

Has EU Enlargement been a success?

This wave looks at some of the issues connected to [enlargement](#) of the EU single market

A Brief Chronology

1989: [The fall of the Berlin Wall](#)

2004: Ten member states join the EU (see below)

2007: Romania and Bulgaria join the EU

2009: A economic / financial crisis in many of the new countries of the EU

Joining the EU Single Market - the Copenhagen Criteria

New entrants to the EU must satisfy these criteria - and their entry must be agreed by all EU countries

- Stable institutions that guarantee democracy, the rule of law, human rights and respect for and protection of minorities;
- A functioning market economy, as well as the ability to cope with the pressure of competition and the market forces at work inside the Union;
- The ability to assume the obligations of membership, in particular adherence to the objectives of political, economic and monetary union

The 2004 enlargement

Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia and Slovenia

Candidate countries:

There are three **candidate countries** - [Turkey](#), [Croatia](#) and [Macedonia](#), as well five ex-Yugoslav nations, including Albania, Serbia and Bosnia Herzegovina, which the EU has agreed should eventually be allowed to join the bloc. Croatia and Turkey started **accession talks** on 3 October 2005. Turkey could complete them in 15 years, Croatia by 2011. [Iceland](#) is the latest country to seek EU membership.

Following the enlargements of 2004 and 2007, the EU is now the largest **integrated economic area** in the world, accounting for more than 30% of world GDP and more than 17% of world trade. The enlargement of the single market during the noughties occurred during a period of strong GDP growth (driven by fast-growing exports in an era of globalisation) and low inflation and interest rates. One can argue that this was an opportune time to widen the EU – conditions were favourable. But progress made by new EU members has not been even – most have achieved some **income convergence** and have managed to bring down unemployment levels. But there have also been underlying problems – notably **property bubbles**, rising inflation and the effects of **depopulation** as migrant workers from central and eastern European countries in particular moved west in search of work and higher incomes.

From late 2007 onwards the global **credit crunch** and ensuing recession hit the EU hard. The sixteen-country Euro Area is **export-dependent** (more than the USA) and economic and financial difficulties have spread into many of the new member states.

Key issues:

- Has the widening/enlargement of the EU been a success?
- What are the main benefits and costs of enlargement for
- New member states
- Established members of the EU including the UK
- How many new states will eventually join the Euro?
- Is enlargement fatigue now setting in? Will it prevent a deepening of the EU?

Successes of enlargement for new nations

For many new entrants to the EU, membership of the single market represents an opportunity to increase trade and investment with established EU countries and through this raise living standards and consolidate their transition to fully-fledged market economies.

For new member states, enlargement is designed to:

- Foster long-term economic convergence
- Increase the flow of capital into their economies and thereby raise each country's productive potential
- Raise productivity through increased trade, competition and investment - in both goods and service industries
- Allow free access to the single market in goods and services
- Improved consumer choice (welfare gains)
- Access to EU funds e.g. net inflow of structural funds to help finance infrastructure projects and environmental projects

For new members it also means increased interdependence with fellow EU countries, especially those with whom trade and investment relationships are deep and significant. Integration within the EU intensifies the cross-country transmission of external demand and supply-side shocks, but it also makes risk sharing possible e.g. coordinated policy action to stabilise economies and financial systems

The evidence so far:

- **Growth and Investment:** Enlargement has enhanced the **growth** of new member states
- EU estimates boost to GDP growth of 1.5% pa for years 2000 to 2008
- Growth boosted by
- Increased trade (intra-EU trade mainly)
- Reduction in interest rate spreads between new EU nations and established EU countries - a monetary stimulus
- Lower unemployment (though employment rates remain low by EU standards)
- Impact of FDI flows into many CEECs e.g. investment in car manufacturing capacity, car parts, mobile phone handsets, computer components and plasma TV screens
- FDI improves the trade balance for the host country, but negative income balance drives a wedge between the GNP and GDP.

But

- Short term rise in domestic demand / GDP of many new member states was fuelled by lower interest rates - e.g. a boom in finance and construction that ultimately proved unsustainable
- The GNP data shows a smaller rate of growth after EU entry, partly because of the net outflow of interest, profits and dividends from foreign-owned businesses in new EU nations
- **Living Standards:** There has been some **income convergence** due to fast growth from early 2000s to 2008 - **income per capita** (PPP adjusted) in new Member States has risen from 40% of the old Member States' average in 1999 to 52% in 2008 and real GDP growth averaged 5.5% from 2004-2008 compared to 3.5 % in 1999-2003. Convergence has also been taking place **within the NMS** country group: economies with lower starting per-capita GDP have tended to grow faster
- **Trade creation** - most of the new EU countries were already closely linked in trade and investment terms with their western European neighbours. Joining the single market has

deepened this - in 2007, almost 80% of exports of the new EU states went to the rest of the EU

- **Macro stability:** Until 2008 progress was good in reducing unemployment and achieving lower inflation and interest rates - the traditional trade-offs between macro objectives improved in most of the new member countries. Some countries have made sufficient progress to join the Euro (Slovenia, Slovakia, Cyprus and Malta)

Enlargement and labour migration flows

According to EU report (published Feb 2009) since 2004, about 1.6 million people migrated from new to old member states, bringing the total to 3.6 million. This is less than 1% of the working age population in the old member states, except in Ireland where it reached a higher level (about 5 %).

- Migrants from EU Accession Countries 2004-08
 - Average age 26.5
 - 1/3rd have been in higher education
 - 90% employment rate whilst in the UK
 - Hourly wage of £6.80 compared to UK average of £11.90
 - 12% claimed benefits or tax credits
 - 6.5% lived in social housing
 - Source: [Centre for Research and Analysis of Migration](#) at UCL

Inward investment (FDI): New EU countries have remained attractive to inward investment because:

- Central European location for many
- Significantly lower unit wage costs
- Lower land prices
- Attractive corporate tax regime + other incentives
- Success of previous inward investments (positive feedback / hysteresis effects)
- Many new states have a highly literate population and some world class universities

But whilst there have been many positives, the recent economic crisis has highlighted some of the fault-lines in the economies of many (but not all) of the new EU members.

The economics crisis of 2008-2009

- Deep recession in 2009
- First major downturn since the post-communist chaos of the early 1990s
- The worst-affected countries are dependent on the Euro Area for investment and exports e.g. in 2007 Czech Republic sent 52.6% of X to the EU-27, 50.4% in Hungary and 53.5% in Poland.
- Good example is the collapse in production in the European car industry
- Several countries (including Latvia, Hungary and Estonia) ran up unsustainable current account deficits on their balance of payments that eventually lead to capital flight and speculative attacks on their currencies.
- Rising unemployment added to by the return of migrants
- Huge government debt - fuelled by the recession but also by longer term factors such as an ageing population
- Asset price deflation after property bubbles burst e.g. Latvia, Estonia
- Many of their currencies are depreciating - making it harder to service debt issued in Euros - Some currencies have come under speculative attack
- IMF called in to provide emergency loans for some countries including Hungary and Latvia
- Economic crisis has served as a reminder that the CEECs need to diversify their industrial structures and move up the value chain to produce manufactured goods of higher prices, less vulnerable to the western European economic cycle

- Some countries have currencies pegged to the Euro – which makes them highly uncompetitive and is costing many jobs especially in export-driven manufacturing businesses
- Banking system suffering from high level of bad debts - many western Banks are heavily exposed - the Vienna agreement has been an attempt to stabilise eastern European banks during the credit crunch
- Some loss of investor confidence in central and eastern Europe – some reversal of FDI flows – which have been a major source of growth over recent years. Private capital flows to eastern Europe are expected to drop to \$30bn in 2009 from \$254bn in 2008, according to the Institute of International Finance
- Inward investment also hit by political uncertainties - governments in Hungary, [Latvia](#), and [Romania](#) have fallen

Implications for the UK economy

1. In the short-term – a fall in exports – this has negative multiplier & accelerator effects
2. Some UK firms will cut back on their FDI into central and Eastern Europe
3. Recession may limit extent to which eastern European migrants head back home

Iceland and EU Membership

For many years Iceland has been part of the European Economic Area - a trading bloc that allows Icelanders to live and work in the EU while leaving their country able to run its own agricultural, fishing and monetary policies. The [economic and financial crisis](#) of 2008-09 has prompted the Icelandic government to seek membership of the EU. [Iceland submits EU membership bid](#) (BBC news, July 2009)

The Hungarian economic crisis

Hungary joined the single market in May 2004 and for several years enjoyed strong GDP growth of 4 per cent or higher, large net inflows of foreign direct investment (FDI) and a significant rise in per capita incomes. However much of the higher consumer spending was financed by borrowed money and an asset price boom including property and stocks and shares proved unsustainable. Many Hungarian consumers opted to borrow money in Euros at low interest rates and perhaps did not understand the risks of doing this – especially the uncertain movements of the exchange rate.

- Fast economic growth in the early / mid years of the decade (growth of around 4%, well above the average for existing EU nations)
- High levels of FDI, export growth and strong consumer spending
- But inflation accelerated (3.9% in 2006 jumping to 7.9% in 2007 and 6.1% in 2008)
- And **positive output gap** also led to growing current account deficit of more than 6% of GDP each year 2005-2008.
- Hungarian government was also running a large **budget deficit** (10.4% of GDP in 2006)
- The economy was accumulating enormous **external debts** including consumers taking out mortgages from foreign banks priced in Euros.
- Speculative attack on the Hungarian Forint led to **devaluation** against the Euro - making it even more expensive for consumers to service their Euro-denominated debts. Economy spiraled into a deep recession in 2009. Hungary was forced to seek emergency financial assistance from the International Monetary Fund.

In July 2008, one Euro bought 230 Forint. By the spring of 2009 the Euro had appreciated so that one Euro bought 315 Forint – devaluation for Hungary of nearly 30 per cent. Since then, and after the [intervention of the International Monetary Fund](#) the Hungarian Forint has recovered some ground against the Euro – it was back to 270 Forint against the Euro by the end of the November 2009. The IMF has introduced austerity measures for Hungary as part of the emergency finance programme.

- In 2009
- Real GDP has fallen by 7%

- Exports are down 15%
- External debt has risen to 132% of GDP
- Government debt is nearly 80% of GDP
- Output gap is -6.2% of potential GDP
- Trend growth has declined from 2.5% in 2006 to less than 1% for 2010-2014 (OECD estimates)
- Unemployment rising sharply

[Hungary's daunting debt mountain](#) (BBC news, Oct 2008)

Evaluation points

- Long term process of convergence with Western Europe was never going to be smooth – the key is how the new EU members respond to the challenge especially on the supply-side of their economies - economic convergence is not a linear process, progress has been uneven
- Some new EU members suffered from unsustainable booms (e.g. the Baltic States) but the same happened in Spain and Ireland and they have much higher levels of private sector debt - all of these economies have suffered during the current financial crisis
- Several countries including Poland, the Czech Republic, Slovakia and Slovenia are out-performing the UK and others during the crisis
- Eastern European region's medium term key competitive advantages remain – especially low-cost higher-skill labour – attractive to manufacturing businesses
- The 2009 crisis may persuade CEEC countries to reduce their dependence on foreign direct investments, foreign borrowing and additional funds from Brussels and build an economic growth model on different grounds
- Some of the economies may also be too dependent on exporting - for example 80% of Czech GDP is dependent on export industries.

Suggestions for further reading

[Financial crisis made in the west hits hardest in the east](#) (Guardian, Nov 2009)

[Tutor2u blog articles on EU enlargement](#)

[Croatia gets EU entry timetable](#) (BBC news, Nov 2008)

[The looming divide within Europe](#) (VoxEU), Jan 2009

[EU commission hails enlargement](#) (BBC news, Feb 2009)

[Polish exodus grinds to a halt](#) (BBC news, May 2009)

[Five years after the enlargement of the EU](#) (VoxEU, May 2009)

[Eastern Europe faces fragile recovery in 2010](#) (Guardian, Oct 2009)

[EU enlargement, past present and future](#) (BBC news, Dec 2009)

[Turkey and the EU - hurtful uncertainty](#) (Guardian, Dec 2009)