

Report on the Lámfalussy Lectures Conference Held in January 2020*

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Named after Alexandre Lámfalussy, the prominent Hungarian-born economist and reputable expert of European finance, the seventh *Lámfalussy Lectures Conference* was held on 20 January 2020, where leading global financial experts and academic researchers discussed the topic of long-term sustainable convergence.

In his welcome address, Magyar Nemzeti Bank (MNB) Governor *György Matolcsy* first greeted Lámfalussy awardee *Peter Praet*, who is a former member of the Executive Board of the European Central Bank (ECB) and a professor at ECARES – Solvay Brussels School Economics and Management at the Université Libre de Bruxelles, and *Gergely Baksay*, who has received the Popovics award and is the Director of the MNB’s Directorate for Fiscal and Competitiveness Analysis.

In his opening speech, *György Matolcsy* emphasised the need to prepare for four main challenges, which are: geopolitics, the emergence of new digital technologies, the transformation of the monetary system and climate change. These challenges have significant reciprocal impacts and also exert an influence on long-term convergence. Since 2013, Hungary has been on a path of convergence in all respects; nevertheless, we need further competitiveness and structural reforms. We must establish a new dialogue with the European Union, the IMF and the global business community. A strong and successful EU is in all our interests; this necessitates greater competitiveness and stronger cohesion. Mr Matolcsy called on all EU Member States to join forces and collectively launch new dialogue about reforming the euro area and the entry criteria. In 2022, we will celebrate the 30th anniversary of the Maastricht Treaty; this is a great opportunity for a thorough reform of the euro area. ECB President Christine Lagarde has already launched the reform of the ECB. The MNB is contributing to this dialogue with a new book, in which it proposes a transformation of existing rules so that Europe, including Hungary, can achieve long-term, sustainable development.

In his speech, *Peter Praet* expressed agreement with *György Matolcsy*, and explained that a strategic review of the ECB was already underway at the Bank;

* The papers in this issue contain the views of the authors which are not necessarily the same as the official views of the Magyar Nemzeti Bank.

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the review is expected to be completed by the end of the year. However, there is also an urgent need for a much wider review of the euro area and European Union strategy. This is a great challenge. It is important to set deadlines for reforms. In his view, hidden imbalances emerged as early as the first decade of the euro area, but these signals were perhaps overly neglected and came to the surface only during the crisis. It transpired that while monetary policy had achieved multiple good results, it was unable to function efficiently by itself without the support of fiscal and structural policies. The good news is that people consider the euro useful and are firmly behind it, as demonstrated by various polls. The ECB is able and willing to make the right decisions, and is functioning well as an institution; nevertheless, confidence in the Bank remains low, albeit improving. Citizens need to be given a better explanation of what a central bank's mission is, and what it can and cannot do. For instance, it cannot solve the problems caused by climate change or ensure a better distribution of incomes by itself. He emphasized that single currency needs the single market and vice versa. In addition, a greater degree of harmonisation is needed in corporate law or insolvency legislation.

MORNING SESSION: The new challenges of sustainable convergence within the European Union

In his introductory speech entitled 'Sound governance of the Economic and Monetary Union (EMU) for sustainable convergence in Europe' *Robert Holzmann*, the Governor of the Oesterreichische Nationalbank emphasised the need for greater stability in the European region, including a strengthening of the banking union and the capital markets union. Analysing the current challenges facing the EMU, he focused on the completion of the banking union in order to protect taxpayers by creating an unconditional European deposit insurance system. It is critical that the risks are first reduced and are shared only afterwards. This is a position also held by the central bank of Austria, the OeNB. Implementing a capital markets union would also be important, but this can only happen if households also take part in capital market financing. Currently there is a limited number of well-capitalised 'capitalists' on the market, but this is not enough to operate an efficient capital markets union. With a well-functioning banking and capital markets union, fiscal policy would need to intervene less in order to smooth the cycles, he noted; for this reason, capital markets in the United States for instance play a much greater role in this process than in Europe. He also spoke of the essential need for fiscal discipline, and the fact that it is not enough to focus on financial debt, the implicit debt burden of healthcare and pension expenditures must also be taken into account. In conclusion, he mentioned the question of Hungary's and Poland's participation in the euro area. Apparently these countries wish to give further thought to that question; no one can be forced to join, everyone must make that decision independently and the question should be debated openly.

The moderator of the ensuing panel discussion was *György Szapáry*, Chief Advisor to the Governor of the MNB. Panel participants included *Poul M. Thomsen*, Director of the European Department of the IMF, *Barry Eichengreen*, Professor of Economics and Political Science at the University of California, Berkeley, *Debora Revoltella*, Chief Economist at the European Investment Bank, *Iain Begg*, Professorial Research Fellow at the London School of Economics and *Olivier Garnier*, Chief Economist and Director General for Statistics, Economics and International Affairs at the Banque de France.

In his keynote speech *György Szapáry* showed two charts: the first concerned the euro area current account surplus as a percentage of GDP between 2012 and 2019 and he highlighted that the surplus was invested outside the euro area. The second chart, of unemployment rates in the euro area in 2019, showed that unemployment was very high in several Member States, i.e. the surplus was not distributed to where it would have been most needed.

Poul M. Thomsen described three different convergence processes. First of all, a very impressive East-West convergence process is taking place in Europe. It is similar to the outstanding economic growth of Japan and South Korea in the sixties and seventies respectively. Yet the rate of convergence has been much lower in Eastern European countries that are not EU members. The second process is convergence within the euro area: the 12 founding Member States had largely been converging prior to signing the Maastricht Treaty, but the process of convergence then started to decelerate and stall, with some southern Member States eventually falling into divergence. The third process is the subdued current convergence of the advanced European countries, which had converged quickly after World War II; these countries, even the best performers among them, are increasingly lagging behind the United States in terms of per-capita GDP.

The main question is how to reboot the convergence process. *Mr Thomsen* highlighted two of the many challenges, emphatically at national level for both: an absence of structural reforms and inappropriate fiscal policies. The consequence of the former is the increasingly wide productivity gap between north and south. Southern states are faced with near-stagnation. While growth has recently restarted in Spain, convergence based on proactivity is still absent in the other southern states. Research by the IMF indicates that the implementation of reforms can benefit the countries lagging behind the most because this is where it can have the greatest impact on the economy and levels of productivity. Structural reforms can improve the crisis resilience of Member States in an economic downturn. The further we are from the crisis, the less concerned certain countries are with implementing structural reforms. The speaker also emphasised that decisions on structural reforms should be adopted at the national level; for the most part, this is not a question for the European institutions.

Another key problem lies in inappropriate fiscal policies, especially in the highly indebted countries. Debt is at or above 100 per cent of GDP in seven Member States, which failed during the good years to raise fiscal buffers for the bad years. As a result of procyclical mistakes made even in the good years, the protracted impacts of shocks solidified into permanent on output. The most highly indebted countries underestimate the need for fiscal adjustment. During the crisis, they cut government investment instead of reducing government spending on consumption. This crowded out productive investments. In conclusion, he highlighted again that Member States should find custom solutions to these problems at the national level. The greatest concern is the lack of an appropriate fiscal policy mix and the high proportion of non-productive expenditures.

European convergence was the subject of *Barry Eichengreen's* speech as well. Nominal convergence had taken place by 2008 in terms of inflation as well as the interest rates on ten-year government bonds. Yet after that date, serious fiscal problems caused a significant rise in the difference between the interest rates of Germany and Greece for instance. The situation is even worse in terms of real convergence. In the period following the introduction of the euro, the variation coefficient of per-capita GDP at purchasing power parity first stagnated but then doubled after the crisis, resulting in divergence. The main reasons were the following: The asymmetric impact of the integration of China into the global trading system had a negative impact on (especially) the southern states. Germany and therefore Hungary benefited disproportionately from the productivity increase created by the integration of Eastern Europe into the single market. The southern countries were not able to benefit from this process. Inefficient financial and banking systems, such as that of Portugal, failed to accelerate the rise in productivity, and capital flowed to services, which are relatively unproductive technologically. Before the crisis, Portugal, Spain and Greece received high capital inflows from other parts of Europe and the world, and suffered the consequences of an overvalued currency as a byproduct of nominal convergence.

In his book 'The European Economy Since 1945', *Mr Eichengreen* describes in detail the standard explanation for Italy's underperformance, with an emphasis on its inflexible product and labour market, weak and undercapitalised banking system, and the high proportion of non-performing loans. This interpretation does not explain, however, why these product and labour markets are inflexible, and it disregards the fact that Italy's total factor productivity had already stopped growing in 1995, or that the Italian economy had been facing problems even prior to that date. He identified the issue in the deviation between the inherited system of institutions and the requirements of the new technologies. In conclusion, he noted that the convergence crisis in Europe originated from the crisis of the

system of institutions; the two crises interact and should be resolved in order to make progress.

Debora Revoltella spoke about the need to accelerate the transformation of Europe in order to achieve sustainable convergence; she called this an old challenge and a structural question. There are three key subject areas associated with this matter, namely: a) Environmental sustainability and an energy transition, which requires more investment than today; b) Speaking of social sustainability, she remarked on the rising income inequality between the richest and those on lower incomes both across the European Union and in the national economies, geographically as well as between the generations, and inter-generational social mobility has also declined; c) We also face numerous problems in terms of competitiveness and productivity. The main obstacles to investments by EU businesses include a lack of staff with the right skills, uncertainty and business regulatory issues, as well as the absence of a flexible European-level environment facilitating transformation. The European Union is lacking new global leaders and the right governance in the new sectors. The EU spends much less than the United States on research and development in most sectors except the automotive industry. As for climate research and development spending, both the US and China are ahead of the EU. There are too few new businesses setting up, their growth process is too slow. There appear to be two main problems underlying this: firstly, the absence of past success stories, which constrains the growth of new businesses, and secondly, the fragmentation of the European market and an absence of openness to disruptive technologies. The US market is much more efficient and much less fragmented. Other problems include the lack of dynamism in our system and the sustained productivity gap between leading and lagging companies. Weak infrastructure investment by governments is holding back private investment in infrastructure. Intelligent infrastructure, financial instruments and improving access to them help manage the fragmentation of the market and the rechanneling of ample liquidity. She concluded by stating that these require investments, the fight against climate change must be strengthened and the transition to zero carbon emissions accelerated. Social cohesion must be rebuilt in Europe. We should take advantage of the great technological advances being made, and governments need to rethink their investment priorities. The Green Deal may be a possible means of convergence.

In his talk entitled 'An EU Level Fiscal Capacity The 'why', 'how' and political economy', *Iain Begg* took as his starting point the design faults of the Economic and Monetary Union; these are the following: the difficulty to achieve a joint fiscal policy, the absence of safe instruments, the unfinished banking union and the deficiencies in the governance and coordination mechanisms, as well as the lack of agreement on burden sharing. He then proceeded to analyse today's problems:

monetary policy has no room to act and respond to any further deterioration of the current downturn. Structural policies are important of course, but most are slow in achieving results and some even cause disruption in the short term, before improvements can happen. The opportunities of fiscal policy are also limited, because Member States must comply with the fiscal rules and are reluctant to agree to new EU-wide mechanisms.

As for the question of 'HOW', he described proposals: there is increasing support for a kind of euro area budget, but the expectations are contradictory. France and Spain support the creation of a certain level of unemployment support. According to Germany, the budget could operate as a convergence and competitiveness instrument, but it is not a suitable tool for stabilisation. There appears to be limited ambition concerning funds earmarked for bad times. It is hard to identify support for the debt instrument and there is no consensus on the best way to shape policy.

He then switched to questions of political economy: the nations that could loosen their fiscal policy will not do so or will otherwise be faced with labour shortages. Whereas those who would need fiscal support have no room for manoeuvre. The absence of trust is attributable to the fixing of moral risks. There are concerns especially about Italy. It is difficult to break the stalemate when Germany and other lenders emphasise moral risk, whereas debtors emphasise solidarity against a backdrop of a population in revolt.

The ideal method for macro-level sustainability would be to agree an euro governance policy and to implement it in a timely manner. This would generate sustainable growth with reduced imbalances and increase the trust in deeper EMU integration. In practice, however, there might be inconsistency for instance if European governance approaches are subjected to the dominance of national priorities, if the parties are unable to resolve the dilemma of risk sharing and risk reduction, if the deviation between economic trends in the Member States hinders joint action or if the compliance with rules and processes is not satisfactory. In such cases, sustainable convergence would continue to be an overly great challenge.

In his closing remarks, he added that an economy that works for the people should go beyond slogans and easy efforts. However, this requires an appropriate level of accountability. Fiscal policy must do more; still, overly high importance has been attributed to fiscal rules, whereas joint fiscal policy has not been given sufficient weight. Essentially, a credible euro area fiscal capacity is now required.

Olivier Garnier, the only central banker on the panel, examined the subject from the perspective of monetary policy. Monetary policy has proven successful so far. Without the ECB's unconventional measures, real GDP would have grown much less in the euro area and the inflation rate would have been even further

from the inflation target. However, monetary policy cannot be the only part of the solution in an environment where the natural rate of interest is low over an extended period. There are two non-monetary questions underlying this. Firstly, the total productivity factor is rising at an ever slower rate, and has remained below 1 per cent in the euro area for more than two decades. Secondly, domestic savings and investments as a percentage of GDP started to diverge after 2009: the gap is wider than in previous periods, with much higher levels of savings than investments. The interaction between the euro area-level single monetary policy and the national fiscal and structural policies plays a limited role in preventing the emergence of inflationary processes. The new macroeconomic environment (stubbornly low inflation, low long-term interest rates) presented a challenge for the former eurozone policies; monetary policy may face an increasing challenge if it does not enjoy adequate support from other policy areas.

He then highlighted the need for a new, more integrated policy mix, one that supports long-term economic growth and boosts investment. By sharing the economic policy burden, fiscal policy should prove a more efficient instrument of stabilisation in an environment of low interest rates and should, together with structural policy, mitigate the potential harmful side effects of monetary policy on financial stability. This new, more integrated euro area-level framework of policy areas would have four components: to raise inflation towards the inflation target; monetary policy to remain supportive as long as necessary; long-term growth and investments, and increasing the r^* , natural rate of interest.

At the level of structural policies, this means completing the creation of the single market in services and digitalisation as well. In addition, national reforms are necessary to increase the total productivity factor by improving education, research and development spending and labour participation. In fiscal policy, joint fiscal instruments are needed to support climate change and digitalisation investments at the euro area level. Beyond that, efforts should be made to achieve a more growth-friendly mix of public expenditures at the national level.

The risk of reaching the effective lower bound on interest rate should be reduced in the business cycle (this would be the stabilisation function). Countercyclical fiscal policy should be given greater scope and there is a need for stronger cross-border governmental and private risk sharing.

Financial stability risk should be minimised – in an environment of low interest rates – with a combination of monetary policy instruments at the level of the euro area and by applying macroprudential policies at the national level.

AFTERNOON SESSION: Preserving sustainable convergence in a changing world/in Asia

The afternoon session started with a keynote address by *H.E. Serey Chea*, Assistant Governor and Director General of the National Bank of Cambodia. She spoke of how the world has changed since the global financial crisis and will never be the same as it was before. The damage caused by the crisis goes well beyond the financial considerations. Regarding Asia, it is clear that global banks have reduced their presence in the emerging world in order to reduce their regulatory burdens. A large number of advanced economies are suffering from their inability to achieve growth comparable to before the crisis. Having been the foundation for success in the past, globalisation is facing challenges now. One problem is that the economies conducting free trade have largely disregarded inequalities. In the United States of America, for example, the average income of the top 10 per cent of society rose threefold over the past four decades, whereas the situation of those in the lowest income category has, at best, remained unchanged since 1980.

One of the new trends is widespread protectionism in the United States. What does this mean for Cambodia? Cambodia has achieved significant growth over the past two decades (8 per cent on average), with exceedingly good macroeconomic indicators in all areas. A deceleration can currently be seen in most sectors. In an environment of global uncertainty, it is very difficult for the government to maintain even the current growth rate, which is 7 per cent at most. Previously a good performer, the financial sector is also more exposed to external shocks now. It is important to point out that 90 per cent of operations in the Cambodian economy are transacted in dollars. Cambodia will, sooner or later, feel the impact of the US-China tensions because the successes of Cambodia are dependent on the prosperity of its trade partners. Also, lower-skilled workers, whose pay is rising, are justifiably fearful that they might be replaced by robots. She highlighted four points as to how to maintain convergence in a quickly changing world:

a) Along with many Asian countries, Cambodia has doubtlessly benefited from the current world order by taking part in the global governance mechanism through its UN/WTO/World Bank/IMF memberships. This has helped it become one of the six fastest growing countries in the world. Asia's aim is to maintain the liberal order of global free trade; a globalised world has to be governed through international rules, although local considerations must also be incorporated in the system to a certain degree. She emphasised that convergence can only take place if we reach the desirable result.

b) Cambodia's largest trading partners, representing 60 per cent of its exports, are the United States and Europe. At the same time, China accounts for 45 per cent of its direct capital investment. This duality causes problems at times: it is

important for a small country to diversify its economic dependencies. Cambodia's membership in ASEAN (the Association of Southeast Asian Nations) is very helpful. Mutual interdependence is good only if the global production chains apply a fair system of distribution, as this is how to avoid conflict.

c) The fast progress of technology and big data will bring changes in almost all areas, from finances to trade. With the boom in e-commerce, cross-border transactions can redefine and change the international mechanisms of trade. Cambodia's population of 16 million has 20 million mobile subscriptions; in 2019 the country was the first in the world to introduce a system of payments using blockchain technology, which complements the instant payment system launched there back in 2016.

d) In order to maintain sustainable convergence, Asia needs to have a far-sighted, comprehensive strategy, which must go beyond the economic models and also take the consequences of geopolitics, technology and climate change into consideration.

The ensuing panel discussion was moderated by *Dániel Palotai*, Chief Economist and Executive Director for Economic Sciences and Priority Matters at the MNB. Panel participants were: *Hoe Ee Khor*, Chief Economist of the ASEAN+3 Macroeconomic Research Office, *Bernard Yeung*, President of the Asian Bureau of Finance and Economic Research and Stephen Riady Distinguished Professor at the National University of Singapore, *Eduardo Pedrosa*, Secretary-General of the Pacific Economic Cooperation Council, and *Harris Kim*, Director of Inflation Research Division at Bank of Korea.

Dániel Palotai in his lead of the panel discussion, raised some thought-provoking topics for sustainable catching up in Asia. He used diagrams to illustrate how the formerly robust global growth and the growth of emerging economies are now slowing. In Asia, the short-term outlook points to a continued deceleration of growth. Important contributing factors include global policy uncertainties and slowing growth in China. One key question in such an environment is how to escape from the middle-income trap. Only a few countries have managed to do that so far. It is clear that there are no universal solutions; however, based on experience, specialisation in high value added exports and a service orientation are key criteria. It is worth focusing the restructuring of the economy on developing education and healthcare as well as on local opportunities for growth. It is also important to consider that a high degree of indebtedness limits fiscal space and there is an broad-based slowdown in labour productivity.

Innovative methods are necessary to achieve sustainable development, such as green bonds and green loans in the area of sustainable debt financing. The

evolving risks have to be considered by the growth models. Quoting the 'World Economic Forum: The Global Risk Report 2020' publication, Dániel Palotai named the following key global risks: extreme weather; the potential climate-action failure; natural disasters; biodiversity loss; human-made environmental disasters; weapons of mass destruction; crises triggered by a lack of clean water. To conclude, he raised the question of whether we were moving towards sustainable development at all. He noted in that respect that modern growth models are facing the following new challenges: climate change; fierce global competition; rapid development and societal technologies; the need for new skills for adapting to technological and societal changes; aging population.

All this highlights the key importance of eliminating the contradiction between growth and prosperity on the one hand, and climate protection and sustainability on the other.

Hoe Ee Khor started his presentation by stating that Asia's growth catch-up over the last two decades has been remarkable. Per-capita income in the ASEAN+3 economies (ASEAN + China, Japan and South Korea) has converged in an impressive manner and pace with the income levels of high-income countries outside the region. The contribution of the manufacturing industry to growth and job creation has reached its peak in the high-income and the ASEAN-4 countries (Philippines, Indonesia, Malaysia and Thailand), but there is still scope for the lower-income Asian countries to develop in that direction.

Over time, the nature of the region's globalisation has changed, shifting to an extended production and growth strategy with a strategy of manufacturing for export. The manufacturing sector has become the driving force in the export strategy of the ASEAN+3 region. In the past two decades of prudent macroeconomic governance, complex challenges have arisen in connection with the savings-investment gap. Long-term shortcomings in savings and investment generate fundamental vulnerabilities. Sustaining funding and managing external shocks make macroeconomic decision-making more complicated and require the aggressive accumulation of currency reserves. Low-income Asian countries benefit greatly from the direct capital investments within the region, which helps fill some of the savings-investment gap, adopt technologies and improve the skills of the labour force. These countries have a labour force that is still relatively cheap but increasingly skilled.

A closer examination can reveal a key change in the engines of growth: China and the ASEAN-5 countries (founding countries: Philippines, Indonesia, Malaysia, Singapore and Thailand) balanced their economies in the wake of the global financial crisis by shifting towards internal demand. More and more domestic manufacturers have turned their attention to domestic consumption in recent

years. The fast increase in demand in the region is a strong driver of economic growth. The transition to the new economy plays an increasingly dominant role within the regional demand for ASEAN+3 countries' exports. There are clear signs suggesting that the ASEAN3 region is becoming a stronger internal demand base for the products manufactured by its own 'new economy'.

The road leading to further convergence is bumpy. Some ASEAN countries wish to diversify their growth factors to make their economies more flexible, while other countries appear to prefer specialisation in an effort to accelerate their growth. The weight of the ASEAN+3 countries within the global economy is expected to increase significantly by 2035. The national plans are ambitious, and the region-wide efforts reflect a heightened degree of solidarity in the implementation of joint development efforts. These may achieve very significant outcomes.

Bernard Yeung structured his presentation around four main topics, namely: economic/political tensions (technological progress, climate change, aging); trade tensions (increasing integration within Asia); Asia growing, urbanising and modernising in general; the need for investment, institutional development and the use of technologies.

Most countries in Asia have seen a healthy and constant rise in their GDP since 2012. Poverty rates are decreasing, the middle class is getting larger and stronger. In response to the global economic and policy tensions, Asia and the ASEAN countries have increased their integration, and strong regional economic cooperation continues in the Asia-Pacific region. Trade, foreign direct investment, equity investments, financing and tourism have all grown within the region. The main characteristics of Asia are integration, urbanisation and modernisation. In the next few decades, urban populations will increase significantly in all Asian countries, resulting in an immense demand to invest in housing and infrastructure construction. In addition, the average annual investment demanded by climate change will exceed 5 per cent of GDP in all regions within Asia by 2030. He highlighted the importance of the investment needed in the fight against environmental risks; as the OECD's records show, over a quarter of all global disasters in the period between 2010 and 2017 took place in Asia.

In response to the above challenges, Asia needs to improve its institutional structures so that it can attract investment by making it easier for businesses to operate. It needs to use technologies more efficiently in order to bridge the investment gap. It has to solve the question of financing. A more efficient distribution of financial resources will encourage inclusive growth. This requires increased liquidity, improved accountability and transparency, and greater overall efficiency in long-term financing and the related projects. More should be spent on education. The partnership between the public and private sectors must be

facilitated and governmental efficiency improved. Action must be taken against corruption.

He concluded by saying that Asia is growing significantly and its increased integration means that it is less exposed to the economic conflicts generated by the United States. It has a high investment demand due to infrastructure development and environmental risk management needs. It needs to improve its institutions and be faster. Technology helps reduce costs, improve efficiency and obtain financing. It needs to solve the problem of missing human capital. In conclusion, he expressed his wish that there should be no war.

Eduardo Pedrosa's lecture was entitled 'The role of the post-2020 vision of the Asia-Pacific region in sustaining convergence in a changing world'. Prosperity grew dramatically in the first 30 years of the existence of APEC (the Asia-Pacific Economic Cooperation). This is supported by the significant increase in trade and investment. In 2020 APEC as an institution and its region find themselves in a critical situation. It must face the existential challenges of environmental sustainability and climate change as well as rapid technological change, which may help accelerate the spread of prosperity but may also intensify social tensions and strengthen the current fragmentation trends. Moreover, there is growing scepticism in certain parts of the societies in the Asia-Pacific region towards the value of openness, which undermines the political support for regional economic cooperation.

APEC's 1994 vision and objectives can be summarised as follows: accelerated, balanced and equitable economic growth not only in the Asia-Pacific region but everywhere in the world, through free and open trade as well as investment by 2020 at the latest. He then spoke about the successful process of poverty reduction between 1990 and 2015. In terms of per-capita GDP, emerging countries have converged significantly with the industrial economies; nevertheless, the rate of economic growth has started to decrease in the Asia-Pacific region: there are increasing signs of the constraints of the liberalisation of conventional trade in encouraging growth and dynamism. He also spoke of the risk of failure. Fractures may jeopardise the future promise of new technologies. The end of mutual economic dependence threatens to undermine our shared interests in the peaceful and constructive governance of international relations. If we do not deal with the constraints on growth, the medium-income economies of APEC will not reach high income status and there is an increased risk that they will fall into the medium-income trap. Similarly, the high-income economies will not take advantage of their opportunities and will not benefit from the broader advantages of enhanced connectivity.

Harris Kim spoke about Korea's experience regarding the challenges of sustainable convergence. First, he presented the history of Korea's convergence. The Korean

economy achieved fast economic growth with a strategy, used since the 1960s, of imitation and input-driven growth. It set up conglomerates and boosted public sector investment. Population growth was high at that time, the demand for education has increased, and the expansion of public education and health insurance led to a significant improvement in human capital. External conditions also favoured an export-oriented economy: world trade and a culture of mass consumption spread fast, and living standards rose significantly in the west, including in the United States.

Nowadays, however, Korea is also facing challenges. Its convergence has slowed: as soon as its growth driven by a quantitative increase in capital and labour inputs reached its limits, its productivity growth quickly decelerated. The structural vulnerability of the Korean economy, the worsening external conditions after the global financial crisis and the inadequate efforts to develop institutions and innovative growth resulted in a growth rate that was consistently low. Demographic changes including a low fertility rate and aging populations now hold back sustainable economic growth.

In addition to product and labour market rigidity, different regulations create another hindrance before the entry of new businesses to the market. The entrenchment of labour market duality is another obstacle to labour mobility, resulting in a fall in the efficiency of human resource distribution. Another detrimental factor is the continual imbalance between households versus the corporate sector, large versus small businesses in the corporate sector, and exporting versus non-exporting companies. The external environment has also deteriorated. Drastic institutional and practical reforms are needed to prepare for sustainable growth in response to the structural changes in domestic and international conditions, in order to help create the environment necessary for innovative investments and the foundations for growth in the new industries. Structural reforms must be implemented in all areas of the economy to facilitate a better distribution of resources and greater productivity. A dynamic corporate ecosystem must be created: regulation must be improved and infrastructure must be established for innovative start-ups. The capacity of companies to develop source technologies must be strengthened: they should be given more support in their R&D investments in basic research. Risk factors such as demographic changes and the rise in household indebtedness must be managed systematically in order to ensure stable growth in the medium and long term.

He then proceeded to describe the key strategies. He explained that a smooth implementation of structural reforms requires identifying appropriate measures so that the benefits of reform can be shared with the market participants who have conflicting interests. The government should focus on incentivising voluntary innovation efforts in the private sector while mitigating market failures. It should

develop medium- and long-term roadmaps taking into consideration the policy outcomes, the conflicts of interest and the changes in domestic and international conditions. Finally, in his closing remarks and conclusions, he said that whereas Asian countries had achieved remarkable convergence to date, they were likely to need much more time to reach the level of the United States or Japan. As is shown by Korea's experience, a country relying merely on imitation and input factors will unavoidably reach its limits of growth. Sustainable convergence is possible only by executing institutional reforms that encourage innovation. In the meantime, it is essential to adopt economically sustainable and politically viable implementation strategies in order to generate social consensus and resolve the conflicts and inequalities between market participants.

In his closing summary, *György Matolcsy* thanked the participants for their interesting presentations, thought-provoking suggestions and the excellent discussion. We all need efficient, inclusive growth, he said. And in order to achieve this, we will need to improve our institutions. Further dialogue is needed among countries and continents. Dialogue can encourage our governments and institutions to launch major, comprehensive reforms. To conclude, he expressed his hope that joint thinking would continue at the Lámfalussy Lectures Conference next year.