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Overview: In this issue of showCASE, our authors analyze the implications of the Belt and Road Initiative for the foreign trade in Central Asia. Building on the Vision Europe Summit in November 2017, our authors also discuss the present-day challenges of globalization and propose ways of tackling them. Moreover, with the turn of the year, our economist team introduces a new set of forecasts for 2018 and 2019.

Possible Impact of the Belt and Road Initiative on Foreign Trade in Central Asia

By: Roman Mogilevskii, CASE Fellow

The Belt and Road Initiative (BRI) has been launched by the leadership of the People's Republic of China in 2013. It is going to cover virtually all countries of Eurasia including five countries of Central Asia (Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan), which are the western neighbors of China. Through the BRI, Chinese government proposes to support very different types of interventions in partner countries including infrastructure development, investments into production capacity, measures in trade facilitation, and human and cultural exchanges, among other things. This may create an opportunity for the landlocked and relatively geographically isolated Central Asian economies to improve their connectivity to China, but also to other parts of the world. Foreign trade of these countries seems to be one of the areas to be affected the most, and it is hoped in Central Asia that the BRI will increase the region's export capacity. So far, these economies mostly export crude oil, natural gas, metals and some agricultural products, and they import a broad spectrum of manufactured products and services.

There could be several channels through which the BRI may influence the foreign trade of Central Asian economies: (i) development of transport infrastructure facilitating trade of these countries with China and/or transit of goods from/to China to/from Europe and West Asia, (ii) development of other infrastructure (electricity, irrigation systems, product quality testing, certification infrastructure, etc.) in order to lower production and export costs, (iii) Chinese FDI into production sectors of the countries of the region, (iv) cooperation in trade policy and trade facilitation in order to reduce trade costs, and (v) macroeconomic effects.

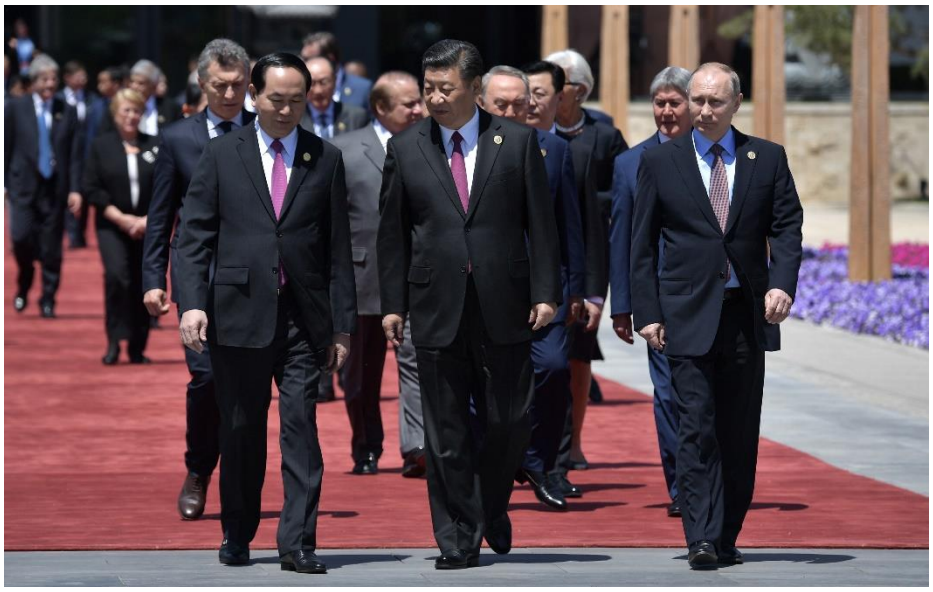


Photo: Reuters, BEIJING, CHINA - MAY 15, 2017: Vietnam's President Tran Dai Quang, China's President Xi Jinping, Russia's President Vladimir Putin (L-R front), Kyrgyzstan's President Almazbek Atambayev and Kazakhstan's President Nursultan Nazarbayev (R-L middle) seen ahead of a group photo ceremony at the One Belt, One Road international forum at the Beijing Yanqi Lake International Convention & Exhibition Center.

Transport infrastructure and transit. Poor transport connectivity is seen as one of the main impediments for export diversification in Central Asia. For the last 15-20 years the governments of the region, with support of international development organizations and bilateral donors including China, have invested very significant resources into the development of rail and automobile road networks, ports and other transport infrastructure elements. More projects are in the pipeline for BRI's support. Governments of the region expect these roads to serve not only/not so much domestic transport flows and exports from Central Asia, but also intercontinental shipments in East-West direction allowing Central Asian transport network operators to benefit from the transit traffic. There are several issues with these transit ambitions: competition from other routes (surface route through Russia, sea route via Indian Ocean etc.), product composition of goods in transit, multimodality of routes (e.g. rail-ferry-rail, except for Kazakhstan), different track gauges, and regulatory barriers. This may mean that the expectations of high transit revenues from BRI projects may need to be carefully evaluated.

Other infrastructure investments may increase Central Asian exports to China if these are targeted to support export-oriented FDI from China, for example, improvement of irrigation systems or testing labs serving agricultural projects (or creation of electricity generation capacity to supply energy to a mine or metallurgical plant) aiming to produce goods for Chinese market.

BRI-related FDI projects. Currently, almost all foreign investments in the region go into either extractive sector (oil, gas, metals) or non-tradeable sectors (telecom, finance, retail, real estate). Chinese investments into tradeable sectors are less probable as Central Asian economies seem to lack many important capabilities in this type of production. In addition to that, investments into tradeable sectors may be aimed at import substitution with a high risk of net welfare losses for FDI-receiving countries. Extractive sector investments would, of course, increase export potential of the region, but may not allow achieving the economic diversification which is a long-term goal of all governments in the region.

Trade policy and trade facilitation measures may become the cheapest and most effective way to increase trade between China and Central Asia. However, the parties do not seem to be prepared going very far in liberalization of this trade. The non-preferential Agreement on Trade and Economic Cooperation between China and Eurasian Economic Union[1] (EAEU), which has recently been approved by the government of China and Eurasian Economic Commission (the executive body of EAEU), is an example of what could realistically be achieved in the trade policy area.

Macroeconomic effects associated with BRI interventions include general improvement in total factor productivity due to better infrastructure, Dutch-disease-type effects caused by the inflow of foreign investments, and, in longer-term, foreign debt issues. Even if some of the BRI infrastructure loans are provided on highly concessional terms, this still may become a very serious debt burden, especially for smaller Central Asian economies. For example, the railroad in Kyrgyzstan from Chinese-Kyrgyz border to Kyrgyz-Uzbek border is estimated to cost some US$5 billion or 76% of the Kyrgyz GDP in 2016. This would imply annual payment of the debt principal and interest in the amount of, at least, 2-3% of GDP.

And, of course, all BRI interventions would be associated with increased imports of goods and services from China, so the direction of change of Central Asia net exports to China is ambiguous.

All these possible BRI interventions may produce significant trade creation and trade diversion effects. Trade creation may emerge due to lower transportation costs (especially for trade with China) and other production costs, reduction of regulatory barriers for trade, and general increase in total factor productivity due to infrastructure improvements. Trade diversion may become a result of asymmetric development of transport infrastructure and re-orientation of

[1] Kazakhstan and Kyrgyzstan are EAEU members.

some trade flows from north-south to east-west direction. It may also be a by-product of re-orientation of Chinese FDI on inputs (equipment, construction materials, components) imported from China rather than from third countries – traditional suppliers to Central Asia.

The Belt and Road Initiative seems to provide unique opportunities for Central Asian countries to develop their infrastructure and production potential and to expand and deepen their trade and economic relations with China. However, all options may need to be carefully analyzed and long-term implications for trade and economic development considered.

Understanding and Correctly Addressing Globalization

By: András Inotai, Research Professor, Hungarian Academy of Sciences

Globalization cannot be stopped. Evidently, as all processes produce benefits and losses, globalization has and will keep on producing its winners and losers as well. The key challenge is to enhance and make sustainable benefits and reduce costs with appropriate medium- and long-term policies.

Understanding the process of (economic) globalization is difficult due to its uneven development, both in time and space. It is not linear and characterized by set-backs, such as economic protectionism, or de-globalization, and populist movements. Also, different areas are differently affected by globalization. Looking at the five decisive factors of economic globalization, we can identify very different degrees of globalization.

Photo: Flickr, faith.e.murphy Murphy

About 60% of the global flow of commodities is covered by free trade agreements, the European Union being the unquestionable pioneer. A bit less but rapidly increasing is the globalization of services, a key element of current and future bilateral liberalization. Any restrictions on the free flow of technology are, in turn, in part due to competition issues and in part due to security considerations.

However, the largest gap can be observed between the practically unlimited globalization of capital and the very restricted cross-country flow of labor. Financial liberalization coupled with modern technologies have become the driving force of globalization in the last three decades. Without any binding international agreement, this process was responsible for the global character of the financial crisis in 2007-08, and, in absence of international rules, it is likely to become or remain the source of new (and repeated) financial crises with unprecedented negative impacts in a world of a rapidly growing network of interdependence.

In contrast, only about 3 per cent of the world's population, about 250 million, is constantly living and working outside its native country. This gap will definitely be narrowed in the next 20 years. In 20 years, taking into account the growth of global population, 6 per cent constituted by such people would represent about 500 million, or the double of the current figure. Accelerated flow of labor will be fuelled by higher education, expectations of better living standards,

ongoing globalization of production and service networks and, last but not least, by the access to current and new forms of communication (from television through computers to smartphones). This prediction does not consider massive flows of people due to natural catastrophes, durable climate change or wars, none of which can be left out of any realistic calculation. Even if large part of the additional flow will be concentrated in the geographical neighborhood, massive migration (pressure) is likely to be experienced in developed countries, not least in Europe, due to its geographic proximity to regions with rapidly growing population and considerable political and economic instability. In addition, the potential impact of digitalization on the future size and structure of labor market demand has to be taken into account.

Correctly addressing the manifold impact of globalization requires a carefully composed package of policy instruments and communication. The former has to include economic incentives, social programmes, future-oriented education, increasing labor market mobility, adequate tax systems, reforming the pension system, and investing much more in sustainable health. The latter has to prepare to face the growing challenge of de-globalization and populist arguments.

In this context, the costs of potential de-globalization have to be highlighted. Most supporters of de-globalization movements feel that they are losers of globalization, although they are in fact clear winners of this process. It has to be made clear for them that, in a complex and interdependent world, there is no possibility of „cherry-picking". Any kind of de-globalization would deprive them of the benefits of globalization they used to enjoy and have become accommodated to as to a „natural state of living". Therefore, a widespread communication campaign should be started both on the global, European, and nation-state level addressing the real and potential costs of de-globalization. This should go hand in hand with the simultaneous implementation of effective policy instruments that are likely to tame the negative consequences of globalization.

However, no sustainable success can be reached without a more active and cooperative role of the societies. Thus, traditional elements of investment into the human factor, the key pillar of sustainable competitiveness and social cohesion (education on all levels, research & development, and healthcare), have to be complemented by „investment into the innovative society". Only innovative societies will be able to remain successful and sustainable over the 21st century, experiencing unprecedented globalization with all of its advantages and disadvantages in a rapidly accelerating timeframe. Innovative societies are characterized by:

- openness (rather than closing down and self-marginalization),
- solidarity (rather than hate-generation),
- cohesion (rather than polarization sometimes fuelled by highly irresponsible government policies),
- future-oriented attitude (rather than fleeing back into the not always „glorious" past),
- increased risk-taking by prioritizing chances and new opportunities (rather than overestimating risks and potential costs of adjustment).

Overcoming the deep-rooted aversion to any change, partly reinforced by the decades-long peace and stability, represents a unique challenge to democratic institutions, policy-makers and societies alike. In order to avoid any new and probably irreparable catastrophe, several times experienced in our history, we have to start a multi-level discussion and dialogue in the broadest form possible among policy-makers, experts, different interest groups, large social strata with different conditions of economic welfare and degrees of education. Convenient fora should be organized on local, regional, national, European, and global levels simultaneously. Rightly addressing and managing globalization is our common and indivisible responsibility.

This week: According to the Central Statistical Office, inflation in 2017 compared to 2016 amounted to 2.0%. Prices of food in 2017 increased by as much as 4.6%. In December, prices of goods and services grew by 2.1% y/y . The growth was driven by raising prices of food (5.8%) and energy carries (2.6%). Inflation in 2018 is predicted to slow down to 1.8%.

GDP (Q3 2017)

5.2% y/y (est.)

Up from 4.2% in Q2

Inflation (Dec 2017)

2.1% y/y

Down from 2.5% in Nov

Unemployment (Nov 2017)

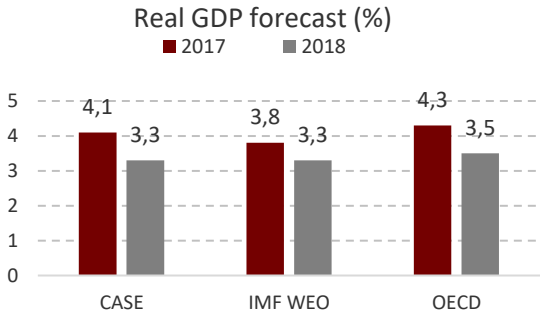
6.5%

Down from 6.6% in Oct

NBP Base rate

1.5%

From 2% Mar 2015



This week: President Vladimir Putin emphasized the importance of cooperation within the Eurasian Economic Union (EAEU) and of the development of digital economy within the Union. The Russian Head of State also suggested that certain members of the Commonwealth of Independent Countries could become EAUE observers.

GDP (Q3 2017)

1.8% y/y

Down from 2.5% in Q2

Inflation (Dec 2017)

2.5% y/y

Unchanged since Nov 2017

Unemployment (Nov 2017)

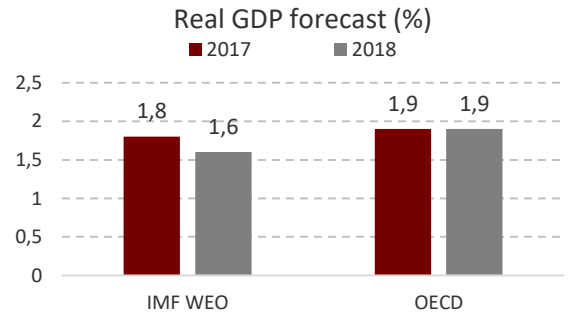
5.1%

Unchanged since Oct 2017

CBR Base rate

7.75 %

From 8.25% in Nov 2017



This week: Christine Lagarde, International Monetary Fund's Managing Director, has urged Berlin to drive down its substantial current account surplus and invest more in public infrastructure. Ms. Lagarde suggested that big surpluses cause trade imbalances, while increased investments could help deal with the problem of demographic transition. In response, the President of the German Central Bank Jens Weidmann defended the policy of conservative spending, adding that any public expenditures must be carefully planned.

GDP (Q3 2017)

2.8% y/y

Up from 2.3% in Q2

Inflation (Dec 2017)

1.6% y/y (est.)

Down from 1.8% in Nov

Unemployment (Nov 2017)

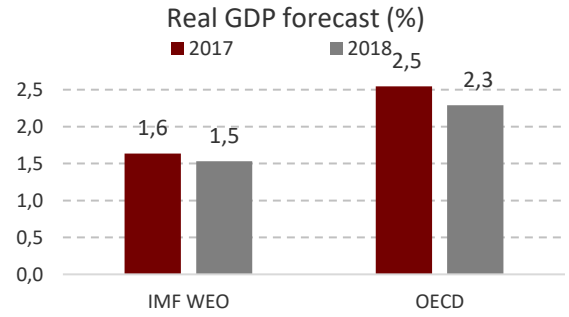
3.4%

Down from 3.8% in Oct

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



On January 18, Ukraine's Parliament adopted the bill on the privatization of state property. The goal of this law is to simplify privatization procedures and enhance transparency in the privatization process. According to the new procedure, the list of large assets subject to sale is to be approved by the Cabinet of Ministers of Ukraine. The list of small-size assets subject to sale is to be approved by the State Property Fund of Ukraine.

GDP (Q3 2017)

2.1% y/y

Down from 2.3% in Q2

Inflation (Dec 2017)

13.7% y/y

Up from 13.6% in Nov

Unemployment (Q3 2017)

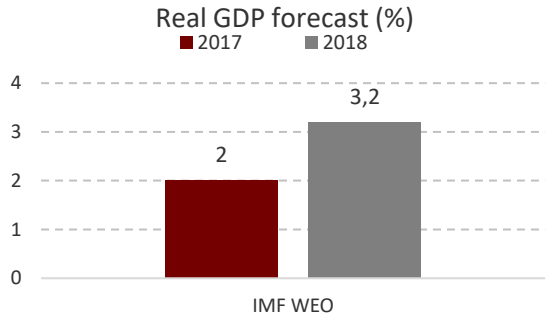
8.9%

Down from 9.1% in Q2 2017

NBU Base rate

14.5%

From 13.5% in Oct 2017



This week: The Czech branch of the telecommunications company T-Mobile is planning to invest EUR 600 mln in fiber-optic systems within the next five years. Milan Vasina, the CEO of T-Mobile Czech Republic a.s., said that the company would like to reach out to one million households to provide this kind of system. In some countries fiber-optic systems are already prevalent; for example in Spain and Portugal they are used in 80% of households.

GDP (Q3 2017)

5.0% y/y

Up from 4.7% in Q2 2017

Inflation (Dec 2017)

2.4% y/y

Down from 2.6% in November

Unemployment (Q3 2017)

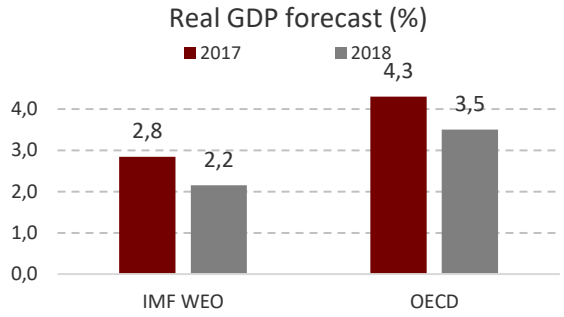
2.8% (est.)

Down from 3.0% in Q2

CNB Base rate

0.50%

From 0.25% (3rd November 2017)



This Week: According to the report "Silver Age – The Older Generation in Hungary, 2016", published recently by the Hungarian Central Statistical Office (KSH), the employment rate among Hungarian women aged 55-64 was only 42%, and among Hungarian men of the same age – 60% (2016). In 2016, the average rates in the EU was 52% for women and 66.6% for men, the highest rates were in Sweden (76.9% for women and 82.5% for men), while the lowest were in Malta (27% for women) and in Slovenia (47.1% of men).

GDP (Q3 2017)

3.9% y/y (est.)

Up from 3.3% in Q2

Inflation (Nov 2017)

2.5% y/y

Up from 2.2% in October

Unemployment (Q3 2017)

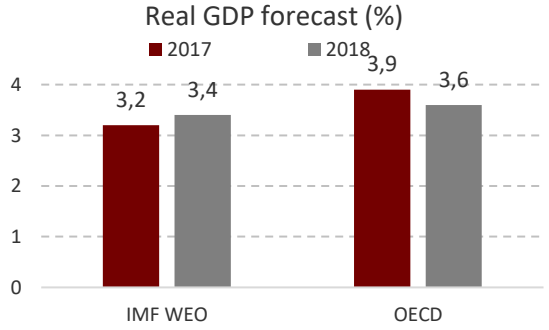
4.0%

Down from 4.3% in Q2

MNB Base rate

0.9%

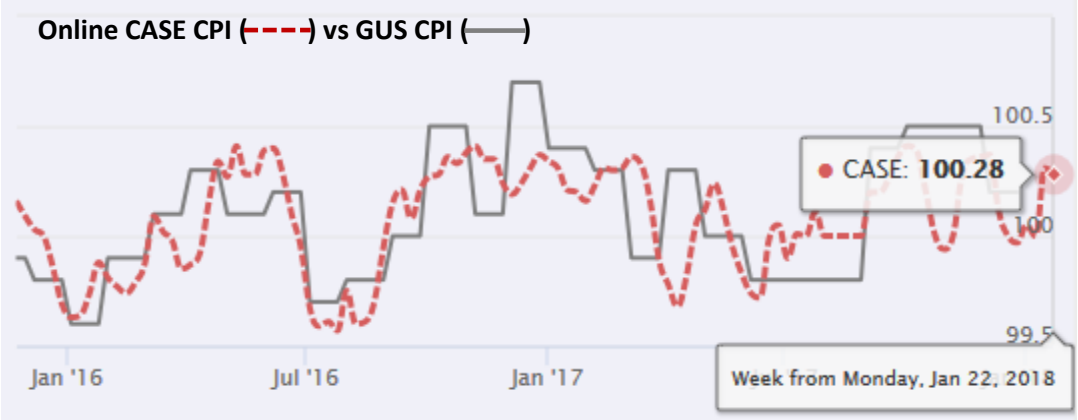
From 1.05% May 2016



The weekly online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly.

Our weekly online CASE CPI



Monthly CASE forecasts for the Polish economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, and foreign trade, current account balance, and the CPI.

CASE economic forecasts for the Polish economy
(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices
2018	3.4	3.5	3.1	3.7	2.5
2019	3.5	3.6	3.3	3.8	2.3

	Nominal monthly wages	Merchandise exports (USD, bn)	Merchandise imports (USD, bn)	Merchandise trade balance (USD, bn)	CA balance (USD, bn)
2018	3.5	233.4	235.2	-1.8	-3.9
2019	3.7	242.7	244.6	-1.9	-4.1

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