The enlargement of the European Union

Abstract

The article provides an overview of some of the economic characteristics of the 10 New Member States (EU10), that joined the Economic Union in May 2004, and explores the (potential) impact of them on the Belgian economy, on the basis of data available in May 2006.

A first section compares the dimension of the EU10 to that of the Belgian economy. With a population seven times that of Belgium, the EU10 produce a GDP that is only 80% higher than that of Belgium, with exports only 17% higher.

The following section describes the performance of the EU10 with respect to some equilibrium criteria (population, labour market, public budget, external sector and prices), production costs (interest rates, labour costs and taxes) and capital formation. A paragraph on the convergence of the EU10 according to the Maastricht criteria and in terms of β - and σ – convergence completes this section.

Population growth is a very serious medium-term problem in the continental New Member States, with over the period 1995-2004, a reduction of the age group 0 to 14 years by more than 20% in five out of the eight States. The unemployment rates in Poland and in the Slovak Republic are - although diminishing - still extremely high.

Latvia, Estonia and Hungary face serious balance of payments deficits. The foreign exchange reserves of those countries only cover some two months' worth of imports. External debt in those countries and in Slovenia represents more than 80 % of GDP.

Hungary continues to have unsustainable budget deficits, increasing in the course of 2006, the level of its public debt above the 60% Maastricht norm. Estonia, at the other end of the spectrum runs surpluses since 2001.

Inflation is high in Latvia and increasing in all Baltic States. It is (rapidly) diminishing in all other continental non – Baltic States.

Interest rates are high in Hungary and in Poland, with over the period 2000 - 2005, an inverse yield curve in Hungary, in Slovenia and, except for the years 2003 and 2004, in Poland.

The average wage costs in the continental New Member States are at least four times smaller than in Belgium, except in Hungary and in Slovenia.

Minimum wages, in most countries more than six times smaller than in Belgium, increased over the period 2001-2004 with more than 10 % a year on average in all continental New Member States, except in Poland where they diminished and in Lithuania.

Fiscal intake represents more than 35 % of G.D.P. in Slovenia, Hungary and the Czech Republic. Indirect taxes create the highest burden except in the Czech Republic, where the social security contributions are the main source of (para)fiscal income. Revenues from social security contributions are higher than from direct taxes in all continental countries, Lithuania being the only exception.

Gross capital formation relative to G.D.P. is weakest in Poland. Net foreign direct investment relative to G.D.P. is on average over the period 2000 – 2004, on the continent, highest in Estonia, the Czech Republic and the Slovak Republic.

Convergence in terms of the Maastricht criteria was in May 2006 only reached in Slovenia, Lithuania not fulfilling the inflation requirement by 0,1 % points only.

Measures of the β - and σ – convergence suggest that the EU10 tend to the "steady state" at a speed of roughly 2,4 % a year. Technical details of the convergence measures are set out in a separate annex.

The final section presents data and views on the (potential) impact of the EU10 on the Belgian economy.

Trade relations are illustrated by bilateral export and import data per country and per sector. Average yearly growth rates of exports and of imports over the period 1996-2004 are well above 10% for a majority of the EU10. Imports from Poland grew with more than 20% a year on average. Exports to the Slovak Republic show a similar growth rate, while exports to Poland increased with some 13 % a year. Bilateral trade flows to and from Hungary also show growth rates in the order of 13 % a year.

Special attention is paid to the problem of relocation, with data on the relocation of Belgian jobs to the EU10 and with an indication of the most vulnerable sectors, according to the Flying Geese Model.

Data collected by the European Restructuring Monitor tend to indicate that relocation is only a marginal phenomenon, concentrated in a few sectors such as metal and construction of machinery and telecom. The Slovak Republic is the most important beneficiary of the relocations.

A description of European and Belgian job entry regulations completes this section. The number of “B” labour permits, although still small, is increasing fast, with more than a tripling in three years, the bulk of the permits being issued to Polish immigrants.