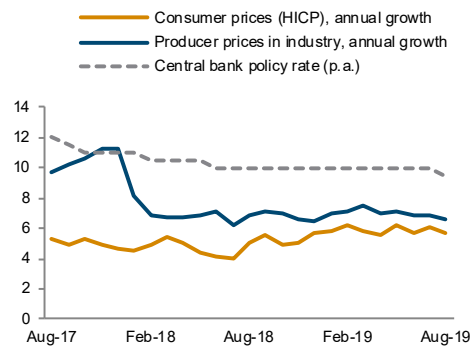
**Real sector development**  
in %



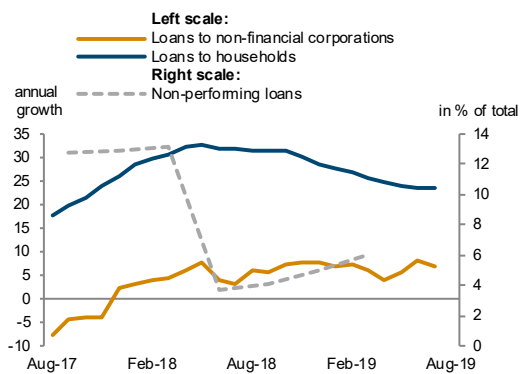
**Unit labour costs in industry**  
annual growth rate in %



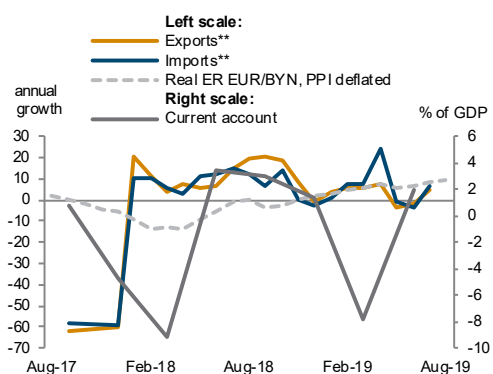
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



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\*\*EUR based.

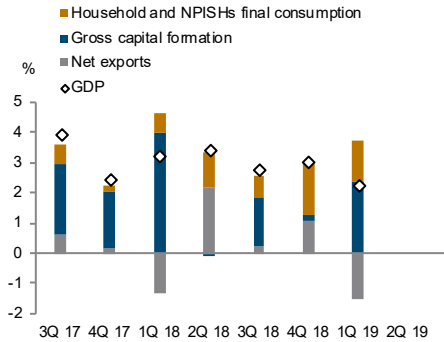
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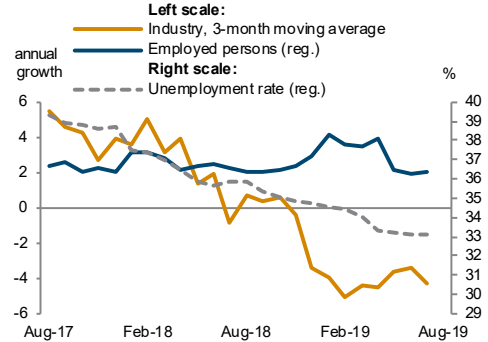
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# Bosnia and Herzegovina

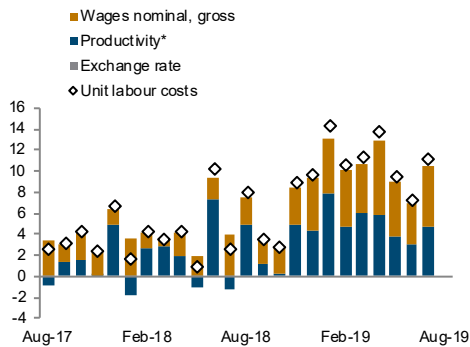
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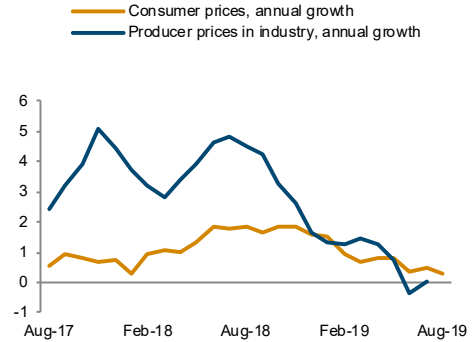
**Real sector development**  
in %



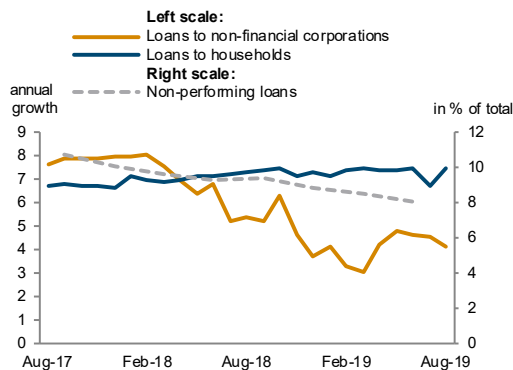
**Unit labour costs in industry**  
annual growth rate in %



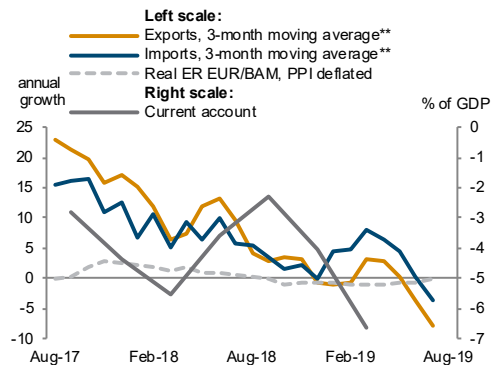
**Inflation**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

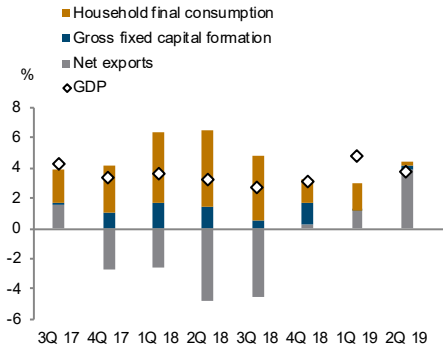
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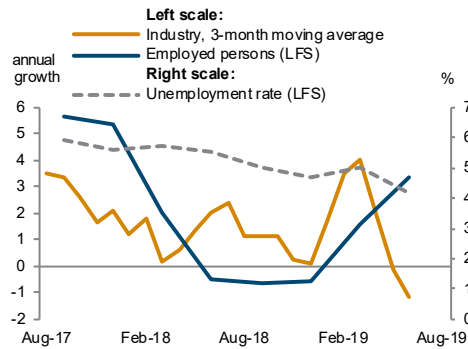
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# Bulgaria

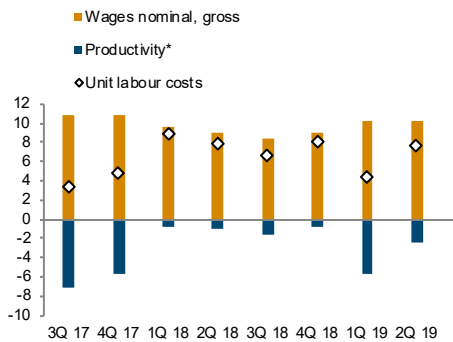
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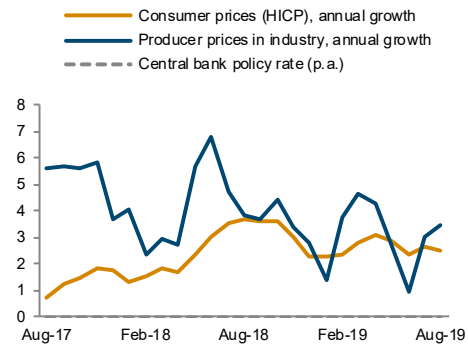
**Real sector development**  
in %



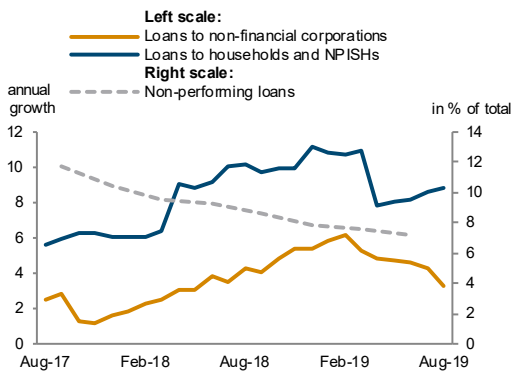
**Unit labour costs in industry**  
annual growth rate in %



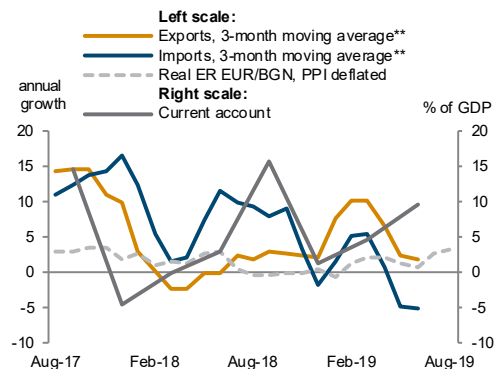
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %

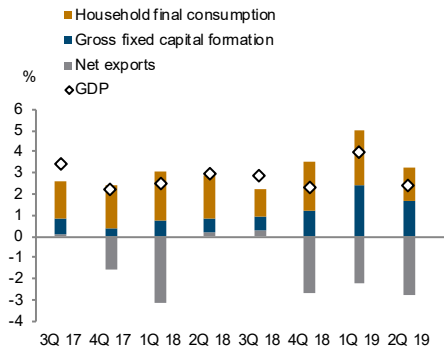


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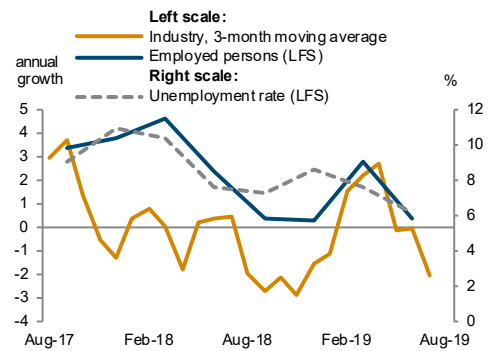
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# Croatia

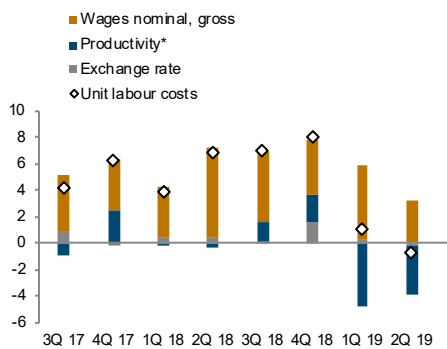
**Real GDP growth and contributions**  
year-on-year



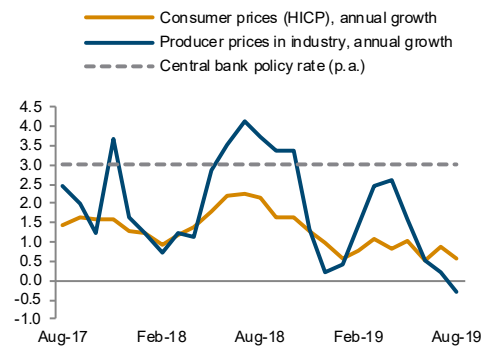
**Real sector development**  
in %



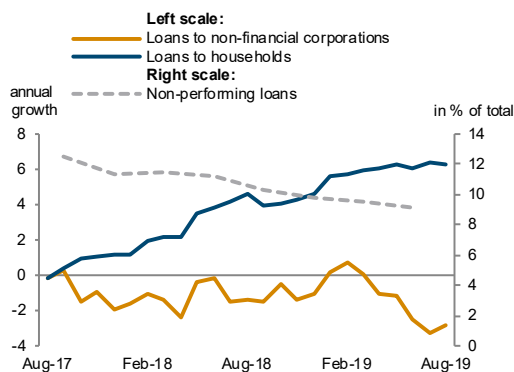
**Unit labour costs in industry**  
annual growth rate in %



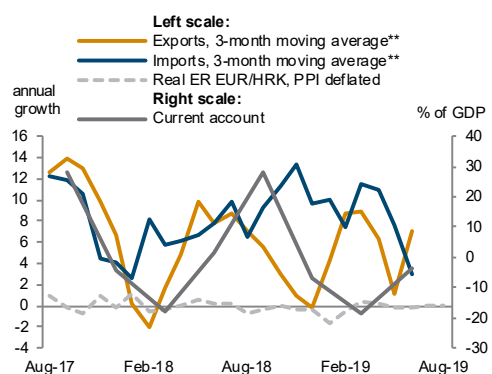
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

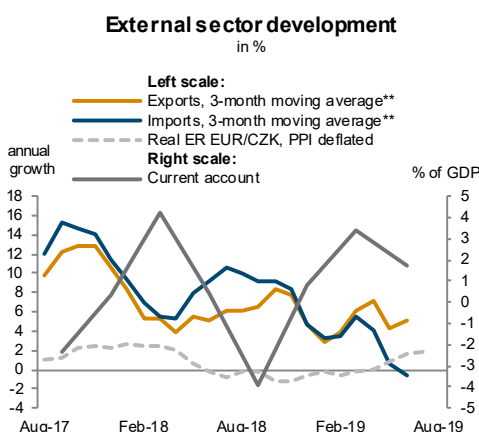
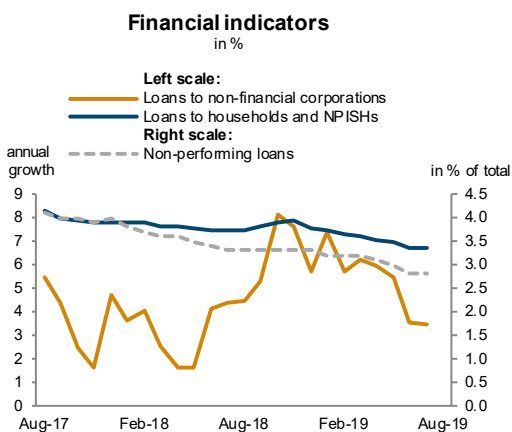
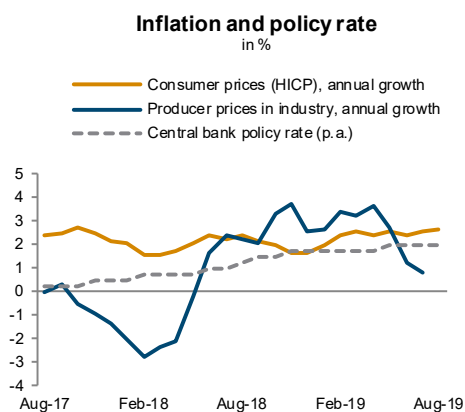
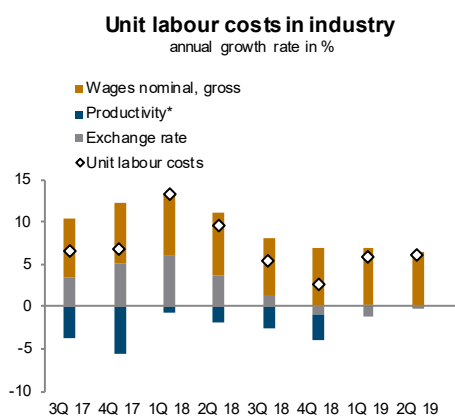
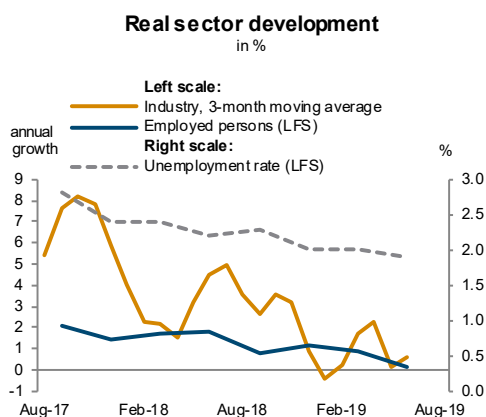
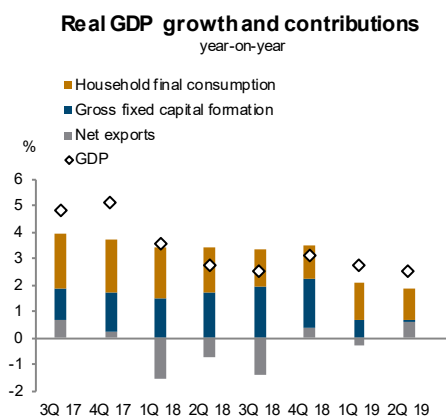
\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

<https://data.wiiw.ac.at/monthly-database.html>

# Czech Republic



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

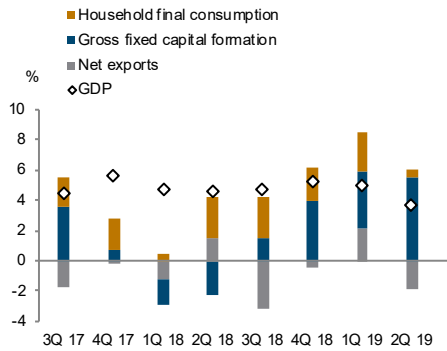
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

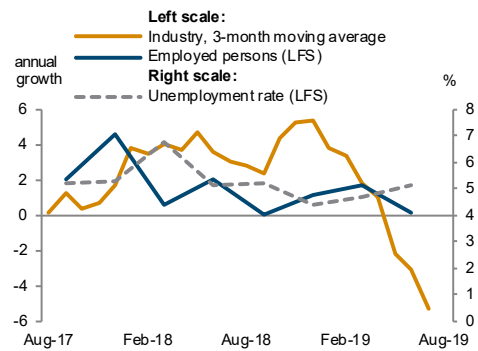
<https://data.wiiw.ac.at/monthly-database.html>

# Estonia

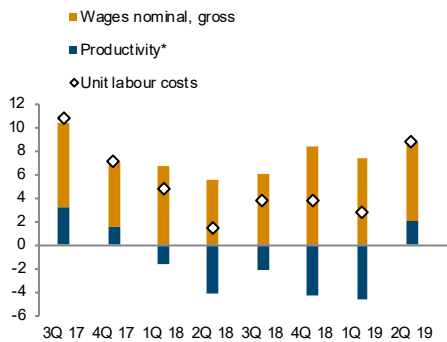
**Real GDP growth and contributions**  
year-on-year



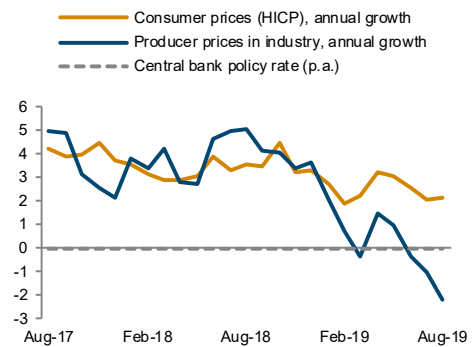
**Real sector development**  
in %



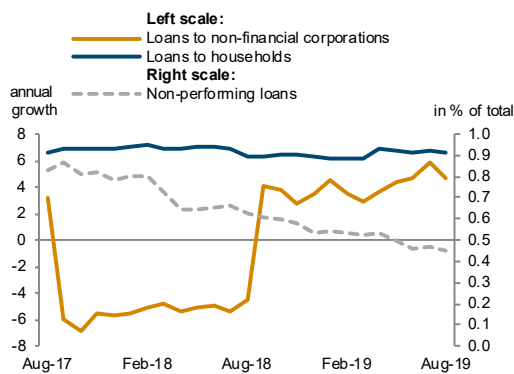
**Unit labour costs in industry**  
annual growth rate in %



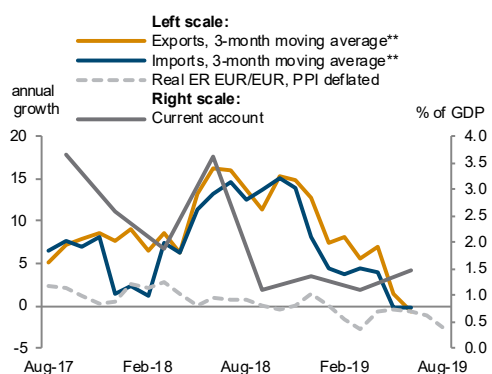
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

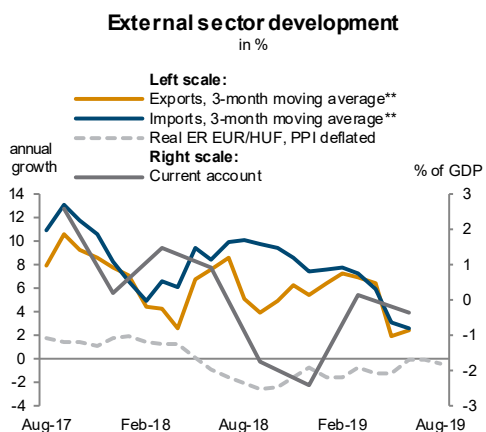
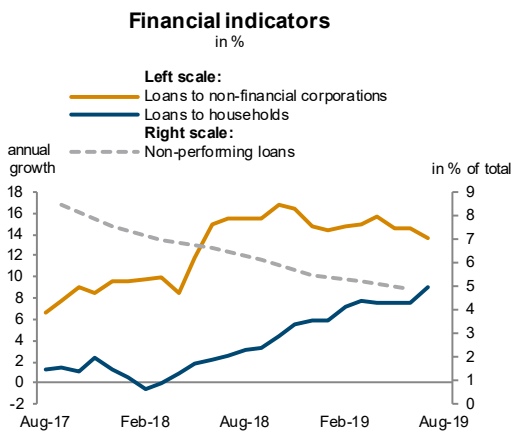
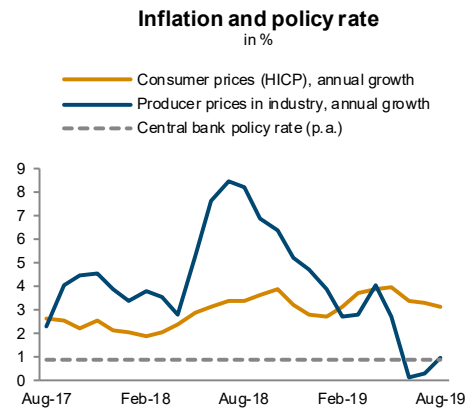
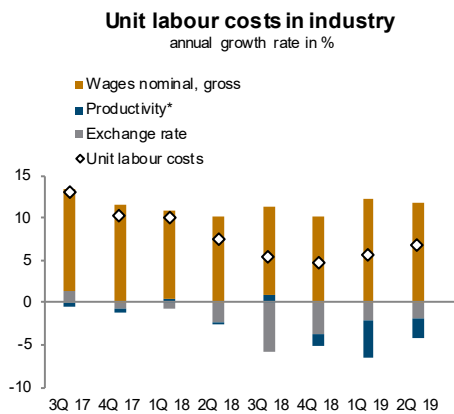
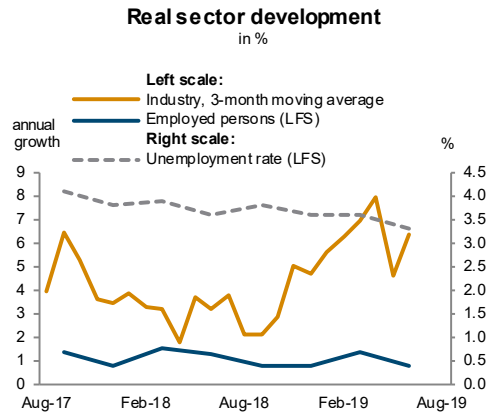
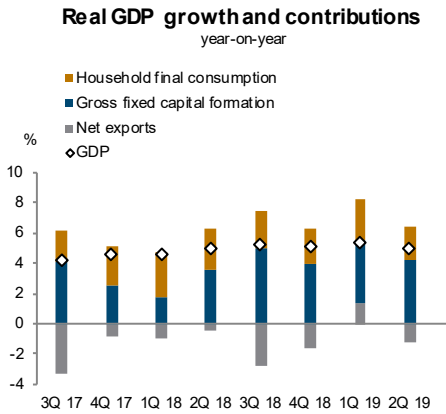
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

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# Hungary

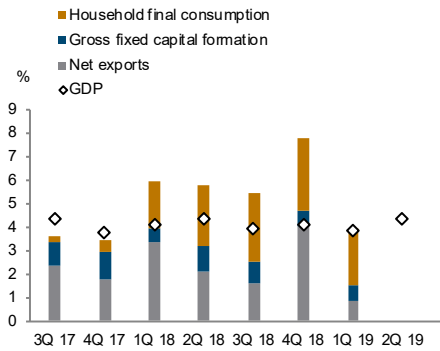


\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
 \*\*EUR based.

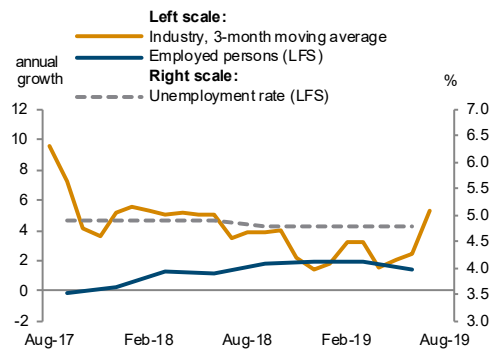
Source: wiiw Monthly Database incorporating Eurostat and national statistics.  
 Baseline data, country-specific definitions and methodological breaks in time series are available under:  
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# Kazakhstan

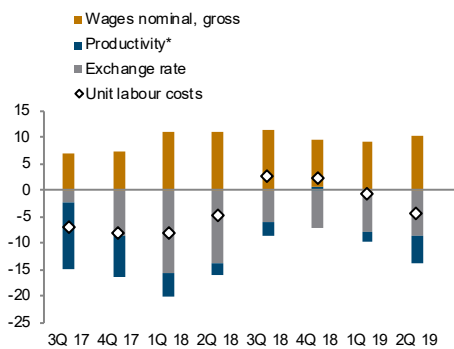
**Real GDP growth and contributions**  
year-on-year



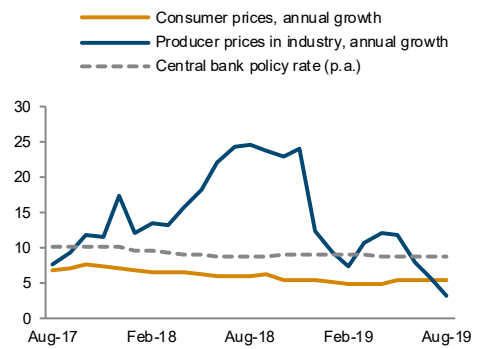
**Real sector development**  
in %



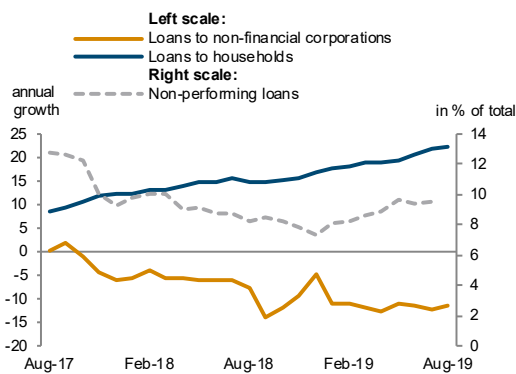
**Unit labour costs in industry**  
annual growth rate in %



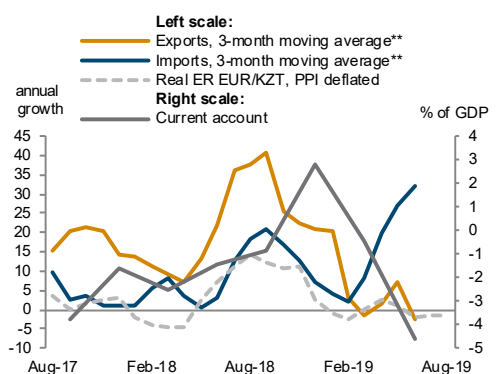
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



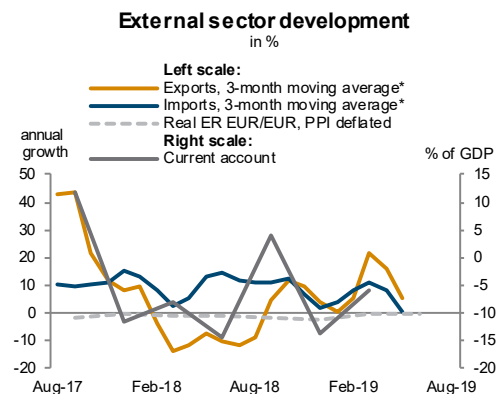
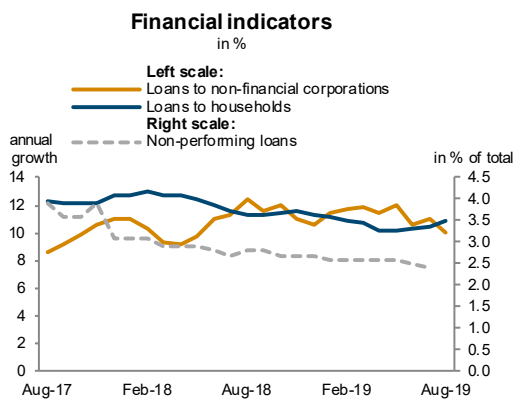
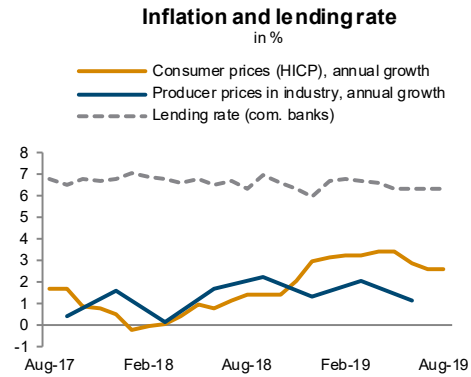
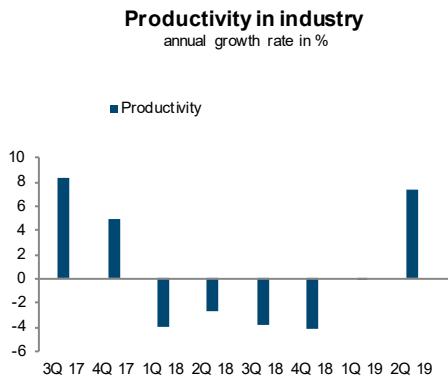
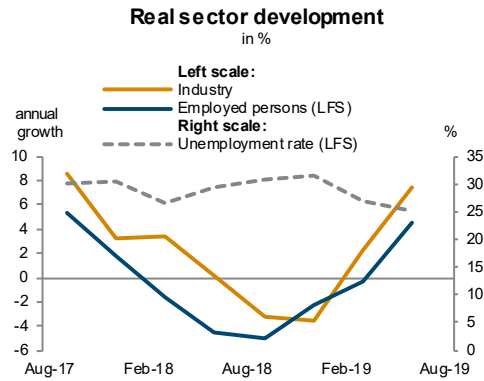
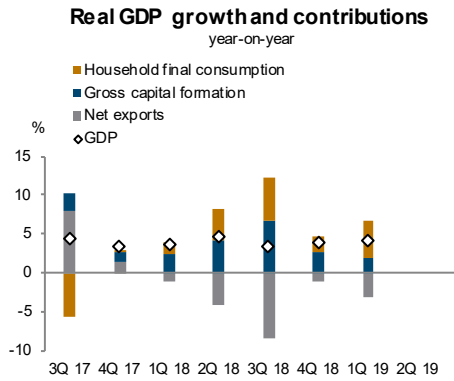
**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.  
\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.  
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# Kosovo



\*EUR based.

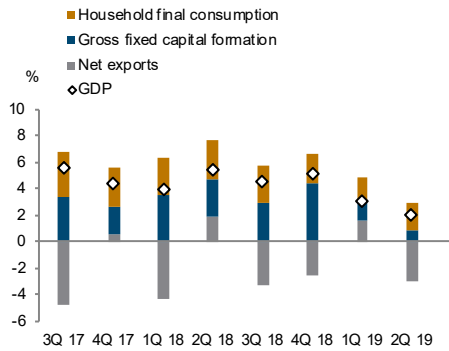
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Baseline data, country-specific definitions and methodological breaks in time series are available under:

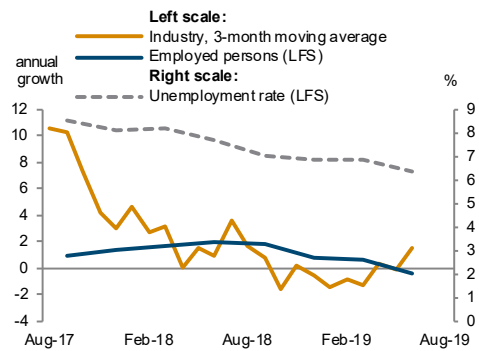
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# Latvia

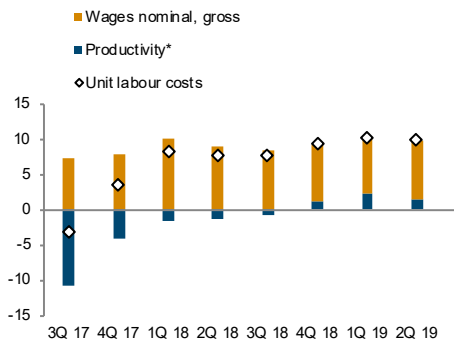
**Real GDP growth and contributions**  
year-on-year



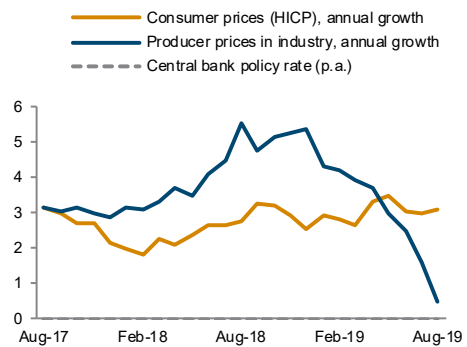
**Real sector development**  
in %



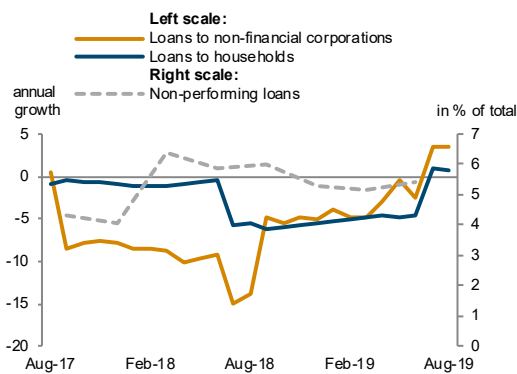
**Unit labour costs in industry**  
annual growth rate in %



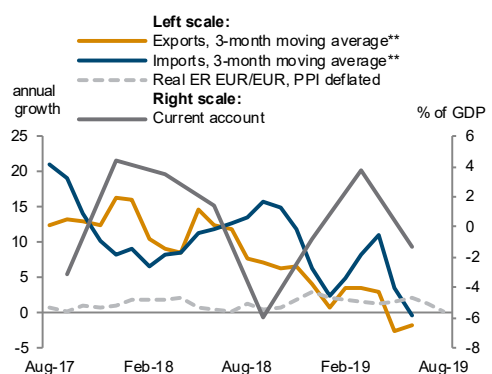
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

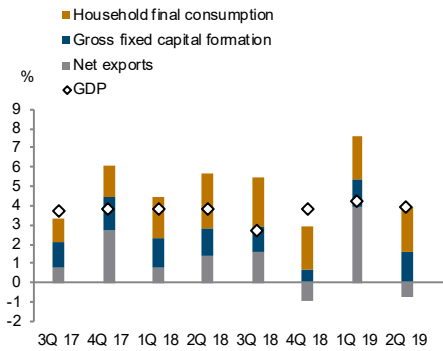
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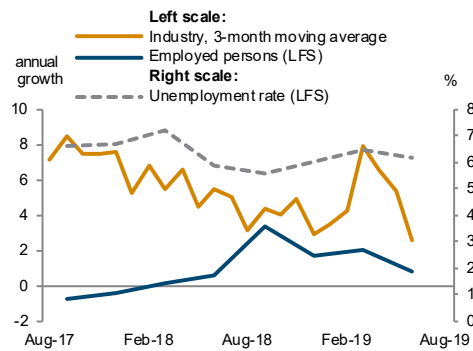
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# Lithuania

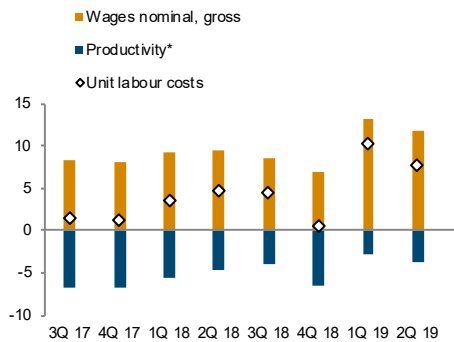
**Real GDP growth and contributions**  
year-on-year



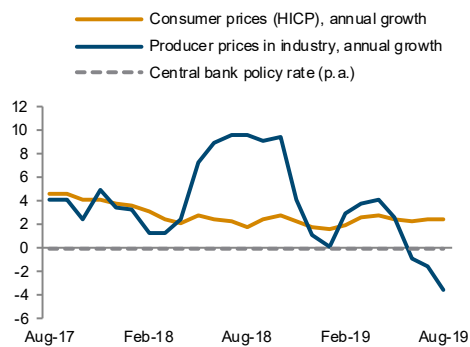
**Real sector development**  
in %



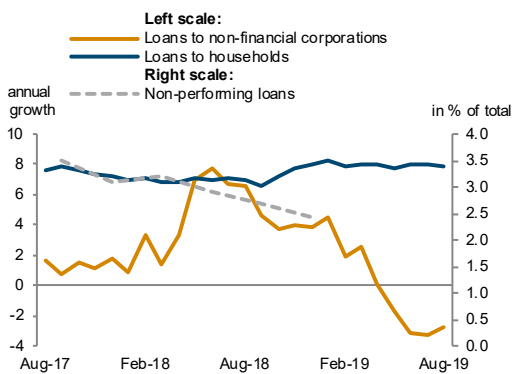
**Unit labour costs in industry**  
annual growth rate in %



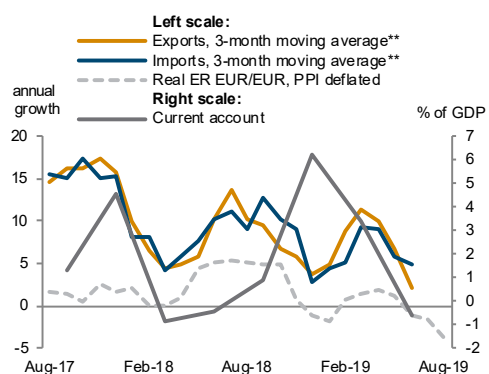
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

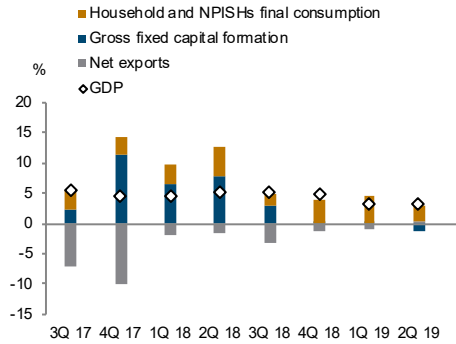
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

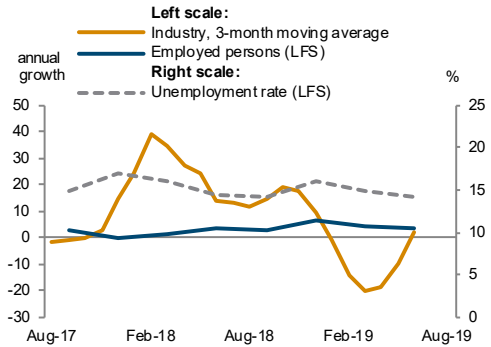
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# Montenegro

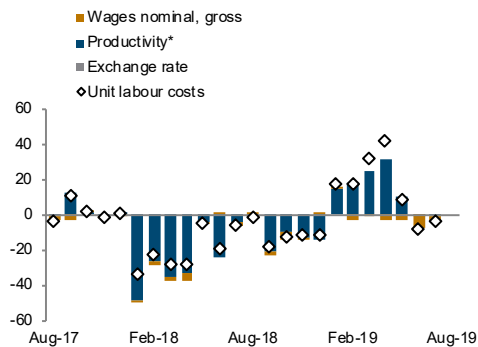
**Real GDP growth and contributions**  
year-on-year



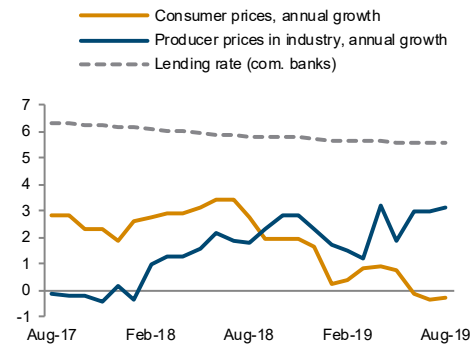
**Real sector development**  
in %



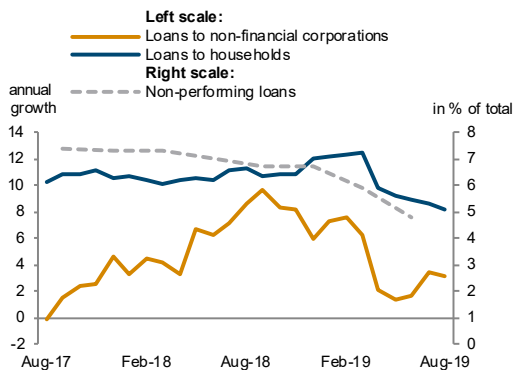
**Unit labour costs in industry**  
annual growth rate in %



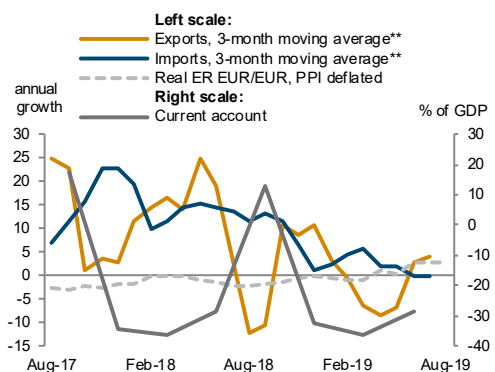
**Inflation and lending rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

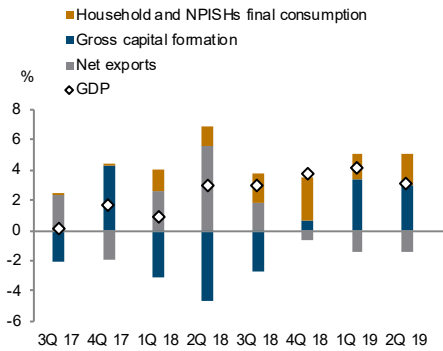
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

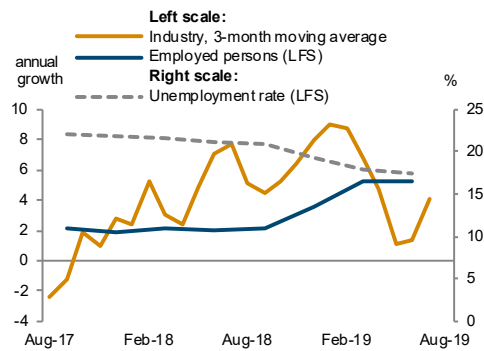
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# North Macedonia

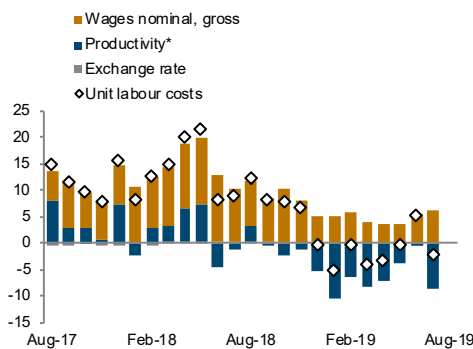
**Real GDP growth and contributions**  
year-on-year



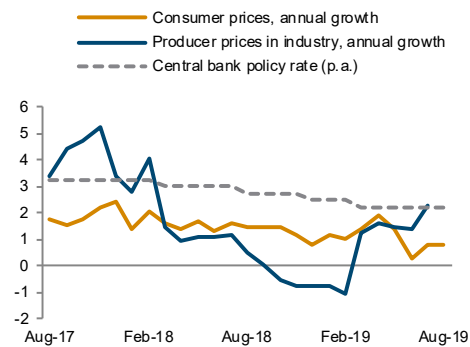
**Real sector development**  
in %



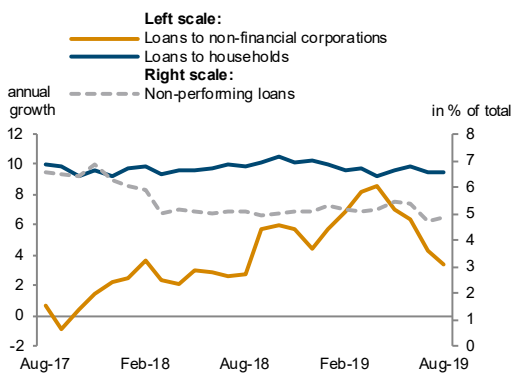
**Unit labour costs in industry**  
annual growth rate in %



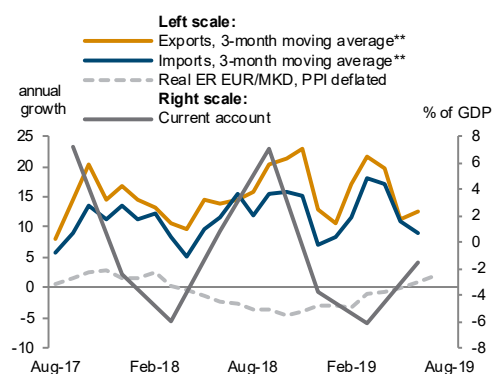
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

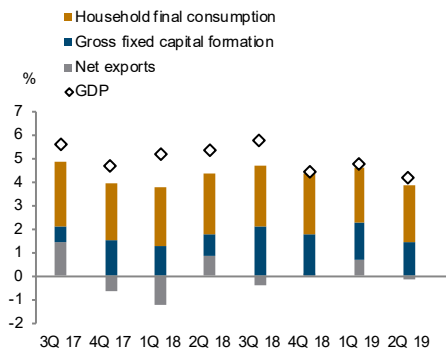
Baseline data, country-specific definitions and methodological breaks in time series are available under:

<https://data.wiiw.ac.at/monthly-database.html>

# Poland

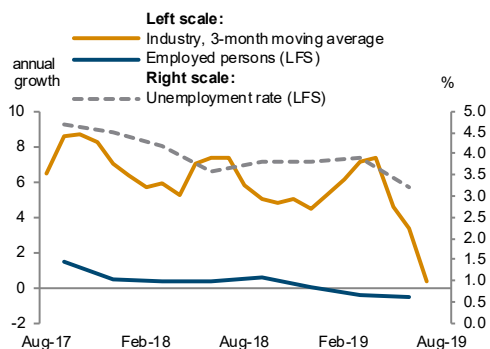
### Real GDP growth and contributions

year-on-year



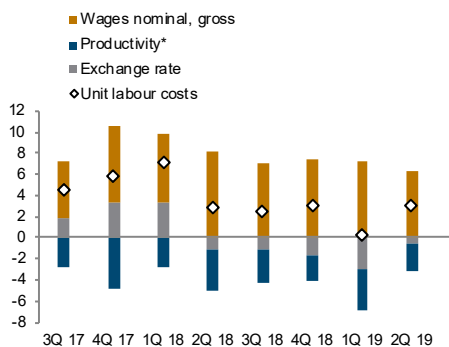
### Real sector development

in %



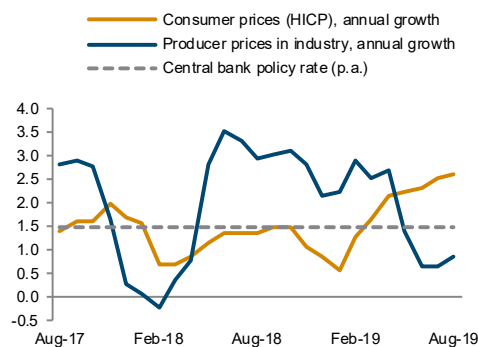
### Unit labour costs in industry

annual growth rate in %



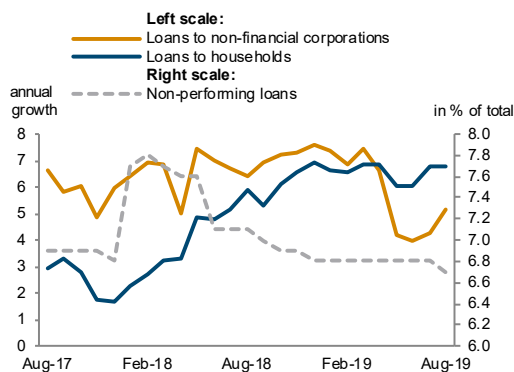
### Inflation and policy rate

in %



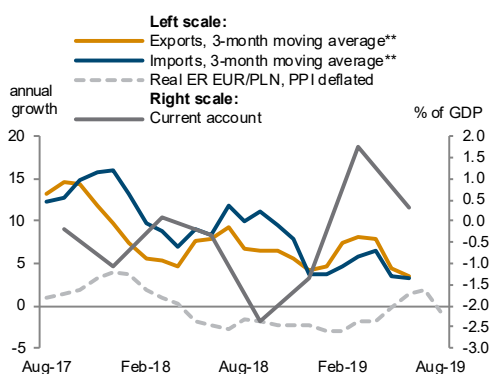
### Financial indicators

in %



### External sector development

in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

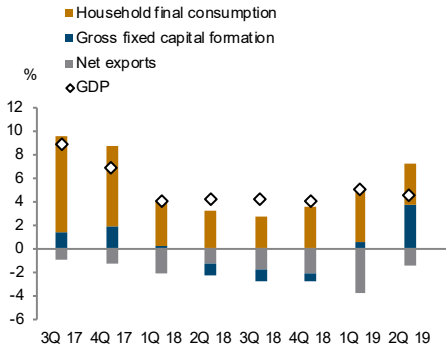
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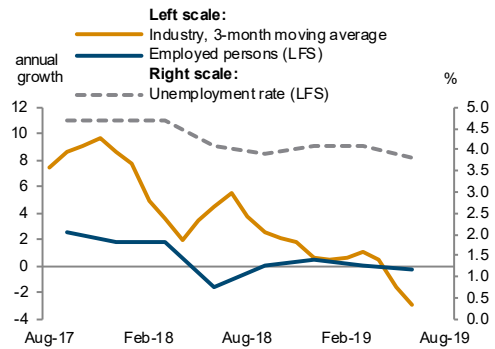


# Romania

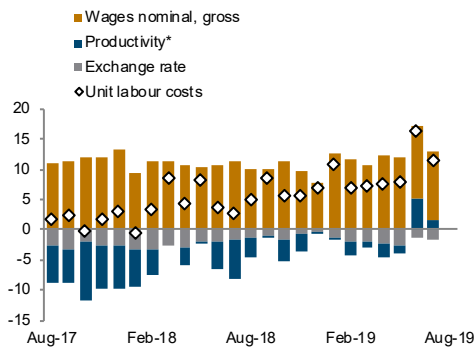
**Real GDP growth and contributions**  
year-on-year



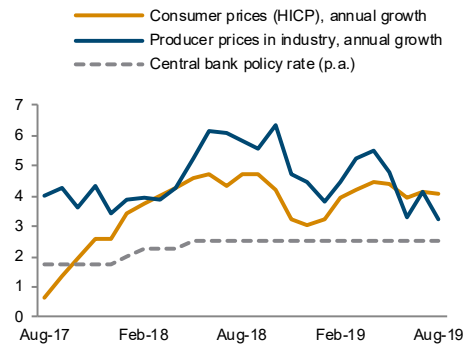
**Real sector development**  
in %



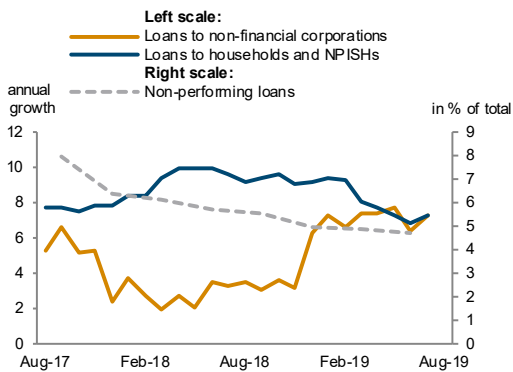
**Unit labour costs in industry**  
annual growth rate in %



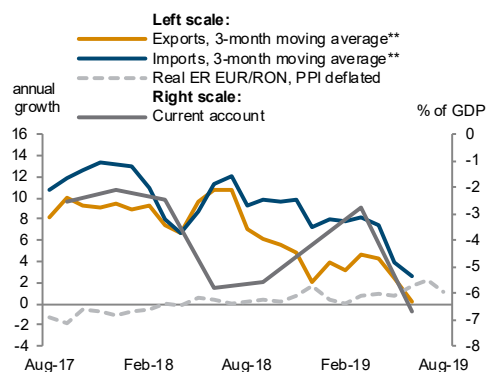
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %

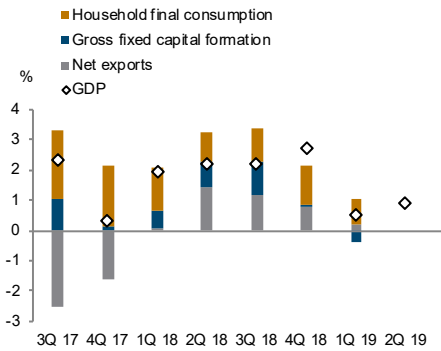


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\*\*EUR based.

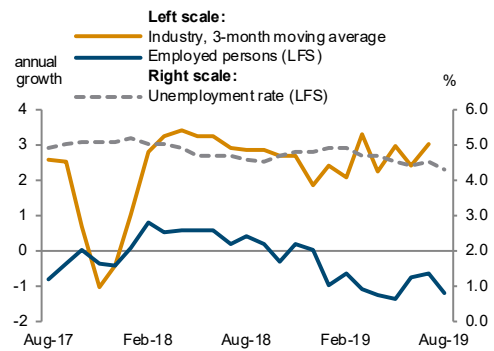
Source: wiiw Monthly Database incorporating Eurostat and national statistics.  
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# Russia

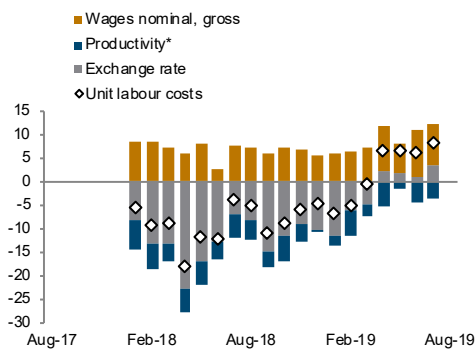
**Real GDP growth and contributions**  
year-on-year



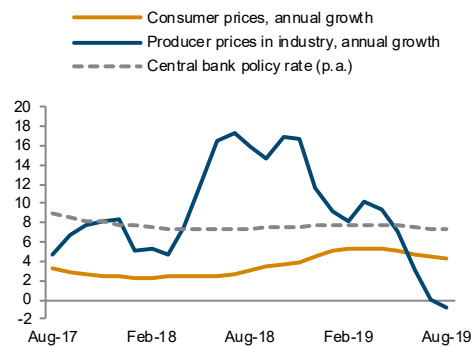
**Real sector development**  
in %



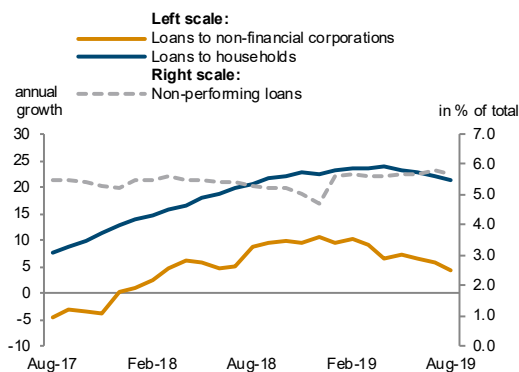
**Unit labour costs in industry**  
annual growth rate in %



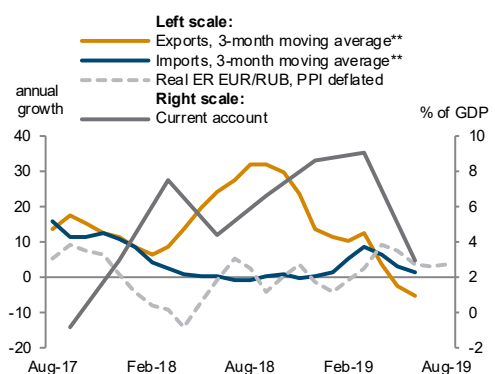
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

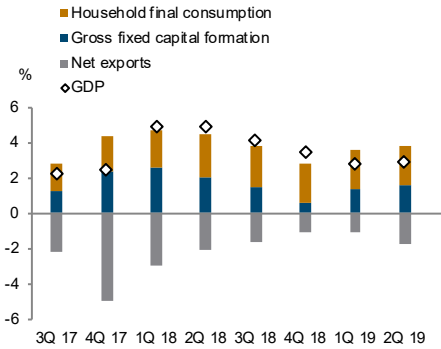
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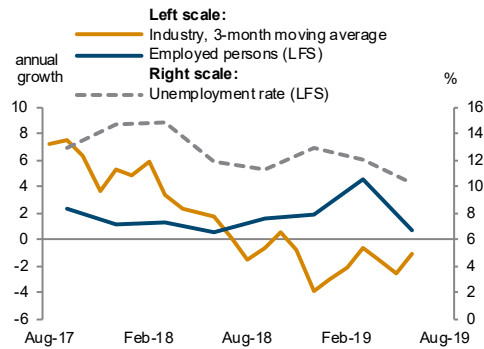
<https://data.wiiw.ac.at/monthly-database.html>

# Serbia

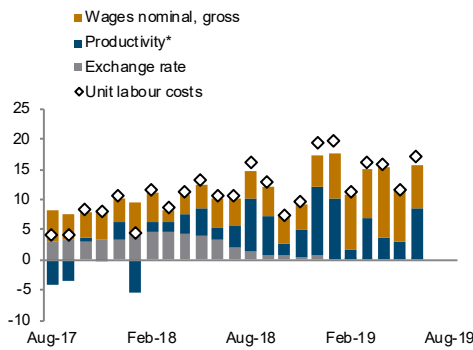
**Real GDP growth and contributions**  
year-on-year



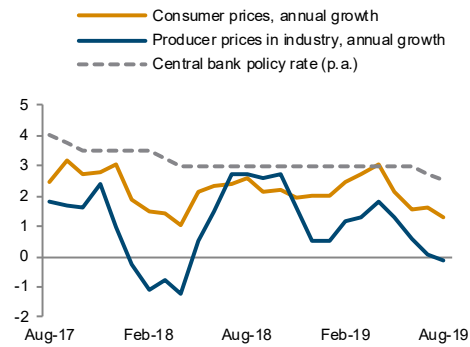
**Real sector development**  
in %



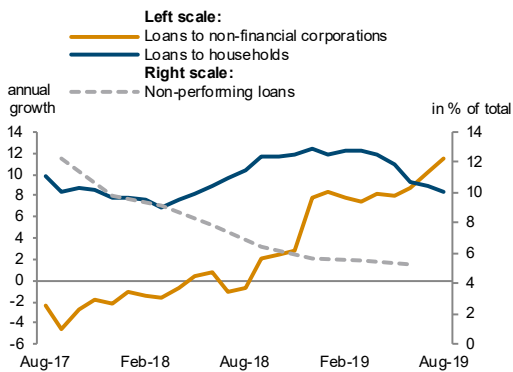
**Unit labour costs in industry**  
annual growth rate in %



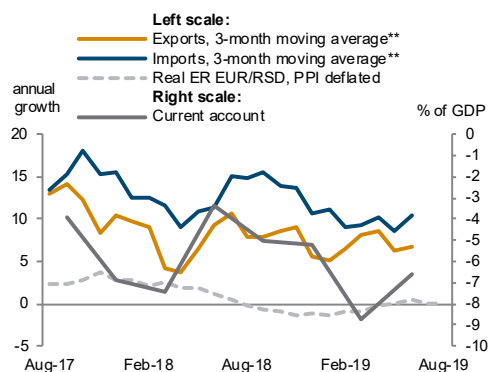
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

\*\*EUR based.

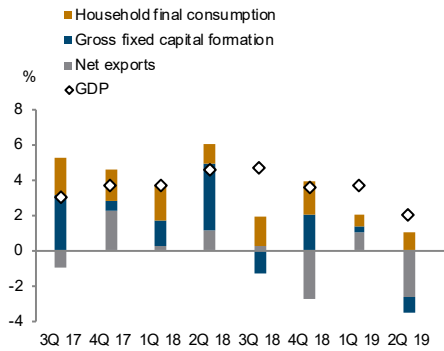
Source: wiiw Monthly Database incorporating Eurostat and national statistics.

Baseline data, country-specific definitions and methodological breaks in time series are available under:

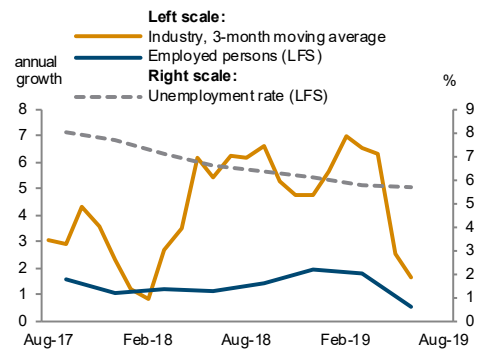
<https://data.wiiw.ac.at/monthly-database.html>

# Slovakia

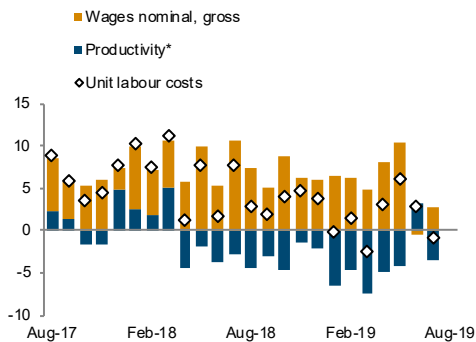
**Real GDP growth and contributions**  
year-on-year



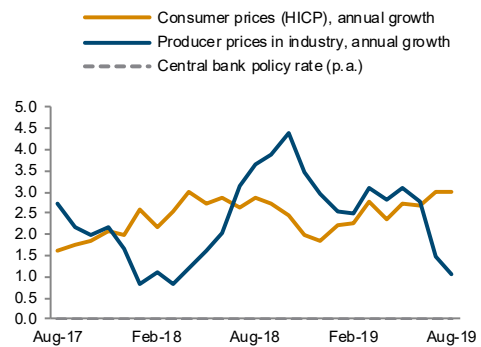
**Real sector development**  
in %



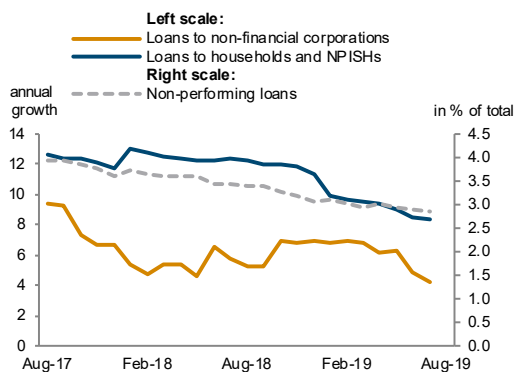
**Unit labour costs in industry**  
annual growth rate in %



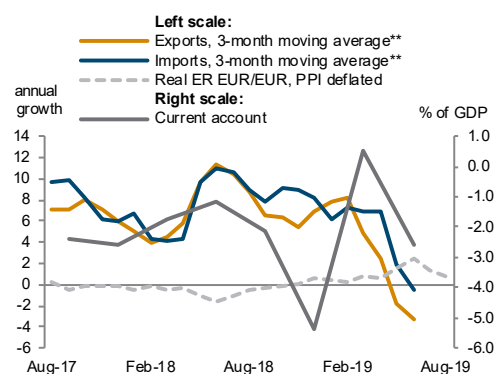
**Inflation and policy rate**  
in %



**Financial indicators**  
in %



**External sector development**  
in %



\*Positive values of the productivity component on the graph reflect decline in productivity and vice versa.

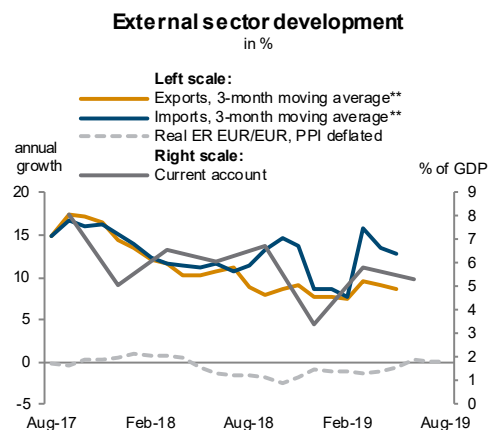
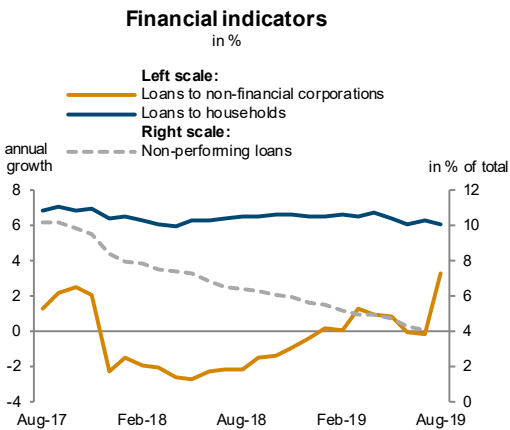
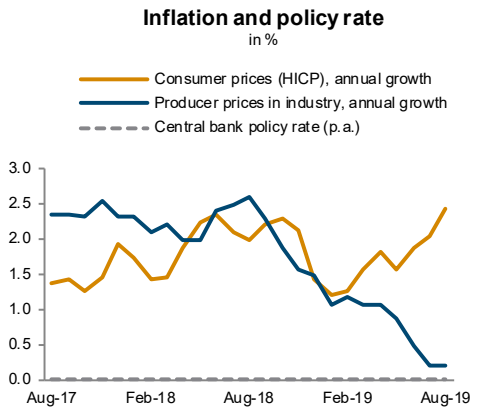
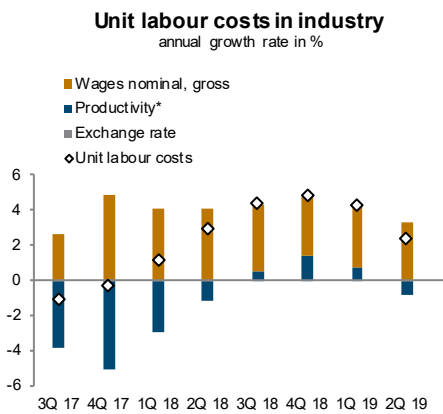
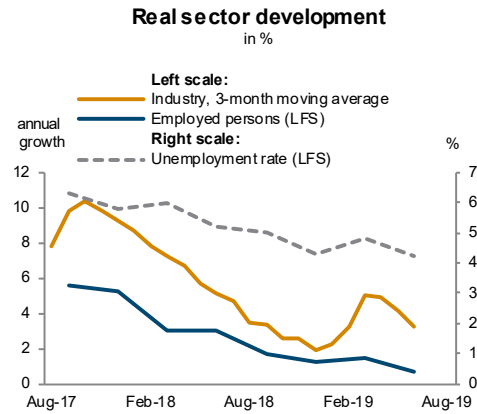
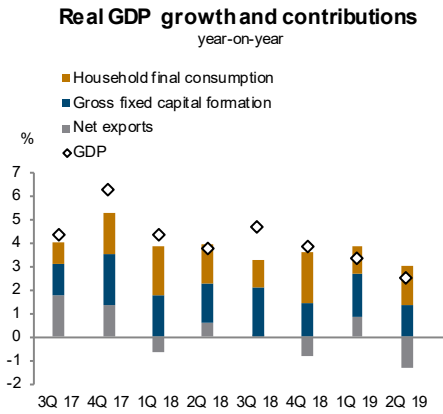
\*\*EUR based.

Source: wiiw Monthly Database incorporating Eurostat and national statistics.

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# Slovenia



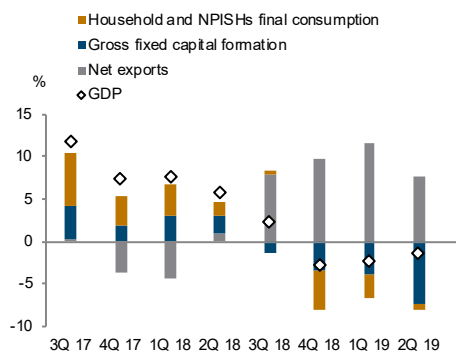
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Source: wiiw Monthly Database incorporating Eurostat and national statistics.  
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# Turkey

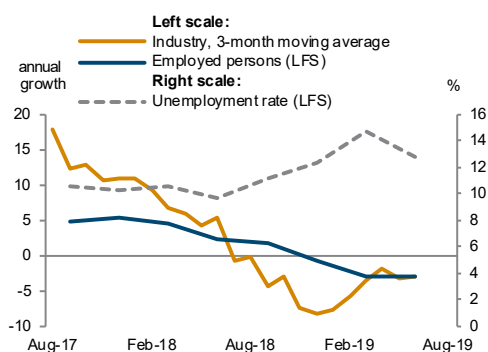
### Real GDP growth and contributions

year-on-year



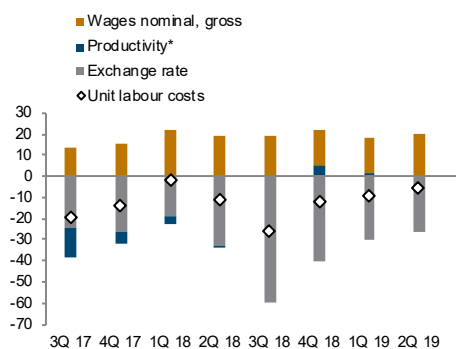
### Real sector development

in %



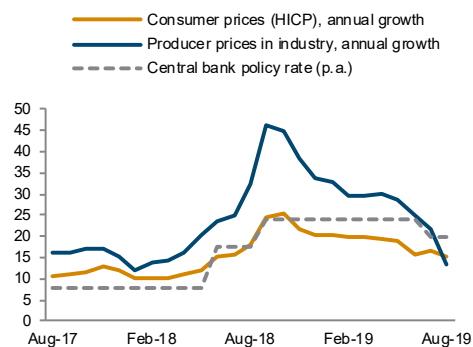
### Unit labour costs in industry

annual growth rate in %



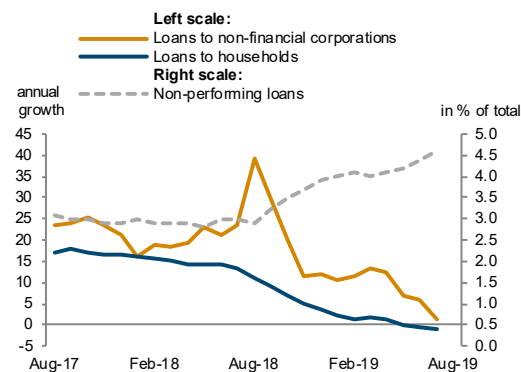
### Inflation and policy rate

in %



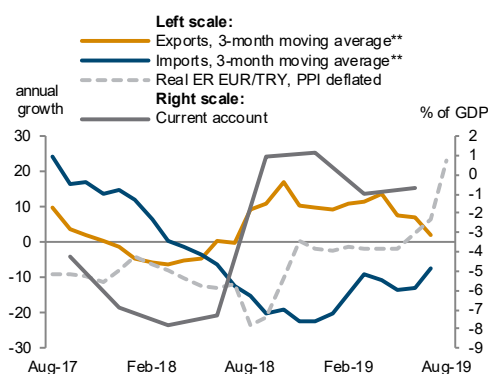
### Financial indicators

in %



### External sector development

in %



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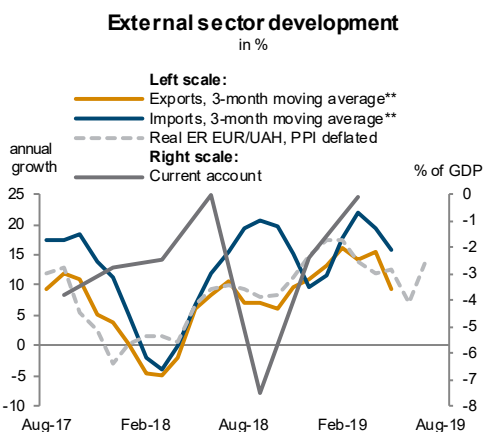
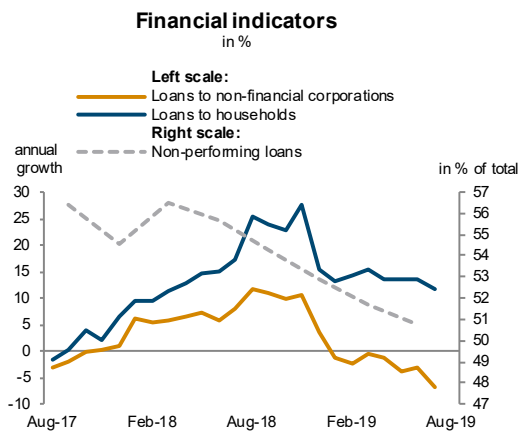
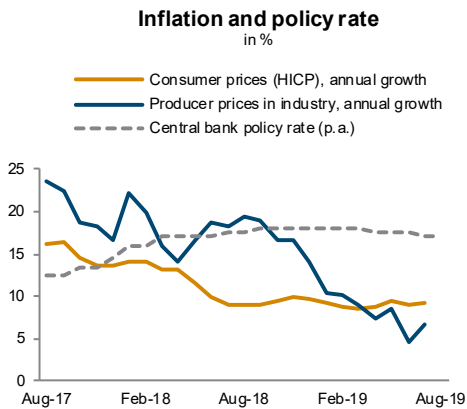
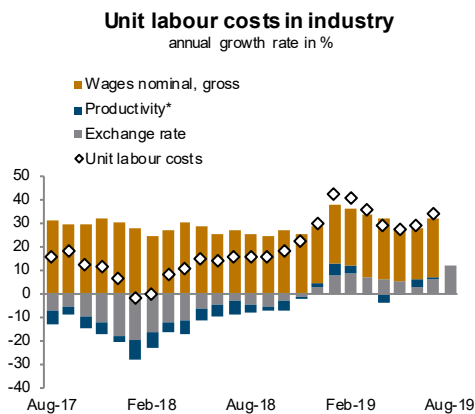
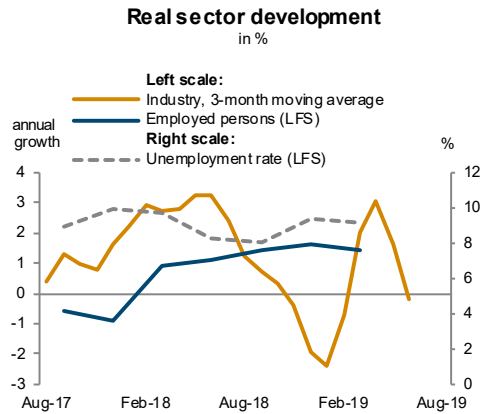
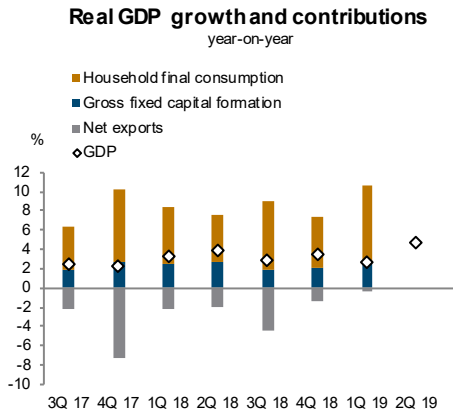
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# Ukraine



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